

CORPORATION TAX ACT 2009

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 3: Trading income

Overview

Chapter 8: Trade profits: herd basis rules

Overview

427. This Chapter gives the rules for what is commonly known as the “herd basis”. It is based on Schedule 5 to ICTA. The corresponding rules for income tax are in Chapter 8 of Part 2 of ITTOIA.
428. The object of the herd basis is to treat a herd of animals in a similar fashion to a capital asset. Without the election the individual animals in the herd would be treated as separate items of trading stock. With the election:
- there is no tax allowance for the initial cost of, or any subsequent increase in the size of, the herd;
 - the net cost of replacing animals in the herd is allowable;
 - any profit or loss on the sale of a single animal or a small number of animals from the herd without replacement is included in the profits of the trade; and
 - if the whole, or a substantial part, of the herd is sold and not replaced the resulting profit or loss is not included in the profits of the trade.
429. An election can be made only in respect of animals kept for their produce.

Section 109: Election for application of herd basis rules

430. This section allows a taxpayer to elect for the “herd basis rules” to apply and introduces some basic concepts. It is based on paragraphs 1, 2, 3 and 9 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 111 of ITTOIA.
431. *Subsection (1)* allows a company or firm of which a company is a member to make a “herd basis election” if it keeps, or has kept, a “production herd”. “Production herd” is defined in section 110(1)(c). The effect of a “herd basis election” is that the “herd basis rules” apply. These rules are set out in sections 112 to 121. The time limits for making the election are set out in sections 122 to 124.

Section 110: Meaning of “animal”, “herd”, “production herd” etc

432. This section provides various definitions used in the Chapter. It is based on paragraphs 8 and 9 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 112 of ITTOIA.

433. This section would be the natural home for the rule in paragraphs 7 and 9(5) of Schedule 5 to ICTA that prevents the herd basis rules applying to working animals. Paragraphs 7 and 9(5) of Schedule 5 to ICTA exclude certain animals from being part of a production herd. These are animals kept for the work they do in connection with the trade or those kept for public exhibition, or racing or other competitive purposes. This rule is unnecessary because animals in a production herd must be kept wholly or mainly for the sake of their produce. So the exclusions are not rewritten.
434. *Subsection (1)(a)* rewrites the definition of “animal” in paragraph 9 of Schedule 5 to ICTA. Most of the definitions in paragraph 9 of Schedule 5 to ICTA refer to “animals and other living creatures”. The main reason for the reference to “other living creatures” is to make clear that the Schedule applies to birds.
435. *Subsection (1)(c)* rewrites the definition of “production herd” in paragraph 8(5) of Schedule 5 to ICTA. Herd basis elections are made by reference to classes of production herd. See section 122. Section 111(2) identifies when different production herds are treated as being of the same class.
436. *Subsection (6)* makes clear that an immature animal can be treated as added to the herd when it becomes mature. There is a definition of maturity for female animals in section 111(5).

Section 111: Other interpretative provisions

437. This section provides further definitions. It is based on paragraphs 3, 8 and 9 of Schedule 5 to ICTA. The corresponding rules for income tax are section 113 of ITTOIA.
438. *Subsection (2)(a)* applies if production herds of animals of different species are kept for the same product; for example, a herd of cows and a herd of goats both kept for milk production. Each herd satisfies the definition of production herd. *Subsection (2)(a)* prevents them being treated as of the same class.
439. *Subsection (2)(b)* prevents animals of the same species being treated as of the same class if they are kept for different products; for example, one herd of cows kept for milk production and another herd of cows kept for its calves.
440. *Subsection (6)* clarifies what is meant by “a substantial part of the herd”. This is a question of fact depending on the circumstances. But 20% of the herd is always regarded as substantial. This change clarifies this practice. This change reproduces Change 32 in ITTOIA. See *Change 30* in Annex 1.
441. The following sections refer to “a substantial part of the herd”.
- Section 116(1) (sale of animals from the herd);
 - Section 117(1) (sale of whole or substantial part of herd);
 - Section 118(4) and (5) (acquisition of new herd begun within five years of sale);
 - Section 120(1) (replacement of part sold within five years of sale); and
 - Section 124(1) (slaughter under disease control order).

Section 112: Initial cost of herd and value of herd

442. This section sets out the treatment of the initial cost, and value, of the herd. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 114 of ITTOIA.

Section 113: Addition of animals to herd

- 443. This section sets out the treatment of additions to the herd. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 115 of ITTOIA.
- 444. *Subsection (1)* makes clear that there is a difference between additions, to which this section applies, and replacements dealt with in section 114.
- 445. *Subsection (2)* prevents a deduction for the cost of the additional animal. It is a similar rule to section 112(1).

Section 114: Replacement of animals in herd

- 446. This section sets out the treatment if an animal in the herd is replaced. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 116 of ITTOIA.
- 447. *Subsection (1)* introduces the terms “old animal” to describe an animal leaving the herd and “new animal” to describe the animal that replaces it. The circumstances in which an animal is treated as sold and the meaning of “sale proceeds” are extended by the definitions in section 111(3) and (4).
- 448. *Subsection (4)* deals with the deduction due for the replacement animal. The basic principle in paragraph 3(4)(b) of Schedule 5 to ICTA is that the cost of the second animal is deducted as a trading expense. But paragraph 3(4)(b) of Schedule 5 to ICTA provides for an exception - “in so far as that cost consists of such costs as are allowable apart from the provisions of this Schedule as deductions in computing profits of farming under Case I of Schedule D”.
- 449. It is not clear from ICTA what these costs are. In fact the exception is aimed at the case where the replacement animal comes from trading stock. Here the costs of breeding or acquiring it and, if relevant, rearing it to maturity have already been allowed. The farmer is not allowed a double deduction for costs that have already been allowed.
- 450. This section does not reproduce that part of paragraph 3(4)(b) of Schedule 5 to ICTA which refers to the cost of the new animal being subject to paragraph 3(6) of Schedule 5 to ICTA. This reference appears to be an error made in the 1988 consolidation of ICTA. It is generally accepted that it is the rule in paragraph 3(4)(a), and not paragraph 3(4)(b), of Schedule 5 to ICTA which should be qualified by paragraph 3(6) of Schedule 5 to ICTA.

Section 115: Amount of receipt if old animal slaughtered under disease control order

- 451. This section limits the amount of the receipt taxed under section 114 if the old animal is slaughtered under a disease control order. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 117 of ITTOIA.
- 452. Paragraph 3(6) of Schedule 5 to ICTA restricts the amount of the receipt to “the amount allowable as a deduction”. It is not immediately clear what this amount is. This section makes clear that it is the amount allowable as a deduction in respect of the new animal. This is called “the equivalent amount for the new animal”.
- 453. *Subsections (4)* and *(5)* define “the equivalent amount for the new animal”. *Subsection (4)* deals with the case in which the replacement animal comes from the farmer’s trading stock. *Subsection (5)* deals with all other cases.

Section 116: Sale of animals from herd

454. This section sets out the rules that apply if an animal is sold from the herd and not replaced. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 118 of ITTOIA.

Section 117: Sale of whole or substantial part of herd

455. This is the first of three sections that set out the rules relating to the sale of all or a substantial part of the herd within 12 months. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 119 of ITTOIA.
456. The section merges the rules in paragraph 3(7) to (9) of Schedule 5 to ICTA. This Change reproduces Change 33 in ITTOIA. See *Change 31* in Annex 1.

Section 118: Acquisition of new herd begun within 5 years of sale

457. This section sets out the rules that apply if, following the sale of the herd (either all at once or within 12 months), the farmer begins to acquire a new herd within five years. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 120 of ITTOIA.
458. *Subsection (4)* applies if the number of animals in the new herd is smaller than the number of animals in the old herd but the difference is not substantial. See *Change 31* in Annex 1.
459. *Subsection (7)* clarifies what is meant by a “substantial difference”. See *Change 30* in Annex 1.

Section 119: Section 118: sale for reasons outside farmer’s control

460. This section limits the amount taxed as a trade receipt under section 118 if the sale is for reasons outside the farmer’s control and the replacement animal is of a worse quality. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 121 of ITTOIA.
461. The section is similar to section 115 although it is not limited, as that section is, to disposals under a disease control order. The source legislation for both sections refers to the amount of the trading receipt being restricted to “the amount allowable as a deduction”. It is not immediately clear what this amount is.
462. *Subsection (2)* makes clear that it is the amount allowable as a deduction in respect of the new animal. The section calls this “the equivalent amount for the new animal”.
463. *Subsections (3)* and *(4)* define “the equivalent amount for the new animal”. *Subsection (3)* deals with the case in which the replacement animal comes from the farmer’s trading stock. *Subsection (4)* deals with all other cases.

Section 120: Replacement of part sold begun within 5 years of sale

464. This section sets out the rules that apply if, following the sale of a substantial part of a herd (either all at once or within a year), the farmer begins to replace it within five years. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 122 of ITTOIA.

Section 121: Section 120: sale for reasons outside farmer’s control

465. This section limits the amount taxed as a trade receipt under section 120 if the sale is for reasons outside the farmer’s control and the new animal is of a worse quality. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 123 of ITTOIA.

466. The section is similar to section 115 although it is not limited, as that section is, to disposals under a disease control order. The source legislation for both sections refers to the amount of the trading receipt being restricted to “the amount allowable as a deduction”. It is not immediately clear what this amount is.
467. *Subsection (2)* makes clear that it is the amount allowable as a deduction in respect of the new animal. The section calls this “the equivalent amount for the new animal”.
468. *Subsections (3) and (4)* define “the equivalent amount for the new animal”. *Subsection (3)* deals with the case in which the replacement animal comes from the farmer’s trading stock. *Subsection (4)* deals with all other cases.

Section 122: Herd basis elections

469. This section sets out the rules for the making of herd basis elections. It is based on paragraph 2 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 124 of ITTOIA.
470. Paragraph 2 of Schedule 5 to ICTA requires that the election must be made “in writing” and to an officer of Revenue and Customs. The general rules in Part 7 of Schedule 18 to FA 1998 that apply to claims and elections mean it is not necessary to repeat these requirements.
471. *Subsection (2)* sets out the time limits for making the election. The election is made by the farmer. The farmer can be a company or a firm in which one of the partners is a company. The time limits are different depending on whether the farmer is a company or a firm.
472. If the farmer is a firm the same time limit applies whether the partners are all income tax payers, all corporation tax payers or a combination of the two. Because of the possible involvement of income tax payers the time limit is set by reference to income tax years. The time limit in section 122(2)(b) is the same as that in section 124(2)(a) of ITTOIA.
473. The different time limits for a company or a firm are reflected in the other two sections that deal with herd basis elections, sections 123 and 124. Those sections identify the difference by referring to the “accounting period” (company) or the “period of account” (firm).
474. *Subsection (4)* expands on *subsection (1)*, which provides that an election must specify the class of production herd to which it relates. This means separate elections must be made for each class of production herd and that an election may not relate to more than one class of production herd. Separate elections may be made for different classes.
475. *Subsection (7)* identifies the period for which the herd basis election has effect. This depends on whether the farmer is a company (accounting period) or firm (period of account).
476. *Subsection (8)* deals with the case in which the farmer is a firm and there is a change in the partners in the firm. Paragraph 2 of Schedule 5 to ICTA refers to “the farmer making the election”. If the farming trade is carried on in partnership, the “farmer” means the firm. If there is a change in the members of a firm, the question arises whether there is a new “farmer”. *Subsection (8)* makes clear that there is.

Section 123: Five year gap in which no production herd kept

477. This section deals with the case where there is a period of at least five years when the farmer does not keep a production herd of the particular class for which a herd basis election has been made. It is based on paragraph 4 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 125 of ITTOIA.
478. *Subsection (2)* explains the consequences for the herd basis rules if the farmer starts to keep another production herd of the same class after the end of the five year period.

*These notes refer to the Corporation Tax Act 2009
(c.4) which received Royal Assent on 26 March 2009*

Subsection (2) enacts an extra-statutory practice. See *Change 32* in Annex 1. This Change reproduces Change 36 in ITTOIA.

Section 124: Slaughter under disease control order

479. This section sets out the rules for making an election outside the normal time limits following slaughter under a disease control order. It is based on paragraph 6 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 126 of ITTOIA.

Section 125: Preventing abuse of the herd basis rules

480. This section provides anti-avoidance rules that may apply if a farmer transfers the whole or part of a production herd in a transaction that is not an open market sale. It is based on paragraph 5 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 127 of ITTOIA.
481. [Section 164\(3\)](#) in Chapter 11 of this Part (trade profits: valuation of stock) makes clear that this section takes priority over the provisions of that Chapter.

Section 126: Information if election made

482. This section allows an officer of Revenue and Customs to obtain information about the animals kept for the purposes of the trade. It is based on paragraph 10 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 128 of ITTOIA.

Section 127: Further assessment etc if herd basis rules apply

483. This section enables effect to be given to a herd basis election made after an assessment has become final, either by amendment or by repayment of tax. It is based on paragraph 11 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 129 of ITTOIA.