These notes refer to the Income Tax (Trading and Other Income) Act 2005 (c.5) which received Royal Assent on 24 March 2005

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 3: Property income

Chapter 5: Profits of property businesses: other rules about receipts and deductions

Overview

1248. This Chapter contains provisions that supplement the basic calculation rules in Chapter 3 of this Part of the Act.

1249. The provisions in this Chapter are about particular receipts or more unusual circumstances.

Section 308: Furnished lettings

1250. This section brings the "letting" of furniture, when it is part and parcel of the letting of accommodation, within the property income charge. It is based on sections 15 and 65A of ICTA.

1251. Without this provision, rent paid for use of the furniture in furnished lettings would not be included in the property income charge because the "rent" for the furniture does not derive from land.

1252. The purpose of*subsection (1)(b)* is to make it clear that related revenue expenses such as the expenses of repair and insurance of the furniture are deductible in calculating the profits of the property business.

1253. *Subsection (2)* excludes income and expenses where the hiring of the furniture is not simply incidental to exploiting an interest in land.

1254. *Subsection (4)* refers to a "caravan and a houseboat". There is a new Act-wide, uniform definition of "caravan": see the commentary on section 875 and *Change 148* in Annex 1.

1255. There is also a new Act-wide, uniform definition of "houseboat": see the commentary on section 878(1) and *Change 150* in Annex 1.

Section 309: Rent-a-room relief

1256. This section modifies the normal profit calculation rules in Part 3 of this Act when a property business consists of, or includes, rent-a-room lettings as defined in Chapter 1 of Part 7 of this Act. It is new.

1257. When the lettings meet the conditions for rent-a-room relief in Part 7 of this Act the income from these lettings may, depending on the total amount, either be exempt from tax or subject to a special calculation rule. This section ensures that the rent-a-room rules take priority over the usual calculation rules in the property income Part.

Section 310: Acquisition of business: receipts from transferor's UK property business

1258. This section taxes certain receipts when a continuing UK property business is transferred from one person to another along with the right to receive future business sums to which the transferor is entitled. It is based on sections 21B and 106 of ICTA.

1259. *Subsection (1)* sets out the circumstances in which the section applies and states the three conditions necessary for it to apply.

1260. *Subsection (2)* treats the "sum" received as a receipt of the property business. As this rule affects the calculation of the profits of a property business it appears in this Chapter rather than with the post-cessation receipt rules of which, in the source legislation, it forms part.

1261. The source legislation applies "for all purposes". This section applies for income tax purposes. Section 106(2) of ICTA (as amended by paragraph 85 of Schedule 1 to this Act) applies for corporation tax purposes. Section 37(1) of TCGA ensures that any sums received as a result of the transfer are not charged to capital gains tax.

1262. *Subsection (3)* makes it clear that these sums are not post-cessation receipts.

Section 311: Reverse premiums

1263. This section sets out the rules for taxing reverse premiums as receipts of a property business. It is based on Schedule 6 to FA 1999.

1264. *Subsection (1)* refers to a "reverse premium". In accordance with *subsection (6)* that expression has the same meaning as in section 99. So this section applies to reverse premiums excluding any of the "excluded cases" within section 100. The subsection also excludes any reverse premium that is charged to tax as a trade receipt by section 101.

1265. *Subsections (2)* and *(3)* bring the reverse premium within the scope of the property income rules. The subsections treat the recipient as entering into a transaction for generating income from land (see sections 264 and 265). So, even if the recipient is not already carrying on a property business, the reverse premium is treated as a receipt of a property business.

1266. If a property business is deemed to be carried on, it is a UK property business if the land is in the United Kingdom or an overseas property business if the land is outside the United Kingdom. So the territorial restrictions on the scope of the charge in section 269 for non-resident or remittance basis persons may apply.

1267. Paragraph 72 of Schedule 2 to this Act rewrites the transitional provision in section 54(2) of FA 1999. These sections do not apply to pre-1999 reverse premiums.

Section 312: Deduction for expenditure on energy saving items

1268. This section provides a deduction for certain expenditure on energy saving items where that expenditure would not otherwise be allowable because it is capital. It is the first of three sections that are based on sections 31A and 31B of ICTA.

1269. The source legislation is a closely targeted relieving provision that provides for a deduction for specified energy-saving items installed in let residential property. It applies to all income tax payers including:

- non-resident companies liable to income tax;

- those with lettings of overseas property, the income from which is charged in the source legislation under Schedule D, Case V; and
- income tax paying members of partnerships.

1270. But it is not available in respect of "rent-a-room" properties or furnished holiday lettings (see Part 7 of this Act).

1271. *Subsection (1)* sets out the basic conditions. *Subparagraph (a)* makes it clear that relief is available only against property business income in respect of a let dwelling house. "Dwelling house" is not a defined term so it takes its ordinary meaning.

1272. *Subsection (1)(c)* states the date by which the expenditure must be incurred. Expenditure incurred before that date (and on or after 6 April 2004) is deductible in what is the appropriate period of account on normal accountancy principles.

1273. *Subsection (1)(d)* states the essence of the relief: it is for expenditure that is incurred wholly and exclusively for the purposes of the property business but which would not otherwise be allowable because it is capital expenditure.

1274. *Subsection (2)* provides for the deduction and in so doing introduces a change. In the source legislation the relief is given only when a formal claim is made. Section 312 provides for the relief as a simple deduction in calculating the profits of the property business that includes the dwelling house in question. See *Change 74* in Annex 1.

1275. *Subsection (4)* allows an apportionment of the expenditure where only part of it, for whatever reason, falls within the scope of the relief. Examples are when only a part of a single amount of capital expenditure is incurred on qualifying energy saving items or when part of the otherwise qualifying capital expenditure is incurred on a let building other than a dwelling house.

Section 313: Restrictions on relief

1276. This section imposes certain restrictions on the relief that would otherwise be due under section 312. It is based on sections 31A and 31B of ICTA.

1277. *Subsection (2)* prevents relief when the expenditure is simply part of the build cost of a new property or the purchase price of an acquired one.

1278. *Subsection (3)* prevents relief in respect of let property that is within Chapter 6 of Part 3 of this Act (commercial letting of furnished holiday accommodation). It makes explicit two aspects that are only implicit in section 31A(11) of ICTA.

1279. The first is that section 31A(11) of ICTA excludes any properties (a) that meet the definition of "commercial letting of furnished holiday accommodation" in section 504 of ICTA and (b) could therefore benefit from the concessions that section 503 of ICTA offers even if they do not, in fact, do so.

1280. The second is that it makes clear the duration of the exclusion. The purpose of the source legislation is to prevent people getting the relief if they are using the property for furnished holiday lettings. A property falls within section 504(4) of ICTA for a year of assessment. Because of the stringency of the conditions in section 504 of ICTA the property can drop in and out of qualifying section 504 of ICTA status from one year to the next. The restriction on relief under these provisions is intended to apply only if the expenditure is incurred in a year of assessment for which the property is within section 504 of ICTA (as described in the previous paragraph) and only for that or those years. So section 313(3) refers specifically to "the tax year".

1281. *Subsection (4)* makes it clear that the relief cannot apply when rent-a-room relief is given (see Chapter 1 of Part 7 of this Act). This prohibition does not apply however if neither form of rent-a-room relief is, in fact, taken.

1282. *Subsection (5)* adapts the general preliminary expenditure deduction rules to the specific circumstances of this relief: the expenditure window is reduced to prevent claims in respect of past expenditure when the dwelling may have been the landlord's own home and it is later let.

Section 314: Regulations

1283. This section provides for the Treasury's powers to make regulations for the purposes stated. It is based on section 31A(13) of ICTA.

1284. The relief applies potentially to all income tax payers, including those non-resident companies liable to income tax. *Subsection (2)* reflects, among other things, the fact that it is not available to companies in respect of their liability to corporation tax.

Section 315: Deduction for expenditure on sea walls

1285. This is the first of four sections that provide relief to a landlord for expenditure on making a sea wall or other embankment to protect let premises against flooding by the sea or a tidal river. They are based on section 30 of ICTA.

1286. Section 315 states the circumstances under which the relief is given. It is based on sections 30 and 65A of ICTA.

1287. *Subsection (1)(b)* states the subject of the relief. Repair and maintenance of an existing sea wall normally qualify for relief as revenue expenses of a property business but the making of a new wall is capital expenditure and would not qualify for relief without special provision.

1288. *Subsection (2)* makes it clear that to obtain a deduction for seawalls expenditure, the person carrying on the property business and the person incurring the seawalls expenditure must be the same person. This may appear to be stating the obvious but section 30(1) of ICTA says merely that the person incurring the expenditure is treated as making a payment "for the purpose of computing the profits of *any* Schedule A business carried on in relation to those premises" (emphasis added). This cannot be taken literally to mean any such business carried on by someone other than the person incurring the expenditure. There would be no point in deeming the payment to be made by that person if it were otherwise. And the provisions on transfer of interests in section 30(2) and (3) of ICTA reflect the notion that the deemed payment, and hence the right to relief, moves from the former owner to the transferee. There is no suggestion of involvement by any other party.

1289. *Subsection (3)* defines the "deduction period" referred to in subsection (2). Qualifying expenditure is deducted over 21 years in calculating the profits of the property business. The "deduction period" is comparable to the "writing-down period" over which expenditure qualifying for capital allowances is written off. This reflects the similarity between the relief given by the sea walls provisions and certain capital allowances provisions. The relief is for expenditure which would otherwise be capital in nature. And the expenditure is not relieved all at once but over a period, even if there are changes in the person who obtains the relief.

Section 316: Transfer of interest in premises

1290. This section deals with the case where the person who incurred the sea walls expenditure sells the premises during the 21 year period over which the deduction is due. It is based on section 30(2) and 30(3) of ICTA.

1291. *Subsection (1)* applies to transfers of the relevant interest "whether by operation of law or otherwise". These words derive directly from the source legislation. They ensure that the provision applies to, for example, successions to estates as well as the sort of merger of interests envisaged in section 317.

1292. *Subsection (2)(b)* requires any apportionment to be "just and reasonable" whereas section 30(2)(a) of ICTA refers simply to an apportionment that is "just". This change reflects the approach that was adopted in CAA and which has been followed in similar contexts elsewhere for consistency. There is no practical difference between the two forms of words. See *Change 14* in Annex 1.

1293. *Subsection (5)* makes explicit what is merely implicit in the source legislation, namely, the extent of the transferor's entitlement to a deduction in subsequent years. In particular, subsection (5)(a) makes it clear that if the transfer is of only part of the premises, the transferor continues to be entitled to a deduction in relation to the part not transferred.

Section 317: Ending of lease of premises

1294. This section deals with the case where the sea walls expenditure is incurred by a lessee and the lease comes to an end before the end of the deduction period. It is based on section 30(3) of ICTA.

1295. The cases to which *subsection (3)* applies include renewals of the lease to the same person. Then the deduction passes to the immediate reversioner.

1296. In the source legislation "lease" is defined for the purposes of the sea walls provisions in section 24(6)(a) of ICTA. But that definition is redundant and, since it no longer applies to any other provisions, is not rewritten in this Act. It is redundant in the sea walls context for the following reasons.

1297. Section 24(6)(a) of ICTA defines references to a lease as extending only to a lease conferring a right, as against the person whose interest is subject to the lease, to the possession of the premises. It originated as paragraph 16 of Schedule 4 to FA 1963. Notes on Clauses to FA 1963 explain that the reference to possession was to ensure that a "lease" in Schedule A and sections 25 to 31 of ICTA must be one of land and not of incorporeal hereditament. So a lease of sporting rights, or a right of way, would not be covered. However, Street v Mountford [1985], AC 809 established that a "lease" of land which does not confer on the tenant exclusive possession is not, in fact, a lease but a licence.

1298. Section 30(2) of ICTA does not explain the meaning of the transfer of the whole of a person's interest in any premises or part of any premises. The transfer of the whole of a person's interest is significant because it can lead to the transfer of entitlement to a deduction for sea walls expenditure. But entitlement to a deduction for sea walls expenditure does not arise anyway unless a person is the owner or tenant of premises. A lease which makes a person a tenant of premises is not a lease of an incorporeal hereditament. So, although section 30 of ICTA does not expressly exclude leases of incorporeal hereditaments, to the extent that they might cover leases of incorporeal hereditaments references to "leases" in that provision are simply redundant.

Section 318: Transfer involving company within the charge to corporation tax

1299. This section ensures that entitlement to a deduction for expenditure on seawalls continues properly when the interest in the premises is transferred between an income tax payer and a corporation tax payer. It is based on section 30(2) of ICTA.

1300. Entitlement to a deduction for expenditure on seawalls can be transferred with ownership of the premises. That transfer can be between an income tax payer and a corporation tax payer. Section 316 deals with transfers between income tax payers. But it cannot deal with a transfer from a corporation tax payer to an income tax payer or the reverse because the provisions in this Act apply only to income tax payers.

1301. Section 318 allows the seawalls provisions in this Act to work properly in respect of the party to the transfer who is subject to income tax.

1302. *Subsection (4)* signposts the reader to the source provision in ICTA that deals with the party to the transfer who is subject to corporation tax.

Section 319: Relief in respect of mineral royalties

1303. This section provides that only half the net profits received in respect of mineral royalties are charged to income tax. It is based on section 122 of ICTA. The other half of the profits are charged to capital gains tax by section 201 of TCGA.

1304. The section applies only to mineral royalties that are not taxed under Chapter 8 of this Part of the Act. That Chapter taxes rents and royalties from concerns such as mines and quarries. In practice nearly all mineral royalties will be taxed under Chapter 8 of Part 3 of this Act. For this reason this section cross-refers to the definitions in that Chapter.

Section 320: Nature of item apportioned on sale of estate or interest in land

1305. This section preserves the capital or revenue nature of an amount due, or payable in arrears, apportioned to a seller on the sale of land. It is based on section 40(3)(b) of ICTA.

1306. Most of section 40 of ICTA is not rewritten because it has become redundant following the application of Schedule D Case I principles to Schedule A.

1307. The original predecessor of section 40 of ICTA (section 20 of FA 1964) was introduced to deal with a specific problem. That was reflecting, in the calculation of income from land, any apportionments of rent (as a receipt or an expense) that took place between seller and purchaser when land was sold. That required two kinds of rule. The first were calculation rules. They were necessary because at the time section 20 of FA 1964 was introduced the charge on income from land was based on *entitlement* to incoming rent and *payment* of outgoing rent. Where there were apportionments on sale there might be neither entitlement nor payment by the "right" person. The second were timing rules to ensure that the consequential adjustments fell in the right tax year.

1308. As a result of the 1995 Schedule A reforms these rules are no longer necessary. Two main factors lead to this conclusion.

1309. The first relates to the object of charge under Schedule A: the profit of a Schedule A business. For there to be a Schedule A business a person has to be exploiting United Kingdom land for rent (section 15(1)1(1) of ICTA). In order to be a receipt (or outgoing) of the Schedule A business it is enough that an amount relates to a period when the person was exploiting the land.

1310. The second factor relates to the time when income within the charge is brought into account. The accruals principle of accounting has been imported from Schedule D Case I into Schedule A. The accruals principle brings an item into account in the period to which it relates. So the rules in section 40(1) to (3) of ICTA about the time of receipt and payment are unnecessary.

1311. Section 40(4) of ICTA is similarly now unnecessary. It provides that any reference in section 40(1) and (2) of ICTA to a party to a contract includes a person to whom the rights and obligations of that party under the contract have passed by assignment or otherwise. Since the test of whether or not an item is to be brought into account under Schedule A is whether it arises from a person's exploitation of land then whether the rights and obligations under the contract pass by assignment or otherwise, the person to whom they pass will be the person exploiting the land.

1312. Section 40(4A) of ICTA is not rewritten. It is linked to the parts of section 40 of ICTA that are unnecessary and also gives in certain circumstances the wrong result.

1313. Section 40(3)(b) of ICTA has a clear anti-avoidance purpose that is preserved in section 320. But it also contains a timing rule. The timing rule in section 40(3)(b) of

ICTA is not rewritten because the accruals principle again attributes the apportioned amount to the correct period.

1314. Section 320 rewrites the anti-avoidance part of section 40(3)(b) of ICTA which preserves the capital or revenue nature of any amount due or paid in arrears and apportioned by the buyer to the seller on the sale of land.

1315. This rule was originally introduced to deal with the common (at the time) practice whereby, under normal conditions of sale, that part of any rent paid in arrears, apportioned to the seller and to be paid to him or her by the purchaser, was adjusted by means of an addition to the sale price. As capital gains tax did not exist the apportioned rent taken as increased sale price escaped tax altogether.

1316. Capital gains tax now takes away much of the incentive to deal with rent in this way. But this rule may still serve a useful deterrent purpose and needs to be preserved.

1317. The time of apportionment referred to in the section is normally the time of completion of the sale.

Section 321: Mutual business

1318. This section makes it clear that the concept of "mutuality" does not apply in the property income context. It is based on section 21C of ICTA.

1319. Mutuality is a concept that has been developed by the courts over a long period. It derives from the principle that one cannot make a profit out of oneself. It may arise in the trading context where a class of contributors to a common fund are entitled, as a class, to share in the surpluses of that fund.

1320. The approach in section 321 is different from that in section 21C of ICTA and simpler. The approach in section 21C of ICTA is to apply the normal profit calculation rules to any "mutual business" and add the result to the profits of the rest of the Schedule A business. Section 321 on the other hand prevents, from the outset, the concept of mutuality operating on amounts within Part 3 of this Act.