

TaxZone Newthwire

Issue 58 - 16 August 2004 - Schedule A and Schedule D, Case VI

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Editorial Note

Schedule A income, from 1995/96, comprises mostly rents received from unfurnished and furnished properties, together with premiums from leases of less than 50 years' duration.

In some ways Schedule D, Case VI is the Cinderella of the taxing statutes of income. A generalisation might be that it is the Schedule that imposes taxes when the Inland Revenue cannot find another schedule of tax in which the particular item of income neatly fits. Income from furnished lettings used to be assessed under this Schedule, but is now assessed under Schedule A, as are rents generally.

Having said that, the items most commonly assessed under Schedule D, Case VI include:

- Commissions
- Copyright receipts
- Post cessation receipts
- Artificial land transactions
- Premiums treated as rent

From 1995/96 Schedule A applies to the annual profits arising from a business carried on for the exploitation, as a source of rents or other 'receipts', of any estate, interest or rights in or over land in the United Kingdom. It does not include profits from the occupation of land, farming and marketing gardening or mineral rents, royalties etc.

In this wire I will attempt a brief overview of both these Schedules, giving subscribers basic information that can be followed up, where necessary, by further research.



Regards

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Disclaimer

No responsibility for loss occasioned to any person acting or refraining from action as a result of any information in this wire is accepted by the author or AccountingWEB. In all cases, appropriate professional advice should be sought before making a decision.

Statutory law

The Schedule A charge is outlined in section 15, Taxes Act 1988. Further provisions relating to the charge are set out in Part II of the Taxes Act 1988 (sections 21 - 43G). These include sections 34-36 regarding premiums treated as rent.

Most references to Schedule D, Case VI occur in the Taxes Act 1988. These include:

Sections 56/56A - certificates of deposit.

Section 69 - basis of assessment.

Section 72 - apportionments.

Sections 103/104 - post cessation receipts.

Sections 392 & 396 - Case VI losses.

Sections 775-778 - sale by an individual of income derived from his personal activities and artificial transactions in land.

Section 786 - transactions associated with loans or credit.

Case law

Cases regarding Schedule A are included in Chapter 51 of Tolley's Tax Cases 2003. Many are historical, but perhaps the most recent and interesting is:

CIR v John Lewis Properties plc [2003] STC 117

In this case a property holding company assigned to a bank the right to receive rental income for a five-year period, in return for a lump sum payment. The Inland Revenue assessed the company on the basis that the amount received was a Schedule A receipt, but the company appealed, contending that the amount received was a capital amount. The court of Appeal, by a 2-1 majority, allowed the company's appeal.

There are numerous tax cases regarding Schedule D, Case VI income in Tolley's Tax Cases 2003, and these are summarised at 64.1-64.50. I will refer to some of the most important of these cases as follows:

Griffiths v Jackson; Griffiths v Pearman [1983] STC 184

Two chartered accountants let 180 rooms in Bristol, mainly to students, on a furnished lettings basis. They contended that the income should be assessed under Schedule D, Case I as they were carrying on a business. This was rejected by the court. Schedule D, Case VI was the correct assessing Schedule. It was a cardinal principle of tax law that income derived from the exercise of property rights was not from carrying on a trade.

Brewin v McVitie SpC 176

A self-employed financial consultant had engaged in business selling products devised by one major company. On her retirement she agreed to sell the goodwill to another individual for 8,000 pounds.

Subsequently she entered into an arrangement to sell her practice to another company within the life company's group, and to continue to run the business for three months.

The consideration for this transaction was 33,415 pounds payable immediately, 11,138 pounds payable one year later and whatever sum the company received for sale of the practice less 250 pound. In the event the company sold the practice to the original intended purchaser and paid the taxpayer 7,750 pounds. The Inland Revenue issued assessments for 33,415 pounds under section 106(1), Taxes Act 1988. The taxpayer appealed, contending that under section 106(2), the amount received was a capital receipt. This contention was rejected by the Special Commissioner, who considered that the only object of the various transactions must have been tax avoidance. The paying company also had no business purpose when engaging the taxpayer for the three-month period.

Gilmore v HM Inspector of Taxes SpC 206

An accountant ceased in practice and received a contingency fee of 50,000 pounds. He then made an election under section 108, Taxes Act 1988 for these fees to be carried back to his final year of trading. He also contended that, because of section 63, Taxes Act 1988, only 25/365 of the 50,000 pounds was assessable (his accounts year being to 30 April). This contention was rejected by the Special Commissioner, who held that section 108 did not affect the calculation of the charge under Schedule D, Case VI.

Other Inland Revenue resources

Schedule A

- Inland Revenue Property Income Manual

- Inland Revenue leaflets:

IR 87 - Letting Your Home

Including the 'Rent a Room' scheme and letting your present home while you live elsewhere.

IR 150 - Taxation of Rents

The Inland Revenue Business Income Manual deals with some items of Case VI in detail as follows:

Case VI generally - BIM 80101-80140

Post-cessation receipts - BIM 80505-80770

Also BIM 82001

Other resources

Other resources available to those who wish to study this subject are:

Tolley's Income Tax 2003-2004

13.2 - Certificates of deposit

52.8-52.12 - Offshore gains

54.5 - Sale of patent rights

Chapter 61 - Post cessation receipts and expenditure

Chapter 68 - Schedule A - Property Income

71.85 - Subsidies, grants etc

Chapter 74 - Schedule D, Case VI - Miscellaneous income

Tolley's Property Tax Planning - fourth edition

Tolley's Property Taxes 2000-2001

Chapter 2 - Rents

Chapter 3 - Premiums

Chapter 14 - Artificial Transactions in Land

Chapter 22 - Miscellaneous

Tolley's Tax Planning 2001-2002

54.45 - Transactions in Land

Basis of assessment

Schedule A income is computed on the full amount of profits arising in the year of assessment. The Inland Revenue will no longer allow any deviation from a strict fiscal year basis except in the case of certain trading partnerships.

The income tax assessment under Schedule D, Case VI is made on the profits arising in the year of assessment. In practice if the income is of a recurrent nature the assessment is often made on the preceding year's income and may be on Schedule D, Case I or Case III lines for the opening and closing years. However, for corporation tax purposes the assessment is on the actual income in the accounting period.

Assessments under Case VI are not earned income unless specifically provided, such as post cessation receipts, distribution of assets of mutual companies, sale of know how and capitalisation of earnings.

Losses

Where a Schedule A loss is suffered it is carried forward without any limit to be set against the first future profits of the Schedule A business.

Losses on transactions which, if profitable, would have been assessable under Schedule D, Case VI can be set off against any profit or gains charged under Case VI for the same year of assessment. Alternatively, losses may be carried forward against future profits assessable under Schedule D, Case VI.

Claims relating to the amount of Schedule D, Case VI losses must be made within five years after 31 January following the tax year in which they arose. A further claim for relief for losses brought forward must be made within five years after 31 January following the year for which relief is claimed.

Items within the charge

Schedule A

- Unfurnished lettings
- Furnished lettings
- Furnished Holiday Lettings (see Newthwire No. 15)

Schedule D, Case VI

- Accrued Income Scheme (Bondwashing)
- Commissions
- Copyright receipts
- Post cessation receipts
- Artificial land transactions
- Certificates of deposit

Deductions from lettings

The following amounts may be deducted in computing profits of a Schedule A business:

- Loan interest, to the extent that it is incurred wholly and exclusively for the purposes of the letting business.
- Capital allowances on plant and machinery. This does not apply in the case of a dwelling house let as a furnished letting. In such a case furniture and furnishings may be dealt with on the renewals basis. An alternative Inland Revenue concession is to allow as depreciation 10% of the rents received as reduced by council tax and water rates or material payments for services borne by the landlord but normally a tenant's burden.

Where the 10% deduction is claimed, no further allowance is given for the cost of renewing furniture or furnishings, nor for fixtures such as cookers, dishwashers, or washing machines which, in unfurnished accommodation, the tenant would normally provide personally. However, the cost of renewing fixtures which are an integral part of the building (e.g. baths, toilets, washbasins) may be claimed in addition, provided that they are revenue repairs to the fabric.

- In general the provisions of section 74 (1)(a), Taxes Act 1988 apply to Schedule A income, so that business expenses wholly and exclusively incurred in connection with the letting are allowable against rents. These will include agent's commission, repairs and maintenance, insurance and cleaning and window cleaning. The provision of utility services in some instances will be incurred, as well as accountancy charges, and, in larger cases, motor and travelling expenses and salaries. Normal administration expenses such as telephone, postage, computer charges are also claimable.
- Please see Newthwire No. 15 for the position regarding furnished holiday lettings.

Rent a room relief

Where a householder takes in a domestic lodger a special relief is available for an individual receiving sums for the use of furnished accommodation, or for other services such as meals, cleaning, laundry etc. Instead of a computation under Schedule A/Schedule D, Case I, the householder can elect to claim rent a room relief. The effect of this is that, if the amount received is 4,250 pounds or less, the assessment is treated as nil. Where the amount slightly exceeds 4,250 pounds, the excess will be taxed (without any deduction for expenses). It must be emphasised that the exemption applies to the gross amounts received before the deduction of expenses.

Premiums treated as rent

A premium received by a landlord under a lease not exceeding 50 years is treated as additional rental, the date the lease is granted. The amount assessable is the premium less 1/50th for each full year (minus one) during the lease's duration. The amount calculated is taken into account in full in computing Schedule A profits for the tax year in which it is treated as received.

Example 1

A taxpayer grants a 16-year lease of premises for a payment of 30,000 pounds. The amount chargeable on him for that year is:

	Ammount (Pounds)
Premium	30,000
Less $((16 - 1)/50) \times 30,000$ pound	9,000
Chargeable	21,000

Special provisions apply where the payer of the premium subsequently grants a sub-lease to another tenant on payment of a premium. The same calculation is made, but with an additional deduction of the 'appropriate fraction' of the amount chargeable on the 'superior landlord'.

Example 2

If, after 5 years, the payer of the premium in Example 1 grants a sub-lease of 11 years for which he receives a premium of 40,000 pounds, the amount chargeable on him is:

	Ammount (Pounds)
Premium	40,000
Less $((11 - 1)/50) \times 40,000$ pound	8,000
	32,000
Less appropriate fraction of amount Chargeable on superior landlord	
$11/16 \times 21,000$ pounds	14,438
Chargeable	17,562

The payer of a premium is entitled to claim additional rent at an annual rate based on the amount charged to the recipient. In Example 1 this would be $1/16\text{th} \times 21,000$ pounds = 1,312 for each year of the tenancy. Where a sub-lease is granted the 'additional rent' is restricted to the appropriate fraction not used to reduce the charge on the later premium. In Example 2 the appropriate fraction is used entirely, so that no additional rent is available.

Any Answers

There have been a number of Any Answers queries on the site regarding property income. A selection of these are summarised as follows:

Schedule A

On 10 October 2001 Mark Banham queried the position where a company leases a building and then sub-lets. Is the rental income and expenditure assessed under Schedule A or under Schedule D with its normal trade?

Phil Rees considered that if it were a pure sub-let, then Schedule A applies. If the company provides services such as reception, secretarial services etc, then the transaction possibly amounts to a trade. Strictly speaking it is not part of the company's existing trade, but a separate one in those circumstances.

<http://www.accountingweb.co.uk/item/60168>

Schedule A loss

Suresh queried a Schedule A loss, in his query of 9 November 2001. A Schedule A loss had been made in 1997/98, but was overlooked when the 1999 and 2000 tax returns were submitted. Was there any way that relief could now be claimed?

Phil Rees provided reassurance in this case. If the Schedule A source of profits had continued after 1997/98, all that was required was to amend the subsequent tax returns or use the error and mistake provisions under section 33, TMA 1970. The loss brought forward should be set off against the first available Schedule A profit. If no Schedule A profits have occurred since 1997/98, then the loss can continue to be carried forward.

<http://www.accountingweb.co.uk/item/63089>

Furnished lettings

Knuckles asked, in a query date 7 January 2002, when claiming the concessionary 10% wear and tear allowance, whether this included the replacement of carpets. Or can their replacement be claimed in addition?

Once again Phil Rees provided the answer. The costs of replacing integral items such as baths, sinks, toilets etc. are claimable in addition to the 10% allowance, but not moveable items such as cooker, freezer, curtains and carpets.

<http://www.accountingweb.co.uk/item/68286>

Mortgage interest relief - Schedule A

Ma Gallagher is renting half her house. Is mortgage interest still available to set against Schedule A income (26 June 2002)?

Phil Rees continued his valuable insights into this subject. The answer is 'yes', but there may be an argument with the Inland Revenue regarding proportions. Is it really half the house? A claim must also be made on a fiscal year basis, so that a certificate from the lender must be obtained. A 31 December statement is not sufficient.

<http://www.accountingweb.co.uk/item/84642>

Offset of Schedule A rental loss

Chris Rhodes asked whether Schedule A losses can be offset against the capital gain made on a property, in a query dated 22 August 2002?

Michael Haig stated that the answer was 'no' except in the case of a company. Company Schedule A losses are much more flexible than personal Schedule A losses. Capital gains can be set off against in-year and brought forward Schedule A losses.

<http://www.accountingweb.co.uk/item/88937>

Capital allowances under Schedule A business

Was it possible for a company that lets property furnished to claim capital allowances on furniture, asked Khurram Kahn, in his query of 31 October 2002?

Both Michael Haig and Michael Gallagher confirmed that a claim could be made, provided that the property is not let as a residence. If it is a flat above a shop there are conditions. If it is a dwelling house the 10% wear and tear allowance can be claimed, or renewals basis. There may also be other items other than furniture on which allowances can be claimed.

<http://www.accountingweb.co.uk/item/95251>

Schedule A

A client of Sarah Kedgely owns a limited company that is considering the purchase of investment properties. Would mortgage interest be allowable against the Schedule A income? Confirmation is also needed that Schedule A losses can be relieved sideways and forward but not backwards. (14 April 2004)

Michael Webster provided some very valuable advice in this case. The point about losses is correct. As regards mortgage interest, in a company situation it is a non-trading loan relationship deficit. This is actually quite useful, as the loss rules for such deficits are very flexible. This includes the facility to claim only partial relief for an NTLR deficit.

<http://www.accountingweb.co.uk/item/125329>

Ask a question

Readers with a current case should post their query in Any Answers.

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