

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 3: Property income

Chapter 8: Rent receivable in connection with a UK section 12(4) concern

Overview

1368. This Chapter charges as property income rent receivable in connection with a section 12(4) concern. It also provides for certain deductions and reliefs to be given from that income.

Section 335: Charge to tax on rent receivable in connection with a UK section 12(4) concern

1369. This section charges rent receivable in connection with a UK section 12(4) concern to tax. It is based on section 119(1) of ICTA.

1370. The loss regime in section 392 of ICTA applies to income charged under this Chapter and not the regime in sections 379A and 379B of ICTA.

1371. The charge under Schedule D Case III imposed by section 119(2) of ICTA is not rewritten.

1372. Section 119(2) of ICTA provides for the rent to be taxed under Schedule D Case III if the rent is paid in produce of the concern. If section 119(2) of ICTA does not apply the rent is charged under Schedule D Case VI.

1373. When section 119 of ICTA was introduced as section 34 of FA 1934 the lessee was required to deduct income tax when paying rent to the lessor. This was achieved by treating the rent as a royalty paid in respect of the user of a patent. But it would be impractical to deduct income tax if the rent were paid in kind. So what is now section 119(2) of ICTA charged rent paid in kind under Schedule D Case III. This avoided the requirement to deduct income tax because these rents are not a category of income from which tax is deducted.

1374. Since the requirement to deduct income tax from rents taxable under section 119 of ICTA was repealed by FA 1995 a separate charge on rents paid in kind is no longer required.

Section 336: Meaning of “rent receivable in connection with a UK section 12(4) concern”.

1375. This section clarifies:

- what is meant by “UK section 12(4) concern”;

- what is meant by “rent”; and
- when rent is treated as “receivable in connection with” such a concern.

1376. It is based on section 119(1) and (3) of ICTA.

1377. *Subsection (1)* identifies when rent is receivable in connection with a section 12(4) concern. It uses the language of section 266(1) (meaning of “generating income from land”) to rewrite the phrase “in respect of any land or easement” in section 119(1) of ICTA. Section 266 is based on paragraph 1(1) of Schedule A (section 15(1) of ICTA). That provision identifies the scope of Schedule A. The approach in section 336 assumes that the income taxed by section 119 of ICTA would otherwise be taxed under Schedule A.

1378. The justification for this assumption is that section 119 of ICTA can have no application to income that is already taxed under Schedule D Case VI. Neither is there any question that the rent would go untaxed if it were not for section 119 of ICTA. Rents are clearly annual profits or gains as described in Schedule D Case VI of ICTA. The effect of section 119 of ICTA is to take income that would be taxed under Schedule A and tax it under Schedule D. So in identifying the scope of the charge it is possible to use the ordinary property business definitions and avoid the need to rewrite the complicated definitions of “easement” and “rent” in section 119(3) of ICTA.

1379. The section makes explicit a territorial restriction to the United Kingdom that is implicit in section 119(1) of ICTA. If a section 12(4) concern is located outside the United Kingdom it would be a foreign possession for the purposes of the charge under Schedule D Case V. Any income arising from such a possession would be taxed under Schedule D Case V. Section 119 of ICTA can have no application to income that is already taxed under Schedule D.

1380. *Subsection (2)* provides that the section applies also to “dead rents”. It is based on section 119(1)(b) of ICTA.

1381. A “dead rent” is usually paid only for the lease of mineral rights. It is a flat rent that is payable whether the minerals are worked or not. The rent is recoverable from the rent due when the minerals are worked. It acts as an economic incentive to work the minerals.

1382. *Subsection (3)* provides the definition of rent. It is based on section 119(3) of ICTA. As explained in the commentary on subsection (1), this section is based on the assumption that the rents taxed by section 119 of ICTA would otherwise be taxed under Schedule A. This means it is not necessary to reproduce the definition of “rent” in section 119(3) of ICTA.

Section 337: Income charged

1383. This section sets out the amount charged to tax. It is based on section 69 of ICTA.

1384. *Subsection (2)* is a signpost to the deductions and reliefs that are available against this income.

Section 338: Person liable

1385. This section states who is liable for any tax charged. It is based on section 59 of ICTA.

Section 339: Deduction for management expenses of owner of mineral rights

1386. This section allows a deduction for the expenses of managing mineral rights. It is based on section 121(1) of ICTA.

1387. *Subsection (1)* sets out the conditions for the section to apply. It does not reproduce the condition that the expenses must be incurred “necessarily”. See *Change 78* in Annex 1.
1388. *Subsection (2)* provides that a deduction is allowed for the qualifying expenses paid in the tax year. This rewrites the requirement that the expenses are “disbursed” in the tax year.
1389. The relief applies only to rents received from a UK section 12(4) concern. If the income is taxed as income from a UK property business, there is no need for special rules identifying what deductions are allowable. The normal rules apply.

Section 340: Relief in respect of mineral royalties

1390. This section provides that only half of the net profit earned in respect of mineral royalties is charged to income tax. It is based on section 122 of ICTA. The other half of the net profits is charged to capital gains tax by section 201 of TCGA.
1391. The provision was introduced in FA 1970 to give relief from the high marginal rates of tax that could arise if the income was liable to betterment levy, surtax and income tax. It has been retained despite the abolition of the first two of those taxes.
1392. *Subsection (1)* limits the relief to royalties taxed under Chapter 8 of Part 3 of this Act. If the royalty is not taxed under this Chapter the same relief is given by section 157 or section 319.

Section 341: Meaning of “mineral lease or agreement” and “mineral royalties”

1393. This section defines various terms used in section 340. It is based on section 122(5) and (6) of ICTA.
1394. *Section 364* includes a definition of “lease” that applies for the purposes of the property income Part. It is based on section 24 of ICTA, which applies for the purposes of Schedule A in the source legislation. Because the definition applies only for Schedule A in strictness it does not extend to the income taxed under section 340. But the definition of “mineral lease or agreement” in section 122(6) of ICTA applies to any agreement to win and work minerals in the United Kingdom. Such an agreement would also satisfy the definition in section 24 of ICTA so there is no change in the law.

Section 342: Extended meaning of “mineral royalties” etc. in Northern Ireland

1395. This section modifies the definition of “mineral royalties” to deal with the different rules that apply to the ownership of mineral rights in Northern Ireland. It is based on section 122(7) of ICTA.
1396. The right to win, and win and work, most minerals in Northern Ireland is vested in the Department of Enterprise, Trade and Investment (DETI). The DETI will grant licences to work the minerals and make compensatory payments to the former owners of the mineral rights under various Acts of the Northern Ireland Parliament. This section treats those payments as mineral royalties for the purposes of section 340.

Section 343: Power of Board to determine what counts as “mineral royalties”

1397. This section allows the Board of Inland Revenue to make regulations concerning the application of the relief in section 340. Any regulations made under this power would apply also to sections 157 and 319 through sections 157(3) and 319(3).