Clause 1 and Schedule 1: Calculation of profits of property businesses

Summary

1. This measure amends and inserts provisions relating to the calculation of the profits of a property business. This includes, in particular, allowing the use of the cash basis to calculate the profits of a property business, and supporting provisions to outline what is to be recognised as income and what deductions are allowed under the cash basis.

Details of the Clause

2. Section 1 states that Schedule 1 contains provisions relating to the calculation of the profits of a property business, in particular using the cash basis.

Details of the Schedule

Schedule 1: Part 1: Amendments of ITTOIA 2005

3. Paragraph 2 introduces new sections 271A, 271B, 271C, 217D and 271E:

4. New Section 271A sets out the conditions in which property businesses cannot use the cash basis and must use GAAP, as follows:

5. New Section 271A(2) contains Condition A which lists certain categories of entities or capacities in which a person may carry on a property business. These are companies, limited liability partnerships, corporate firms, trustees, or personal representatives.

6. New Section 271A(3) defines a corporate firm as a partnership having a non-individual member for the purposes of Condition A.

7. New section 271A(4) contains Condition B which is that the cash basis receipts of the business exceed £150,000.

8. New Section 271A(5) clarifies that the receipts referred to in Condition B are the amounts that would be brought into account in calculating the profit of the property business on the cash basis under section 271D.

9. New Section 271A(6) contains Condition C which is that the person carrying on the property business receives a share of joint property income and the profits of another person also receiving a share of that joint property income are calculated in accordance with GAAP.

10. New Section 271A(7) defines joint property income to have the meaning within section 836 or section 837 of ITA 2007. These sections relate to properties owned jointly by spouses or civil partners.

11. New Section 271A(8) contains Condition D which is that a business premises renovation allowance is made in calculating the profits of the property business, and a balancing event would give rise to a balancing adjustment.

12. New Section 271A(9) contains Condition E which is that a GAAP election under New section 271B is made by the person carrying on the property business.

13. New Section 271A(10) requires that the election in Condition E be made to an officer of HM Revenue and Customs within one year following the ordinary filing date for that tax year.

14. New Section 271A (11),(12) and (13) allow Conditions A and B to be amended by regulations following the draft affirmative procedure for statutory instruments. However, where regulations remove paragraphs in section 271A(2) the negative procedure will apply in accordance with section 873.

15. New section 271B defines references to calculating profits of a property business in accordance with GAAP as meaning generally accepted accounting requirements subject to adjustments required by law.

16. New section 271C requires the profits of a property business to be calculated on the cash basis if the conditions in section 271A do not apply.

17. New section 271D(1) defines references to calculating profits of a property business on the cash basis as having the meaning in section 271D(2) and (3).

18. New section 271D(2) sets out how profits are to be calculated under the cash basis, which is that receipts are brought into account when received and expenses brought into account when paid

19. New Section 271D(3) states that section 271D(2) is subject to adjustments required or authorised by law.

20. New Section 271D(4) states the provisions of this Part which apply only where the cash basis is used. These are new section 272ZA (sets out which trading rules apply), new section 307B (on capital expenditure), new sections 307C and 307D (which relate to deductions and modifications of deductions for costs on loans) and new Chapter 7A (which relates to adjustments for capital allowances when entering the cash basis).

21. Paragraph 3 inserts a heading after section 272.

22. Paragraph 4 inserts new section 271E which requires that profits of a property business are calculated in the same way as a trade, subject to section 272 for non-cash basis businesses and section 272ZA for cash basis businesses.

23. Paragraph 5 amends section 272 to restrict this section to apply only where profits of a property business are calculated in accordance with GAAP.

24. Paragraph 6 inserts new section 272ZA which sets out which rules for calculating the profits of a trade also apply to calculating the profit of a property businesses under the cash basis.

25. Paragraph 7 inserts a heading before section 272A.

26. Paragraph 8 amends the existing finance cost restriction rules in section 272A to refer to the additional new rule in section 307D restricting loan costs also applying where profits of a property business are calculated on the cash basis.

27. Paragraph 9 amends section 274(1)(b) and section 274(3) to add references to sections 38 and 55 as applied by section 272ZA and new section 307D . These subsections give exceptions to the general rule in section 274(1)(a) that permissive rules take priority over prohibitive rules in this Part.

28. Paragraph 10 amends section 276(5) to refer to section 276A regarding the treatment of deductions for premiums paid by a property business using the cash basis.

29. Paragraph 11 inserts new section 276A which prevents any deductions for a premium paid under a property business using the cash basis by ceasing to apply sections 291 to 294, 296 and 298 to these businesses.

30. Paragraph 12 inserts new sections 307A, 307B, 307C and 307D introducing restrictions to certain deductions for property businesses using the cash basis as follows:

31. New Section 307A states that sections 307B, 307C and 307D only apply to property businesses using the cash basis.

32. New Section 307B restricts the items of capital expenditure for which deductions can be allowed in a property business using the cash basis as follows:

33. New Section 307B(2) allows no deduction for capital costs of acquiring or disposing of a business or part of a business.

34. New Section 307B(3) allows no deduction for capital costs of training or education.

35. New Sections 307B(4), (5), (6) and (7) taken together allow no deduction for capital expenditure on land and items provided or used in a residential property unless that property is part of a UK or EEA furnished holiday lettings business. A just and reasonable apportionment is required for any item of expenditure falling within these subsections that relates to both an FHL and non-FHL part of a residential property business

36. New Section 307B(8) requires for a just and reasonable apportionment of the capital expenditure where an asset is used partly in a residential property and partly for another purpose.

37. New Section 307B(9) prevents deductions for some specific items, including non-depreciating

items, items not used in the business, cars, relevant land, non-qualifying intangible assets and financial assets.

38. New Section 307B(10) excludes from new section 307B(9)(d) capital expenditure on a depreciating asset which is fixed to relevant land. This is to the extent that the expenditure is not incurred on the categories in new section 307B(5)(b). The effect of this is that deductions for capital expenditure on certain fixtures and fittings are still available for non-residential properties. New Section 307B(11) defines a "depreciating" asset as one which within 20 years will cease to have a useful life or decline in value by 90%.

39. New Section 307B(12) defines the end of the useful life of the asset as being when it is no longer of any use to any person as a business asset.

40. New Section 307B(13) defines "relevant land" for the purposes of new section 307B(9) as being land other than land on which a residential property business that is not a UK or EEA furnished holiday lettings business is carried on.

41. New Section 307B(14) defines what is meant by an "intangible asset" for the purpose of this section as being an intangible asset within the meaning of FRS105.

42. New Section 307B(15) defines what is meant by "non-qualifying" for an intangible asset, which is any intangible asset with a useful life of over 20 years from the date the expenditure on the asset is incurred.

43. New Section 307B(16) extends the meaning of "non-qualifying" to include rights to receive assets that would be non-qualifying.

44. New Section 307B(17) adds that intangible assets in respect of which other parties have been granted a licence or right for their use are also non-qualifying

45. New Section 307B(18) defines a "financial asset" as an right relating to a financial instrument or an economic equivalent.

46. New Section 307B(19) requires that potential acquisition, provision, alteration or disposal be treated as if that event had actually happened.

47. New Section 307B(20) provides definitions of various terms used in this section.

48. New Section 307C applies new section 307D to restrict the deduction for the cost of loans where the total business amount of the loans is greater than the value of the property. The business amount of the loan is the total amount of the loan multiplied by the proportion of the deduction for that loan in that year which is wholly and exclusively incurred for the purpose of the business.

49. New Section 307D restricts deductions for loans which come within section 307C by only allowing an amount equal to the deduction but for this section multiplied by the fraction of the value of the property divided by the business loan amount. This is also subject to the general finance cost restriction for residential properties under section 272A.

50. Paragraph 13 amends the definition of the "capital expenditure rule" in section 311A to give separate definitions in relation to property businesses using the cash basis and property businesses not using the cash basis. The "capital expenditure rule" for GAAP property businesses means the rule in section 33 as applied by section 272. The "capital expenditure rule" for cash basis property businesses means the rules in new section 307B.

51. Paragraph 14 adds an interpretive provision to section 315 (deductions for expenditure on sea walls) so that any reference to "expenditure incurred" is taken to mean "expenditure paid" where the profits of a property business are calculated using the cash basis.

52. Paragraph 15 amends section 322 to add a reference to new section 307B as one of the rules where it matters whether a UK or overseas property business consists of or includes "commercial letting of furnished holiday accommodation".

53. Paragraph 16 inserts new section 329A, which states that Chapter 7 relating to adjustment income applies to property businesses using the cash basis when they transition into calculating profits on the cash basis from GAAP or vice versa.

54. Paragraph 17 amends section 331 to add that these provisions become subject to the new section 334A which determines the effect of spreading adjustment income on leaving the cash basis.

55. Paragraph 18 inserts new section 334A, and Chapter 7A with sections 334B and 334C:

56. New Section 334A applies existing sections 239A and 239B for the trading cash basis provisions to the property cash basis. Section 239A requires the spreading of any adjustment income over 6 tax years whilst section 239B allows an election to bring an additional amount into charge in a tax year than would otherwise be brought in under the section 239A spreading rule.

57. New Section 334B defines where a person carrying on a property business is considered to have entered the cash basis for a year, which is where they use the cash basis for the current year and used GAAP in the previous year.

58. New Section 334C applies sections 240C, 240D and 240E from the trading cash basis rules which determine the treatment of certain capital allowances items where a person enters the cash basis.

59. Paragraph 19 inserts a new subsection 6A to section 786 so that certain capital receipts brought into account by section 96A and section 272ZA under the cash basis are recognised as rent-a-room receipts where they otherwise satisfy the criteria of rent-a-room receipts under section 786.

60. Paragraph 20 amends section 860(5) to add that an election made under section 239B as applied by new section 334A must be made by all members of a firm where the property business this relates to is carried on by a partnership.

61. Paragraph 21, 22, 23, 24, 25 and 26 amend sections 860, 866, 867, 868, 869, 870 and 872

respectively to include references to new section 272ZA alongside references to section 272

62. Paragraph 27 adds to the index of defined expressions in Part 2 of Schedule 4 the definition of "the cash basis" for Part 3 purposes at section 271E and "in accordance with GAAP" for Part 3 purposes at section 271D.

Schedule 1: Part 2: Amendments of other acts

63. Paragraph 28 amends section 42 of TMA 1970 to add a reference to the new section 271A(9) ITTOIA 2005 – election to use GAAP – to the list of provisions to which the claims procedures in section 42 apply.

64. Paragraph 29 amends section 47A of TCGA 1992 to extend this exemption for disposals by persons using the cash basis to persons who use the cash basis to calculate profits of a property business under new section 271D ITTOIA 2005.

65. Subparagraph 7 inserts a new subsection 47A(8) TCGA 1992 which defines a property business for the purposes of this section as a UK or overseas property business within the meaning of Part 3 of ITTOIA.

66. Paragraph 30 amends section 47B TCGA 1992 to apply the rules on disposals made after leaving the cash basis to persons who have used the cash basis to calculate profits of a property business under new section 271D ITTOIA 2005.

67. Paragraph 31 amends section 1(4) CAA 2001 to exclude persons who have calculated profits of a property business on the cash basis from claiming capital allowances except for expenditure on a car.

68. Paragraph 33 amends section 59 CAA 2001 as follows:

69. Subparagraph (2) inserts a new subsection (4A) to section 59 CAA 2001 which prevents any unrelieved qualifying expenditure from being carried forward from the last day of the tax year prior to the one in which the property business enters the cash basis.

70. Subparagraph (3) amends section 59(5) CAA 2001 so that the restriction in the new subsection 4A does not apply to unrelieved qualifying expenditure on a car.

71. Subparagraph (4) applies the definition of "entering the cash basis" from the new section 334B ITTOIA 2005 to this section.

72. Paragraph 34 amends the capital allowances provisions for persons leaving the cash basis in section 66A CAA 2001 as follows:

73. Subparagraph (2) amends section 66A(1)(a) to extend this to apply to property businesses under the cash basis, and replaces section 66A(1)(b) to apply this section to expenditure which would have been qualifying had the profits of the property business been calculated in

accordance with GAAP.

74. Subparagraph (3) amends section 66A(2) to include property businesses.

75. Subparagraph (4) inserts new subsection 66A(6A) to define the meaning of a property business leaving the cash basis for the purposes of this section as meaning that its profits are calculated using GAAP in that tax year, and using the cash basis in the previous tax year.

76. Paragraph 37 Amends the loss provisions for property businesses in Chapter 4 of Part 4 ITA 2007 as follows:

77. Subparagraph (2) amends section 120 ITA 2007 to prevent this section from applying where the new section 127BA applies.

78. Subparagraph (3) inserts new section 127BA which prevents losses from a property business using the cash basis from being set against general income where section 120 would have otherwise allowed this.

79. Paragraph 38 amends s384B(1) ITA 2007 to extend this restriction to partnerships where their profit for a tax year is calculated on the cash basis.

Schedule 1: Part 3: Commencement

80. Paragraph 39 provides that the amendments in this schedule take effect for tax years from 2017-18 onwards.

Background note

81. This measure provides a simpler option for the majority of unincorporated property businesses with straightforward affairs to arrive at their taxable profits for a tax year. This supports the government's commitment to reduce administrative burdens on businesses.

82. The cash basis is simpler for landlords as it generally requires them only to account for income actually received and expenses actually paid during the year and lessens the need for accounting adjustments at the year end.

83. The cash basis may be used to calculate the profits of property businesses with receipts not exceeding £150,000, although certain persons are also excluded from using it. The cash basis is now the default option for the calculation of the profits of eligible property businesses, although the person carrying on the business may elect to use GAAP to calculate profits instead.

84. At Budget 2016 the government announced their intention to consult on extending the cash basis to unincorporated property basis and the consultation ran from August to November 2016, and following this it was decided to proceed with introducing the cash basis to property

businesses as provided in this measure. If you have any questions or comments please contact propertycashbasis.consultation@hmrc.gsi.gov.uk.