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## The Personal Tax Planning Review

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# THE NEW SCHEDULE A REGIME — MORE COMPLEX THAN PORTRAYED

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### Introduction

Two years of assessment have passed since the introduction of the new Schedule A income tax regime. At the time of its enactment, this new code was heralded as a simplification of the income tax rules dealing with the taxation of rents and other annual receipts from land. The Financial Secretary to the Treasury at the time is reported as stating:

"The clause and schedule<sup>7</sup> make changes to the income tax rules which apply to the taxation of income from property...[T]hey simplify a complicated area of taxation and will make it easier for those liable to income tax to compute their income from property...In future the starting point for the computation of income from property will be the application of commercial accountancy principles...The commercial profit will be adjusted under the computational rules that apply to trading activities..."<sup>8</sup>

The aim of this article is to assess whether, for the purposes of income tax, the proposition that taxable rental income is calculated in the same way as taxable trading

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<sup>7</sup> That is clause 33 and Schedule 6 of the 1995 Finance Bill (which became section 39 and Schedule 6 of the Finance Act 1995 respectively).

<sup>8</sup> *Hansard*, H C Standing Committee D (Sixth Sitting, Thursday 9th February 1995 (Morning)), col. 165.

profit<sup>9</sup> is an accurate statement of the law. It will be concluded that this representation is somewhat misleading. On the one hand there are "computational rules that apply to trading activities" which are not in the new Schedule A code, and on the other, there are provisions that are exclusive to that code. This gives the new code a complexity that was (perhaps) not intended. All statutory references are to the Income and Corporation Taxes Act 1988 ("the Act") unless otherwise stated.

### The Computation of Schedule A Profits

The first objective is to describe and analyse the way in which the legislation deals with the computational aspects of the new Schedule A regime.

### The basic trilogy

The foundations of the computational edifice of the Schedule A code comprise three sections. Section 1(1) of the Act directs, *inter alia*, that income tax shall be charged in respect of profits described in Schedule A. Paragraph 1(1) of section 15(1) of the Act provides that tax under Schedule A shall be charged on the annual profits arising from a Schedule A business.<sup>10</sup> Section 21(1) in turn states that income tax under Schedule A shall be computed on "the full amount of the profits...arising in the year of assessment". This combination of sections is not unique to Schedule A. It is already entrenched in exactly the same way in the case of Cases I and II of Schedule D<sup>11</sup> and

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<sup>9</sup> For example, *Simon's Direct Tax Service* at paragraph A4.330 states: "[The] provisions treat all income from property in the UK as income of a Schedule A business and apply the rules of Schedule D Case I regarding the receipts and deductions to be taken into account in arriving at the profits of that business..."

<sup>10</sup> "'Schedule A business' means any business the profits or gains of which are chargeable to income tax under Schedule A, including the business in the course of which any transaction is by virtue of paragraph 1(2) of that Schedule to be treated as entered into" — s.832(1). Paragraph 1(2) of Schedule A provides: "To the extent that any transaction entered into by any person is entered into for the exploitation, as a source of rents or other receipts, of any estate, interest or rights in or over any land in the United Kingdom that transaction shall be taken for the purposes of this Schedule to have been entered into in the course of such a [Schedule A] business" — s.15(1).

<sup>11</sup> In the case of a trade, profession or vocation, the basic trilogy comprises s.1(1) (which also refers to Schedule D), s.18(1) (which provides that tax shall be charged in respect of the annual profits arising to a person residing in the United Kingdom from any trade, profession or vocation), and s.60(1) (which states that income tax shall be charged under Case I or II of Schedule D on the full amount of the profits of the year of assessment).

clearly the draftsman has used this existing foundation upon which to build the computational edifice of the new regime. There is one problem, however. Although each of these three sections contains the word "profits", this term is not defined in the Act. The same difficulty also presents itself in relation to the Schedule D code,<sup>12</sup> and this was recognised (and solved) by the courts one hundred and ten years ago. In *Russell (Surveyor of Taxes) v Aberdeen Town and County Bank*.<sup>13</sup> Lord Herschell said:

"[T]he duty is to be charged upon "a sum not less than the full amount of the balance of the profits or gains of the trade..." and it appears to me that that language implies that, for the purposes of arriving at the balance of profits, all those deductions from the receipts, all that expenditure which is necessary for the purpose of earning the receipts must be deducted, otherwise you do not arrive at the balance of profits, indeed you do not ascertain and cannot ascertain whether there is such a thing as profit or not. The profit of a trade or business is the surplus by which the receipts from the trade or business exceed the expenditure necessary for the purpose of earning those receipts. That seems to me to be the meaning of the word 'profits' in relation to any trade or business. Unless and until you have ascertained that there is such a balance, nothing exists to which the name 'profits' can properly be applied."<sup>14</sup>

It is submitted that this definition of the term "profits" applies *mutatis mutandis* in the case of a Schedule A business. In recent years the courts have shown a willingness to rely on the principles of commercial accounting to quantify the profits of a trade,<sup>15</sup> and this is likely to apply to a Schedule A business too. It follows, therefore, that the starting point for the computation of taxable income from property is the application of commercial accountancy principles. The Financial Secretary's remarks in this regard are, with respect, correct. Attention must now be turned to asking whether the

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<sup>12</sup> The terms "Schedule D" and "Schedule D code" are used in the rest of this article as a convenient shorthand to refer to Cases I and II of that Schedule.

<sup>13</sup> (1888) 2 TC 321 at p 327.

<sup>14</sup> In *Usher's Wiltshire Brewery Ltd v Bruce (Surveyor of Taxes)* (1914) 6 TC 399 Lord Sumner alluded to the same problem. At p.435 His Lordship prescribed the same solution for "[t]o do otherwise would neither be to arrive at balance between two sets of figures, a credit and a debit set, which balance is the profit of the trade, nor to ascertain the profits of the trade, for trade incomings are not profits of the trade till trade outgoings have been paid and deducted." See also the *dictum* of Lord Templeman in *Beauchamp (Inspector of Taxes) v Woolworth (F W) plc* [1989] STC 510 at p.512.

<sup>15</sup> See *Gallagher v Jones (Inspector of Taxes)* [1993] STC 537; *Johnston (Inspector of Taxes) v Britannia Airways Ltd* [1994] STC 763.

commercial profit (or indeed loss) so struck is always adjusted using the statutory computational rules that apply to trading activities (i.e. the Schedule D code).

### **Central computational provision**

Schedule A is defined in section 15 which is in Part I of the Act. Part II then contains further provisions relating to the charge to income tax under Schedule A, including a number of computational provisions. Amongst them is the central computational provision of the Schedule A code — section 21(3)<sup>16</sup> — which reads as follows:

"Except in so far as express provision to the contrary is made by the Income Tax Acts, the profits or gains of a Schedule A business and the amount of any loss incurred in such a business shall be computed as if Chapter V of Part IV applied in relation to the business as it applies in relation to a trade the profits or gains of which are chargeable to tax under Case I of Schedule D."

The subsection divides into two limbs. The first (ending at the comma) comprises a proviso; the second, which is the main limb, comprises reference to the basic rules according to which the accounting profits are to be adjusted. It is useful to consider each separately, but in reverse order.

### **The second limb**

#### *Drafting of the enactment*

In drafting the second limb the draftsman has employed a deeming provision. He has taken another part of the Act (namely Chapter V of Part IV) and has bidden one to imagine that part applies in the case of a Schedule A business.<sup>17</sup>

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<sup>16</sup> It is probably this sub-section that springs to mind when one reads the Financial Secretary's statement that, for Schedule A purposes, commercial profit is to be "adjusted under the computational rules that apply to trading activities".

<sup>17</sup> The draftsman could have achieved the same result by introducing into Part II a new Chapter dealing exclusively with the computational provisions applicable to the new Schedule A code. This was not done however.



*Effect of the drafting*

What has been achieved by the draftsman in adopting this technique? Part IV of the Act contains provisions that relate to the Schedule D charge, and Chapter V of that Part is entitled "Computational Provisions". The broad effect of the second limb of section 21(3) is, therefore, to take the computational provisions of the Schedule D code and apply them in computing the profits arising from a Schedule A business. In other words, the computational provisions of the Schedule D code have been effectively incorporated into the Schedule A code with the result that there are, for practical purposes, two versions of Chapter V: a Schedule D version, and a Schedule A version. An example of how the incorporation works can be illustrated by quoting (with necessary amendments) section 74(1)(a) as it would be applied for the purposes of Schedule A:

"Subject to the provisions of the Tax Acts, in computing the amount of the profits or gains to be charged under *Schedule A* no sum shall be deducted in respect of:

- (a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the *Schedule A* business;..."

There are advantages to using this particular technique of incorporation by reference. It saves space; it also has the effect of attracting into Part II the case law and other learning attached to the provisions so incorporated. The major disadvantage, however, is that the reader is left to effect correctly the incorporation, and to work out what is involved in applying the provisions so incorporated. He has, for example, to make any necessary verbal changes in the incorporated provisions as these adjustments have not been spelt out.<sup>18</sup> And this is where the problems of interpretation begin!

*Extent of the deeming provision*

The second limb sets out the basic rules according to which the accounting profit or loss of a Schedule A business is to be adjusted for tax purposes. An appreciation of the broad effect of the drafting must not, however, cloud an understanding of the finer detail.

In the first place, it is essential to observe that the computational rules of the Schedule D code are effectively imported into the Schedule A code only to the extent that they

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<sup>18</sup> See F Bennion, *Statutory Interpretation* (2nd ed, 1992), p. 522.

are contained in Chapter V of Part IV of the Act. Computational rules of Schedule D that are outside that Chapter, are not (by virtue of the second limb of section 21(3) alone) part of the Schedule A code. Moreover, the Schedule D rules in Chapter V of Part IV that are incorporated are only those that apply in calculating the profits of a trade which are chargeable to tax under Case I of Schedule D. This, it is submitted, is the effect of the formula in the second limb of section 21(3) which reads "as it applies in relation to a trade the profits or gains of which are chargeable to tax under Case I of Schedule D". The formula acts as a signpost and is used to identify accurately which parts of Chapter V are so incorporated. The result is that not every enactment in Chapter V of Part IV has been incorporated into the Schedule A code, but only the Schedule D Case I provisions in that Chapter.<sup>19</sup> For example, the provisions of that Chapter that apply to investment companies<sup>20</sup> are not incorporated by virtue of section 21(3) into Part II of the Act.

It should also be emphasised that the incorporation into the Schedule A code of the relevant computational provisions of the Schedule D code goes no further than that. It is submitted that what is incorporated into Part II is a verbatim version of the sections comprised (from time to time) in Chapter V<sup>21</sup> (but for, of course, the necessary verbal changes that reflect their inclusion in the Schedule A code). This, it is submitted, follows from giving emphasis to the word "it" in the subsection. The profits of a Schedule A business are computed as if Chapter V of Part IV applied to the Schedule A business as it (i.e. the said Chapter V) applies to a trade. The second limb of section 21(3) does not of itself incorporate provisions contained in any other Part of the Act, or in any other Act, which have some connection with, or make some reference to, Chapter V or the computation of the profits of a trade but which are not actually comprised in it. "The intention of a deeming provision, in laying down a hypothesis, is that the hypothesis shall be carried as far as necessary to achieve the legislative purpose, but not further."<sup>22</sup>

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<sup>19</sup> These may be referred to as the "relevant" provisions/enactments/parts/elements etc.

<sup>20</sup> The provisions that apply exclusively to investment companies are s.75 (Expenses of management: investment companies) and s.76 (Expenses of management: insurance companies).

<sup>21</sup> At any time Chapter V of Part IV comprises the original piece of legislation (as consolidated) with such amendments as have been introduced, together with those enactments (if any) which are deemed to be part of Chapter V, and those provisions (if any) which are directed to be construed as one with Chapter V.

<sup>22</sup> F Bennion, *op cit*, p.664. See also *Polydor Ltd and RSO Records Inc v Harlequin Record Shops Ltd and Simons Records Ltd* [1980] 1 CMLR 669 at p.673.

*Other observations*

It will also be noticed that section 21(3) does not provide that a Schedule A business is to be treated as a trade; nor does it say that the Schedule D charge is substituted for the Schedule A charge.<sup>23</sup> On the contrary, Schedule A remains a discrete Schedule, and a Schedule A business is a concept that is quite separate from that of a trade. In other words, section 21(3) is a deeming provision for the purposes only of identifying the appropriate computational provisions. This observation (somewhat obvious though it is) is supported by comparing the wording of section 21(3) with that of section 503(1). In the latter case, if a Schedule A business consists in the commercial letting of furnished holiday accommodation in the United Kingdom, then it "shall be treated as a trade the profits or gains of which are chargeable to tax under Case I of Schedule D". The wording of section 503(1) is in stark contrast to that found in the second limb of section 21(3). The former section is a deeming provision in relation to an activity (i.e. the letting of holiday accommodation) — it lays down a hypothesis that has the effect of ousting the real.

*A paradox imported*

The incorporation of section 74(1) into Schedule A brings with it the computational paradox normally associated with Schedule D. In order to illustrate this, a fourth section must be added to the trilogy referred to earlier. It is section 817(1)(a), and it provides:

"In arriving at the amount of profits...for tax purposes no other deductions shall be made than such as are expressly enumerated in the Tax Acts."

Section 817(1) does not leave matters to the taking of a commercial account *simpliciter* but requires that, in arriving at the amount of taxable profits for the purposes of Schedule A, no other deductions shall be made than such as are expressly enumerated

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<sup>23</sup> S.18(3) expressly provides that Schedule A is excluded from Schedule D. This preserves the principle laid down in *Salisbury House Estates Ltd v Fry (Inspector of Taxes)* 15 TC 266 that income derived from an owner's rights of property in the UK cannot be income from a trade. It also reflects the political will; the Financial Secretary to the Treasury is reported as saying: "The changes to Schedule A are designed to simplify the rules for calculating profits...They do not address wider issues...[T]he present treatment of landlords as investors of property reflects the long-established distinction in our tax system between earned income and investment income. I accept that a landlord might put much time and effort into managing property, but rental income is derived less from what the landlord does than from the property itself. The rental income is a return on the capital invested in the property...I am afraid I cannot [accede to the request to treat a Schedule A business as a trade]." (*Hansard, op cit*, cols. 167-8).

by the Act. There are a handful of sections that expressly allow for a deduction (see below). However, the main computational provision of the Schedule A code (i.e. the one that deals with the majority of expenditure most commonly encountered) is section 74(1), and it gives rise to a problem in this regard as it is drafted in a somewhat complex way. It essentially prohibits the deductibility of expenditure because one finds not an enumeration of permitted deductions, but an enumeration of items the deduction of which is prohibited, with certain exceptions from or qualifications of those prohibitions. It consists of one very broad disallowance, and fourteen more specific disallowance. So, for example, section 74(1)(a) does not provide that money wholly and exclusively laid out or expended for the purposes of a business may be deducted, but that no sum shall be deducted in respect of any expenditure not being money wholly and exclusively laid out or expended for the purposes of the business. Given this nature, when it interacts with section 817(1)(a), the main computational provision results in no deduction of expenses from gross receipts being allowed. It is, therefore, impossible to arrive at the taxable profits of the business as the statute requires, and this in turn means that without a profit a charge to tax under Schedule A can arise!

#### *The solution*

The solution to this conundrum (in the Schedule D context) was given in the following terms by Lord Herschel in the *Russell* case<sup>24</sup>:

"It is to be observed that, properly speaking, there is nothing to which [the words of section 817(1)(a)] are applicable. The provisions of [section 74(1)] do not expressly allow any deductions. What they do is to prohibit certain deductions with certain exceptions, and therefore it may, perhaps, in any sense be said that, having prohibited certain deductions with certain exceptions, the excepted things are allowed."

This interpretation of the operation of section 74(1) has become an entrenched feature of the computational schema of the Schedule D code. As the Schedule A code in this regard shares exactly the same structure as that code, it is submitted, by a parity of reasoning, that the same solution must apply in the case of Schedule A.

<sup>24</sup>

*Op cit*, p. 327. See also *Usher's Wiltshire Brewery Ltd*, *op cit* p. 436.

## **The proviso**

### *Its effect*

The second limb of section 21(3) is prefaced by a proviso, the effect of which is to limit or qualify the words to which it applies.<sup>25</sup> In this case, the relevant parts of Chapter V of Part IV are deemed to apply to Schedule A "[except in so far as express provision to the contrary is made by the Income Tax Acts..." In order to appreciate precisely what the proviso does, it is necessary to distinguish between the way in which the second limb of the sub-section operates, and what it achieves. The second limb achieves an incorporation by reference of the relevant parts of Chapter V of Part IV of the Act into the Schedule A code. However, the incorporation is effected by way of a deeming provision. That is how the second limb operates. It is submitted that the proviso affects only the section's operation as a deeming provision. In the result, one brings into the Schedule A code the verbatim versions of the relevant enactments in Chapter V of Part IV of the Act unless one is told expressly (by some other provision in the Income Tax Acts) that those enactments are not to be deemed to apply to Schedule A. Put another way, it is considered that a section triggers the proviso to section 21(3) only if it misapplies (for Schedule A purposes) any of the relevant enactments in Chapter V of Part IV in their entirety. A section does not trigger the proviso if it merely modifies in respect of Schedule A the application of a relevant section already duly incorporated.<sup>26</sup>

### *Giving effect to the proviso*

This leaves the question as to where one would find a provision that states that any relevant part of Chapter V of Part IV of the Act is not to be deemed to apply to a Schedule A business. The only aspect of the wording of the proviso itself which limits the source of such a command is that it be given by the Income Tax Acts.<sup>27</sup> It is submitted, therefore, that an appropriate prohibition is not necessarily to be found in Chapter V itself. On the contrary, the provision effecting the prohibition can appear anywhere in the Income Tax Acts. Wherever the command appears, however, the requirement of the proviso is that it must be given expressly — a prohibition by necessary implication is not admitted.

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<sup>25</sup> F Bennisson, *op cit*, p. 492.

<sup>26</sup> This point is illustrated below (see the text following n.27).

<sup>27</sup> The Income Tax Acts comprise the Income and Corporation Taxes Act 1988 and any other enactment relating to income tax (s.831(1)(b)). This would include, obviously, all Finance Acts.

*Exclusion of the incorporated rules of Chapter V of Part IV*

Notwithstanding the potentially wide source of any enactment that might activate the proviso, it is, at present, triggered only by provisions found within Chapter V itself. Some provisions within Chapter V are worded in such a way that they are excluded from applying to a Schedule A business. For example, sub-section (6) of section 82 (Interest paid to non-residents) reads as follows:

"This section...shall be treated as excluded from the provisions that have effect by virtue of section 21(3) for the computation of the profits or gains, or losses, of a Schedule A business."<sup>28</sup>

Awareness of these exclusions immediately highlights the inaccuracy of the proposition under consideration.

**Additional computational provisions**

In addition to the computational provisions effectively incorporated into the Schedule A code by section 21(3), the Act extends that code to include other such provisions. These enactments do not trigger the proviso; they do not operate to affect the incorporation of the Chapter V Part IV rules. Rather they either modify the Schedule A version of the duly incorporated, profit-adjustment rules of Chapter V of Part IV, or they add entirely new rules to the code. So these provisions are additional to, and not part of, the body of computational rules incorporated by section 21(3). The Act appears to effect this extension in four ways.<sup>29</sup>

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<sup>28</sup> Three other provisions within Chapter V of Part IV which are similarly excluded are s.87 (Taxable premiums — s.87(10)), s.96 (Farming and market gardening: relief for fluctuating profits — s.96(11)), and s.98 (Tied premises — s.98(9)). Paragraph 9.40 of the Inland Revenue publication SAT1 *Self Assessment: The new current year basis of assessment* (July 1995) says that the "general Case I rules in ss.74 to 99 of IATA 1988 apply [to the Schedule A code], with two exceptions". It then goes on to state the exceptions as ss.96 and 82. This is not, with respect, correct — there are, in total, six sections in the above range that do not apply to Schedule A.

<sup>29</sup> A fifth method that may have been employed to add computational rules would be to deem a provision which is applicable to a trade but which is outside Chapter V of Part IV to be treated as part of that Chapter. At present, the author can find no evidence that this method has in fact been used.

### **Method I**

A computational provision of the Act outside Chapter V of Part IV may be expressly included in the Schedule A code by reference. In other words, the Act expressly provides that the provision shall apply to a Schedule A business in the same way in which it applies to a trade. Section 21(5) is such a provision, and it states:

"Sections 103 to 106, 108, 109A and 110 shall apply in the case of the permanent discontinuance of a business the profits... of which are chargeable to income tax under Schedule A as they apply in the case of the permanent discontinuance of a trade."

### **Method II**

A computational provision of the Act outside Chapter V of Part IV may be expressly included in the Schedule A code through the mechanism of a deeming provision. Section 588 deals with expenditure on training courses for certain employees and is illustrative of this method. Subsection (3) authorises a deduction for such expenditure for the purposes of Schedule D. Sub-section (4A) provides as follows:

"Subsection (3) above shall have effect where the employee is or was employed for the purposes of a Schedule A business carried on by the employer as if the references to computing for the purposes of Schedule D the profits or gains of a trade, profession or vocation mentioned in that subsection were references to computing for the purposes of Schedule A the profits or gains of that business."<sup>30</sup>

### **Method III**

A computational provision of the Act outside Chapter V of Part IV may be expressly included in the Schedule A code by direct application, either by its referring to "Schedule A" or a "Schedule A business". This differs from the other two methods in that there is no inclusion by incorporation or via some deeming mechanism.

An example of such a provision is section 579(4) which provides:

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<sup>30</sup> See also s.589A (Counselling services for employees — s.589A(9A)), and s.401 (Relief for pre-trading expenditure — s.401(1B)).

"Where a redundancy payment...is made in respect of employment wholly in a Schedule A business carried on by the employer...the amount of the redundancy payment...shall (if not otherwise so allowable) be allowable as a deduction in computing for the purposes of Schedule A the profits or gains or losses of the business..."<sup>31</sup>

This method is also used to expressly prohibit the deductibility of expenditure. For example, section 577(1) (in so far as is material) provides:

"Subject to the provisions of this section:

- (a) no deduction shall be made in computing profits or gains chargeable to tax under Schedule A or Schedule D for any expenses incurred in providing business entertainment..."<sup>32</sup>

An examination of this section illustrates the earlier claim regarding the limited operation of the proviso to section 21(3). In the computation of the profits of a Schedule A business, expenditure incurred in providing business entertainment is ordinarily deductible on general accountancy principles. Moreover, section 74(1)(a) does not affect this treatment. However, that implied deductibility for tax purposes is reversed by the express statutory prohibition in section 577. Although section 577 modifies the application of section 74(1)(a), this does not amount to saying that, in terms, section 577 operates in these circumstances to prevent the incorporation of section 74(1)(a). On the contrary, section 577 modifies the Schedule A version of section 74(1)(a). It modifies a provision that has already been incorporated into the Schedule A code, and it does that, not by reason of the proviso to section 21(3), but by reason of the proviso to section 74(1) itself which applies "[subject to the provisions of the Tax Acts".

Within this head one may also include those rules under the old Schedule A regime that are exclusive to Schedule A. These are retained within the new regime but they differ from the sections referred to previously. Those sections already existed in relation to Schedule D and have been amended so as to be brought within the Schedule A code. The current set of rules, on the other hand, deals, and has always dealt, with Schedule A alone. For example, section 30(1) provides:

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<sup>31</sup> See also s.692(1) (Reimbursement of settler). This section is in Chapter V of Part XV of the Act and deals with maintenance funds for historic buildings.

<sup>32</sup> See also s.577A(1) (Expenditure involving crime), s.368(3),(4) (Exclusion of double relief [for interest]), and s.779(4) (Sale and lease-back: limitation on tax reliefs — s.779(13)).



"Where in any year of assessment the owner or tenant of any premises incurs any expenditure in the making of any sea wall or other embankment necessary for the preservation or protection of the premises against the encroachment or overflowing of the sea or any tidal river, he shall be treated for the purposes of computing the profits or gains, or losses, of any Schedule A business carried on in relation to those premises as making in that year of assessment and in each of the succeeding 20 years of assessment a payment in relation to the premises preserved or protected by the embankment of an amount equal to a twenty-first part of the expenditure and incurred as an expense of the business for that year." <sup>33</sup>

#### **Method IV**

Other provisions of the Income Tax Acts operate by placing a blanket disallowance on the deduction of expenditure. These would of course apply to Schedule A as they do to any other Schedule; for example, section 586 of the Act provides:

"(1) In computing the amount of the profits or gains of any person for any tax purpose, no sum shall be deducted in respect of any payment made by him to which this section applies.

(3)...this section applies to any payment made by any person under any contract...under which that person is, in the event of war damage, entitled or eligible...to...any form of indemnification...in respect of that war damage." <sup>34</sup>

"Any tax purpose" in sub-section (1) clearly includes a computation of profits made for the purposes of Schedule A, Schedule A being a subset of tax as a whole.

#### **Comment**

By and large the computational rules added to the Schedule A code in the above ways apply in like measure to Schedule D. There are also a number of rules that are within

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<sup>33</sup> See also s.34 (Treatment of premiums etc.), s.35 (Assignment of lease granted at undervalue), s.36 (Sale of land with right to reconveyance), and s.37 (Premiums paid etc.: deductions from premiums and rent received).

<sup>34</sup> Also see s.587 (Disallowance of certain payments in respect of war injuries to employees), s.787 (Restriction of relief for payments of interest), s.827 (VAT penalties etc.) and TA 1970, s.90 (Disallowance of relief for interest on tax).

Schedule A alone. This observation highlights further the inaccuracy of the general proposition under consideration.

### The computational schema

In the light of the above discussion, it is now possible to arrive at the first objective set out above, namely to describe the schema according to which the Act deals with the computational provisions of the Schedule A code. It is submitted that the schema is as follows:

- (a) first the profit or loss of a Schedule A business is ascertained through the application of commercial accountancy principles;
- (b) the profit or loss figure so arrived at is then modified by any legislation that either;
  - (i) expressly allows a deduction to be taken; or
  - (ii) expressly prohibits a deduction from being taken.<sup>35</sup>

This is identical to the format of the computational schema of Schedule D,<sup>36</sup> and from it may be distilled a statement that encapsulates the general principle of calculation of the profits of a Schedule A business, namely that a deduction which is neither within the terms of an express statutory prohibition, nor within the terms of a section that expressly allows a deduction to be taken, is one to be made when computing the balance of profits if the principles of commercial accounting regard it as a proper debit item to be charged against the incomings of the business.<sup>37</sup> However, the constituent

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<sup>35</sup> Inland Revenue publication SAT1, *op cit*, paras 9.37-9.38 reflects this view.

<sup>36</sup> See *Absalom v Talbot* (1944) 26 TC 166 and *I.C. v Land Securities Investment Trust Ltd* (1969) 45 TC 495.

<sup>37</sup> P G Whiteman *et al*, *Whiteman on Income Tax*, (3rd ed, 1988) at p. 288. This expression of the general principles of calculation is supported by the *dictum* of Jenkins L. in *Morgan (Inspector of Taxes) v Tate & Lyle Ltd* 35 TC 367 at p. 393: "It has long been well settled that the effect of these provisions as to deductions is that the balance of the profits and gains of a trade must be ascertained in accordance with the ordinary principles of commercial trading, by deducting from the gross receipts all expenditure properly deductible from them on those principles, save in so far as any amount so deducted falls within any of the statutory prohibitions contained in the relevant Rules, in which case it must be added back for the purpose of arriving at the balance of profits and gains assessable to tax." This *dictum* was approved by Lord Morton, *ibid*, at p.407. It also summarises the solutions found in the earlier cases (see, for example, *Usher, op cit*, at p. 436).

elements of the two schema differ, and it is this that renders the general proposition inaccurate. This inaccuracy is underlined further by the discussion that follows.

### **Apparent Oversights and Other Anomalies**

In the second part of the article, attention is turned to looking at:

- (a) further computational provisions in the Act that are part of the Schedule D code but that raise doubts as to their inclusion in the Schedule A code, and
- (b) certain other anomalies that arise in relation to the computation of the profits of a Schedule A business.

### **Provisions for emoluments**

The matter which prompted the author to address the issues raised in this article is found in the Inland Revenue's Booklet IR150.<sup>38</sup> It states the following at paragraphs 229 and 230:

"229. Salaries and wages you pay to employees engaged full time or part time in managing the land or property within your rental business are allowable. This includes any normal pension contributions you may pay for your employees...

230. You can't claim a deduction for salaries and wages which were not paid during the tax year unless they are paid within nine months after the end of it. This is a special rule which only applies to pay. The relief isn't lost if the wages are paid late; in that case you get the deduction in the tax year when the payment is actually made. (*Section 43 FA 1989*)"

The first question that arises is whether paragraph 230 is correct.

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<sup>38</sup>

*Taxation of rents: A guide to property income*, March 1996.

**Statutory provision**

The parts of section 43 of the Finance Act 1989<sup>39</sup> that are material to the present discussion read as follows:

"(1) Subsection (2) below applies where:

- (a) a calculation is made of profits or gains which are to be charged under Schedule D and are for a period of account ending after 5th April 1989,
- (b) relevant emoluments would (apart from that subsection) be deducted in making the calculation, and
- (c) the emoluments are not paid before the end of the period of nine months beginning with the end of that period of account.

(2) The emoluments:

- (a) shall not be deducted in making the calculation mentioned in subsection (1)(a) above, but
- (b) shall be deducted in calculating profits or gains which are to be charged under Schedule D and are for the period of account in which the emoluments are paid."

**Analysis**

Section 43(2) applies if the conditions set out in section 43(1) are satisfied. A selective combination of those conditions is as follows:

- (a) profits are being calculated for a period of account;
- (b) those profits are to be charged under Schedule D;
- (c) in making the calculation certain emoluments are deductible under general principles; and

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<sup>39</sup> To be referred to simply as s.43 in this part.

- (d) those emoluments are not paid within the nine-month period as defined.

### **Exclusion from the Schedule A code**

It is submitted that the statement in paragraph 230 of the Inland Revenue's booklet does not accurately reflect the law and that section 43 is not a computational provision comprised in the Schedule A code. This submission is based on the following arguments.

#### *The wording of section 43(2)*

The effect of section 43 is to deny a deduction for salaries and wages in the computation of profits for the period of account in which they are incurred, unless they are actually paid within nine months of the end of that period. However, the pertinent question in the present context is: "When does that rule operate?" The calculation at which section 43(1) is aimed, is one carried out in respect of profits to be charged under Schedule D. Although emoluments are, on general principles, deductible for both Schedule D and Schedule A, section 43, in terms, restricts their deduction for Schedule D only. As Schedule A is entirely separate from Schedule D, the result is that the subsection cannot apply to Schedule A; condition (b) of the combination is not satisfied.

#### *The effect of section 21(3)*

It might, however, be put by way of counter-argument as follows. Emoluments are deductible for both Schedule D and Schedule A on general principles, and moreover, neither the Schedule D nor the Schedule A versions of section 74(1)(a) operate to deny the deduction. Section 43 modifies the operation of those principles "where a calculation is made of profits or gains which are to be charged under Schedule D". If the general principles (and, in particular, section 74(1)(a)) are modified for the calculation of profits to be charged under Schedule D Case I, they are *ipso facto* modified for the purposes of Schedule A.

This argument hints that the modification effected to the Schedule D computational rules by section 43 is incorporated into the Schedule A code by the operation of section 21(3). It is submitted, however, that section 21(3) has no bearing on the matter. As argued earlier, section 21(3) operates in a limited way; it does not have the effect of incorporating all the provisions of the Income Tax Acts that may apply in some shape or form to a trade. It incorporates into Schedule A but a verbatim version of those computational rules of Chapter V of Part IV of the Act which apply to a trade. The incorporation does not include any enactment outside that Chapter which modifies the Chapter, unless the modifications are expressly extended to Schedule A. Moreover, as

emphasised earlier, the second limb of section 21(3) is not a deeming provision that replaces Schedule A with Schedule D.

The better view, it is submitted, is as follows. Emoluments are deductible by reason of the general principles of calculation that apply to both Schedules. In particular, they are recognised in striking the balance of profits according to the principles of commercial accounting, and that recognition is not, apart from section 43, disturbed by the Act because section 74(1)(a) impliedly allows the deduction. The fact that this equilibrium is disturbed by section 43 is because that section overrides section 74(1)(a), the latter section being "subject to any other provisions of the Tax Acts".<sup>40</sup> Section 43 triggers the proviso to section 74(1)(a), but it does so, in terms, for Schedule D only; in other words, it is only the Schedule D version of section 74(1)(a) that is affected. There is no provision in the Tax Acts to which the Schedule A version of section 74(1)(a) is subject, and so it is concluded that a Schedule A business is not bound by the "nine-month rule".

#### *Argument by analogy*

This conclusion appears to be supported further by comparing two other provisions of the Act. First consider section 577 which expressly prohibits a deduction for business entertaining expenses in the computation of profits. As stated earlier,<sup>41</sup> it does so for both Schedule A and Schedule D. The reference to Schedule A would be otiose if the mere mention of Schedule D were sufficient to trigger the proviso to section 74(1) for the purposes of both Schedules. It is conceded that the reference to Schedule A was not inserted as a consequential amendment following the introduction of the new Schedule A regime; it has always been a feature of section 577.<sup>42</sup> This still leaves open the possibility that the introduction of the new regime has rendered the reference to Schedule A redundant. This argument is not viable, however, when one considers further sub-sections of section 577.

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<sup>40</sup> "[The Tax Acts', except so far as the context otherwise requires, means [the Act] and all other provisions of the Income Tax Acts..." (s.831(2)). This latter expression includes Finance Acts in so far as they relate to matters dealing with income tax (see n. 22 *supra*).

<sup>41</sup> See text to n.27 *supra*.

<sup>42</sup> Section 577(1) was introduced by s.15(1) of the Finance Act 1965. It referred only to Schedule D, which included at that time Case VIII of that Schedule. When Case VIII of Schedule D was recast as the modern Schedule A, the reference to Schedule D in the said s.15(1) had to be construed as a reference also to Schedule A (see para 1(1)(a) of Schedule 20 to the Finance Act 1969). Section 15(1) (as amended) was consolidated as s.411(1) of the Income and Corporation Taxes Act 1970, the wording of which is identical to the current consolidated enactment (i.e. s.577(1)).

The following sub-sections of section 577 are quoted in the form in which they were drafted before the enactment of the Finance Act 1995:

"(8) This section shall apply in relation to the provision of a gift as it applies in relation to the provision of entertainment...

(9) Subsection (8) above shall not preclude the deduction, in computing profits or gains under Case I or II of Schedule D, of expenditure incurred in making a gift to a body of persons or trust established for charitable purposes only;..."

Subsection (8) expressly prohibits a deduction for expenditure incurred in making a gift; subsection (9) reverses the prohibition if the gift is to a charity. Paragraph 22 of Schedule 6 to the Finance Act 1995 added to section 577(9) the words "Schedule A or" so that the sub-section now commences: "Subsection (8) above shall not preclude the deduction, in computing profits or gains under Schedule A or Case I or II of Schedule D..." The express extension of the provision to Schedule A is clear evidence, it is submitted, that the reference to Schedule A in sub-section (1) is not a redundancy, and that a mere mention of Schedule D in a computational provision is not sufficient *per se* to bring that provision within the Schedule A code.<sup>43</sup> It is concluded, therefore, that if section 43 were to apply to Schedule A, a similar express amendment would have to be made. The fact is, however, that none of the methods of extension have been used here.

This conclusion is further supported by reference to section 43 itself. Section 43(13) provides as follows:

"In section 436(1)(b) of the Taxes Act 1988 (profits to be computed in accordance with provisions of that Act applicable to Case I of Schedule D) the reference to that Act shall be deemed to include a reference to this section."

It is useful to quote section 436(1) in full:

"Subject to the provisions of this section, profits arising to an insurance company from pension business shall be treated as income within Schedule D, and be chargeable under Case VI of that Schedule, and for that purpose:

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<sup>43</sup> If, to the contrary, the mere mention of Schedule D in the Act (otherwise than in Chapter V of Part IV) did automatically incorporate Schedule A, then rental income would be treated as "net relevant earnings" for personal pension scheme purposes under s.644(2)(c). Such a conclusion is unlikely to be received sympathetically by the Inland Revenue. Moreover, it would fly in the face of the entrenched distinction between earned and unearned income (see n.18 *supra*).

- (a) that business shall be treated separately, and
- (b) subject to paragraph (a) above, and to subsection (3) below, the profits therefrom shall be computed in accordance with the provisions of this Act applicable to Case I of Schedule D."

The structure of this sub-section bears remarkable resemblance to that of section 21(3). In both cases there is an incorporation of computational rules by reference. The only distinction between this incorporation and that found in the Schedule A code is that here the computational provisions of the whole Act are included, and not just those of Chapter V of Part IV. Section 43(13) goes to show, however, that section 43 is not part of the Schedule D code in the Act as the section requires specific inclusion within the Act. If it is necessary in this case for section 43 to be so included by specific provision, a like consequence must follow in relation to a part of the Act (i.e. Chapter V of Part IV). If section 43 is to be comprised in the Schedule A code, it must either be expressly extended to include Schedule A or it must, for Schedule A purposes, be deemed to be part of Chapter V of Part IV so that it is, by virtue of section 21(3), duly incorporated into that code.

### Comment

In the light of the foregoing arguments, the author concludes that a *lacuna* exists in the legislation. The draftsman has failed to effect all the consequential amendments needed to provide a total match between the Schedule D computational rules and those for Schedule A (assuming of course that this was his intention). In any event, the conclusion reached further reflects the inherent inaccuracy of the proposition postulated earlier.<sup>44</sup>

### Other oversights

There are a number of other computational provisions which, like section 43 of the Finance Act 1989, fall within the Schedule D code but outside that of Schedule A, and attention is now turned to considering them.

<sup>44</sup>

It is interesting to note that there is an inconsistency in Inland Revenue publications on this point. The discussion in the text is based on the extract from IR150. By contrast, however, SAT1, *op cit*, paras 9.40-9.41 does not include s.43 of the Finance Act 1989 as part of the Schedule A code.



### **Restrictive covenants**

What is the position where a payment is made to an employee employed in a Schedule A business for the giving by him of an undertaking that restricts him as to his future activities or for the total or partial fulfilment of that undertaking?

#### *Statutory provision*

Section 73(2) of the Finance Act 1988<sup>45</sup> provides as follows:

"Notwithstanding anything in section 74 of the Taxes Act 1988, any sum to which section 313 of that Act applies, and which is paid or treated as paid by a person carrying on a trade, profession or vocation, may be deducted as an expense in computing the profits or gains of the trade, profession or vocation for the purposes of tax."

#### *Analysis*

The effect of this section is that the profits of a trade<sup>46</sup> may be computed by taking a deduction for certain sums, and this is so even though section 74 may otherwise expressly prevent it.<sup>47</sup> In order for the deduction to be given, the sum must meet two conditions, namely:

- (a) it must be a sum to which section 313 of the Act applies;
- (b) it must be paid (or deemed to be paid) by a person carrying on a trade.

#### *Exclusion from the Schedule A code*

Generally speaking, the arguments against the inclusion of section 73(2) in the Schedule A code mirror those put forward in the case of section 43 of the Finance Act 1989.

*The wording of section 73(2):* Section 73(2) requires that the payer of the sum be a person who carries on a trade. Where the payer carries on a Schedule A business, the

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<sup>45</sup> To be referred to simply as s.73(2) in this part.

<sup>46</sup> Including a profession or vocation.

<sup>47</sup> A deduction is unlikely to be authorised on account of s.74(1)(f), the payment being of a capital nature (see *Associated Portland Cement Manufacturers Ltd v Kerr* (*H M Inspector of Taxes*) (1945) 27 TC 103).

conditions for the application of the section are not, in terms, satisfied.

*The effect of section 21(3):* Again section 21(3) plays no part in this matter. It is the proviso to section 74(1) that is again brought into effect by section 73(2) so that section 74(1)(f) is set aside here, and section 73(2) applies in spite of it! But this is only achieved for the purposes of Schedule D. The mere reference in the enactment to section 74 is not sufficient to bring section 73(2) within Chapter V of Part IV of the Act (thereby ensuring its incorporation into Part II). In other words, section 73(2) needs express extension in order to become comprised in the Schedule A code.

*Argument by analogy:* That such an extension is necessary is illustrated by reference to section 579 of the Act. The sidenote to that section reads "Statutory redundancy payments". Prior to the promulgation of the Finance Act 1995, that section allowed (in spite of section 74(1)) a deduction for a redundancy payment in respect of Schedule D. The section was extended by paragraph 23 of Schedule 6 to the Finance Act 1995 to provide specifically for a deduction in the case of a Schedule A business. This indicates that the unamended version of section 579 did not go far enough of its own accord to be included within the Schedule A code. Similarly, without amendment, section 73(2) does not go far enough either.

#### *Comment*

Having considered the foregoing arguments, it is concluded, therefore, that as none of the methods of extension have been employed here, section 73(2) remains without the Schedule A code. A person carrying on a Schedule A business is denied a deduction for a sum to which section 313 of the Act applies.

#### **Security Assets**

Section 112 of the Finance Act 1989 provides as follows:

"(1) This section applies in computing, for the purposes of Case I or Case II of Schedule D, the profits or gains of a trade, profession or vocation carried on by an individual or by a partnership of individuals.

(2) In a case where this section applies, nothing in section 74(a) or (b) of the Taxes Act 1988...shall prevent the deduction of a sum in respect of expenditure incurred in connection with the provision for or use by the individual, or any of the individuals, of a security asset or security service."

For the same reasons as those given in relation to section 73(2) of the Finance Act 1988, it is submitted that this section does not extend to Schedule A.

### **Pension contributions**

Paragraph 229 of IR150 also says that normal pension contributions paid for employees in a Schedule A business are allowable deductions in the computation of the profits of that business. Again the question arises as to whether this is correct. The booklet does not define "normal" pension contributions. It is assumed, however, that ordinary and special contributions to an approved retirement benefits scheme (within Chapter I of Part XIV of the Act), and contributions to an employee's personal pension scheme (within Chapter IV of Part XIV of the Act) are "normal" pension contributions for the purposes of paragraph 229.

### **Personal Pension Schemes**

As regards an employer's contributions to an employee's personal pension scheme, the statement in paragraph 229 is, with respect, correct. There is no specific allowance in Chapter IV of Part XIV for such contributions. However, being part of an employee's remuneration package, they are business expenses of a revenue nature that should be deductible on general principles for both Schedule D and Schedule A purposes.

### **Retirement Benefits Schemes**

The position is somewhat more complex in relation to an employer's contributions into a retirement benefits scheme.

#### *Trades, professions and vocations*

In the case of an exempt approved scheme, section 592(4) of the Act provides that any sum paid by an employer by way of contribution under the scheme shall be allowed to be deducted as an expense for the purposes of Schedule D. This statutory right to relief means that an employer does not have to rely on arguing for a deduction under general principles. One implication of this is that a lump-sum capital contribution is an allowable deduction (which may not have been the case had general principles alone been applicable).<sup>48</sup> Yet, despite the statutory right to a deduction it might still be argued that costs incurred by the employer in setting up and administering a retirement benefits scheme are non-deductible expenses. The Inland Revenue do not take this point. Paragraph 8054 of the Inspector's Manual states:

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<sup>48</sup> cf. *British Insulated & Helsby Cables v Atherton* (H M Inspector of Taxes) 10 TC 155.

"In strictness any legal or other incidental costs incurred by an employer in establishing an exempt approved scheme are likely to be capital and therefore inadmissible. But by long-standing concession Inspectors should allow an expense of this nature for the period of account in which it is paid."

Paragraph 8055 deals with continuing administration expenses incurred by an employer and states:

"An employer may provide accommodation and equipment for running a scheme and paying out benefits. The cost of this to the employer should be allowed as an expense but only insofar as it represents an expense of a revenue nature which would otherwise have fallen upon the administrator and been met by allowable contributions from the employer."

By contrast, if the scheme is an approved scheme, then the provisions of section 592(4) do not apply,<sup>49</sup> and one is thrown back on general principles alone to argue for the deductibility of employers' contributions. It is submitted that only those of a revenue nature (i.e. ordinary and special contributions) would be allowed. Furthermore, it may be more difficult to get a deduction for expenses incurred in setting up and administering such a scheme.

#### *Schedule A businesses*

Section 592(4) is a provision within Part XIV of the Act and it applies in relation to Schedule D only. This specific statutory deduction is not part of Chapter V of Part IV of the Act, and so, in view of the discussion earlier, would need specific extension to include a Schedule A business within its ambit. There is no such extension. Consequently, it is submitted that the special statutory deduction does not apply to contributions made by a person carrying on a Schedule A business. In the case of Schedule A, irrespective of whether the pension scheme is exempt approved or merely approved, an employer, in the computation of his profits, will have to fall back on general principles (which alone govern his situation).<sup>50</sup> This should not present a problem for contributions of a revenue nature,<sup>51</sup> but clearly those of a capital nature are in jeopardy of being denied a deduction. So, for example, an initial lump sum contribution to form the nucleus of the scheme, and the setting up costs, may be

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<sup>49</sup> cf. provisions of s.592(1) which dictates the scope of the section.

<sup>50</sup> In other words, a retirement benefits scheme set up by a person who runs a Schedule A business will be treated in the same way as an approved scheme set up by a trader.

<sup>51</sup> cf. *Jeffs v Ringtons Ltd* [1985] STC 809.

disallowed on the authority of *Atherton's* case.<sup>52</sup> It might be argued that IR150 implies that, by practice, the Inland Revenue will accord the same practice in this regard as they do in relation to an exempt approved scheme for the purposes of Schedule D. The precise position is far from clear, however.

Another interesting aspect of this matter relates to employers' special contributions. In the case of an exempt approved scheme in a Schedule D context, such contributions may be spread and relieved over a period.<sup>53</sup> As section 592 is not within Schedule A at all, it appears to follow that the spreading provisions do not apply in the case of Schedule A. Similarly, the arguments as to the timing of a Schedule A deduction are not governed by the rule in section 592.<sup>54</sup>

### **Other anomalies**

#### **Unapproved retirement benefits schemes**

Continuing with the theme of pension contributions, interesting questions arise in the present context as to the treatment of employers' payments to unapproved retirement benefits schemes.

#### *Section 76 of the Finance Act 1989*

Generally speaking, the deductibility of employers' contributions into funded unapproved schemes, or of the benefits payable under unfunded schemes, is determined by general principles. Those principles, however, are modified further by section 76 of the Finance Act 1989 which applies "in computing the amount of the profits or gains to be charged under Case I or Case II of Schedule D".<sup>55</sup>

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<sup>47</sup> See n.43 *Supra*

<sup>53</sup> See s.592(4) as read with s.592(6) and IR 12 paras 5.7-5.9 as amended by PSO Update No.16.

<sup>54</sup> S.592(4) allows a deduction for sums "paid". In the view of the Inland Revenue this excludes a deduction for sums incurred.

<sup>55</sup> S.76(1) of the Finance Act 1989. The section deals with the relief an employer may obtain for payments he makes on or after 27th July 1989 to a funded scheme or in providing benefits under an unfunded scheme. The section provides for an express statutory prohibition on the deductibility of such payments unless certain conditions are met (s.76(2),(3)). By implication, therefore, where the conditions are met, the payments are allowable. The section also provides for the timing of the relief (s.76(4),(5),(6)).

*Application to Schedule A*

For the same reasons as stated before, it is considered that the provisions of section 76 of the Finance Act 1989 do not form part of the Schedule A income tax code. The result is that employers who carry on Schedule A businesses need only rely on general principles in obtaining deductions for expenditure incurred in relation to unapproved retirement benefits schemes. This used to be the position in relation to Schedule D Cases I and II in respect of expenditure incurred before 27th July 1989.<sup>56</sup> In this regard, paragraph 8411 of the Inspector's Manual states as follows:

"Where a funded scheme is established under an irrevocable trust, so that the employer retains no control (except possibly as a trustee) over his contributions thereto...annual contributions incurred by the employer...are to be allowed as admissible expenses in computing profits...if they are:

- (a) reasonably regular in amount,
- (b) related to the needs of the fund on the basis that both capital and investment income are available to meet those needs, and
- (c) are of a capital nature..."

Although it deals with Schedule D, the same reasoning may apply in the case of a funded scheme of a Schedule A business. Furthermore, the incidental costs of setting up and running an unapproved retirement benefits scheme are not expenses of providing benefits nor expenses paid with a view to the provision of benefits, and thus are not covered by section 76 of the Finance Act 1989. General principles should be applied to determine whether such costs are deductible, and this applies both in the case of Schedule A and Schedule D.

**Expensive Car Rentals**

Section 35(2) of the Capital Allowances Act 1990 provides as follows:

"Where, apart from this subsection, the amount of any expenditure on the hiring of a motor car the retail price of which when new exceeds £12,000 would be allowed to be deducted in computing for the purposes of tax the profits or gains of any trade, that amount shall be reduced in the proportion

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<sup>56</sup>

That is the date on which s.76 of the Finance Act 1989 came into force.

which £12,000, together with one half of the excess, bears to that retail price..."

The sub-section applies, in terms, to the computation of the profits of a trade; does it, however, apply in the case of a Schedule A business? The answer in this case is yes, but for reasons which are entirely different from those discussed up to now. Section 35(2) is part of the Capital Allowances Act 1990 and in that Act the new concept of a Schedule A business has (following Finance Act 1997<sup>57</sup>) been dealt with as follows. Section 28A(1) of the Capital Allowances Act 1990 provides that where any person carries on a Schedule A business, that person's business "shall be treated as a trade" for the purposes of the code on plant and machinery allowances. For capital allowances purposes a Schedule A business is deemed to be a trade, and this approach provides for comparative simplicity in the application of the capital allowances rules to such a business. It is easy to conclude, therefore, that the restriction for rental payments in respect of expensive cars applies in the case of the computation of the profits of a Schedule A business.<sup>58</sup>

### **More on capital allowances**

In order to appreciate the extent of the above deeming provision in the capital allowances code, consider the precise wording of section 28A(1) of the Capital Allowances Act 1990:

"[W]here any person carries on a Schedule A business:

- (a) that person's Schedule A business shall be treated as a trade for the purposes of this Part and of the other provisions of the Tax Acts so far as relating to allowances or charges under this Part..."

The term "Tax Acts" (which is not defined in the Capital Allowances Act 1990) is

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<sup>57</sup> S.28A of the Capital Allowances Act 1990 was introduced by paragraph 3 of Schedule 15 to the Finance Act 1997 and that enactment came into force on 13th March 1997, the date of the Royal Assent to that Finance Act. Before this amendment similar provision was made under s.32 of the Income and Corporation Taxes Act 1988 (now repealed — see FA 1997 s.85 and paragraph 1 of Schedule 15, and s.113 and Pt.VI(11) of Schedule 18).

<sup>58</sup> Sections 9(1A) and 132(2A) of the Capital Allowance Act 1990 similarly deem a Schedule A business to be a trade for the purposes of industrial buildings allowances and agricultural buildings allowances respectively. The same conclusion does not follow, however, in respect of expenditure not of a capital nature on scientific research related to a trade (s.136 of the Capital Allowances Act 1990) because the concept of trade in that section is not extended.

defined, for this purpose, in Schedule 1 to the Interpretation Act 1978 as "the Income Tax Acts and the Corporation Tax Acts". Consequently (and in theory at least) a Schedule A business is deemed to be a trade for certain purposes of the Income and Corporation Taxes Act 1988 and subsequent Finance Acts. It is deemed to be a trade, for example, in relation to capital allowances on patents and know-how.<sup>59</sup> This renders the Act quite complex because a Schedule A business is deemed to be a trade for some computational purposes contained within it, but not for others.

### **Conclusion**

At the start of this article it was asked whether the proposition that taxable rental income is calculated in the same way as taxable trading profit is an accurate proposition. The discussion has highlighted that it is not and this may come as a surprise to many. Additional anomalies in the computational schema of the Schedule A code have also been discussed. The apparent oversights and anomalies generally appear in legislation that is outside the 1988 and 1990 consolidations of income tax and capital allowances. It is almost as if, in drafting the consequential amendments made necessary by the introduction of the new Schedule A income tax regime, all enactments other than the consolidated ones were completely overlooked. This conclusion is based on the unprovable assumption that in 1995 the political will was that, for computational purposes, Schedule A and Schedule D were to be matched precisely. Be this as it may, the discussion highlights the inaccuracy of the Financial Secretary's statement that rental income is adjusted in exactly the same way as trading profit, and gives the new Schedule A regime a complexity that was not (perhaps) intended.

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<sup>59</sup>

S.532 of the 1988 Act deems ss.520-531 of that Act to be part of the Capital Allowances Act 1990. Consequently, references in those sections (e.g. ss.520 and 528) to a trade the profits of which are chargeable under Case I of Schedule D include references to a Schedule A business and Schedule A respectively. Whether there is a practical application of these sections in the context of Schedule A is another matter.