CHAPTER 11

PROPERTY INCOME

11.1 Introduction

Income from **UK situated property** is taxed on companies as profits from a UK property business.

Income from **overseas property** is taxed as profits of an overseas property business.

Income from all UK property is treated as a single source of business income. A single source means that all profits and losses **are pooled together.** Where the pool creates a profit, we tax it as profits from a UK property business; where the pool creates a loss, we relieve it according to the loss relief rules for a UK property business.

We bring the income into charge to tax using accounting principles as applied for trade profit, ie the basis of taxation will be an accruals basis for the recognition of income.

Example 1

Renton Limited acquires an investment property on 1 July 2010 and lets it out immediately on an annual rent of £24,000, payable on the first day of each month in advance.

How much rental income will be taxable in Renton Limited's accounting period for the year ended 31 March 2011?

11.2 Expenses

As rental income is treated as business income, deduction of expenses follows the normal rules. **Relief** is given for **expenses** which have been incurred **wholly and exclusively for the purposes of the rental business.** CTA 2009, s.210

Common deductible expenses include:

(i) Maintenance and repairs but not improvements - redecoration would therefore qualify but not anything to actually improve the fabric of the building. For instance, a complete refurbishment when the property is first purchased would not be an allowable deduction against rental income. If a window gets broken and a new pane is fitted, that is deductible as a maintenance or repair cost.

(ii) Insurance

(iii) Management and agents fees

(iv) Rent collection costs

(v) Advertising for tenants

(vi) 10% wear and tear allowance - this is only available for furnished property and is calculated as 10% x (rents less council tax and water rates).

Example 2

Comlet Limited lets a furnished property on commercial terms. The rental income charged for the period to 31 December 2010 was £20,000 rising to £22,000 for the period to 31 December 2011.

Expenses relating to letting included:

	£
Water rates	1,000
Insurance	500
Ground rent	700

Agent's fees amounted to 15% of rental income. In November 2010 the tenant accidentally damaged the ceiling in the living room. Comlet Limited took the opportunity to refurbish the whole room at a total cost of £4,000. The cost relating to rectifying the damage amounted to only £500.

Comlet Limited makes up accounts for the year ended 31 March 2011.

What is the UK property business income?

11.3 Loan interest

For companies, **interest on a loan taken out to purchase a rental property is not an allowable expense** in arriving at the income taxed as profits from a property business. Instead the loan interest is treated as a non-trading loan relationship debit under the loan relationship rules. These are covered in a later chapter. CTA 2009, s.211

11.4 Losses from a property business

The relief for losses from a property business is covered later in the chapter entitled Relief for Other Losses.

11.5 Reverse premiums

A reverse premium arises when a person receives **a payment to enter into a lease.** For many years the tax treatment of reverse premiums was uncertain and often depended on the facts of the case.

Reverse premiums are **revenue receipts**. Where they are received in connection with land used for the purpose of a trade they will be taxed as part of the profits of the trade, otherwise they will be chargeable as profits of a property business. CTA 2009, s.98

Generally the premium will be taxed over the life of the lease. However this rule will not apply if the lease is between connected persons and not on arm's length terms in which case the premium will be brought in as a revenue receipt in the period that the lease is entered into. CTA 2009, s.99

The following **are not** covered by the rules: CTA 2009, s.97

- receipts taken account of for capital allowances;
- transactions relating to a PPR;
- transactions caught by the sale and lease back rules.

The aim of the legislation is to tax payments or other benefits which are inducements to enter leases.

The most common forms of **commercial inducements** include:

- Rent free periods;
- Contribution to tenant costs;
- Assumption of the tenant's liabilities;
- Writing off sums owed.

The legislation only charges those inducements that involve the laying out of money not amounts forgone or deferred.

The following **will not be taxed**:

- Rent free periods;
- Replacing a lease when market conditions have changed so as to reduce the rent;
- Replacing an existing lease to remove clauses made onerous by market conditions.

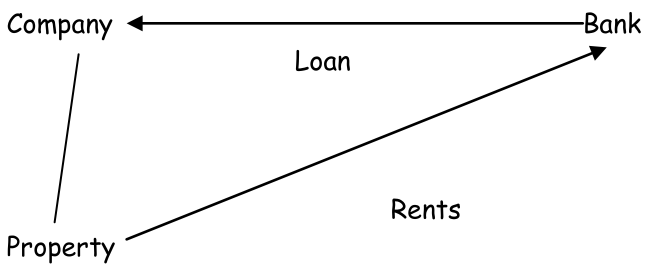
The Revenue have given guidance in relation to fitting out costs. If the landlord pays the tenant's fitting out costs then this will be caught. However if the tenant effectively repays the landlord in the form of higher rents then this will not be caught.

The Revenue give the example of completion cost of a building. A tenant wants a special type of roof and agrees to be responsible for the installation. Reimbursement by the landlord of the cost of installing the roof will not be taxable irrespective of whether the landlord reimburses the cost of a normal roof or a specialist roof as to complete the building there must be a roof.

11.6 Rent factoring

Tax planning schemes involving the factoring of rent receipts seek to avoid tax on rental incomes. The type of scheme caught is shown in Illustration 1 below.

Illustration 1



This type of structure will be caught by the rules covering income factoring. These rules are dealt with in the anti-avoidance chapter. CTA 2010, Part 16

Answer 1

The rental income accrues for the period 1 July 2010 to 31 March 2011, which is a period of nine months.

£24,000 x 9/12 = **£18,000**

Answer 2

	Y/e 31.3.11
	£
Rental income accrued:	
$£(20{,}000 \times \frac{9}{12}) + (22{,}000 \times \frac{3}{12})$	20,500
Expenses:	
Agent's fees: £20,500 x 15%	(3,075)
Redecoration	Nil
Water rates	(1,000)
Insurance	(500)
Ground rent	(700)
Wear and tear: 10% x (20,500 – 1,000)	(1,950)
Profits from UK property business	**£13,275**