CHAPTER 13

INTRODUCTION TO PROPERTY INCOME

13.1 Property income

ITTOIA 2005, ss. 264

In this chapter we will deal with income which is chargeable to tax as **property income from a UK property business.** A UK property business is a business which a person carries on for generating income from land in the UK. For example, property income from a UK property business includes **rents from properties in the UK** such as houses and flats. We will deal with property income from an overseas property business in the next chapter.

Property income also covers income from such sources as shooting and fishing rights. For instance, if a taxpayer owns some land which is let to a gun club for clay pigeon shooting, or if a taxpayer owns part of a river and sells fishing permits to anglers, such income is taxed as property income.

ITTOIA 2005, s. 266

Premiums on leases are also taxed as property income. A lease is a right to occupy land for a specified period of time. If a taxpayer owns a property and he grants a lease to another taxpayer in return for a payment of cash called a premium, that premium is chargeable to tax as property income. We will look at lease premiums in more detail later.

ITTOIA 2005, s. 276

ITTOIA 2005, s. 277

13.2 Accruals basis

In order to calculate the taxable property income profit, we apply the **accruals basis.** This concept means that we do not simply take cash received less cash spent to give a cash profit.

The accruals basis involves taking **rents receivable** rather than rents received. Note the difference here. "Receivable" means the rents that relate to a tax year, which is not necessarily the same as the cash physically received.

From rents receivable we deduct any **allowable expenses payable**. Again note the use of the word "payable". "Payable" means expenses that relate to the tax year, this may not necessarily be equal to the cash physically spent.

Rents receivable minus expenses payable gives the taxable property income profit (or in some cases the loss) for the year. Property income computations are always prepared for a tax year – i.e. from 6 April to 5 April.

	£
Rents receivable	X
Less: Expenses payable	(X)
Property income profit/(loss)	X/(X)

Illustration 1

A taxpayer starts to let out a property on 1 October 2010 and charges his tenant rents of £6,000 per annum. All of these rents are due for payment in advance on 1 October 2010. On 1 October 2010 the landlord receives £6,000. How much of that £6,000 is taxable in 2010/11?

The rents received in 2010/11 are £6,000, but this amount covers the period from 1 October 2010 to 30 September 2011 which is not the same as the tax year.

To work out how much of the £6,000 is taxable as property income in 2010/11, we simply do a time apportionment:

1 October 2010 – 5 April 2011

$\frac{6}{12} \times$ £6,000 **£3,000**

The other £3,000 will be taxed in 2011/12.

13.3 Allowable expenses

Expenses are deductible from rents only if those expenses are incurred **"wholly and exclusively"** for the business of the letting. Examples of deductible expenses will include **agent's fees** and **commissions** and genuine **repair expenses.** ITTOIA 2005, s. 272

By "genuine repairs" we mean we **exclude any expenditure of a capital nature** – i.e. any expenditure that improves or enhances the value of the property.

For example, if a tenant breaks a window and the landlord repairs that window, that is a genuine repair and the costs can be deducted from rents. Repairing a broken window has not enhanced the value of the property. However, if instead of simply repairing some broken roof tiles, the landlord takes the opportunity to replace his whole roof, there is obviously some degree of improvement here and the costs will not be deductible.

HMRC do now accept that replacing single glazed windows with double glazed windows counts as allowable expenditure on repairs. Changes in technology means that double glazing is now the standard and is no longer considered an improvement.

An exception to the rule that capital expenditure is not deductible is the Landlord's Energy Saving Allowance. This allows a deduction of up to £1,500 in relation to the installation of loft, floor or cavity wall insulation in a let dwelling house. ITTOIA 2005, s. 312

Any **water rates** or **Council tax** paid by the landlord are deductible expenses, as is any **interest paid on a loan** taken out to purchase the property in the first place. Many property purchases are funded by way of mortgages and if the property is subsequently let out, the mortgage interest is an allowable deduction.

Insurance premiums paid by the landlord are also deductible. In practice the landlord will usually be responsible for paying the buildings insurance, but any contents insurance tends to be the tenant's responsibility.

The accruals basis applies in the same way for expenses and sometimes a landlord will incur expenses such as buildings insurance and council tax, both of which can be paid in advance to cover the forthcoming 12 months. For property income purposes, we apportion these expenses into the relevant tax year.

Illustration 2

A landlord pays his buildings insurance premiums in advance. On 30 June 2009 he paid a premium of £600. One year later on 30 June 2010 he paid buildings insurance of £800.

The expenses deductible in 2010/11 will be:

Buildings insurance:
6 April 2010 – 29 June 2010 and 30 June 2010 – 5 April 2011

$$\left(\frac{3}{12} \times 600\right) + \left(\frac{9}{12} \times 800\right) = \underline{£750}$$

13.4 Wear and tear allowances

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Wear & tear allowances are available in respect of **furnished** lettings. The allowances are essentially compensation given to the landlord for the dilapidation of any furniture within the property.

There is a standard formula for calculating the wear & tear allowance:

10% x (Accrued rents – water rates – council tax borne by the landlord)

If the landlord does not wish to claim wear & tear allowances, there is an alternative called the **renewals basis**. Under the renewals basis, the landlord **cannot claim a deduction for the initial costs** of any furniture he buys, but when the furniture is replaced the **costs of the replacements can be included as allowable expenses.**

Landlords must adopt either one basis or another – they cannot change between wear & tear allowances and the renewals basis as and when it suits them.

Illustration 3

Roger lets out a property to a tenant, Sally. The property is furnished. Roger originally charged rents of £12,000 per annum payable monthly in advance, but he has increased the rents to £15,000 per annum with effect from 1 January 2011.

Roger has total expenses paid in the year of £16,950 as listed below:

	£
Interest on loan	4,000
Repairs to roof	600
New garage	10,000
Cavity wall insulation	1,000
Water rates	250
Council Tax	500
Buildings Insurance (1.10.10)	600
Total paid in year	16,950

The buildings insurance premium paid of £600 was a payment in advance on 1 October 2010. On 1 October 2009 Roger had paid a buildings insurance premium of £500.

Roger's property income profit or loss for 2010/11 is calculated as follows:

		£
Rents receivable:		
12,000 x 9/12		9,000
15,000 x 3/12		3,750
		12,750
Less expenses:		
Loan interest	4,000	
Repairs to roof	600	
New garage (capital)	-	
Energy Saving Allowance (Cavity wall insulation)	1,000	
Water rates	250	
Council tax	500	
Buildings insurance (6/12 x 500 + 6/12 x 600)	550	
Wear & tear allowance		
(12,750 – 250 – 500) @ 10%	1,200	
		(8,100)
Property income profit		**£4,650**

This property income profit of £4,650 will be taxed in 2010/11 as non-savings income.

13.5 Property business losses

Where expenses exceed income, a **property business loss** will arise. **All profits and losses in the year are pooled together** for these purposes to give an overall profit or loss for the year. A landlord renting out a number of properties has one UK property business and the net profit is taxable as non-savings income.

However, where the **overall result is a loss,** we insert a figure of **nil** in the property income line in the income tax computation. We should never insert a negative figure in the "income" part of our tax computation. A loss is effectively a profit of zero.

If a taxpayer has a property business loss, that **loss can only be carried forward and set against property income from a UK property business in future tax years**. The taxpayer cannot set a property business loss against non rental income. It must be carried forward and set against future rental profits. Neither is there any possibility of carrying the loss back to a previous tax year. ITA 2007, s.118

13.6 Nominal leases

An exception to the general rule for losses concerns nominal or non-commercial leases. A nominal lease is one where the landlord does not charge the tenant a full market rent for the use of the property. So if a landlord lets out a property to a member of his family, this is likely to be a nominal or non-commercial lease.

In these instances, the rents received under the lease are taxable, but the expenses incurred in relation to the non-commercial let are only allowable up to a maximum of the rents received. In essence, the expenses will cancel out the rent leaving a nil profit, but no loss will arise.

13.7 Rent-a-room relief

ITTOIA 2005, s. 784 - 802

If a landlord is letting out a room to a tenant in his home (i.e. his only or main residence), a special relief is available. Note here that the landlord and tenant will be living in the same property, so the tenant is a "lodger" of the landlord.

If the tenant pays the landlord a rent of, say, £100 per week, this is chargeable to tax as property income. The landlord has two choices of method for calculating his property income profit for the year. His first choice is to prepare a normal property income computation by taking annual rents of £5,200 and deducting any expenses to give him a profit or loss.

The problem with this method is that it is difficult for the landlord to determine his deductible expenses, as he will have to take all of the expenses relating to the property and do some sort of apportionment. Remember that only part of the property is being let out – the remainder is the landlord's own home. This is a fiddly and time-consuming process. The legislation has therefore simplified the computation by using the **rent-a-room scheme**.

Again we start with the rental income of £5,200. This time in order to arrive at the taxable profit, we simply deduct the **rent-a-room limit,** which for the current tax year is £4,250. The excess of rents over the threshold is the taxable profit. Here it is £950. The amount of any allowable expenses is irrelevant.

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Where gross rents are not more than £4,250, rent-a-room relief applies automatically and the rental income is exempt from tax. If allowable expenses exceed gross rents, a claim can be made for the relief not to apply in order to crystallise a loss.

Where gross rents exceed £4,250 a claim must be made for rent-a-room relief to apply. The relief will then continue to apply each year until the claim is withdrawn.

A few more small points about the rent-a-room scheme:

a) The **landlord and** the **tenant must be sharing the landlord's home** for the scheme to be applied, so it will not apply to normal commercial leases.

b) The **£4,250 threshold applies per property and not per tenant**. So if a landlord takes in 2 tenants, each paying rents of £100 a week, only one amount of £4,250 can be deducted.

c) If a property is jointly owned, half the rent-a-room limit is given to each joint owner (even if the rents are apportioned differently).

d) If rent-a-room relief applies, it **does not affect the availability of Principal Private Residence relief** when the owner comes to sell the property.

Example 1

Mark lets out two furnished properties in the UK:

Rent on Property X	£24,000 p.a. (started 1.9.2010)
Rent on Property Y	£200 per month
Loan interest 2010/11	£7,200 for X and £3,000 for Y

All the other expenses are paid by the tenants.

Calculate Mark's UK property business income.

Example 2

Julian lives in a 3 bedroom house. He lets 2 rooms to students, each of whom pays rent of £80 per week.

Julian also owns a small flat which he leases to his grandfather for £10 a week. Expenses in the year relating to this flat were £2,000.

Calculate Julian's UK property business income.

Answer 1

	X	Y
	£	£
Rents receivable:		
$24{,}000 \times \frac{7}{12}$	14,000	
200 x 12		2,400
Less: Loan interest	(7,200)	(3,000)
Less: Wear and tear		
10% x 14,000	(1,400)	
10% x 2,400		(240)
Profit/(loss)	£5,400	£(840)

Overall UK property business income
£(5,400 – 840) **£4,560**

Answer 2

		£
House:		
Rent receivable (160 x 52)		8,320
Less: rent a room limit		(4,250)
Taxable Profit		4,070
Flat:	£	
Rents receivable (10 x 52)	520	
Less: expenses - limited to rents as nominal lease	(520)	
Profit/loss	Nil	
Profit for year		**£4,070**