CHAPTER 7

SALES OF LEASES

7.1   Basic definitions

A lease is essentially a **right to use an asset**. Where the asset in question is land or buildings, the lease is the right to occupy the land or buildings for a specified period of time, and usually in return for a specified rent. You may be living in a house or flat under the terms of a lease – i.e. you have the right to occupy that property for a certain period of time.

You may also have heard of the term "freehold". A "freehold" and a "lease" are two separate assets. If an individual owns a property as a **freeholder,** this means that the individual **owns the property outright** – i.e. he owns the entire building as well as the land on which that building is situated. A freeholder therefore has more than simply a right of occupation.

A **lease** is therefore a piece of paper that gives the tenant – also called the lessee – a **right to occupy somebody else's property**. As this lease is a valuable asset, leases can be bought and sold, and in this session we shall look at the CGT effects of a tenant selling a lease.

The legal term for **the sale of a lease is the assignment** of a lease. The way we calculate the gain on the assignment of a lease depends on whether the taxpayer is selling a long lease or a short lease. A **long lease** is a lease which has **more than 50 years to run** at the date it is sold. A **short lease has 50 years or less to run** when the taxpayer sells it.

The way we calculate the capital gain on the sale of a **long lease**, is by using **normal CGT rules**. We take the proceeds and deduct cost to arrive at the gain.

7.2   Assigning a short lease

TCGA 1992, Sch 8

The calculation of a gain on the assignment of a short lease is slightly more complex. Consider a taxpayer who has a 40 year lease which he acquired in March 1996. The taxpayer therefore has the right to occupy the land or buildings for 40 years from March 1996.   The taxpayer sells his lease in March 2011.   The taxpayer is essentially selling a piece of paper which thereafter gives the purchaser the right to occupy the property for the remaining duration of the lease.

Between March 1996 and March 2011, 15 years have expired. This means that in March 2011, the taxpayer is selling a lease that has 25 years left to run. He is therefore selling a short lease, and special rules will apply. **An asset with a useful life of 50 years or less is called a "wasting asset"**. A 25 year lease is therefore a wasting asset. Special rules apply to calculate gains on wasting assets.

TCGA 1992, s. 44

Our starting point is sale proceeds from which we deduct the base cost of the asset. However, where a wasting asset is being sold, the taxpayer **cannot take a deduction for the whole of his acquisition cost.**

As wasting assets depreciate over time, the taxpayer can only deduct part of his original base cost. The way we calculate the allowable base cost, is by using percentages from the lease **depreciation tables**.   The CGT base cost is the original acquisition cost of the lease, multiplied by the fraction:

$$\frac{S}{P} \times \text{original cost}$$

where   "S" = % for years of the lease remaining at the date of sale
        "P" = % for years of the lease remaining at the date of purchase.

These percentages can be found at Schedule 8 TCGA 1992 and also in the Tax Tables. For your convenience we have reproduced a copy of the lease depreciation table at the back of this chapter.

Illustration 1

A taxpayer bought a 40 year lease in March 1996 for £60,000. In March 2011, the taxpayer sells the lease for £90,000. As 15 years have expired between March 1996 and March 2011, the taxpayer is selling a lease with 25 years left to run.   As he is selling a short lease, we need to apply the special rules.

We start with sale proceeds of £90,000, from which we need to deduct the allowable base cost.   As the taxpayer is selling a short lease, we multiply cost by the fraction $\frac{S}{P}$.

However, we cannot simply multiply £60,000 by the fraction of 25 over 40. At this point we must refer to the lease depreciation tables. If you look at your lease depreciation tables, you will see that the relevant percentage for a 25 year lease is 81.100. The relevant percentage for a 40 year lease is 95.457.

The gain is therefore:

	£
Proceeds	90,000
Allowable cost	
$60,000 \times \dfrac{81.100}{95.457}$	(50,976)
Gain	£39,024

7.3   Further points on lease depreciation percentages

If you look at the lease percentages you will see that the percentages are given for whole years only. In order to calculate the percentage if the lease is not an exact number of whole years, **apportionment** is required and this is done on a monthly basis.

Illustration 2

A taxpayer bought a 60 year lease on 1 December 1994 for £75,000. At this point he had a long lease. The taxpayer sold the lease on 20 March 2011 for £150,000.

As any apportionments will be done on a monthly basis, we first need to decide whether or not to count the month of March 2011. Schedule 8 tells us, that when **14 days or more** of the month have expired, we can assume the lease has been sold at the end of the month. For apportionment purposes therefore, we can assume the lease was sold on 31 March 2011.

At 31 March 2011, 16 years and 4 months of the original 60 years have expired. The number of years remaining as at 31 March 2011 is therefore 60 years less the amount expired, leaving 43 years and 8 months. As this is less than 50 years, the taxpayer is selling a short lease.   This illustrates the point, that a **long lease will eventually become a short lease**, once 50 years or less are remaining.

As the taxpayer is selling a short lease, we need to refer to the lease depreciation tables. The first thing we need to do, is to work out "S" and "P" – i.e. the percentages for the number of years remaining at the date of sale and the date of purchase. The lease has 60 years to run when it was originally acquired.

If you look at your tables, you will see that the percentage for 50 years or more is exactly 100.

The position is slightly more complicated for the number of years left at the date of sale. We need to work out a percentage for 43 years and 8 months. From the table you will see that the percentage for 43 years is 97.107, and the percentage for 44 years is 97.595. Schedule 8 tells us, that where the duration of the **lease is not an exact number of years**, the relevant percentage is found by taking an **appropriate point between these two figures.**

As the number of years in this instance is 43 years and 8 months, we take 8/12[ths] of the difference between these two figures, and add it to the percentage for 43 years.

$$\text{"S"} = 97.107 + \frac{8}{12} \times (97.595 - 97.107) = 97.432$$

The gain here is therefore:

	£
Proceeds	150,000
Less: cost	
£75,000 × $\frac{97.432}{100.0}$	(73,074)
Gain	£76,926

7.4   Leases acquired before 31 March 1982

Illustration 3

A taxpayer acquired a 59 year lease on 1 April 1972 for £20,000. The taxpayer sells the lease on 31 March 2011 for £110,000. Between April 1972 and March 2011, 39 years of the lease have expired. This means that in March 2011, the taxpayer is selling a lease which has 20 years left to run. As a short lease is being sold, we need to apply the special rules.

However, as the lease was originally acquired before 31 March 1982, we will prepare the gain computation using the 1982 value which is £35,000.

If the taxpayer had bought this lease on 31 March 1982, he would not have been buying a 59 year lease – instead he would have bought a 49 year lease. This is because 10 years of the original lease will have expired between April 1972 and March 1982. The number of years of the lease remaining in March 1982 is 49 years. The relevant percentage for a 49 year lease is 99.657. We need to factor this into our CGT computation.

When we prepare the calculation based on the March 1982 value, **we multiply the £35,000 by "S" over "P",** but this time what goes on the bottom of the fraction – i.e. the **"P" figure** – is not the number of years remaining at the date of acquisition, but **is instead the number of years left to run at 31 March 1982.** In this instance, "S" is still 20 years, but "P" is 49 years.

	£
Proceeds	110,000
Less: March 1982 value	
£35,000 × $\frac{S}{P}\frac{72.770}{99.657}$	(25,557)
Gain	84,443

Example 1

Lawrence bought a 30 year lease on a piece of land for £10,000 on 31 August 2000. Lawrence sold the lease on 28 February 2011 for £18,000.

Calculate Lawrence's chargeable gain.

Answer 1

		%
31 August 2000	30 year lease	87.330
28 February 2011	19½ year lease	
	70.791 + ½ × (72.770 – 70.791)	71.781

	£
Proceeds	18,000
Less: cost	
$£10,000 \times \dfrac{S}{P} \quad \dfrac{19.5y}{30y} = \dfrac{71.781}{87.330}$	(8,220)
Gain	9,780

Lease Depreciation Table taken from TCGA 1992, Schedule 8

Years	Percentage		Years	Percentage
50 (or more)	100		25	81.100
49	99.657		24	79.622
48	99.289		23	78.055
47	98.902		22	76.399
46	98.490		21	74.635
45	98.059		20	72.770
44	97.595		19	70.791
43	97.107		18	68.697
42	96.593		17	66.470
41	96.041		16	64.116
40	95.457		15	61.617
39	94.842		14	58.971
38	94.189		13	56.167
37	93.497		12	53.191
36	92.761		11	50.038
35	91.981		10	46.695
34	91.156		9	43.154
33	90.280		8	39.399
32	89.354		7	35.414
31	88.371		6	31.195
30	87.330		5	26.722
29	86.226		4	21.983
28	85.053		3	16.959
27	83.816		2	11.629
26	82.496		1	5.983
			0	0