

Chapter 3

PROPERTY INCOME AND INVESTMENTS – INDIVIDUALS

1 Property Income liable

The following income is liable to assessment as property income:

- (a) rents under any lease or tenancy agreement
- (b) premium received on the grant of a short lease

1.1 Basis of assessment

Income from land and buildings prior to 2018/19 was computed for individuals as if the letting of property was a business, and the amount assessable in the tax year was computed as the rental income accrued less allowable expenses incurred - the accruals basis.

From 2018/19 a simple cash basis is now usually applied and in an exam question should be assumed to apply unless specifically stated to the contrary - a taxpayer may choose to use the accruals basis, but must use the accruals basis where property income receipts exceed £150,000.

Therefore on the cash basis the assessment will now be rental income received less allowable expenses paid.

EXAMPLE 1

Jim bought a property and rented it out for the first time on 1 July 2021. The rent of £6,000 per annum is paid alternatively (1) quarterly in advance, or (2) quarterly in arrears.

He paid allowable expenses of £300 in November 2021 for redecoration and £500 in May 2022 for repairs completed in March 2022.

Calculate the Property Income assessment for 2021/22 and also compute the assessment if the taxpayer chose to use the accruals basis

1.2 Allowable deductions

- (a) To be allowable an expense must have been incurred wholly and exclusively in connection with the business for example
 - » insurance
 - » agents' fees
 - » other management expenses, for example cleaning expenses
 - » repairs
 - » for motor expenses incurred the taxpayer may now use the HMRC approved mileage allowances (see chapter 9) which will be at 45p per mile instead of computing actual motor expenses incurred
 - » Finance expenses in relation to a residential property are NOT allowable expenses but see section 3 below - Finance expenses on property incomes - to see how tax relief is given in relation to such expenses.

- (b) Capital expenditure is not allowable.
 - » Repairs are allowable revenue expenses.
 - » Improvements are capital and therefore disallowed
- (c) Capital allowances may be claimed for expenditure on plant and machinery used for the maintenance of the property
- (d) If residential lettings are either partly or fully furnished, tax relief is usually given for the furniture and furnishings by Replacement Furniture relief. There is NO relief for the initial cost of furniture and furnishings. There is ONLY relief when assets are replaced. This will include furnishings such as carpets and curtains, electrical equipment such as TV's, fridges, freezers and washing machines and even cutlery and crockery
- (e) The amount of relief is reduced by any proceeds from selling the old asset which has been replaced and relief is not given for any cost which represents an improvement, for example, if a fridge is replaced with a fridge freezer, only the cost of an equivalent fridge qualifies for relief.
- (f) Replacement furniture relief does not apply to furnished holiday lettings because the cost of furniture and furnishings in such properties qualifies for capital allowances (see Section 4 that follows)
- (g) Relief is available for revenue expenditure incurred before letting commenced, under the pre-trading expenditure rules. ie expenditure incurred up to 7 years prior to renting is treated as being incurred on day one of the letting business

EXAMPLE 2

Sid owns a furnished property that is let out at an annual rent of £9,600, payable monthly in advance. During the year 2021/22 he made the following payments:

May 2021	Construction of a garage, replacing the car port	£2,000
June 2021	Insurance for year from 1 July 2021 (insurance for the previous year to 30 June 2021 was £420 paid in June 2020)	£480
November 2021	Drain clearance	£380
January 2022	New Cooker with integrated microwave oven replacing a cooker sold for £50 (a replacement cooker would have cost £300)	£550
May 2022	Redecoration (work completed in March 2022)	£750

The tenant vacated the property during June 2021 without having paid the rent due for June. Sid was unable to trace the defaulting tenant, but managed to let the property to new tenants from 1 July 2021.

Calculate the Property Income assessment for 2021/22.

2 Property losses

If total expenses exceed total rental income, the property income assessment is **nil** and the excess property loss is carried forward and offset against future property income profits only.

3 Finance Expenses on Property Income

Up until the 2018/19 tax year, finance expenses, namely mortgage interest, were a fully allowable expense to be deducted in deriving the property income assessment for the tax year on rental property.

From then there has been a fundamental change for residential property to how tax relief is achieved for such finance expenses incurred in a tax year, such that now, no tax relief will be given as an allowable expense against property income but relief will instead be given entirely as a tax reduction in computing the tax liability of the taxpayer.

This relief will however only be given at the basic rate of 20% - so that this change will therefore have no overall effect on the tax liability of a basic rate taxpayer, but will increase the tax liability of a higher rate or additional rate taxpayer.

In 2021/22 therefore if a taxpayer incurs mortgage interest expense of £5,000 on a residential property, none of it will be shown as an allowable expense against property income, but it will instead achieve tax relief as a tax reduction at the basic rate of 20%, thus reducing the tax liability by £1,000 (£5,000 x 20%)

EXAMPLE 3

Dora House has employment income of £60,000 in 2021/22 and rental income received of £10,000. She paid maintenance expenditure on the property in 2021/22 of £800 and mortgage interest charges of £6,000.

Compute the 2021/22 income tax liability of Dora.

The new rules apply only to residential property, but do not include furnished holiday lettings.

The new rules are also only applicable to individuals and NOT to companies, such that higher and additional rate taxpayers with a highly geared (high debt) residential property portfolio may well consider incorporating their property business to maintain the tax relief for finance expense against property income.

Details of the finance costs restriction will be given in the tax rates and allowances section of the examination.

4 Furnished holiday lettings

There are special rules for furnished holiday lettings.

The letting is treated as if it were a trade. This means that, although the income is taxed as income from a UK property business some of, the provisions which apply to actual trades also apply to furnished holiday lettings as follows:

- (a) Capital allowances (see chapter 5) are available on furniture
- (b) Income qualifies as earnings for pension relief (see chapter 10)
- (c) Capital gains tax rollover relief, gift relief and business asset disposal relief are all available (see chapter 14).

The profit or loss is computed for tax years on a cash basis, but losses may only be carried forward against future profits from furnished holiday lettings

The lettings must be of UK or European Economic Area furnished accommodation made on a commercial basis with a view to the realisation of profit. In addition the following conditions must also be satisfied:

- (a) The accommodation must be available to let for at least 210 days in the tax year.
- (b) The accommodation must actually be let for at least 105 days in the year
- (c) No one person occupies the property for more than 31 consecutive days. If one or more persons do occupy the property for more than 31 consecutive days then these periods of long letting must not exceed 155 days in the year.

5 Rent a Room relief

If an individual lets a room or rooms, furnished, in his or her main residence as living accommodation then gross rents up to £7,500 p.a. are exempt.

The exemption may be ignored if the tax payer wants to generate a loss where expenses exceed income, or where actual expenses exceed £7,500.

If gross rent exceeds £7,500 p.a. the tax payer may choose to assess as follows:

(a) Ordinary calculation

Gross rent	X
Less: expenses	(X)
	<u>(X)</u>
Property Income	X

(b) Alternative calculation (election)

Gross rent	X
Less: rent a room relief	<u>(7,500)</u>
Property Income	X

The election must be made for 2021/22 by 31 January 2024 and stays in force until it is revoked.

EXAMPLE 4

Barbara rents out a room in her main residence. Gross rents received are £650 per month and annual expenses amount to £1200 in 2021/22

Calculate Barbara's Property Income assessment for 2021/22 and state the due date for any relevant election.

6 Lease premiums on grant of short lease (50 years or less)

6.1 Introduction

- (a)** When a tenant takes on a new lease he may be required to pay a one-off premium in addition to the annual rent. If the lease is for less than 50 years, part of the premium is assessed on the landlord as property income, the remainder is treated as a capital receipt.

The treatment of the capital receipt is outside the syllabus

- (b)** The amount of the premium assessed as Property Income is:

$$P \times \frac{51 - n}{50}$$

Where: P = total premium

n = duration of lease in years

Alternatively the assessable premium may be computed as the full premium received less 2% of the premium for the number of years of the lease less one year.

EXAMPLE 5

Bill grants Richard a lease to a shop on 30 June 2021

Annual rent £5,000 due on 1 July 2021

Term 20 years

Premium £60,000

Calculate the Property Income assessment for Bill in 2021/22

6.2 Trading Profit deduction for traders

Where a trader has paid a premium for a short lease he may deduct the following annual amount against his Trading profit in each of the years of the lease in which the property is used in the trade. This is in addition to any rental cost incurred:

$$= \frac{\text{Property Premium Income assessment on landlord}}{\text{Life of lease}} \text{ p.a.}$$

EXAMPLE 6

Using example 4 above, show the relief available to Richard for the premium paid.

7 Individual Savings Accounts (ISA's)

7.1 Individual Savings Accounts (ISA's) have for many years been the most common form of tax efficient investment.

The main advantages of ISAs are:

- (a) Income is free of income tax
- (b) Disposals of investments within an ISA are free from capital gains tax (CGT)
- (c) No minimum holding period - withdrawals can be made at any time
- (d) The introduction of the savings income and dividend income nil rate bands have removed the main benefits to most taxpayers of investing in an ISA but still give advantage to taxpayers with larger amounts of such income and for taxpayers selling shares where they have already made full use of their annual exempt amount (see later notes on CGT)

7.2 Components of an ISA

- (a) Cash - for example in a bank account
- (b) Stocks and shares listed anywhere in the world

7.3 Subscription limits

The annual subscription limit is £20,000 per tax year and ISA's permit the taxpayer complete flexibility over the mix of investments in either cash or stocks and shares.

This limit will be provided in the tax rates and allowances section of the exam paper.

A person can now withdraw money from a cash ISA and replace it in the SAME tax year without this replacement counting towards their ISA investment limit, for example if a person invested £10,000 into a cash ISA in June 2021 and then withdrew £2,000 from this account on 10 January 2022 a further investment of up to £12,000 (20,000 – (10,000 - 2,000)) into his cash ISA for 2021/22 (between 11 January and 5 April 2022) would be available.

8 National savings

These offer a variety of products some of which are tax free, namely:

National Savings Certificates

However, some National Savings & Investments (NS&I) products are taxable, namely:

- NS&I Easy Access account / NS&I Direct Saver Account
- NS&I Investments accounts

The income is received gross without deduction of tax at source.

The nature of the investments are historically risk free.

You should now attempt Practice Questions 7 to 9