In this chapter you will learn about some further aspects of taxation of property income including:
- overseas property business income;
- furnished holiday lets;
- non-resident landlords;
- Real Estate Investment Trusts;
- premiums on leases;
- grant of a sub-lease.

15.1 Overseas Property Business

If a taxpayer lets out an overseas property, such as a villa in Spain, any profits are charged to income tax as income from an overseas property business. ITTOIA 2005, s.269

To calculate the profits on the foreign property, we use the same rules as for the UK property business – i.e. rents receivable less expenses payable - to arrive at the overseas property business profit or loss.

However, an overseas property business loss – e.g. a loss on a villa in Spain – cannot be set off against UK property business income - i.e. from properties situated in the UK. This also applies the other way round, so there is never any mixing of UK and overseas property business profits and losses.

If a taxpayer has an overseas property business loss, that loss can only be carried forward and set against future overseas property business income.

15.2 Furnished Holiday Lettings - Conditions

We need to identify any income or losses made in respect of furnished holiday lettings. This is because landlords with a furnished holiday let (FHL) can benefit from certain tax advantages. ITTOIA 2005, ss.322-328

A property will be treated as a FHL if all of the following conditions are satisfied:

a. The property needs to be furnished.

b. The property must be situated in the UK or any other state in the European Economic Area (EEA).

c. The property must be available for commercial letting to the public for at least 210 days in the relevant 12 month period (usually the tax year).

d. Out of those 210 days, the property must actually be let out for 105 days or more – the 'letting' condition.

The 105 days actual occupation test can be met by making an election to average periods of occupation of any or all of the furnished holiday lettings owned.
by the taxpayer. However, an averaging election has to be made separately for properties in the UK and properties in any other EEA state. ITTOIA 2005, s.326

Accommodation is not normally regarded as holiday accommodation where it is let for a period of “longer-term occupation” – i.e. a continuous period of more than 31 days during which the property is in the same occupation. Therefore, properties normally let on a long-term basis do not qualify.

Any such periods of longer term occupation must in any event not exceed 155 days in the tax year.

Some longer-term lettings can still qualify where circumstances giving rise to longer-term occupation are not “normal”. The word “normal” ensures that genuine cases are not denied FHL relief due to exceptional and unforeseen circumstances. This will cover examples such as where a holiday-maker falls ill or has an accident and cannot vacate the accommodation on time, or where holiday visitors unexpectedly require a longer vacation. Qualifying lettings exceeding 31 days should be the exception rather than the rule, so HMRC will review such claims critically.

All of these conditions must be satisfied, and you will find them listed in Sections 322 to 326 of ITTOIA 2005.

It is possible that a property could qualify as a furnished holiday letting in one year but fail to qualify in the next year as the property was not actually let for enough days. ITTOIA 2005, s.326A

Where a property fails to qualify because it was not actually let for enough days, the taxpayer can make an election to treat the property as continuing to qualify as a furnished holiday letting for the first year in which the letting condition is not met and, if necessary the next year as well. The individual must have had a genuine intention to meet the letting condition in each year.

This election must be made by the anniversary of 31 January following the first tax year in which the failure occurs.

Illustration 1

Joy lets out a furnished holiday cottage in Devon. In 2014/15 the property was available for letting for 250 days and was actually let for 120 days. In 2015/16 the property was available for 220 days but was only actually let for 95 days.

Would the cottage be treated as a furnished holiday letting for tax purposes? Explain the reasons for your answer.

In 2014/15 the conditions are met as the property was both available for letting for at least 210 days and was actually let for at least 105 days. However, in 2015/16, although the property was available for letting for at least 210 days it was not actually let for at least 105 days and therefore does not qualify as a FHL.

As the property qualified as a FHL in 2014/15 Joy can make an election for the property to be treated as a FHL in 2015/16, even though the letting condition is not met in that year. A similar election can be made in respect of 2016/17, provided an election has been made for the earlier year. There must be a genuine intention to meet the letting condition in each year.
Provided there is a genuine intention to meet the letting condition, it would be possible to meet the 105 days requirement only once every 3 years but continue to receive FHL treatment indefinitely.

15.3 Furnished Holiday Lettings – Advantages

As we have said the reason why we need to define a FHL is that landlords with FHLs can benefit from certain tax advantages. ITTOIA 2005, s.322

The first advantage of a FHL is that the landlord may treat any profits from that letting as earned income. This is important if the landlord wishes to make pension contributions, because the amount a taxpayer can pay into his or her pension depends on the level of their earnings.

Profits on normal letting activities are not regarded as earnings for pension purposes.

FHLs qualify for certain capital gains reliefs that normal lettings do not. These reliefs will include rollover relief, gift relief and entrepreneurs’ relief.

Finally you should note that a landlord cannot claim wear & tear allowances in respect of furnished holiday letting. Instead, capital allowances will be available on the furniture, furnishings and equipment in the property.

15.4 Furnished Holiday Lettings – Losses

If a loss is incurred in a FHL business, that loss can only be offset against future income from the same FHL business. UK FHL businesses and overseas FHL businesses are identified separately so that a loss in respect of a UK FHL business can only be offset against income from the UK business and not against income from an overseas FHL business. Equally, a loss on an overseas FHL business can only be relieved against income from the overseas FHL business. ITA 2007, s.127 & s.127ZA

15.5 Non-resident Landlords

If a tenant living in the UK rents a property from a landlord who lives outside the UK, the UK tenant is paying rents to a non-resident landlord. Even though the landlord doesn’t live in the UK, he will still be taxable in the UK on his UK rental income.

HMRC has had difficulty in persuading taxpayers who live abroad to pay their tax bill, so what they ask the tenant to do is to withhold basic rate tax (currently 20%) from the rents paid to the non-resident landlord. If the letting is through an agent, the agent will do this on the tenant’s behalf. ITA 2007, s.971; SI 1995/2902

For example, if the tenant is due to pay rents of £1,000 to the non-resident landlord, what the tenant should actually do is send the landlord a cheque for £800 and send HMRC a cheque for the remaining £200. This is HMRC’s way of at least getting some tax in the event that the non-resident landlord decides to ignore his UK tax obligations.

If the non-resident landlord prefers, he or she can make an application to HMRC to receive his rental income gross from the tenant.

HMRC will only agree to this application if the non-resident landlord promises to file a self-assessment return and pay his income tax in the normal way. Before agreeing the application, HMRC will look at the landlord’s record for filing returns and paying income tax.
If the landlord has a good record and is up to date etc., HMRC will agree to him receiving rents gross. Otherwise the Tax Office will reject the application and the tenant or agent will need to deduct 20% tax at source.

If HMRC do not notify the tenant/agent that rents can be paid gross, it is the tenant/agent’s responsibility to register with HMRC and withhold tax from the rents before they are remitted to the non-resident landlord. Tax should be withheld at the basic rate and sent to HMRC 30 days after each calendar quarter along with a quarterly return. Calendar quarters run to 30 June, 30 September, 31 December and 31 March. The tenant should continue to withhold tax until notified otherwise by HMRC.

Basic rate tax is applied to gross rents, less any tax deductible expenses paid by the tenant or letting agent out of the rental income.

Each year, the tenant/agent will also complete an annual return and submit it to HMRC. The return is due by 5 July after the tax year and certifies the rents paid and the tax withheld.

The tenant/agent will also produce a certificate for the landlord showing the tax withheld from the rents. The landlord will use this certificate to complete his self-assessment return. The tax paid will be credited against any tax owing to leave additional tax due or repayable.

15.6 Real Estate Investment Trusts (REITs)

Certain companies which invest in property may elect for special rules to apply to their property business and to the profits they distribute to their shareholders. Those companies who make an election are known as UK-REITs (Real Estate Investment Trusts).

For UK-REITs, their qualifying rental income and gains on disposals of investment properties will be exempt from corporation tax. Any profits and gains on any other activities carried on by the UK-REIT will be subject to corporation tax in the normal way.

Dividends paid out by a UK-REIT out of tax-exempt property income or gains, will be treated as UK property income in the hands of its shareholders (as opposed to “normal” dividend income). CTA 2010, s.548

Investors will be deemed to have received a UK-REIT dividend under deduction of basic rate income tax (20%).

UK-REIT dividends will therefore be taxed as non-savings income carrying a 20% tax credit (repayable to non-taxpayers). If the UK-REIT pays a stock dividend when making a distribution out of tax exempt income or gains, this stock dividend will also be treated as non-savings income carrying a 20% tax credit.

Dividends paid out of other profits will be treated as normal dividends for UK tax purposes.

15.7 Premiums on Leases

A “lease” is a right to occupy property for a specified period of time and, usually, for a specified rent. ITTOIA 2005, ss.277-307
A “premium” is the amount paid by a tenant to a landlord for the grant of a lease. The person who grants the lease is called the “lessor” and the person to whom the lease is granted is called the “lessee”. So, any premium will be paid by the lessee to the lessor.

If a landlord owns the freehold of a property, we mean that the individual owns the land and the building outright i.e. he is not leasing it from someone else.

If the landlord grants a lease to the tenant, he is giving the tenant a right to occupy his property for a certain period of time. In return, the tenant will pay the landlord a premium for the grant of this lease. Note that the landlord still owns the freehold of the property, so when the lease comes to an end, the landlord can take the property back.

This premium is taxed in the hands of the landlord as property income. The way in which it is taxed will depend on the length of the lease.

If the lease is granted for a period of more than 50 years, there is no income tax charge. Instead the full amount of the premium will be charged to capital gains tax.

Contrast this with the grant of a lease by a landlord to a tenant for a period of 50 years or less. Leases of 50 years or less are called “short” leases. On the grant of a short lease, part of the premium received by the landlord is chargeable to income tax under property income. The part of the premium which is not charged to income tax, will instead be charged to capital gains tax.

To calculate the income tax charge we take the premium (P) and we deduct the amount which will be charged to capital gains tax (C):

\[ \text{Premium} - 2\% \times P \times (n-1) \]

\[ \text{Property income} = \frac{P}{2} \]

In the formula above, “n” is the number of years in the lease.

This amount is chargeable to income tax as property income in the year in which the premium is received by the landlord.

An alternative formula for calculating the amount of the premium chargeable as property income is:

\[ P \times \frac{(50 - Y)}{50} \]

where P is the amount of the premium and Y is the length of the lease minus one year. This formula is found in s.277 of ITTOIA 2005.

If the lease provides for some rents to be paid by the tenant to the landlord for the duration of the lease, these rents are charged on the landlord in the normal way using the accruals basis.

**Illustration 2**

Beth owns a property and on 5 October 2015 she grants a 20 year lease on that property to a tenant called Donald. The premium paid by Donald is £30,000.

Calculate how much of the premium will be chargeable to income tax.
As this is a short lease, some of the premium will be chargeable to income tax on Beth as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>£30,000</td>
</tr>
<tr>
<td>Less: 2% × 30,000 × (20 − 1)</td>
<td>(11,400)</td>
</tr>
<tr>
<td>Property income</td>
<td>£18,600</td>
</tr>
</tbody>
</table>

All of this £18,600 is taxed in the year of receipt – i.e. in 2015/16 – as non-savings income. The fact that it is received half way through the year makes no difference as the accruals basis only applies to rents, not to premiums.

Normally as part of the rental agreement, Donald will also be required to pay an annual rent for the use of the property. If he does, the rents receivable by Beth in 2015/16 will need to be added on to the taxable premium to give the total property income figure for the year.

### 15.8 Grant of a Sub-Lease

A slightly convoluted area is dealing with the grant of a sub-lease. We will look at these rules by working through an illustration. **ITTOIA 2005, s.288**

**Illustration 3**

Referring back to the previous illustration, Donald has a right to occupy Beth’s property for the next 20 years having paid Beth a premium of £30,000.

In March 2016, Donald decides that he no longer wishes to live in the property so he grants a 5 year sub-lease to a sub-tenant called Angela. In return Angela pays Donald a premium of £10,000 for the grant of this short sub-lease.

A premium received by a taxpayer for the grant of a short lease is partly chargeable to income tax and partly chargeable to capital gains tax.

However, where a taxpayer has a lease and from that lease he grants a short sub-lease, that taxpayer receives an allowance for part of the original premium paid.

To calculate this deduction, we take the amount chargeable to income tax in the hands of the head Landlord and multiply this by a fraction as follows:

\[
\text{Property Income for Landlord} \times \frac{\text{Length of sub-lease}}{\text{Length of head-lease}}
\]

Calculate the amount chargeable to income tax for Donald.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>£10,000</td>
</tr>
<tr>
<td>Less: 2% × 10,000 × (5 − 1)</td>
<td>(800)</td>
</tr>
<tr>
<td>Less: Allowance for original premium paid (18,600 × 5/20)</td>
<td>(4,650)</td>
</tr>
<tr>
<td>Property income for Donald</td>
<td>£4,550</td>
</tr>
</tbody>
</table>
EXAMPLES

Example 1

Steve lets out 3 properties in 2015/16 giving rise to the following profits and losses:

<table>
<thead>
<tr>
<th>Property</th>
<th>Profit/(Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flat in West London (long term let)</td>
<td>£(1,000)</td>
</tr>
<tr>
<td>Apartment in New York (long term let)</td>
<td>£16,000</td>
</tr>
<tr>
<td>Villa in Tuscany (long term let)</td>
<td>£(3,000)</td>
</tr>
</tbody>
</table>

He has no other income.

Calculate his net income.

Example 2

Assume the facts are as for Example 1 but the villa in Tuscany is a furnished holiday letting.

Calculate Steve's net income.

Example 3

Harriet grants a 25 year lease on a property to Anita on 1 January 2016.

Anita pays a premium of £40,000 plus an annual rent (in advance) of £8,000.

Calculate Harriet's property income for 2015/16.
ANSWERS

✓ Answer 1

£
Profit on apartment in New York  16,000
Less: Loss on villa in Tuscany  (3,000)
Overseas property business profit  13,000

Loss on flat in London  (1,000)
(carry forward against future UK property business income)

Net Income  13,000

✓ Answer 2

£
Profit on apartment in New York  16,000

Loss on flat in London  (1,000)
(carry forward against future UK property business income)

Loss on villa in Tuscany  (3,000)
(carry forward against future overseas FHL business profits)

Net income  16,000

✓ Answer 3

£
Premium received  40,000
Less: 2% × 40,000 × (25 – 1)  (19,200)
Add: Rents receivable (8,000 × 3/12)  2,000
Property income  22,800

Note:

An alternative method for calculating the amount of the premium assessable as property income is:

40,000 × [(50 − 24)/50] = £20,800