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PRACTICE NOTE

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Assessment Of Income Arising From Land And Property

The object of this Practice Note is to set down legislation and existing concessions and practices dealing with rents and allied subjects.

Reference to sections herein refer to sections of the Income Tax Act 1970.

1 . Sources Of Income Which Are Classed As Trading Income

These comprise: -

Tourist Accommodation

Tourist Accommodation refers to premises registered under the Tourist Act 1975. Income from this type of property is assessed as trading income. Registration includes guest houses, boarding houses, flats, flatlets and other such accommodation which is used or intended to be used for accommodating tourists.

Properties Similar to Tourist Accommodation

Because of the decline in the tourist industry, properties such as guest houses and boarding houses which may have previously qualified to be registered under (a) above often no longer apply for registration with the Tourist Board. Instead the rooms are let to persons such as visiting workers and no advertising for tourist business normally takes place. Where facilities, optional or otherwise, such as meals, fresh bed linen, or a bar are made available, the whole of the income arising is classed as trading income. If property such as a flat is let to a person but that person has to vacate the property so that it can be let to visitors during the tourist season, the whole of the income is classed as trading income.

Properties from which a trade/profession or vocation is being conducted

Where a subsidiary part of the trading premises is let it is accepted practice that such income is treated as part of the trading income.

2. Basis Of Assessment

- Apart from the commencement and cessation provisions of Sections 3, 4, 5, 6, and 7, all persons resident in the Isle of Man are assessable on rental income on a preceding year basis in accordance with Section 81.
- Where individuals provide accommodation in their own homes only during TT fortnight and as part of the Department of Tourism's "Homestay Scheme", the Assessor will not pursue the Manx resident income tax liability on that income, provided the gross income received before expenses does not exceed £500.
- Where a trade/profession or vocation is being carried on and a subsidiary part of the trading premises is let, such income and associated expenses are treated as part of the trade and the basis of assessment applicable to the trade will be applied.
- When a person has already owned property for several years and commences to receive rent from it the rental income is assessed on a preceding year basis as it is not income from a new source.
- When a property is transferred between an individual and a private company, (not due to death) of which the individual is the majority shareholder, any rental income continues to be assessed on a preceding year basis unless the company ceases to trade or the transfer is due to the death of the individual.
- Office practice allows an accounts basis to be adopted, especially in the case of limited companies, but the right is always reserved for the fiscal basis to be used.
- Persons resident outside the Isle of Man are assessable on a current year basis in accordance with Section 73.

3. Expenses

Deductions in respect of interest paid are dealt with separately at (4) below.

Relief on rental income arising in the Isle of Man.

The provisions relating to relief on Manx source rental income are contained within Sections 58, 58A and 59. Only the costs of Maintenance, repair, insurance and management are allowable.

- Repairs will include the maintenance and replacement (like for like) of existing installations of the following:
- Furniture, curtains and carpets (including fitting costs);
- Fires, boilers, radiators, cylinders, pipework and the cost of installation;
- Sanitary ware, associated pipework and the cost of fitting (but not the cost of any tiling);
- Smoke detectors, alarms, emergency lighting, fire doors, fire escapes and other fire prevention measures;
- Kitchen units (but not the cost of tiling) and;
- The cost of the electrical installation and supply of immersion heaters, showers and extractor fans;
- Costs of re-guttering, renewing existing plumbing systems;
- Re-roofing, re-flooring, re-plastering.
- Capital expenditure (e.g. altering or improving the land/property, legal expenses in purchasing or selling the land/property) are not allowable

Relief on rental income arising outside the Isle of Man.

It is the Division's practice to accept the computation as agreed by the foreign tax jurisdiction. In the absence of evidence of this the same code of relief will be allowed as would have applied had the land/property been situated in the Isle of Man.

If the person has suffered foreign tax then by concession, the Division will compute the assessable rent figure which is subject to double tax relief as agreed by the foreign tax jurisdiction and evidenced by the production of the foreign assessment notice.

In cases where there is already a track record of double taxation relief, provisional relief will be given in cases where the overseas assessment has not yet been determined.

4. Interest Paid

(a) Rents from properties in the Isle of Man.

Section 58 provides that interest paid can be included as maintenance costs (and so allowed as a deduction against rents) provided the following conditions are satisfied:-

The interest must be paid on a bona fide loan obtained and continuing to be used solely for the purpose of the purchase of the land/ property and any payment for the improvement, maintenance, repair, insurance or management of the land/property, by the person liable to pay the tax on rental income.

The interest payable on the loan must be assessable to Manx income tax on the lender.

N.B. A non-resident person may qualify for relief for interest paid under Section 58, unlike the provisions of the Income Tax (Deductions) (Prescribed Cases) Order 1989 which specifically excludes a non-resident person from obtaining relief.

(b) Rents arising to Manx residents from properties outside the Isle of Man.

Where the Manx resident person assessable on the rental income has not been charged to tax by the foreign tax jurisdiction the Manx liability will be computed on the same basis as if the property were situated in the Isle of Man. Exceptionally in instances where the Manx resident has obtained finance for the acquisition of a foreign property (other than in the UK) from an institution outside the Isle of Man the interest payable will be allowed as a deduction up to the level of rental income received in the year.

5. Capital Allowances

Sections 27A and 29 refer to allowances for capital expenditure incurred for the purposes of the assessment of income tax in respect of the profits and gains of any trade, profession or vocation. Provided that the premises in respect of which the rental income is received are being used for such purposes it is the Division's practice to grant capital allowances against the rental income to the same extent that they would be allowed if the lessor was carrying on the trade.

If the rental income arises from residential properties there is no allowance for capital expenditure. However, by concession and subject to the following conditions, certain capital allowances are now to be granted.

The former concessional treatment whereby rental income, after deduction of any direct costs such as rates, electricity, cleaning expenses etc, from furnished property was apportioned so that a 20% allowance was given against 25% of the rental income for depreciation of property contents, ceased to have effect in respect of expenditure incurred after 5th April, 1993.

- The following new concession applies in respect of expenditure incurred from 6th April, 1993.
- The concession will only apply to properties that are available for permanent letting for residential purposes. Permanent letting means that the property is intended to be available for let for a continuous period exceeding 5 years.
- There will be a 10% straight line allowance for the cost of any qualifying capital expenditure as defined in (i) below.
- There will be no balancing charges or allowances when the property is transferred from one owner to another provided that the property continues to be available for permanent letting.
- Balancing charges or allowances will be calculated when the property ceases to be available for permanent letting (whether on disposal or not based on the market value of the assets at that time).

Qualifying capital expenditure will follow the normal capital allowances rules. As a guide the first time expenditure on those items listed at 3(a) will qualify.

Expenditure which does not qualify for capital expenditure includes:-

- Expenses already admitted as a revenue deduction (i.e. repairs).
- Structural additions, alterations, modifications, expansions and improvements to the property including re-divisioning or partitioning and creating car parking facilities.

Transitional Arrangements

In consideration of the termination of the former concessional treatment, a one-off £250 deduction will be given in addition to the capital allowances claim in respect of the year ended 5 April 1994. If a taxpayer can demonstrate that he/she is disadvantaged by the transition, consideration will be given to their representation.

6. Losses And Excesses

Excess expenditure on rents is not available for set-off against non-rental income.

Section 59 allows for excess expenditure on rents to be carried forward for relief against subsequent rents from the same property.

Section 58A allows for two or more properties or parcels of land to be treated as one (i.e. pooling) subject to two provisos:-

- Expenditure relieved under the pooling provisions is not available for carry forward (but any excess not relieved under pooling is still carried forward).
- Expenditure on properties let at less than a commercial rent cannot be pooled.

By concession any excess capital allowances can either be carried forward under Section 59 or offset against other rental income under Section 58A.

7. Agents

Sections 70 to 78 include the legislation for the deduction of income tax, assessment and returns in non-resident cases.

It is the Division's practice to issue the tenant of a non-resident landlord with a requirement under Section 71 to deduct income tax at source from any rents paid. The requirement is also applied to persons like estate agents who collect rent on behalf of non-resident landlords.

The authorisation is made on a form N15. This requires that tax deducted should, in the case of a tenant, be paid over to the Assessor within 14 days of the date on which the deduction was made or the date on which the deduction should have been made. In the case of a landlord's appointed agent a quarterly return and payment system is to apply.

An N4 certificate of tax deducted is issued to the taxpayer by the person making the deduction of tax.

Under the provisions of Section 71(3) a person who has had non-resident income tax deducted from a payment may within 3 years after such deduction make a claim for any allowances/deductions to which they may be entitled.

8. Lease Premiums

This is a complex area and will be the subject of a separate Practice Note in due course.