

Land and leases, the valuation of land and Capital Gains Tax

i **Contacts**

Please phone:

- the number printed on page TR 1 of your tax return
- the SA Helpline on **0845 9000 444**
- the SA Orderline on **0845 9000 404** for helpsheets

or go to
www.hmrc.gov.uk

This helpsheet explains how certain disposals of land, including leases, are treated for Capital Gains Tax. But it is only an introduction. If you are in any doubt about your circumstances you should ask your tax adviser. We will also be pleased to help. You can also consult our Capital Gains Manual, which explains the rules in more detail, at www.hmrc.gov.uk

This helpsheet will help you fill in the *Capital gains summary* pages of your tax return.

Your Capital Gains Tax liability

If you dispose of land or any interest in land, you may make a chargeable gain or an allowable loss. The calculation of the gain or loss arising on a disposal is in many cases the same as for other assets, but there are some special rules which apply only to land.

Leases

This is only a summary of the main provisions.

Grant of lease

The grant of a lease, whether out of a freehold or leasehold interest, is a part disposal. In certain circumstances, you may also be chargeable to Income Tax. Grants of leases fall into three categories:

- the grant of a long lease out of a freehold or long leasehold interest
- the grant of a short lease out of a freehold or long leasehold interest
- the grant of a short lease out of a short leasehold interest.

The tax treatment is different for each category. A long lease is one with more than 50 years duration remaining and a short lease has 50 years or less remaining. The duration of a lease for Capital Gains Tax purposes will normally be the time remaining until the expiry of the current term of the lease, but can also be affected by any provision in the lease allowing the landlord or the tenant to give notice to terminate the lease, or by a provision allowing the tenant to extend it.

Grant of a long lease out of a freehold or long leasehold interest

To calculate the gain arising on the part disposal, any allowable expenditure (apart from the costs of disposal) is apportioned between the freehold reversion or superior leasehold interest retained and the lease granted. This is done by applying the fraction $\frac{A}{A+B}$ to the allowable expenditure, as for part disposals of other assets, but with one difference. For the granting of a lease:

- A is the premium or consideration received for the grant of the lease, and
- B is the value of the interest retained plus the value of the right to receive the rent due under the lease.

Example 1

On 30 June 1988, Mr Jones bought the freehold of a property for £150,000.

On 30 June 2011, he granted a 75-year lease of the property for a premium of £200,000.

Rent of £5,000 a year was due under the lease. Mr Jones incurred legal fees of £3,000 on the grant of the lease.

The value of the freehold reversion at 30 June 2011 was £30,000, and the value of the right to receive the rent was £70,000.

Mr Jones' allowable expenditure is:

$$£150,000 \text{ (cost of property)} \times \frac{A}{A + B}$$

$$£150,000 \times \frac{£200,000}{£200,000 + (£30,000 + £70,000)} = £100,000$$

The gain accruing to Mr Jones is then calculated as follows:

Premium received		£200,000
Minus apportioned cost (as above)	£100,000	
legal fees	£3,000	£103,000
Chargeable gain		£97,000

Grant of a short lease out of a freehold or long leasehold interest

Part of any premium you may receive for the grant of a short lease is chargeable to Income Tax. See page UKPN 7 (box 22) of the *UK property notes* for further details. The calculation is made as for the grant of a long lease (see page 1), except that the amount chargeable to Income Tax is:

- left out of the consideration brought into the calculation of the gain or loss arising, and
- left out of the numerator A in the $\frac{A}{A + B}$ fraction used to apportion the allowable cost between the freehold or superior leasehold interest retained and the lease granted, but
- is included in A in the denominator of the $\frac{A}{A + B}$ fraction.

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Example 2

On 6 April 1986 Miss Smith bought a freehold property for £45,000. On 6 April 2011 she granted a 46-year lease for a premium of £35,000 and a rent of £2,000 a year. The value of the reversionary interest in the property was £30,000 and the value of the right to receive the rent over the term of the lease was £20,000. The amount chargeable to Income Tax is:

$$\text{£35,000 minus } \frac{(\text{£35,000} \times 45)}{50} = \text{£3,500}$$

The consideration for Capital Gains Tax is:

Premium received	£35,000
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Minus amount chargeable to Income Tax	£3,500
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Consideration for Capital Gains Tax purposes	£31,500
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Allowable expenditure – applying the part disposal formula

$$\text{£45,000} \times \frac{\text{£31,500}}{\text{£35,000} + (\text{£30,000} + \text{£20,000})} = \text{£16,677}$$

Please note: The A factor (see page 1) in the numerator is the consideration for Capital Gains Tax purposes; the A factor in the denominator is the entire premium.

The chargeable gain is then:

Disposal proceeds	£31,500
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Minus allowable expenditure	£16,677
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Chargeable gain	£14,823
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Grant of a short lease out of a short leasehold interest

Part of any premium you may receive for the grant of a short lease is chargeable to Income Tax. See page UKPN 7 (box 20) of the *UK property notes* for further details. In calculating the amount chargeable to Capital Gains Tax:

- the full amount of any premium payable for the granting of the lease is brought into the calculation of the gain or loss as the consideration received, but a deduction of the amount chargeable to Income Tax is made later in the calculation
- special rules apply for calculating the allowable expenditure to be deducted from the consideration in calculating the gain or loss
- if a capital loss arises, it may be restricted in some circumstances.

We will let you have the details necessary to calculate your chargeable gain or allowable loss.

Other sums received after you grant a lease

During the existence of a lease you may receive a capital sum in exchange for the surrender of the lease, or instead of rent, or for the variation or waiver of some of the terms of the lease. Such a capital sum is chargeable to Capital Gains Tax. To find out how to calculate your chargeable gain or allowable loss, ask us or your tax adviser.

Assignment or surrender of a lease

If you have assigned or surrendered a lease, you have made a complete disposal of that leasehold interest. The amount of your gain or loss depends on whether the lease was a long lease or a short lease at the date of disposal.

A long lease is one with more than 50 years duration remaining, and a short lease has 50 years or less remaining. The duration of a lease for Capital Gains Tax purposes will normally be the time remaining until the expiry of the current term of the lease, but can also be affected by any provision in the lease allowing the landlord or the tenant to give notice to terminate the lease, or by a provision allowing the tenant to extend it.

For a long lease, any allowable expenditure is allowed in calculating the gain or loss in the normal way. For a short lease, the allowable expenditure is restricted and special rules apply. To find out how to calculate your taxable gain or allowable loss, ask us or your tax adviser.

Compulsory purchase

If your land is compulsorily purchased, you are subject to Capital Gains Tax in the normal way, but there are some special rules. These:

- determine the date of disposal
- provide for some small disposals not to be treated as a disposal
- allow for any gain arising to be rolled over against the acquisition of new land in certain circumstances
- provide for an apportionment of the compensation between its constituent factors.

Date of disposal

Where land is acquired by an authority exercising compulsory powers, the date of disposal is the time at which the compensation for the acquisition is agreed, or otherwise determined. Any variation on appeal is ignored.

Before 1996–97 this rule was different. If you are in any doubt about your date of disposal, ask us or your tax adviser.

Small part disposals

Where the land compulsorily acquired is only part of a larger holding of land, and the following conditions are satisfied, you can claim that the compensation received should not be regarded as a disposal, but that it should instead be deducted from the allowable expenditure on the entire holding. On a later disposal, or part disposal, of the remainder of the holding, only the reduced expenditure is taken into account in calculating any subsequent gain or loss. The conditions are:

- the holding is not a wasting asset; for land this usually means that the land is not held under a lease with 50 years or less still to run, and
- the market value of the land is small, compared to the value of the entire holding. A holding for this purpose does not necessarily comprise the whole of your estate, but means the smallest unit of land with a separately identifiable cost, which includes all of the land compulsorily acquired, and
- you must have taken no steps to make it known, by advertising or otherwise, that you were prepared to sell any part of the holding.

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Example 3

The freehold of an area of land was purchased at a cost of £200,000 in 1989. A small strip of the land is acquired by compulsory purchase for £8,000 in 1993. A claim is made for the disposal to be disregarded. The remaining land is sold for £250,000 in 2011.

There is no gain or loss on receipt of the compensation and the chargeable gain on the sale in 2011 is:

Sale proceeds		£250,000
Minus original cost	£200,000	
Compensation	£8,000	£192,000
Chargeable gain		£58,000

If you want to claim this relief in your tax return, on page CG 2 of the *Capital gains summary* pages, please put 'X' in box 34 and provide details of the claim in the 'Any other information' box, box 36, or in your computations, providing a clear statement that this relief is being claimed.

Compensation used to acquire new land

If you apply the compensation you received, for land compulsorily acquired, in acquiring new land, you may claim to roll-over the gain you make against the cost of the new land. In that case, the compulsory purchase is treated as giving rise to neither a gain nor a loss, and the cost of the new land is reduced by the amount of the gain which would otherwise have arisen.

The two main conditions which have to be met are:

- you must have taken no steps to make it known, by advertising or otherwise, that you were prepared to sell any part of the holding, and
- the new land cannot include a dwelling house that is or may become your only or main residence.

If the new land will become a wasting asset within 10 years (typically a lease which on acquisition has 60 years or less to run), the rules are modified. They are also modified where only part of the compensation is applied in acquiring the new land. If you require further details, ask us or your tax adviser.

If you want to claim this relief in your tax return, on page CG 2 of the *Capital gains summary* pages, please put 'X' in box 34 and provide details of the claim in the 'Any other information' box, box 36, or in your computations, providing a clear statement that this relief is being claimed. You can do this by completing the form attached to Helpsheet 290 *Business Asset Rollover Relief* and sending it in with your tax return.

Example 4

Mrs Davies bought some land for £50,000 in April 1991. It is compulsorily purchased for agreed compensation of £80,000. The date of disposal is May 2011. The compensation is used to buy more land costing £100,000 and she claims that the gain should be rolled over.

The gain is:

Compensation	£80,000
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Minus cost	£50,000
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Gain	£30,000
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The gain is reduced by the rollover to zero and the allowable cost of the new land becomes:

Cost	£100,000
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Minus gain rolled over	£30,000
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Allowable cost	£70,000
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Apportionment of compensation

In law, compensation for compulsory purchase is a single sum but for tax purposes it is apportioned between its constituent factors, and is taxable accordingly. The categories for which compensation may be received are:

- for the land itself
- for disturbance
- for severance or injurious affection.

Compensation for disturbance may include several items and the tax treatment varies accordingly. The most common elements are dealt with as follows:

- compensation for losses on stock and loss of profits is taxable as income
- compensation for loss of goodwill is chargeable to Capital Gains Tax
- compensation for expenses is set against those expenses
- any remaining amounts are chargeable to Capital Gains Tax if they derive from chargeable assets.

Compensation for severance or injurious affection is paid for a fall in the value of land you retained caused by the compulsory purchase. This is treated as giving rise to a part disposal of that retained land concerned. Any resulting gain or loss is calculated in the normal way, subject to the rules for small disposals referred to above.

Part disposals – alternative basis of calculation

Where part of a holding of land is disposed of, it is necessary to apportion the allowable cost of the land, and any other allowable expenditure, between the land sold and the land retained in order to calculate the gain or loss arising. The statutory rules for doing this require a valuation of the land retained.

In order to avoid the need for this, we will usually accept an alternative basis of apportioning the expenditure. Under the alternative basis, the land disposed of is treated as a separate asset from the land retained and we will accept any fair and reasonable method of apportioning part of the allowable expenditure to it. We may insist on the statutory rules if we are not satisfied that the resulting apportionments are fair and reasonable.

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Example 5

Part of a holding in land which was acquired in 1975 is sold in May 2011 for £50,000. The market value at 31 March 1982 of that part was £20,000. The costs of disposal were £2,000. The gain using the alternative basis is:

Sale proceeds		£50,000
Minus market value at 31 March 1982	£20,000	
costs of disposal	£2,000	£22,000
Chargeable gain		£28,000

If the alternative basis is not used it would be necessary both to value the whole property at 31 March 1982, and to value the whole of the land retained at the date of the sale.

Small part disposals

To determine the cost of the land retained the cost of the part disposed of is deducted from the total cost. Once the statutory rules have been applied to a part disposal of a holding of land, they also have to be applied to subsequent disposals.

Where you have disposed of part of a holding of land you may, if certain conditions are met, claim that it should not be regarded as a disposal and that the consideration you have received should instead be deducted from the allowable cost of the rest of the holding. On a later disposal, or part disposal, of the remainder of the holding, only the reduced expenditure is taken into account in calculating any subsequent gain or loss. The main conditions, which must **all** be met, are:

- the amount or value of the disposal does not exceed 20% of the market value of the holding, and
- the amount or value of the disposal does not exceed £20,000, and
- the total amount or value of all disposals of land you have made in the year does not exceed £20,000, and
- the holding of land must not be a wasting asset (a typical example of land which is a wasting asset is a lease with 50 years or less to run).

If you wish to claim this relief in your tax return, on page CG 2 of the *Capital gains summary* pages, put 'X' in box 34 and provide details of the claim in the 'Any other information' box, box 36, or in your computations, providing a clear statement that this relief is being claimed.

Valuations of land

You may need a valuation to calculate the gain or loss arising when you dispose of an interest in land. The main circumstances where this will be so are where:

- the land was owned at 31 March 1982, or
- the disposal is not by way of a bargain at arm's length, or
- the disposal is to a person with whom you are connected, or
- there has been a disposal of part of a holding of land and the alternative basis for calculating the allowable cost (see page 6) is not being used.

If you have used any valuation to calculate any gain or loss, on page CG 2 of the *Capital gains summary* pages, put 'X' in box 35 and provide details of the valuation in the 'Any other information' box, box 36, or in your computations, whether you have prepared your own estimate of the value, or have taken professional advice. If you have already asked us on form CG34 to check any of the valuations you have used in your calculations, put a note to that effect in the 'Any other information' box, box 36, or in your computations.

In each case your valuation must be of the asset you owned as it was at the date of valuation. This can affect the basis of valuation and some of the more common examples are explained below.

Valuation at 31 March 1982

Your valuation should not be on a like-for-like basis. If the land has been substantially altered since 31 March 1982, for example, by further building work, the valuation must nevertheless be of the land in the state that it was in at 31 March 1982.

Similarly, you may dispose of a property with vacant possession but if it was occupied by tenants at 31 March 1982, it must be valued taking account of the tenancies. The opposite applies if the property was sold with tenants in occupation; it should still be valued with vacant possession at 31 March 1982, if it was in fact vacant at that date.

Joint ownership

If you own land with one or more other persons, any valuation will need to take account of this. The valuation has to be of your interest, which in this case is an undivided share in the property. In view of the difficulties inherent in selling such a share, this will normally mean that the value is less than a proportionate share of the value of the entire property. Thus for a property which is equally owned by two people, the valuation for each of them would normally be less than one half of the value of the entire property.

Post transaction valuation checks

If you need to provide any valuations, there is a free service from us to help you complete your tax return. You can ask us to check your valuations before you make your tax return.

You will need to complete a form CG34 for each valuation you want checked. Form CG34 is available from www.hmrc.gov.uk

The notes attached to form CG34 give more information about the service.

These notes are for guidance only and reflect the position at the time of writing. They do not affect any rights of appeal. Any subsequent amendments to these notes can be found at www.hmrc.gov.uk