

Property – A Tax Guide

When considering the letting of an existing or recently acquired property it is important to understand the tax implications. This guide sets out the general rules applicable to most landlords in relation to tax. It is not intended to be a substitute for proper professional advice from your accountant or tax adviser.

INCOME TAX

The rent that you receive from letting properties is usually treated as unearned income by HM Revenue & Customs irrespective of your employment or self-employment status. You will be liable to pay Income Tax, but only on the profit generated from your property. To calculate your profit you are entitled to claim certain allowable expenses.

Allowable expenses

HM Revenue & Customs have rules regarding what expenses are allowable for tax purposes. They also expect you to keep records to support the figures entered onto your tax return and retain them for six years. This will help if HMRC were to open an enquiry into your tax return.

Expenses must have been incurred solely in connection with the letting of property. If a cost only partly relates to this you will only be able to claim a part of it.

The most common allowable expenses are:

- Interest paid on a loan to purchase or improve the property (mortgage interest)
- Letting agents fees
- Repairs and maintenance (but not costs of improvements)
- Insurance premiums for buildings and contents
- Utility bills (gas, electricity and water) – although often these are paid by the tenant
- Rent, ground rent and service charges
- Cleaning and gardening
- Accountants fees for preparing letting accounts
- Costs of travelling to the property during and after a tenancy (the current approved rate is 40p per mile)
- Stationery costs (such as rent books, stamps etc)
- Other direct costs such as telephone calls and advertising



Relief for mortgage interest is one of the most important allowable expenses. This **may** include interest on subsequent remortgage, subject to certain conditions.

The common expenses that are **not** allowable are:

- Any costs associated with the buying and selling of the property (stamp duty, legal fees etc.)
- Improvements to the property (extensions or increasing the size of the kitchen or bathroom)
- The “value” of your own time (for example carrying out your own repairs)
- Life assurance payments
- Capital element of any mortgage or loan repayments

A complex area within this is - when is the expenditure an improvement and not a repair? As a rule of thumb if the expenditure is incurred in making good damage arising from the letting of the property, whether by way of repair or replacement to an equivalent modern standard, it should qualify as a deduction against income. If, on the other hand, it significantly upgrades and improves the property then it would generally be considered of a capital nature. Great care needs to be taken in this area as there have been several tax cases taken to court for a ruling. You should always seek professional advice on any expenditure of this nature.

Furnished or Unfurnished properties

If you are letting the property as a furnished let you may also be entitled to a “wear and tear” allowance. There is no legal definition in tax legislation of what constitutes a furnished property, but HMRC guidance says “sufficient furniture must be provided for normal occupation”. In practice this means beds, chairs, tables, sofas, cupboards, cooker, fridge etc.

If this requirement is met you are entitled to a “wear and tear” allowance of 10% of the gross rent (less any council tax or water rates paid) each year. If you choose this method you cannot claim the cost of buying these items. An alternative is to claim the cost of replacing these items as and when necessary. No relief is claimed for the initial purchase of the items of furniture or equipment but a claim can be made for replacement when they are damaged or worn out. You must stick to the method chosen; you cannot claim the 10% wear and tear allowance one year and then claim the cost of replacement items the next. In practice it is usually preferable to claim the 10%.

If the property has no furniture, or only a few of these items are provided, the property will be treated as unfurnished. In these circumstances no allowance can be claimed for furniture expenditure.

Losses

If your expenses exceed your income in any year then you have made a loss. There are only limited ways in which you can get tax relief for a property loss. You can set it against a profit from another



property that you own. If there are not any profits available you can carry it forward to set against the rental profits (from any property) you make in the future. Rental losses cannot be offset against any non rental income.

Non-Resident Landlords

If you live outside the UK you will still have to pay income tax on the rent you receive. The Non-Resident Landlord Scheme requires your letting agent to deduct basic rate tax from the rent that is collected on your behalf. However you can apply to HM Revenue & Customs for approval to receive your rental income with tax deduction. This is requested by submitting a form to HM Revenue & Customs stating your current tax situation and obligations. It will be granted if you do not expect to be liable to UK tax for the year in which you make the application and your UK tax affairs are up to date. If you become due to pay income tax you have an obligation to complete a self assessment tax return and pay the tax due on time.

CAPITAL GAINS TAX

At some stage you are likely to want to sell a property that has previously been rented out. Not surprisingly HM Revenue & Customs will want you to pay some tax, but how much and what sort of tax?

Capital Gains Tax (CGT) is based on the profit or gain arising from the increase in value of the property during the period of ownership. This is the difference between:

Sale proceeds, less costs of making the sale

and

The original purchase price, plus costs of buying and cost of any capital improvements

It is therefore important to keep copies of all of the relevant documents at the time of purchase, as it could be many years until you sell. Similarly, any invoices relating to improvements carried out during the period of ownership should be retained.

In straightforward cases the tax calculation is then easy to work out; start with the first figure and deduct the second figure, if this is the only Capital Gain you have in the tax year you can deduct your annual exemption (for 2011/12 this is £10,600). The resulting figure is then taxed at 18% or 28% for the proportion of the gain that falls into the higher rate tax band.

Many cases are not so straightforward. A gain on jointly owned property is split between the owners in the relevant proportion and each part owner has their own annual exemption if applicable.



Other factors to consider are:

1. Have you ever lived in the property or elected to treat it as your **Principal Private Residence** (PPR)? If you have, the period that you lived in it as a proportion of the whole period of ownership is likely to be exempt from Capital Gains Tax.
2. Part of gain may be exempt under the **Residential lettings exemption**. There does need to be a period of residence by the owner for this to apply.
3. If the property was purchased before 31 March 1982 the original cost and capital improvements incurred before 31 March 1982 is replaced by the market value at that date.
4. If there has been a period of residence at any time during the period of ownership then the last three years count as a period of residence.
5. There is also relief available if periods of absence are for job related reasons.
6. If you have losses arising from previous capital transaction you can offset the loss against the gain.

Tax Payment date

Capital Gains Tax is payable on 31 January following the tax year in which the property is sold. For example, if you sell a property on 31 August 2010 it will fall into the 2010/11 tax year (ending 6 April 2011) and so the tax is payable on 31 January 2012.

SEEK ADVICE. Capital gains tax can be very complicated. It is advisable to seek professional advice before you sell a let property. This avoids any nasty surprises and allows time to take any measures that may reduce the potential tax liability.

INHERITANCE TAX

A furnished or unfurnished property is treated as part of your estate for inheritance tax purposes.

Property does not qualify for any special inheritance tax relief.

Ownership of property can be varied quite easily by deed of trust, but care is required in changes of ownership as they could be regarded as **disposals** for CGT purposes.



SEEK ADVICE. Let property should always be considered in any inheritance tax planning. Owning a let property probably means that you should carry out some inheritance tax planning.

ACTION POINTS

- Tell HM Revenue and Customs as soon as you have purchased your let property.
- Keep records of all income and expenditure, including mortgage statements.
- Keep a record of any capital improvements or major works to the property.
- If you intend to claim PPR relief for living in the property for a period make sure that you can demonstrate this residence was 'real' as HMRC can challenge this.
- Ask if your letting agent provides an annual statement – this saves time in putting the figures together at the end of year.
- Prepare a summary statement of income and expenditure on your rental properties made up to 5 April each year.
- Consider the ownership of the property – is it how you want it?
- Always seek professional advice before you make a decision relating to your let property.

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