

A LANDLORDS' TAX GUIDE

INCOME TAX

CAPITAL GAINS TAX

INHERITANCE TAX



*A concise summary of the tax implications of letting property
- in plain English!*

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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. Different rules apply to commercial lettings and furnished holiday accommodation and are not covered in this guide. 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 and is calculated each tax year from 6 April to 5 April. Income tax will be payable on property income, but the method of payment will depend on whether your property income is more than £2,500.

If gross (before expenses) property income for the tax year is £1,000 or less the income does not need to be declared as it is covered by the Property Allowance. Where net (after expenses) property income is between £1,000 and £2,500 you can telephone HMRC and they will collect the tax owed by adjusting your PAYE tax code. This means you pay the income tax owed via your salary or pension.

If net property income is above £2,500 you will need to register for, then submit a self-assessment tax return each year. In calculating your profit you are entitled to claim certain expenses against the income received. The rate of tax will be determined by the other income you receive in the year.

Allowable expenses

HM Revenue & Customs have rules regarding what expenses are allowable for tax purposes. They also expect you to keep records, including receipts, 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:

- Letting agents fees
- Mortgage interest (but see below)
- Repairs and maintenance (but not costs of improvements)
- Replacing domestic items such as: moveable furniture, furnishings, household appliances and kitchenware
- Insurance premiums for buildings and contents
- Council Tax and utility bills (gas, electricity and water) – although not if 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 45p per mile)
- Stationery costs (such as rent books, stamps etc)
- Other specific costs such as telephone calls and advertising

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 repair an improvement? As a rule of thumb if the expenditure is simply making good damage arising from the letting of the property or replacement to an equivalent modern standard, it should qualify as a repair and therefore 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. If a property is bought in a derelict or run down state the cost of putting it into a fit state for letting is likely to be capital rather than revenue in 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 contentious expenditure of this nature.

Mortgage Costs

Finance costs including mortgage interest, product and arrangement fees qualify for a tax credit of 20%. They are not deducted against rental receipts like the other qualifying expenses mentioned above. The tax credit is applied after your overall tax liability has been calculated. The capital element of mortgage repayments do not qualify for any form of tax relief.

Losses

If your deductible expenses exceed your total property income in any year then you have made a loss. This loss is carried forward to set against future available rental profits (from any property). Rental losses cannot be offset against any non-rental income and they cannot be carried back. If you sell your property or your property income ceases for any other reason, unrelieved losses are lost.

Non-resident landlords

If you live outside the UK you will still have to pay income tax on profits from rental properties. The Non-Resident Landlord Scheme requires your letting agent to deduct basic rate tax from the rent that is collected on your behalf. You can apply to HM Revenue & Customs for approval to receive your rental income without tax deduction. This is requested by submitting a form NRL1 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.

Jointly Owned Properties

There are special tax rules for jointly owned property for married couples and civil partners. The rules mean that you can't simply decide between yourselves how you want to be taxed or, for example, just give the rental income to the member of the couple with the lower income. The income must be split and taxed in equal shares (50:50).

In special circumstances a different split can be used. This is when the property is owned in unequal shares and so income is divided in the same proportion. HMRC must be advised of the split via Form 17 with supporting documentation.

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 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 2019/20 this is £12,000). 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 however 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. Some exemptions will apply if you have lived in the property yourself.

Different rules apply if a non-resident person sells UK residential property and specific advice should be sought as the disposal needs to be reported on a non-resident Capital Gains Tax return within 30 days of the sale.



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 CGT.
2. If there has been a period of residence at any time during the period of ownership, then the last nine months count as a period of residence.
3. There is also relief available if periods of absence are for job related reasons.
4. If the property was purchased before 31 March 1982 the original cost and capital improvements incurred before 31 March 1982 are replaced by the market value at that date.
5. If you have losses arising from previous capital transaction you can offset the loss against the gain.

Tax payment date

For disposals of residential property made after 6 April 2020 a separate Capital Gains Tax return and payment (if applicable) is due within 30 days. This means that CGT could be payable before the tax year has finished. Individuals will need to estimate their other income for the year to decide whether they will owe 18% or 28% tax, or a combination of the two.

The disposal will also be reported on the tax return for the relevant year, so that a disposal on 31 May 2020 will go on your 2020/21 Tax Return. If any further CGT is owed this will be payable on 31 January 2022. If CGT was originally overestimated this will be credited back to you when the personal tax return has been filed.

SEEK ADVICE: Capital gains tax can be very complicated. It is advisable to seek professional advice before you sell a 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.

Residential property does not qualify for any special inheritance tax relief.

Ownership of property can be varied 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.

STAMP DUTY LAND TAX

Additional Stamp Duty Land Tax (SDLT) of 3% is payable when you purchase a property to let out unless it will be the only property that you own. The SDLT bands do not change for such purposes, but the additional cost needs to be considered when you are considering investing in a property to let out. The base cost for CGT will include any SDLT paid on the purchase price.

SEEK ADVICE: If you are unsure whether the extra SDLT will be payable on your proposed purchase you should seek professional advice.

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.

this guide has been produced by:



Hugh Davies & Co.

35 CHEQUERS COURT
BROWN STREET, SALISBURY SP1 2AS
Telephone: 01722 336647
Email: hugh@hugh-davies.co.uk
Email: shirley@hugh-davies.co.uk
www.hugh-davies.co.uk

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