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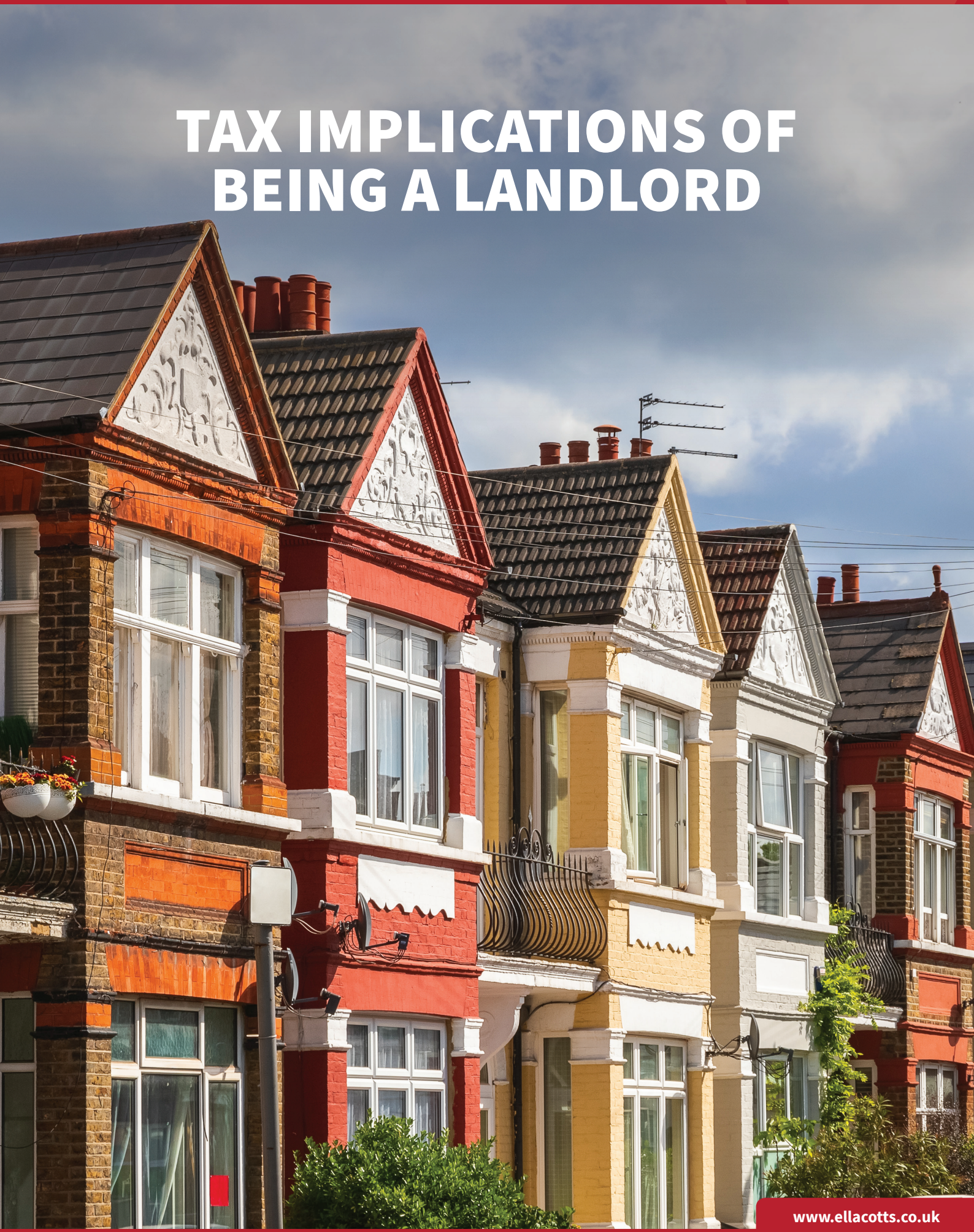
TAX IMPLICATIONS OF BEING A LANDLORD



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Tax Returns

If you receive rental income and incur related expenditure, you will need to complete a Self Assessment tax return and inform HM Revenue & Customs (HMRC). You are required to inform HMRC by 5 October following the end of the tax year (6 April to 5 April) in which you begin to rent out a property. Failure to do so can result in penalties.

If HMRC already issue you with a Self Assessment tax return then you must complete it and include the rental figures and appropriate expenditure on it.

What can I claim for?

With effect from 6 April 2017, a £1,000 tax free property allowance was introduced. There are a number of conditions in order to qualify for this, but it will essentially benefit those with rental income of less than £1,000. Where income exceeds £1,000 you can chose to either offset the £1,000 allowance and not claim expenses, or claim expenses. Claiming expenses would be beneficial if they are greater than the income so that a loss can be carried forward and set off against future rental profits.

In addition, there are different tax rules and considerations, depending on the type of property you are renting out and the rules will vary if you hold the property in a structure other than personal ownership, i.e. a company or trust. This document provides an overview of the general rules for property held by individuals. However, if you are a property owner then you should seek advice from a tax expert to ensure you are disclosing income and expenditure correctly and not overlooking any options to be more tax efficient.

The general types of property that people will own are as follows:

- Residential properties
- Renting a room out in your main residence
- Furnished holiday lettings
- Commercial properties

To give some guidance, the type of expenses that can be set against income include:

- Letting agents' fees
- Accountants' fees
- Buildings and contents insurance
- Legal fees for lets of less than a year, or for renewing a lease for less than 50 years
- Interest on property loans (subject to a restriction to basic rate tax relief for residential properties which will be fully phased in by 2020)
- General maintenance and repairs to the property but not improvements
- Water rates, Council Tax, electricity and gas
- Service charges, rents and ground rents
- Phone calls, stationery and advertising relating to the letting of the property
- Vehicle running expenses relating to the rental business (HMRCs approved mileage rate can be used instead of deducting actual running costs and claiming capital allowances)
- Services such as cleaning and gardening

Also included in the types of expenses that can be set against income is the cost to replace domestic items such as moveable furniture; sofas, tables, bed frames, furnishings; curtains, rugs, carpets, household appliances (fridges, freezers, washing machines, etc.) and kitchenware (utensils, crockery, cutlery etc.). The cost is not deductible on the first purchase but deductible when the replacement cost is incurred. It is restricted if the replacement is substantially different from the old item, however, items that are improved to meet new regulations, i.e. wooden windows replaced with UPVC windows are allowed with no restriction.

Fixtures are not domestic items and do not qualify for domestic item replacement relief. Fixtures are plant and machinery that are installed within a house and become part of it, i.e. a bath and toilet. A boiler or water system fitted into a house that is part of the system of the house would also be a fixture. Where these items are replaced in their entirety they would be deemed to be adding value and therefore capital, deductible against the future sale of the property. Where parts are replaced and maintained then this would be deemed a repair and the expense can be offset against rental income.

Capital allowances can also be considered for landlords operating a rental business and incurring certain capital items. This means they can receive tax relief to offset against the income over the useful life the asset.

Where expenses are capital in nature such as an extension or costs that create a substantial improvement and add value to a building, these may not be a deducted as an expense from rental profits but could be offset against the future sale, reducing the capital gains. It is therefore important to understand the difference between revenue and captial expenditure.

Furnished holiday letting

A furnished holiday letting is subject to different rules than other residential properties. The special regime means they have some tax advantages normally associated with trading properties, whilst profits are still treated as rental income. In order to qualify for these benefits there are a number of conditions that need to be met including; the number of days the property is available to the public, actually let and the property shouldn't be let for long periods of time. If you own a furnished holiday let or are considering acquiring one, you should ensure you understand the rules, benefits and conditions.

Other considerations

There are many other considerations with regards to property:

- Is the property held overseas?
- Was expenditure incurred pre-letting?
- Can property income be used when considering income levels for pension contributions?
- Do I pay Inheritance Tax on property?
- What are the impacts if property is used in one of my businesses?

Seeking advice is therefore key to ensure nothing is overlooked.

What do I need to keep?

You must keep records of all rental income and expenditure for a minimum of 5 years after the 31 January submission deadline of the relevant year. A penalty of up to £3,000 per year can be imposed if records are not kept. Records include rent books, receipts, invoices, bank statements and mileage logs.

A round-up of changes to property tax

Mortgage interest relief restriction

From 6 April 2017, the higher rate relief for interest on loans for residential properties is being restricted until it is completely removed by 2020. This affects all higher rate and additional rate taxpayers who receive rental income that have mortgages outstanding on them.

For a higher rate taxpayer, this will increase your annual tax bill by £4,000 for every £20,000 of interest paid, even if there is no rental profit made.

In addition, the way in which relief will be given from 2020 means that the interest is no longer offset as a deduction against rental profits, reducing your taxable income. It is a tax deduction that then reduces your tax liability. The impact of this is that the total income position will be increased and some perhaps unintended results could arise such as the loss of Child Benefit.

If you have rental properties you should therefore understand your increased tax bill and any other impact this change has.

Non-resident landlords and indirectly held UK property

From April 2015 non-resident individuals became subject to UK Capital Gains Tax on the sale of a residential property situated in the UK. Previously, as long as the individual was not a UK resident for 5 years after the sale of any UK asset, they were not subject to Capital Gains Tax.

This change was to promote fairness compared with UK landlords. The rules do provide the option of rebasing the cost of the property to the market value at April 2015, meaning any property purchased some time ago would benefit from an uplifted based cost.

The Capital Gains Tax rates for selling residential property is 18% and 28% as opposed to 10% and 20% for all other assets.

The rules were further extended and from April 2019 this legislation includes commercial property and indirect disposals of UK property such as the sale of shares in a company that owns UK property. Again, similar rebasing rules apply to the cost of commercial property and base cost of shares as at April 2019.

You must report any capital gains within 30 days of the conveyancing even if you already complete a UK Self Assessment tax return. This will be extended in 2020 for UK resident landlords also.

Jointly owned property

Do you own your property jointly with your spouse and, if so, do you know how this is held?

Most jointly owned properties are held as joint tenants where each of you own half of the whole of the property. Your share would then normally pass to your spouse on death and this would overwrite any differing instruction in your Will.

This might not be the best way to own rental property for a number of reasons. On death it can increase the survivors estate unnecessarily and generate higher Inheritance Tax bills and it can prevent you from sharing rental income in the most tax efficient way, i.e. if a couple share rental profits equally and one is a basic rate taxpayer and one is higher, it would be more beneficial to have more rents assessable on the lower rate taxpayer.

By reviewing how you hold property combined with your objectives and plans, other options can be explored.

Principle Private Residence and Letting Relief

Currently, if you let a residential property you have once lived in and decide to sell it, you could benefit from up to £40,000 Letting Relief (£80,000 if joint owners and you both lived in the property), to reduce your taxable gain. This has been a valuable relief for many years, and is especially helpful to those couples who each had their own home and then move into one and rent the other.

However, from April 2020 you will only be able to claim Letting Relief if you are still living in the property at the time of letting. This could make a significant impact for landlords who have banked on this relief reducing their Capital Gains Tax exposure. Many people may consider selling such property before these rules come into effect.

In addition, current rules that mean the last 18 months of ownership of a main residence are deemed to be exempt from Capital Gains Tax, even if you did not live in the property during this time, are being reduced to 9 months at the same time.

If you rent out a room in your main home then there are separate rules which provide tax relief of up to £7,500 and these should be explored to optimise your tax position.

If you let out a property that was your main home then it is worth reviewing your entitlement to these reliefs now before it is too late.

Sam Hubbard – My Mortgage Experts
"Ellacotts helps my clients, advising them in the best way to manage their properties in a tax efficient manner. Ellacotts offers bespoke tax planning helping property owners make the most of relevant tax reliefs and ensuring that they are kept up to date and compliant with changes to property tax."

Meet some of our team

You will have key contacts in our team available to answer queries and develop strategies.

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