

## **A short tax guide for property owners**

***Disclaimer***

*This report is intended to give a broad outline of the subject. It does not attempt to cover such matters as the various anti-avoidance rules that may apply to any particular set of circumstances. Specific advice should be obtained on any proposed transaction. Kirkpatrick and Hopes accepts no liability unless specific advice has been requested and given in respect of any transaction undertaken based on the advice given in this report.*

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## **Paying tax on a buy to let property**

### **What you need to know about tax**

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## **Paying tax on a buy to let property**

### **What you need to know about tax**

#### **Introduction**

This short guide is to help you pay the correct amount of tax on your rental income.

It covers the taxation of the following property:

- Renting a furnished house
- Renting an unfurnished house
- Renting rooms in the house you live in
- Renting a furnished holiday property

It is not intended to be and cannot be treated as a substitute for proper professional advice.

This guide gives an overview of the tax rules for property owners, but for professional advice on your own circumstances please contact

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## **Paying tax on a buy to let property**

### **What you need to know about tax**

#### **Renting a furnished house or flat**

**What is a furnished property?** Surprisingly, in the Taxes Act there is no legal definition of what constitutes a furnished property.

The HM Revenue and Customs' published guidance says that 'sufficient furniture must be provided for normal occupation'.

This means that the tenant can happily live in the property without providing his own furniture.

**How are tax bills calculated?** Tax is paid based on the profit you make from letting the house.

It is calculated annually on a tax year basis.

The tax year runs from 6 April until the following 5 April. For example, the 2009/10 tax year starts on 6 April 2009 and ends on 5 April 2010.

The amount of taxable rental income is arrived at by deducting your allowable rental expenses from your rental income.

You are taxed on the amount of income receivable in the tax year even if the rent was paid late. This means that if a tenant falls into arrears and does not pay the rent due in March 2010 until July 2010 the income is taxed during the 2009/10 tax year and not 2010/11.

The same rule applies to letting expenses.

**How much tax will I pay on my rental income?** This will depend on the extent of your other income during the tax year. If you are a basic rate taxpayer then you will pay tax at 20% on your rental income. Higher rate taxpayers will pay 40% tax on their rental income and possibly 50% from 5 April 2010.

**How do I declare my rental income to HM Revenue and Customs?** You will need to complete an annual tax return to declare this income. You will incur financial penalties if you do not do this. Additional penalties apply if you do not pay your tax on time.

If you do not receive a tax return, you **must** tell HM Revenue and Customs and they will send you one.

We complete your annual tax return as part of our annual tax services for property owners. We calculate how much tax you have to pay and tell you when you have to pay it.

**What records should I keep?** You must keep a careful note of the rents you receive and any expenses as they arise.

You must retain these records, together with back-up records, such as receipts and invoices, for six years after the tax year in question. These will help you if your HM Revenue and Customs office decides to make enquiries into your tax return.

We can help you implement a simple book keeping system to help you with this.

**What expenses can I claim?** The most common allowable expenses are:

- gas and electricity (although in most tenancy agreements the tenant is responsible for paying all the bills when living in the property)
- insurance premiums for buildings and contents
- maintenance and repair costs, but not the costs of improvements
- water rates
- rent, if you do not own the property
- the fees an agent charges to let your house for you
- cleaning
- gardening
- council tax
- accountancy fees for preparing your letting accounts
- ground rent and service charges for flats
- costs of travelling to inspect the property during and after the tenancy. The easiest way to do this is to charge a mileage rate of 40p per mile
- costs of stationery such as rent books, letterheads, stamps etc
- interest paid on a loan to purchase or improve the property

**What about the cost of furniture and white goods?** You cannot deduct the cost of these items in your rental accounts but there is a special tax relief to allow for this.

It is called 'wear and tear' and you may claim 10% of the gross rents (less council tax and water rates) each year as a wear and tear deduction to cover the cost of replacement furniture

### **What if these expenses are incurred before I start to let the property?**

You may be able to claim relief for these if they:

- Are incurred in the period beginning seven years before the date you started the letting

### **And**

- The expenses would have been allowable if you had already started the letting. This means you cannot claim for the cost of furniture and for costs that are 'capital'

The tax relief is given by treating the expenses as though they were incurred during the first year of the letting.

This can be a complicated area and we always suggest you ask us about costs incurred before the property is let.

**What about if I replace single glazing with double-glazing, is it an improvement or a repair?** In the past HM Revenue and Customs have treated this as a capital improvement which meant that you could not claim these costs as an expense in your rental accounts.

This no longer applies - HM Revenue and Customs accepts that replacing single glazing with double-glazing is a repair.

**What about if I replace the kitchen or bathroom, is it an improvement or a repair?** This depends on the replacement. For example replacing old units for new is accepted as being a repair provided that:

- you do not increase the number of units

### **And**

- the new units are of a similar standard of quality as the old units.

This means that you can claim these costs as a repair cost in your letting accounts. You will obtain income tax relief for these costs.

The costs are treated as improvement expenditure if:

- you have increased the number of units

**Or**

- if the overall standard of the kitchen has been improved, such as replacing laminate worktops with granite

This means that the costs cannot be claimed as an allowable expense in your letting accounts. You will not obtain income tax relief for these costs.

Similar rules would apply to a bathroom.

To avoid any nasty surprises please talk to us about your plans **before** you spend money updating a kitchen or bathroom.

**What expenses are not claimable?** The most common expenses that are not claimable are as follows:

- any costs associated with buying and selling the property such as stamp duty and legal costs.
- improvements to the property such as extensions
- life assurance payments

**What happens if my expenses exceed my income? Can I claim the loss against my other non-rental income?** The short answer is no, but you can offset losses from one rental property against profits from another in the same year.

Any unused rental income losses from a tax year can be carried forward to set against rental income profits in a future tax year.

Different rules apply to the letting of furnished holiday accommodation. Please refer to the relevant section of this report.

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#### **Renting an unfurnished house or flat**

Exactly the same rules apply to letting an unfurnished property as to letting a furnished property, (See text above), with the exception that you do not receive the 10% wear and tear allowance if you let an unfurnished property.



## **Paying tax on a buy to let property**

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#### **Non-Resident Landlords**

**What if I live abroad?** You still have to pay income tax on the rent you receive if you let your property in the United Kingdom (UK) while you live abroad.

Your letting agent, or your tenant where there is no letting agent, must deduct tax from your rental income and pay that tax to HM Revenue and Customs.

You can then offset that tax against your personal tax bill when you complete your tax return.

The deduction of tax will not apply

- where there is no agent and the rent paid is less than £100 a week, unless the tenant has been told to deduct tax by HM Revenue and Customs
- where HM Revenue and Customs has issued a notice confirming that rents may be paid without deduction

You can apply to receive rental income without deduction of tax on the grounds that

- you do not expect to be liable to UK tax for the year in which you make your application,

**Or**

- your UK tax affairs are up-to-date.

Your application includes an undertaking that you will meet your UK tax obligations, including sending in Self Assessment Tax Returns and paying any tax due on time.

## **Paying tax on a buy to let property**

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#### **Capital Gains Tax**

**What tax will I pay when I sell my rented property?** You will pay Capital Gains Tax on any profit made when you sell your rented property.

**How much tax will I pay?** The amount of tax you will pay depends on a number of factors including:

- the amount of profit you make on the sale
- whether you have any Capital Gains Tax losses to set against the gain
- whether you can set your annual Capital Gains Tax exemption (currently £10,100) against the gain
- whether you pay tax at basic or higher rates. If you are a basic rate taxpayer, you will pay tax at the rate of 18% on the taxable gain.
- whether you lived in the property at some stage during your period of ownership

**What special tax reliefs apply when you sell a rented property?** A rented property is treated as a non-business asset for Capital Gains Tax purposes.

**When is the Capital Gains Tax payable?** Capital Gains Tax is payable on 31 January following the tax year in which you make the capital gain.

For example if you sell a let property during the tax year ended 5 April 2010 (i.e. between 6 April 2009 and 5 April 2010) the tax is payable on 31 January 2011.

## **Paying Tax on a Buy to Let Property**

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#### **Inheritance tax**

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

It does not qualify for a special Inheritance tax relief.

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## Paying Tax on a Buy to Let Property

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#### Renting part of the house you live in

**Will I have to pay tax?** This will depend on:

- whether you are within the Rent a Room exemption scheme

**Or**

- whether your taxable income for any year, including any profit from letting, is more than your personal tax allowances

**Rent a Room** The Rent a Room scheme has special rules that usually apply when you take in a lodger.

Under the scheme, a certain amount of gross (that is, before expenses) income can be received tax-free from letting a room or rooms in the house you live in.

This tax-free amount is £4,250 per tax year.

You do not have to take part in the scheme if it is not to your advantage. Instead, you simply declare all your letting income and claim expenses as mentioned earlier.

**Do the rules mean I do not have to pay tax on the rent I get?** As long as the total rent you get during the tax year is no more than £4,250, you do not have to pay tax on that income.

If you do not receive a tax return and you receive rent of £4,250 a year or less, you do not need to tell the tax office about this income.

**What happens if the rent is more than £4,250?** In that case, you can choose between:

- Paying tax on the profit you make from letting the room, worked out in the normal way, (see above)

**Or**

- Paying tax on the amount of rent over £4,250

**Will I have to pay capital gains tax when I sell my home?** The Rent a Room scheme makes no difference to the capital gains tax rules that apply when you sell your home.

**Seek Advice** Please contact us if you would like help with calculating your Capital Gains Tax bill in these circumstances.

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## **Paying tax on a buy to let property**

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#### **Furnished Holiday Lettings**

There are many tax benefits of buying a furnished holiday property as opposed to a furnished or unfurnished let.

**How does a property qualify as furnished holiday accommodation?** To qualify as a holiday letting a property must meet **all** of the following conditions:

- it must be let furnished
- it must be available for letting for 140 days in a 12 month period
- it must be actually let for 70 of those days
- the same person must not occupy it for more than 31 consecutive days during 7 months of the same 12 month period.

**What are the Income Tax benefits?** The Income Tax benefits of a holiday letting are as follows:

- losses can be set against your other non-rental income. Losses from a buy to let for example cannot be used in this way.
- income is regarded as earned and can be used for the purposes of calculating a personal pension premium
- capital allowances is claimed instead of the wear and tear allowance. This means that currently furniture expenditure of up to £50,000 a year may be fully claimable against taxable profits. This is called the annual investment allowance.

The good news does not stop there. There are also Capital Gains Tax savings.

**What are the Capital Gains Tax savings?** The Capital Gains tax savings of a holiday letting are as follows:

- rollover relief is available. This means you can defer a tax bill by investing the proceeds from a sale of a furnished holiday letting into another holiday letting or business asset
- you can give away a furnished holiday let and avoid a Capital Gains Tax bill by claiming a special tax relief called holdover relief

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- the property qualifies for Entrepreneurs Relief Business Asset Taper Relief. This means that you only pay 10% Capital Gains Tax if you sell a qualifying property owned for at least two years.

**How about Inheritance tax?** We have researched the Inheritance Tax consequences of owning a furnished holiday letting. Set out below in italics is a direct quote from HM Revenue and Customs' own instruction manuals.

*The Revenue solicitor has advised the Office that in some instances the distinction between a business of furnished holiday lettings and, say, a business running a hotel or motel may be so minimal that the courts would not regard such a business as one of 'wholly or mainly holding investments' for the purposes of IHTA 1984 s105(3).*

*You should normally allow (business property) relief where:*

- *The lettings are short term (for example weekly or fortnightly);*
- *The owner – either himself or through an agent such as a relative or housekeeper, was substantially involved with the holidaymaker(s) in terms of their activities on and from the premises even if the lettings were for part of the year only.*

**This means a holiday letting property qualifies for 100% exemption from Inheritance Tax.**

## **BUT**

These are the current rules for letting a holiday property. They will only apply to 5 April 2010.

This is because the UK government only applied the holiday letting rules to UK properties and not to properties held in other EU states.

This means that the revenue have stated that they intend repealing the special rules applying to holiday lettings from 6 April 2010. Although this was stated in the notes accompanying the April 2009 the new rules did not appear in the final finance act. Assuming that the rules become law the changes will be as follows:

1. Holiday lettings will be taxed in the same way as furnished property for income tax purposes
2. Losses from holiday property income cannot be set against other income
3. Income from holiday lettings will not count as income for pension contribution purposes.
4. There will be no need to let the property for a set period of time.
5. Owners will claim a 10% wear and tear allowance of gross rents each year as opposed to claiming capital allowances.
6. The beneficial inheritance treatment will be abolished holiday properties will be included as part of your estate.
7. The beneficial capital gains treatment will disappear. All profits from the sale of a property will be taxable at 18%. You will be unable to defer paying tax on the sale of one by property by reinvesting into another property. You will not be able to gift without paying capital gains tax.



## **Paying tax on a buy to let Property**

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#### **Action points**

- tell the tax office as soon as you have purchased your let property.
- make sure you keep proper records
- make sure you send in your tax returns in on time
- make sure you pay all tax on time
- review your current position if you let holiday properties