WSM PRIVATE CLIENT

# RESIDENTIAL LANDLORDS
## TAX INFORMATION

The following notes are intended to provide a useful background for investors buying and letting individual residential properties. Independent advice, tailored to your specific needs and circumstances is essential and these notes should be used as general guidance only.

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# General Considerations Before Buying

## Investment or Trade

The tax treatment of your purchase is determined by your future intentions for the property. If bought for letting, generally the property will be regarded by HMRC as an investment. If the intention is development and sale, it will be regarded as a trading activity. If treated as an investment property, any profits on disposal are taxed under Capital Gains Tax (CGT) regime.

## How to Hold Property

Many landlords buy in their own name but Partnerships, Limited Liability Partnerships, Limited Liability Companies and trusts are all useful vehicles. Proper planning is essential before you buy your property as this could have a significant impact on your total taxes both in terms of the annual income tax and capital gains tax on disposal.

Even if you are an existing landlord, you should consider how your business is structured, it is often not too late to implement changes to reduce tax exposure.

## Capital Expenditure

Expenditure on repairs to bring a newly purchased un-lettable property up to a rentable condition is regarded by HMRC as capital expenditure; so if you are planning to buy and refurbish, do not assume that the expenditure will make your rental income free of tax for a few years: it may not!

## Restrictions of loan interest relief from April 2017

Gearing up a property purchase is a common feature of this asset class and can make an investment more tax efficient. Mortgage interest is often the largest expenditure and can help to eliminate tax liabilities on rental income. It can also be tax efficient to re-mortgage following periods of capital growth. Interest relief will normally continue to be allowable on the additional loan, subject to certain restrictions.

However, it was announced in the July 2015 Budget that mortgage interest relief (and finance costs) is to be restricted to the basic rate of tax. This is a significant change for landlords and to ease the full impact of the proposed change, the measure is to be phased in starting from April 2017 (2017/18 tax year), with full implementation in the 2020/2021 tax year. In light of this significant change, investors need to review their strategy as they will be exposed to higher taxes. This change affects all landlords (including basic rate tax payers) as relief will be given as a tax deduction, not as an allowable expense.

# Tax Issues at the Time of Purchase

## Stamp Duty Land Tax (SDLT) - 3% Increased Rates for Landlords

SDLT is payable on the purchase or transfer of property or land in the UK, at rates ranging from 0% to 12% for residential property and from 0% to 5% for commercial property.

Confirmed in the March 2016 Budget, from 1 April 2016 the rates charged on purchase of additional residential property (second homes or buy to let properties) will be 3% above the current SDLT rates on purchases over £40,000, so ranging from 3% to 15%.

For companies, each purchase of a residential dwelling will be subject to higher rates.


*For full details of SDLT bands and other tax rates download our free WSM Tax App for iPhone, iPad, Android and Blackberry*

## Value Added Tax (VAT) on Professional Fees

VAT is charged on all professional fees at the standard rate (currently 20%) and this will include fees for your surveyor, valuer, estate agent, lawyer and accountant. VAT incurred on these costs cannot be claimed back from HMRC.

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# Tax Issues During the Period of Ownership

## Advising HMRC

If you do not already submit a self assessment tax return, you have to notify HMRC if you receive rent in excess of £10,000 or your rent after expenses exceeds £2,500 in a tax year. Even if your rental income is below these limits you should notify HMRC if you owe tax on your rental income or you wish to claim a tax loss. If you already submit an annual tax return you should include your property income and expenses on the return each year.

## Record Keeping

Proper record keeping is essential. HMRC requires property letting to be treated like a business, and income and expenditure should be recorded appropriately and details kept for six years. Records of the purchase and any capital expenditure should always be kept for at least three years after the property is sold.

## Income Tax/Corporation Tax on Profits

Tax is charged each year on the net rental profit generated from the property. The profits are calculated at the end of each year and the accounts showing the rental income less expenses should be prepared on an accruals basis in line with UK Generally Accepted Accounting Principles (GAAP).

Rental profits are added to other income during the tax year and are taxed at the individual or corporate marginal rate of tax applicable.

## Allowable expenses

All expenses incurred (other than capital items) wholly and exclusively on the rental business are allowed against the rental income when calculating the taxable profits. The wholly and exclusively requirement sometimes causes difficulty and professional advice may be required; indeed there is a variety of case law surrounding the definition. The expenses that can be claimed are typically, but not exclusively letting and management fees; maintenance and repairs; building service charges; ground rents; insurance and mortgage interest.

## Replacement Furniture Relief - A New System

The previous generous wear and tear 10% allowance for fully furnished properties has been abolished and replaced by RFR. Under the new system, tax relief will be given for the actual replacement cost of furnishings. These will include moveable furniture, furnishings such as carpets, curtains, household appliances such as fridges and freezers, televisions etc.

Items must be provided solely for the use of the tenant within the residential property. This is bad news for many landlords as the change will result in higher profits and hence, higher tax liability as the previous wear and tear allowance was more favourable.

## Council Tax

The tax is usually only paid by the landlord if the property is empty, otherwise it is normally the responsibility of the tenant occupying the property.

## Rent a Room Relief

Rent a room relief can relieve income up to £7,500 from April 2016 (previously £4,250) each year tax free for letting of a room in your home, but sometimes such a claim is not advantageous as no deductions for allowable expenses can be made where this relief is claimed.

## Tax Losses

Where the computation of rental income and expenditure for the property portfolio produces a tax loss, the loss can be carried forward and set off against profits from the property portfolio in subsequent years.

# Tax Issues on Disposal

## Capital Gains Tax

Tax is charged on the increase in the capital value of your investment property. In calculating the gain, the rules allow the deduction of the original purchase price, SDLT and other purchase costs, capital improvements during the period of ownership and selling expenses from the sales proceeds. The resulting gain is the chargeable gain.

Currently, CGT is payable on 31 January following the end of tax year, which may be up to 22 months after the date of disposal, giving landlords the cash flow advantage of funds. However from 2019, taxpayers will be required to make a payment on account of any CGT due on disposal within 30 days of completion. This is subject to review.

## Annual CGT Allowance

Each individual owner of the building is entitled to deduct, from their portion of the chargeable gain, an annual exempt amount which is £11,100 for both the 2015/16 and 2016/17 tax year.

## Indexation Allowance

A corporate owner of an investment property is liable to pay corporation tax on the chargeable gain. Companies do not get an annual exempt allowance. However, companies are entitled to deduct an indexation allowance from the chargeable gain to remove the eroding effects of inflation from the gain. The indexation allowance is based on published monthly RPI movements.

## Principal Private Residence Relief

If you sell your own home, you usually do not have to pay tax on any gain you make. This is known as Principle Private Residence (PPR) relief. If a rental property has at some time been occupied by you as your main residence, you may be able to take advantage of PPR to reduce, or even eliminate the taxable gain arising on disposal. The gain arising is time apportioned between the period of owner occupation (exempt) and the letting period (taxable).

## 18 Months Rule and Letting Exemption

When a property has qualified as your main residence, the last 18 months of ownership are usually also entitled to exemption from CGT, even if the property is let out during this period. In addition, lettings relief of up to £40,000 per owner may be available; so where the property is jointly owned by two persons, the lettings relief can exempt a further £80,000 (£40k x 2) of gain - so long as various other criteria are met.

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# Tax Issues: Special Circumstances

## Furnished Holiday Lettings

Special legislation exists for properties in the UK and the European Economic Area (EEA) that are used to provide commercial furnished holiday lettings. This provides certain tax advantages including some CGT reliefs (ie. business asset roll-over relief and entrepreneur's relief).

To qualify for this tax treatment, various conditions must be met. They include strict rules on the commerciality of the letting and availability of accommodation during the year.

## Non-UK Resident Investors/Landlords

Non resident investors who own an investment property in the UK will be treated as carrying on a UK property business. Income tax is applicable on the rental profits and specific rules are applicable.

Letting agents and/or tenants are required to withhold tax at the basic rate and account this to HMRC, unless successful registration has been made to formally register as a non resident landlord and to receive rent without any tax deduction.

## Removal of CGT Exemption for Foreign Investors in UK Residential Property

The major change in this area came into effect for disposals after 5 April 2015. Generally, an individual who is resident in the UK for tax purposes, is chargeable on his or her worldwide income and capital gains.

Prior to 5 April 2015, non residents could dispose of UK residential property without fear of UK CGT. It is important to note that only gains arising after 5 April 2015 will be liable for the new change. Taxpayers can choose between using the property's 6 April 2015 value as a base cost or applying a time apportionment of the entire gain. The most favourable method will not be apparent until the property is sold, which may be years away and it would be advisable for non residents to obtain a 6 April 2015 valuation for future use while evidence is easily available.

The rate of tax for non resident individuals will be the same as the CGT rates for UK resident individuals: currently 18% or 28% depending on the total UK income and chargeable gains in the tax year.

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uk tax specialists

Here at WSM, we have in depth knowledge and experience in dealing with this complex area and are able to provide practical tax planning solutions. We have many "landlord/investor" clients. Many of them are non UK residents and we have enormous practical experience in dealing with the additional complications caused by this, such as registering under the non resident landlord scheme. Indeed our experience covers the widest range of property tax issues to minimise tax, from initial buying strategies right through to disposal.



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Shakeel trained and qualified with a Central London firm and is a fellow of the Association of Chartered Certified Accountants. Shakeel has over 25 years of hands-on experience and is able to advise on a wide range of accountancy, taxation and business related issues.

**Specialities**

- **Tax planning advice for resident and non-resident property investors**
- **Personal, corporate and capital gains tax compliance and planning**
- **Personal, business advisory and consultancy services**
- **Tax mitigation strategies**

"My approach is to understand fully my client's needs and requirements. I help to organise their affairs accordingly and build a good working relationship to achieve their goals. Successful clients become profitable and need tax planning to mitigate their liabilities. With over 25 years experience, I am able to offer effective tax strategies to achieve these ends."