



BUY TO LET GUIDE

204 Mauldeth Road
Burnage
Manchester
M19 1AJ

Tel: 0161 432 1238
Fax: 0161 432 2127

E-mail: info@purcell-co.com
Website: www.purcell-co.com

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KEEPING YOU UP TO DATE AND INFORMED

Buy-to-let: the basics

Why become a landlord?

You may decide to become a landlord when you inherit a house, or when you move and let your former home. There is an attractive tax incentive for letting a former home (see Former home), but you need to pay a supplementary 3% land tax charge when you acquire a second home without disposing of the first property (see Acquisition). This also applies when you buy residential property in the UK in order to let it, if you already have a home.

An investment in let property can create a second income stream for you or your spouse or civil partner (see Joint owners). Some people hold property to provide an alternative fund for retirement and let the property in the meantime.

In this brief guide we look at the pros and cons of letting out residential property in the UK, including furnished holiday accommodation. We do not cover the letting of commercial properties in this guide but we are happy to advise on that area of investment on an individual basis.

Acquisition

If you buy a second home worth £40,000 or more, which is not a replacement for your main home, you must pay a land tax supplement of 3% on the entire purchase price. This will be charged as Stamp Duty Land Tax (SDLT) in England and Northern Ireland, Land And Buildings Transaction Tax (LBTT) in Scotland and, from 1 April 2018, Land Transaction Tax (LTT) in Wales.

For example, a main home purchased in England for £250,000 will incur an SDLT charge of £2,500, but when it is purchased as a second home or to let out (without disposing of an existing main residence) the SDLT charge will be £10,000.

The 3% SDLT supplement has to be paid by any company which purchases a residential property worth over £40,000. A company may have to pay SDLT at 15% when it buys residential property worth over £500,000 which it does not intend to use for a commercial or charitable purpose. In addition, where a company holds a residential property located anywhere in the UK, which is not commercially let to an unconnected tenant, or acquired for development, it may have to pay the Annual Charge on Enveloped Dwellings (ATED). This charge for 2018/19 starts from £3,600 per year for properties worth over £500,000 on 1 April 2017, or on acquisition if later.

What are you taxed on?

The amount of tax you pay depends on whether you hold the property as an individual, jointly, or through a company (see How to hold your property).

As an individual landlord you must pay income tax on your 'property income'. This is the sum of the rents you receive less the tax deductible costs (see Tax-allowable expenditure). Property income does not include the profit you make when you sell the property, and it doesn't take into account the costs of buying, selling or improving the property.

All of the income you receive from letting property in the UK, both residential and commercial, is combined and taxed as one property investment business. A loss on one property can be relieved against profits made from another in the same tax year or in later years. Overseas property and furnished holiday lets are treated as separate businesses.

Deposits collected from tenants are not part of your property income unless they become non-returnable under the tenancy agreement. You should only include the retained deposit in your property business accounts when the funds are used to cover the costs the deposit was designed to pay for, such as renewal of furniture, repairs or legal fees.



Start

Your property letting business commences when you have acquired your first property and it is available for letting. This means the property is in a condition where it can be let, subject to cleaning, furnishing and drawing up letting agreements. If the property is in such a poor state that it cannot be let, it can't be treated as part of your property letting business. The expenses connected with renovating a property to bring it into a habitable condition are not immediately deductible (see Capital costs).

Expenses incurred before you start the lettings business, such as advertising or minor repairs, can be deducted from the rents you receive in the first tax year if:

- the expenses are classified as revenue costs rather than capital
- the costs are incurred within seven years of start of the property letting business

Once your property letting business has started, any later expenditure leading up to the letting of the second and subsequent properties is part of your lettings business and can be deducted, as long as it qualifies as tax deductible.

End

Your property letting business finishes when you no longer have any properties available for rent, and you are not looking for tenants. This may be because you have decided to occupy the last property yourself, or you are keeping the property empty prior to sale.

You can't deduct any revenue expenses which are incurred after the last property has been withdrawn from the lettings market. Thus, the costs of sprucing-up the property post-letting but pre-sale are not tax deductible.

How to hold your property

Single individual

If you hold the let properties in your own name, you will be taxed on the income and gains arising from those properties. You can't transfer the income before tax to another person without first transferring an interest in the property to that person.

You should declare all of the income and expenses from your let properties in the property income section of your personal self-assessment tax return. If you make a loss from the letting, you need to declare that loss on your tax return so it can be deducted from profits you make from lettings in a later period.

Overseas properties

If you let properties which are situated overseas, the income and expenses from those properties must be shown on the foreign income section of your tax return. Profits or losses from overseas properties need to be calculated separately from those arising from UK properties.

Joint owners

Where a let property is held in the joint names of a married couple or civil partners it can provide a useful income stream where one of the couple has little or no other income.

In England and Wales you can own a property as joint tenants; where both owners hold an equal interest in the whole property; or as tenants in common, where each owner holds a separate and identifiable share, say 10% and 90% of the property. There are different rules for properties located in other countries, including Scotland.

When a legally joined couple (married or civil partners) own property as joint tenants, any income from that property must be split equally between them for tax purposes and declared as such on each person's tax return.

If the same couple hold the property as tenants-in-common in unequal shares, they can make a declaration on HMRC's Form 17 to have the property income taxed in the proportion that reflects each partner's beneficial interest in the property. Without the Form 17 declaration the couple will each be taxed on an equal share of the income from the property. The Form 17 election is not reversible, so once you have elected to be taxed on your actual share that's it, unless your beneficial interest in the property changes.

Where the joint owners of a property are not married or in a civil partnership, they can agree to share the income from the property in whatever ratio they choose, although this profit-sharing ratio would normally reflect the underlying beneficial ownership of the property.

If you want to split the property income in unequal shares, instruct your solicitor to acquire the property as tenants-in-common in the ratio of ownership desired. Where you already own the property as joint tenants it is quite simple to change to tenants-in-common, but there can be a land tax charge where the property is mortgaged.

When the property is sold, any capital gain arising must be split according to the beneficial ownership of each owner.

Limited company

There are tax advantages to running a property letting business through a limited company, as the company pays tax at 19% on its income and capital gains. Also, unlike individuals, companies do not suffer a restriction on the deduction of interest and finance charges (see Interest restriction).

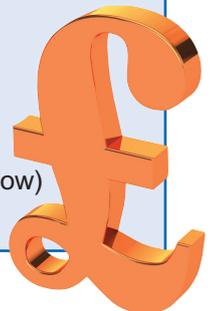
In comparison, individuals pay income tax at rates of up to 45% and Capital Gains Tax (CGT) on gains from residential property at 18% or 28%. However, there may be further significant tax and National Insurance charges when you extract funds from your company.

If you already own a company which holds surplus funds, investing in buy-to-let property can make commercial sense, provided the company can secure a mortgage for the balance of the purchase price. However, where the trade may become overshadowed by the value of the properties it holds, it may no longer be classified as a 'trading' company, which means it is no longer eligible for a number of tax reliefs, including entrepreneurs' relief.

Tax-allowable expenditure

Allowable revenue expenses can include:

- accountancy fees for drawing up the property business accounts
- advertising for tenants
- ground rent and service charges for leased property
- heating and lighting costs
- insurance for the buildings and contents
- interest paid (see below)
- legal fees for drawing up tenancy agreements or collecting debts, but not those connected with acquiring properties
- letting or managing agents' fees
- maintenance and repairs
- motor expenses for travelling to the property
- replacement of furnishings (see below)
- water charges and council tax



Not all expenses associated with letting a property are deductible from the rental income for tax purposes, so you need to sort your expenses into categories. Start by dividing them into the 'capital' costs connected with buying, selling or improving your properties, and other costs which reoccur as the tenants change – known as revenue expenses.

From 6 April 2017, landlords with rental income not exceeding £150,000 are expected to account for income and expenditure on a cash basis. This means deducting allowable revenue expenses paid from the rents actually received in the tax year. You can opt out of the cash basis and use normal accruals accounting if you wish.

A list of common allowable revenue expenses is given in the box on previous page – ask us about any other costs you have incurred that don't fall under one of those headings, as they may be deductible. If your tenant is responsible for paying some expenses – such as energy and council tax bills – you can't also claim a deduction for those items.

Interest paid

All the interest paid on all loans used to finance your property letting business is potentially deductible (but see Interest restriction, below). It doesn't matter whether the money borrowed was used to purchase the property, improve it, or pay for a repair – the interest is deductible, as is any loan arrangement fee, or similar finance charges.

If you extend the mortgage on your own home to release funds to help to finance your property letting business, you can set off the interest (subject to restrictions) paid on the extended portion of the mortgage against the rents received from the let property. However, to show HMRC where the capital has come from you need to include a balance sheet for your property letting business with your tax return. We can help you with that.

Interest restriction

The interest and finance charges paid by individual landlords are restricted as follows:

Tax year	Amount of interest deductible
2017/18	75%
2018/19	50%
2019/20	25%
2020/21 and later	Nil

Up to 20% of the disallowed interest is deducted from the tax due on the rental income. Where this interest deduction exceeds the tax charge for the year, the excess amount is carried forward to be relieved against tax payable on the profits from the property letting business in a future tax year.

This effectively gives the landlord tax relief for the interest at 20%, which is equivalent to the basic rate of income tax. Corporate landlords do not suffer a restriction on interest deductions; neither do landlords of furnished holiday lettings (provided various conditions are met).

Where you have significant loans connected to your property letting business, we can help you calculate whether that level of borrowing will be sustainable in future years.

Repairs

The cost of repairs is always deductible from rental income, but the cost of improving a property is a capital cost which is not immediately deductible (see Capital costs). The difference between a repair and an improvement is: a repair restores what was originally there without adding new functionality – everything else is a capital improvement.

Example

Refurbishing a kitchen will count as a repair if the new kitchen is of a similar standard to the one it replaces. HMRC will accept the following as repairs: rewiring, plastering, tiling and replacement of fixed fittings such as sink and cooker. If the kitchen is substantially upgraded by, say, increasing the size or by using higher quality materials, the whole project cost should be treated as a capital improvement.

You can't apportion the cost of a project between improvement and repairs. If the work done will fall into both headings, ask the builder to quote and bill for each piece of work separately.

Example

Fred has a new bathroom fitted where one didn't exist before, and at the same time redecorates the adjoining bedroom. The new bathroom is an improvement, as it is a new feature added to the house. The redecoration is a repair. Fred asks his builder to give him separate bills for the new bathroom and bedroom. He claims the cost of decorating the bedroom against rental income and treats the bathroom cost as a capital improvement.

Capital costs

Any capital costs, such as improvements, can only be deducted from the sale proceeds of the property. You need to keep track of which capital expenses relate to which let property and retain all the relevant receipts and contracts.

Furnishings

From 6 April 2016, you can deduct the actual cost of replacing furnishings in your let property. This covers the cost of replacing items such as carpets, curtains and free-standing white goods, but not the initial cost of those items.

The cost of replacing items that are fixed to the property should be claimed as repairs (see above).

Record keeping

Landlords must keep adequate records to enable them to calculate their profits or losses accurately, without recourse to estimates. You should retain a record of every relevant expense. HMRC accept scanned copies of documents. Deposits will relate to individual tenancies, so details of the start and finish dates of each tenancy should be recorded.

Note down details of any personal assets you use for the letting business, such as the date and distance of car journeys, or the time spent on administration at your own home.

All the records relating to your property business must be kept for at least five years after the submission date for the tax return in which you reported that the property was let or sold, in case HMRC ask about those figures. So documents relating to the tax year to 5 April 2017 should be retained until 31 January 2023.

Holiday lettings

If you let your furnished property for short-term lets (each less than a month) it could qualify as a Furnished Holiday Letting (FHL). This has a number of tax advantages.

Conditions

The property doesn't have to be in a recognised holiday centre; it can be situated in any part of the UK or even in another European country. However, it must be let to the general public (not just to family and friends) on a commercial basis for short lets totalling 105 days or more in the year, and be available for short-term lets for at least 210 days in the year. For the remaining five months of the year it can be let for longer periods. The 105 day total can be averaged over a number of properties and skipped for a year or two, if the other conditions apply.

Tax effects

The profits and losses for an FHL business are calculated in a similar way to those for an ordinary lettings business, but your total costs may be higher as the turnover of tenants is more frequent. One difference in the calculation is that you can claim capital allowances on equipment and furnishings used in and around the property, rather than the 'renewals' basis. Thus, the initial purchase of items such as a fridge can qualify for a tax deduction, usually in the year of purchase.

Your profits are treated as earnings for pension contributions, but losses can only be set against other FHL profits.

Depending on your turnover, you may also have to register for VAT, as holiday lettings are subject to standard rate VAT, whereas normal residential letting is exempt from VAT.

When you sell the property, any CGT due on gains can be deferred by buying another business asset. Entrepreneurs' relief can also reduce the rate of CGT to 10% when you close your FHL business.

Selling the property

Capital gains

When you sell your let property, you would expect to make a profit, after deducting allowable costs (see below). If all the capital profits you make in the year (not just from property disposals) exceed your annual capital gains exemption (£11,300 for 2017/18, rising to £11,700 for 2018/19), you must declare the profits on the capital gains section of your tax return.

Gains in excess of the exemption are subject to CGT at either 18% or 28%, depending on the level of your net taxable income for the tax year. For higher or top rate taxpayers, the CGT rate will be 28%. The CGT is payable by 31 January following the end of the tax year in which the property was sold or disposed of.

When you give away the property to someone other than your spouse/civil partner, or sell it to someone connected to you at a discount, that disposal is treated as a sale at market value for tax purposes.

Allowable costs

The following costs may reduce the taxable gain on the disposal of a property:

- solicitors' and estate agents' fees paid on the sale and purchase
- land tax paid on purchase
- cost of improvements
- capital losses made in the same or earlier tax year
- exemption as a main home (see Former home)
- lettings relief (see Former home)



Former home

When you live in a property, the gains made relevant to your period of occupation are exempt from CGT on disposal of the property. Other periods you spend away from the property may qualify as deemed periods of occupation if you return to live there at a later date – the detailed rules on this are very complicated!

If you live in more than one home concurrently, you can nominate which property is to be treated as your 'main home' and thus exempt from CGT. You can change that nomination at will. You must make the first nomination within two years of the date on which you started to use the second property as your home. A husband and wife, or civil partners, can only have one CGT-free main home between them.

The nomination of a property as your main home can save you CGT in the long term. If you move out before the property is sold, the gain relating to the last 18 months of your ownership is also exempt from CGT. This last 18 months can cover a time when the property was let or unoccupied.

Lettings relief

If a property, or part of the property, was treated as your main home either before, during, or after the time it was let out, you can get a deduction for 'lettings relief' on the proceeds of the sale. Lettings relief is restricted to the lowest of three amounts:

- the part of the gain exempt because it was used as your main home
- the gain attributed to the let period
- £40,000 per owner

Lettings relief can't apply to a buy-to-let property that you have never occupied as your main home. We can help you claim all the reliefs due on the sale of your property.

Inheritance Tax

The value of all your possessions, including the home you live in and your buy-to-let properties, are all potentially subject to Inheritance Tax (IHT) on your death. There are exemptions for gifts made more than seven years before you die, amounts left to your spouse/civil partner or to charities, and the value of your estate which falls within your nil rate band.

This nil rate band is set at £325,000, but any unused nil rate band may be inherited by your spouse/civil partner. There is an additional residential nil rate band of £100,000 per person (increasing to £125,000 from 6 April 2018) that can be deducted if you leave the value of your home to one or more of your direct descendants. It's essential to have a well drafted Will to take full advantage of the IHT exemptions available on death.

Non-resident landlords

If you live outside the UK and let property located in the UK, your letting agent (or tenant where there is no agent) should deduct 20% tax from the rents before paying you. However, where you gain approval from HMRC (under the non-resident landlord scheme) to receive gross rents, tax is not deducted. You have to promise to declare the income from your let properties on a UK tax return, and pay any tax due on the profits.

Capital Gains

Gains arising from the disposal of UK residential property are subject to CGT in the UK, even where the landlord lives in another country. Such disposals, whether they result in a gain or loss, made by non-resident owners must be declared to HMRC within 30 days of completing the sale. Any tax due is also payable within 30 days if the owner is not already registered with HMRC. Gains made by purchasing 'off-plan' and selling before the property is finished are also taxable. We can help you with the calculation of gains and the reporting requirements.

This report is written for the benefit of our clients and is based on information available on 16 January 2018. Further advice should be obtained before any action is taken.