

A Simple Guide to Property Rental Income Tax and Property Capital Gains Tax For UK Landlords

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About this guide

If you are a landlord with less than 10 properties, which you are letting out in the UK, then this guide will give you a thorough grasp of the basics of property tax and capital gains tax in the UK.

If you have more than 10 properties we expect that you would already know about the basics or that you have a tax adviser who handles it all for you. If you do not and are not being advised, then please, get in touch... quickly.

I have written the guide to give UK Landlords a straight forward understanding of the current tax rules as they apply to property before letting, whilst letting and on selling property in the UK.

I particularly hope it answers the many questions we get asked every day from those landlords who are new to letting and unused to dealing with HMRC and the way our tax system works outside of PAYE.

The guide should take you no more than 30 minutes to read from start to finish.

As a Fellow of the Institute of Chartered Accountants in England and Wales, and having worked in practice for nearly 40 years, I would urge anyone reading this guide that if they are not completely comfortable in their understanding of the tax rules as they apply to property, then seek professional advice. So often, when it comes to property and tax, mistakes can be very expensive indeed!

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Taxation of Property

Introduction

Income from property for individuals is assessed to income tax for each tax year. Records therefore need to be kept for each year ending on 5th April. Married couples or civil partners who let their property out jointly are usually assessed on one half of the income, unless they actually legally share the profit in unequal shares **and** make a formal election to HMRC. Where property is jointly owned it is not usually treated as a partnership, unless there is a trading activity as well. The accounting period for partnerships and limited companies do not have to end on 5th April.

Types of UK Property

Commercial Property

This is a property which is not residential including land. If you let out part of your business accommodation because it is temporarily surplus to current business requirements, then the income and expenses, as long as they meet the conditions, can be treated as trading profits. The advantage is that it becomes pensionable earnings but it is then income assessable to Class 4 National Insurance.

Furnished Holiday Lettings

There are special rules for furnished holiday lettings. The advantage is that any Capital Gains on the sale of the property are eligible for Entrepreneurs Relief, Hold-over relief or Roll-over relief. To qualify, the property must be let commercially for at least 105 days and available for at least 210 days in any tax year. There are elections which may assist if the qualifying days are not reached in a particular year. If, the property is let to the same person for more than 31 days at a time, this period is not included. Further if the total of any periods that it is let for more than 31 days exceeds 155 days in a tax year then the property does not qualify as a furnished holiday letting. Losses from furnished holiday lettings can no longer be set against other income.

Rent a Room

If you let out a furnished room in your home, provided it is not an office, Rent a Room relief can be claimed rather than paying tax on the net profit. Rent a room relief was increased significantly from 6th April 2016 to a fixed figure of up to £7500 p.a. per household or £3750 p.a. each for a couple and is deducted from the gross rents received. You cannot deduct any expenses if you claim Rent a Room relief nor can it create a loss. It is simpler than apportioning all the home expenses and is normally more beneficial.

Other Residential Lettings

These will be other lettings which do not qualify as furnished holiday lettings or you are not claiming Rent a Room relief. From 6th April 2016 there is a new relief for actual expenditure on replacement furnishings. Relief cannot be claimed for expenditure on new capital items which are not replacements on a like for like basis.

Summary of Allowances available:

	Revenue Expenses	Capital Allowances	Replacement Furniture Relief	Loss Relief against Income
See pages	7-9	10-11	11	11
Commercial Property	√	√	×	*
Furnished Holiday Lettings	√	√	×	×
Rent a Room	×	×	×	×
Other Residential Lettings	√	×	√	×

* Loss relief against other income may be available if created by surplus capital allowances

Rental Income

Income is normally accounted for on an arising basis, but if the total gross rents received are less than £15,000, HMRC will accept the cash received basis provided that it does not produce a significantly different figure. Any deposits received have to be safeguarded by an approved scheme or will be dealt with by your agent. Deposits received should not be included in your income.

There are some specific rules for agricultural tenancies which are not included below.

Expenses that CAN be Deducted against Rental Income

The general rule is that the expenditure must be expended wholly and exclusively for the Rental Income business. The rules are exactly the same as trading expenses.

Interest and other finance charges

The interest accrued and any arrangement fees on any loan taken out to purchase the property are claimable but for residential properties the full amount is only allowed up until 5th April 2017. If it is a repayment mortgage, then it is only the interest element which can be claimed, not the total repayments. If you have a separate bank account for the property business then any bank charges can also be claimed.

From 6th April 2017, tax relief on interest paid by landlords of residential properties will be restricted gradually (by 1/4 for each tax year) so that from 6th April 2020, interest will not be an allowable expense in computing the profits of the business, but will attract tax relief at 20%.

The best way of explaining this is by way of an example:

Joe is a teacher and is 49 years old; he is a 40% taxpayer. He has purchased a buy to let property as an investment. As he has owned the property for some time, the outstanding debt on the property is relatively low. Here is the effect of the change:

	2016-17	2020-21
Gross rents	£7,200	£7,200
Repairs and other tax deductible costs	£1,000	£1,000
Interest on mortgage	£2,500	-
Net rental profit	£3,700	£6,200
Tax at 40%	£1,480	£2,480
Less interest relief at 20% on £2,500	-	£500
Net tax liability on rental income	£1,480	£1,980
Tax Increase		£500

If Joe decided to increase his borrowings to allow him to buy a second buy to let, he would see his tax rate rise still further, as his interest costs will be higher initially, and his net return lower.

The new rules are being phased in over 4 years beginning on 6th April 2017.

Basic rate (20%) taxpayers should see no change to their liabilities unless the rental income before interest causes them to go into the higher rate of tax. However, if you pay tax at a higher rate, the effective tax increase on any mortgage interest paid as a percentage of that amount is as follows:

Your marginal rate of tax	Effective percentage increase in tax liability on the mortgage interest paid:			
	2017-18	2018-19	2019-20	2020-21
20%	0%	0%	0%	0%
40%	5%	10%	15%	20%
45%	6.25%	12.5%	18.75%	25%
60% (Income between £100,000 and 123,000*)	10%	20%	30%	40%

*This figure will increase as the personal allowance increases

Commercial properties and Furnished Holiday lettings are not affected by the proposals.

Repairs and maintenance

Repair work carried out on the property can be claimed provided that it is not a capital improvement. If you lived in the property prior to letting it, then work carried out before the property is let is seen as maintenance of the property as a result of private use rather than for rental purposes. Do not forget to include the gas safety certificate cost if applicable.

Legal, management and accountancy fees

You cannot claim any legal fees in connection with the purchase of the property or any fees for the initial lease if it is for more than one year. Any legal fees in connection with the renewal of a lease, a short hold tenancy of less than 1 year, eviction of clients, rent collection or management fees and accountancy are all claimable.

Insurance

It is important that you insure the property and the premium for the buildings and/or contents can be claimed. Life assurance premiums are not claimable.

Rent rates and council tax

You may pay ground rent if the property is a flat. The tenant normally pays the rates or council tax, but if you suffer any costs or there are any void periods where you pay these costs, these can be claimed.

Services

If you pay any service charges or for any other services in connection with the letting e.g. electricity in common areas, these should be claimed. If the property is a furnished holiday letting then it is likely that you will pay for electricity, gas, water, television licence, telephone and other services.

Wages

If you need someone to carry out a regular service for you e.g. cleaning, we recommend that you pay a fixed rate for that service and do not provide any tools or materials so that they can be treated as self-employed. However, if for example, you employ a cleaner for one hour a week and provide all the materials, then that person is probably an employee. Be aware, that if you do employ an employee, you need to ensure that you comply with Employment Regulations including Working Time Directive, National Minimum Wage, Health and Safety, auto enrolment for pensions and PAYE/NIC. The national living wage from 1st April 2017 is £7.50 per hour for adults over age 25. We advise that you should ask your employee to complete a “Starter Checklist” which is available on the Government website <https://www.gov.uk/government/publications/payee-starter-checklist>. Provided that you do not pay £113 or more per week, you have no other employees and your employee marks either certificate A or B, you can retain the Starter Checklist and take no further action. If certificate C or no box is marked or you pay £113 or more per week it will be necessary to have a PAYE scheme in place. If you have a PAYE scheme then you will need to pay the employee under RTI (Real Time Information) even if they earn less than £113 per week.

Travelling expenses

Do you travel to the property to carry out maintenance or deal with issues with the tenants? If so you should claim the cost of travelling. It does have to be reasonable – if you live in London and spend a week on holiday in Cornwall, popping in for ten minutes to check that the holiday home next door was alright would not make the journey a business trip!

Advertising

If you need to advertise for tenants, then this expense can be claimed.

Administration expenses

These can include postage, stationery, telephone calls and other administration expenses. Either a complex calculation has to be made justifying the charge or the following can be claimed depending on the hours worked in an office:

Number of hours worked per month	Monthly claim
25 or more	£10
51 or more	£18
101 or more	£26

It is unlikely that a charge for using your home as an office can be justified unless you are managing a number of properties yourself.

Other expenses

The licence fee for Houses of Multiple Occupation (HMO) is claimable for example. Any other expenses incurred wholly and exclusively for the property business can be claimed.

Expenses That CANNOT Be Deducted Against Rental Income

Capital Expenditure

The cost of purchasing or improving a property (e.g. an extension) cannot be claimed as revenue expenditure against your property income. The distinction between capital and revenue expenditure is not black and white. If you buy a property and simply redecorate it before you let it out, this will be considered to be revenue expenditure. If however you bought a property for a significantly lower price than normal because it was in a poor condition and then carried out substantial works, this expenditure would probably be considered as capital expenditure.

However, most capital expenditure is eligible for relief for Capital Gains Tax purposes when you come to sell the property, so it is important that you keep records and receipts for the expenditure incurred.

Any costs and expenses associated with a property purchase which falls through are not allowable.

Whilst the interest payable is an allowable deduction, the repayment of any capital on a loan or mortgage raised to purchase/improve the property cannot be claimed.

Private Use

If you use the property for private purposes, which is most likely if it is a furnished holiday letting or you are not claiming Rent a Room relief in your own home, then any expenditure claimed must be restricted for its private use.

If you have previously occupied a property then any expenditure which relates to that period of occupation cannot be claimed. So any maintenance of the property prior to the first letting is private. Conversely, if for instance you had paid an annual insurance premium on 1st April and left the property with a view to letting it on the following 1st October, then you would claim one half of the insurance premium paid even though it was paid when you occupied the property.

Other Allowances

Capital Allowances (Cannot be claimed on Other Residential Lettings)

Whilst structural works cannot normally be claimed, capital allowances are available on the purchase of fixtures, plant and machinery. There is an Annual Investment Allowance for expenditure up to £200,000 from 1st January 2016. As most landlords will not be spending more than the annual limit or claiming for a car, cars and eligible expenditure over the annual limit are not discussed.

Examples of expenditure eligible for Annual Investment Allowance are as follows:

Cookers	Washbasins	Furniture	Storage equipment
Washing machines	Sinks	Carpets	Counters
Dishwashers	Baths	Curtains	Machinery
Refrigerators	Showers	Boilers	Lifts
Electrical systems	Water systems	Heating systems	Alarm systems

The list is not exhaustive and you should obtain further advice from us, particularly if your expenditure is over the annual limit.

If you sell an asset on which you have previously claimed Capital Allowances, the proceeds are taken into account and may create an additional income charge.

Replacement Furniture Relief

From 6th April 2016, where a residential property is not a Furnished Holiday let or no Rent a Room relief is claimed, the expenditure on **replacing** items of furniture and white goods will be allowed as an expense less any proceeds on the disposal of the item being replaced. The cost of assets which are not replacements are not be allowed as an expense.

Prior to 6th April 2016, where a property was let fully furnished, a 10% Wear and Tear Allowance was available.

Losses

If the expenses and allowances above are more than the income from the properties, then there will be a loss. Losses are usually only available to carry forward against future property income unless the loss arises from a property which is not let out on a commercial basis.

Loss Relief against Other Income

Losses on standard residential lets are not allowed against other income. If, however, your losses arise from surplus capital allowances, they can be claimed against other income.

Is it worth having a limited company?

Properties can be held in either in individual name(s) or in a limited company. They can also be held in trusts or non-domestic properties can be held in self-administered pension schemes, which are not dealt with here.

Up until 8th July 2015, unless you intended to hold the properties for a long period and did not need to use the income, we would not have recommend holding your properties in a limited company. Because of the changes made in the Budget on 8th July 2015, this now needs to be considered on an individual basis as it will depend on the amount of interest paid in each case.

For a more detailed explanation please see our comprehensive article on this subject.

www.uklandlordtax.co.uk/isitworthhavingalimitedcompany

Capital Gains Tax

Basics

In 2008, the calculation of Capital Gains was simplified as follows:

Proceeds of sale less any selling costs	X
Cost of asset including purchase plus any enhancement expenditure*	Y
	——
Capital Gain	X-Y
	====

*If the asset was purchased before 31st March 1982 then cost is substituted with the market value on this date plus any enhancement expenditure after this date.

Enhancement expenditure does not include any items of maintenance or finance costs. If you carry out work on a property and then sell it immediately, this may be treated as trading income rather than a capital gain.

Some reliefs are discussed below. After deducting the reliefs there is an annual exemption of £11,300 for 2017/18 and £11,100 for 2015/16 and 2016/17, for each individual, which is deducted from the net gains after losses in the tax year. For **residential properties/non-residential properties**, tax is then charged at **18%/10%** on any surplus basic rate band available for income tax purposes and **28%/20%** on the remainder unless Entrepreneur's Relief can be claimed.

Gains on residential properties in the UK arising after 5th April 2015 will be taxable on non-residents. If you are a non resident and you dispose of a property in the UK, you must report this to HMRC with 30 days of the disposal. You may have a liability if you dispose of any other asset and you were to return to the UK within five years of leaving.

Private Residence Relief

If at any time the property has been your only or principal private residence then you should be entitled to some private residence relief. Married couples, civil partners and unmarried individuals can only have one principal private residence at a time. If it has been fully used as your only private residence and there has been no letting or other business activity carried on at the premises throughout the period of ownership, normally Private Residence Relief will apply in full. If you incur a capital loss on your principal private residence then you cannot claim this loss against other gains.

If the property occupies more than ½ hectare (approx. 1.25 acres) then you will have to prove that the additional area is required for the reasonable enjoyment of the property having regard to the size and character of the dwelling otherwise the Private Residence relief will be restricted.

The final eighteen months (three years if you are disabled or moving into long term care) are treated as eligible for relief whether you were actually living in the premises or not, provided that you have had the property as your principal private residence at some time. So if you leave the property, let it out for eighteen months and sell it at the end of this period there is no chargeable gain.

Owning more than one residence at a time

If you do have more than one residence which is not let out then you can elect for one or other to be treated as your principal private residence. This must be done within two years of acquiring the second property and once this has been done, the election can be varied. Both properties must be used by you as a residence, so for example if you have a main residence and a holiday home which you use personally, then you should consider making an election.

If no election is made then it is a question of fact and generally it is the property that is most lived in. Where there are two properties, substantial savings in Capital Gains Tax can be made with careful use of the election.

So if you bought a holiday home and sold it 18 months later without making an election, you could have a Capital Gains Tax liability with no relief. However, if you had elected for the holiday home to be your principal private residence and then one week later elected for your normal home to become your main residence again, you would not have a Capital Gains Tax liability on the sale of the holiday home (as long as it is sold within 18 months of purchase).

This would mean that your normal home would have one week out of the period of total ownership as a chargeable gain but this should be so small that it would be covered by your annual exemption.

From 6th April 2015, you cannot elect for a property to be your principal private residence in a particular tax year if it is in a different country to your residence and you have not occupied it for more than 90 days in that tax year.

Business use of your home and lodgers

If you have a study at home, do not use it exclusively for your business otherwise you may have a Capital Gains Tax liability. Any area that has exclusive business use is not eligible for Private Residence Relief and the proportionate gain would be chargeable.

If you let a room in your house to a lodger and they eat with you and use the facilities, then there will not be a restriction on the Private Residence Relief. If you let out a room and you do not provide any services then a proportion of the Private Residence Relief would be lost although you would then be eligible for Lettings Relief.

Lettings Relief

Lettings relief is only available if the property has been used as the principal private residence at some time. Quite often the two reliefs will extinguish the gain or bring it down to below the annual exemption, so no Capital Gains Tax is payable.

The relief is only available for the period of letting, so if there is a period that the property was neither let nor qualifies as your principal private residence then this is chargeable. To work out whether you are entitled to lettings relief, you work out the total gain as above. You then allocate the period of ownership after 31st March 1982 over the time it was your principal private residence (plus the final 18 months if appropriate) (1), the period of letting (2) and any other period (3). Take the proportions and apply them to the gain. The gain relating to (1) is exempt and lettings relief is the lowest of a) the gain calculated using period 2, b) the private residence relief calculated using period 1 and c) £40,000.

The £40,000 cap is per individual, so if a couple own a property equally, £80,000 would be available. This does mean that a couple can realise a gain of at least £160,000 tax free provided that the property is let for a period equal or less than the period of private residence and there is no other use of the property.

Let's see how this works by way of an example.

Example:

Joe and Brenda own a house which they purchased for £160,000 and they lived in it for nine years. They then left the property and it was empty for one year following which they let it out for ten years. They then sell the property for £360,000. (Costs of purchase and sale have been ignored but would be relieved.)

The Capital gain is £200,000 (360,000 – 160,000)

1. Private residence relief	9 years + final 1.5/20	Relief	£105,000
2. Period of letting	10 years/20	Gain	£100,000
3. Other period	1 year/20	Gain	£10,000

The total is not the gain because the final eighteen months are eligible for private residence relief.

To calculate the lettings relief it is the lowest of:

a) The gain at 2	£100,000
b) Private residence relief at 1	£105,000
c) Lettings relief maximum of £40,000 each	£80,000

The lettings relief for the couple is therefore restricted to the lowest (c) £80,000.

The Capital Gains Tax is then calculated as follows:

Capital Gain on sale of property	£200,000
Private residence relief (1)	£105,000
Lettings relief (c)	£80,000

	£185,000

Chargeable Gain	£15,000
Annual Exemptions (assuming no other gains) 2 x £11,300	£22,600

Even with a gain of £200,000 there would be no tax payable with this scenario.

However using the same figures but with the period of letting first and the period of occupation as a private residence last, the private residence relief would fall to £90,000. The chargeable gain would now be £30,000 (£200,000 – £90,000 – £80,000). Deducting the annual exemptions of £22,600 would leave a taxable gain of £7,400 which would normally suffer tax at a rate of between 18% and 28% depending on each individual's income. So by a slight change in the way the property is occupied can cause an additional tax liability of up to £2,072 in this example.

Job related accommodation

If you have to live in job related accommodation for a period, then you can claim principal private residence relief on a dwelling which you own in that period, provided that you have bought it with the intention of living there, even if you let it out.

Living accommodation is job related if:

- it is provided by reason of the individual's employment, or by reason of the employment of the individual's spouse or civil partner,

- for the proper performance of their duties, or
- for the better performance of their duties and where the provision of living accommodation is customary for that type of employment, or
- Where the accommodation is provided as part of special security arrangements.

There are anti-avoidance rules which prevent directors of their own companies claiming that accommodation is job related.

Entrepreneurs Relief

Entrepreneurs' relief is available if you dispose of a trading asset or furnished holiday lettings. It could also apply if you sell a commercial property which was used in your trade or by your personal company within the three years prior to disposal. If you are entitled to Entrepreneurs relief, then the tax rate reduces from 18/20/28% to 10% of gains up to a lifetime limit of £10 million. As this relief is not available to most landlords, no further details are given and advice should be sought.

Business asset Rollover Relief

This is available on furnished holiday lettings and on certain trading assets. If you reinvest all or some of your proceeds, you may be able to defer the gain by claiming rollover relief. As this relief is not available to most landlords, no further details are given and advice should be sought.

Stamp Duty Land Tax

Rates for property purchases

Since 1st April 2016, Stamp Duty Land Tax (SDLT) is paid progressively as follows:

Type of property purchased:	Residential Dwellings		Commercial
Residential Properties already owned: (England Wales and Northern Ireland only)	None	1 or more	N/A
	Individuals only		
Purchase price falling into band	Rate of SDLT on the relevant band		
First £125,000 (unless below £40,000)*	0%	3%*	0%
Over £125,000 to £150,000	2%	5%	0%
Over £150,000 to £250,000	2%	5%	2%
Over £250,000 to £925,000	5%	8%	5%
Over £925,000 to £1,500,000	10%	13%	5%
Over £1,500,000	12%	15%	5%

*If the purchase price of the property is less than £40,000 then there is no SDLT but if it is £40,000 or more, the 3% applies to the whole of the purchase price up to £125,000 where one or more residential properties are already owned.

For companies, the Residential Dwellings rates for one or more properties applies to all transactions even if no properties are owned. The charge for properties costing a company more than £500,000 are charged at 15%. There is also then Annual Tax on Enveloped Dwellings (ATED) for limited companies where the properties are worth more than £500,000.

Rates for property purchases

The additional rate of 3% to owners of more than one property does not apply where there is the sale of the main residence and the replacement of that residence within three years of its sale. If a new main residence is purchased before the old one is sold then the additional 3% has to be paid and then it can be reclaimed if the previous residence is sold within three years of the purchase of the second residence.

If you are married or in a civil partnership then you can only have one property between you. The 3% charge can catch the unwary. Examples of where it would apply is where you buy a property for your student son to live in while he is at university or if you live in rented property and own a buy to let property then want to buy a property in which to live. If you are considering buying a number of properties and do not own any, it is advisable to buy the most expensive first.

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