Landlord Guide to Tax

This guide is designed to assist you in understanding your liabilities and responsibilities as landlord in relation to taxation. However, we are not accountants so we always recommend seeking professional advice in relation to all tax matters.

Income Tax

The income that you receive from letting property, whether furnished or unfurnished, is generally regarded as unearned income by the Inland Revenue, regardless of your employment status.

However, as we have already mentioned, you are only liable to pay income tax on the *profit* generated from letting, after deductions made for 'allowable expenses'.

What are 'allowable expenses'?

The general rule as to whether an expense is an allowable deduction from income is to ask the following two questions:

1 - Is it an expense of income?
2 - Was it incurred 'wholly and exclusively' for the purposes of renting the property?

The first question generally rules out any capital expenditure. However, whether this applies to renovations depends on the extent of repair in each particular case. If a property is in a condition suitable for letting when it is acquired then renovations such as redecorating will usually qualify as allowable expenses. However, if a property is acquired at a low cost and requires a great of work before it can be let then it will usually be classed as a capital expenditure and not an allowable expense that can be set against rent received. As a general rule, where there is an element of improvement then such expenditure will be treated as capital.

The second question rules out any situation where a landlord benefits personally from the expenditure. For example, decorating materials purchased and used at the landlord's private home are not an allowable expense.

Whilst you cannot charge for your own time spent collecting rents and managing properties, payments made to others for this purpose (even family members) are allowable expenses if actually performed and recorded. This includes the cost of employing a letting agent such as ourselves.

Examples

The following types of expenditure are usually regarded as 'allowable expenses':

• Interest paid on loans taken out to purchase the property.

• Travel expenses incurred by inspecting the property and/or collecting rent.

• The costs of building and contents insurance.

• Maintenance expenses.

• Leasehold expenses (such as ground rent or management company charges).

• Water rates and council tax.

Furnished properties

Special rules apply to furnished properties where, technically, the cost of providing furniture and fittings is a capital expenditure and therefore not an allowable expense. However, the Inland Revenue offers landlords two options to offset such expenses for this type of property.

The first and most popular option is permitting the landlord to deduct a 10% wear-and-tear allowance, calculated on the rent net of any council tax or rates.

Alternatively, you may deduct the full cost of replacing items on an 'as you go' basis as and when it is necessary.

It is important to remember that the original outlay for furniture and fittings is **not** allowable – only replacements for damaged or worn-out items. Also, once you have chosen one option for offsetting this expenditure then you are not allowed to change to the other whenever it suits best.

Losses

If expenses and capital allowances for any year are greater than the rental income received then you have suffered a loss on your investment for that year.

You are not allowed to set this loss against other forms of income and instead you must carry it forward to set against the profits of future years.

Non-Resident Landlords

If you reside outside England and Wales during the tenancy then you will still remain subject to income tax on rents received.

The Non-Resident Landlord Scheme requires us as your agent to deduct basic rate tax from any rent we collect on your behalf. However, you can apply to the Inland Revenue for approval to receive your rental income without tax deductions. This is submitted on a NRL1 form that we can supply you with, which requires you to disclose your current tax situation and obligations

If this application is successful we will be able to collect your rent and pay it to you gross. Although the rent may be paid with no tax deducted it will still remain liable to tax, so if you are a non-resident landlord then you must include it in any tax return that the Inland Revenue provides you with.

Capital Gains Tax

Capital Gains Tax (CGT) is not usually payable on a private individual's own home, but is payable on most property that is let. As landlord, your liability for CGT is on the profit made when the property is sold.

You will be exempt from paying CGT if the let property is sold within 3 years of being purchased. If this exemption does not apply, then you will pay CGT for the amount of time that the property was not your 'principle residence' (where you actually live).

Reducing CGT Liabililty

The capital gain generated upon sale is not simply the sum arrived at by subtracting the purchase price from the sale price. The following allowances can often reduce your liability:

• Annual exemption allowance – Every individual has an annual amount that is exempt from CGT. Where a property is in joint names then this allowance is doubled. The current annual allowance for CGT exemption is £8200.

• 'Tapered relief' – Applying to each complete year of ownership after the first two years, this allowance provides that the longer the property has been owned then the greater the discount on the taxable gain, subject to a maximum of ten years.

• Capital expenditure on improvements – Installing central heating or upgrading to double-glazed windows would be examples. As long as these have not attracted relief as an income expense then such expenses are deductible.

• Professional fees – Charges made by solicitors, surveyors, financial advisers and mortgage specialists to facilitate the purchase and sale are also deductible.

For further information please visit www.hmrc.gov.uk

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