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Residential Property Letting Tax Guide

Property tax: a Haslers guide

If you have invested in property to provide a home for yourself or a family member, or to let out – on a small scale, perhaps to supplement other income or a pension, or on a more advanced level, to run as a business – you want to operate as tax efficiently as possible.

This guide looks at some of the key tax issues around owning and letting residential property, although it can only provide a general overview.

The Haslers team is experienced in all aspects of residential property tax and can provide expert advice on investing in, letting and selling property for individuals, trusts and companies. For expert advice tailored to your specific circumstances, please contact us.

Stamp Duty Land Tax (SDLT)

Stamp Duty was traditionally paid at single slab rate on the whole purchase price of a property, resulting in big jumps in the tax levied when the value tipped into a new band. The system meant that the buyer of a property worth £250,000 paid £2,500 in tax but if the purchase price was £1 more, the Stamp Duty bill would soar to £7,500.

From 4 December 2014, a new system for residential property was introduced, which means that:

- there is no tax on the first £125,000 paid
- 2 per cent tax on the portion up to £250,000
- 5 per cent tax on the portion up to £925,000
- 10 per cent tax on the portion up to £1.5 million
- 12 per cent on everything above £1.5 million.

Letting residential property: the basics

From a tax perspective, letting residential property can be complex. If you're new to property letting, a good place to begin is by seeking professional accountancy advice on the most tax-efficient options.

When you start letting a residential property, you must tell HM Revenue & Customs (HMRC) and report property rental income of more than £2,500 a year on your tax return. If the income is less than £2,500 a year, you need to complete HMRC's form P810.

The amount on which you pay tax is the net rental income for each tax year (i.e. the year ending on 5 April). Net income consists of the gross rent in the tax year, less allowable expenses. These cover costs involved in the day-to-day running of the property, including:

- accountants' fees
- agent and management fees
- buildings and contents insurance
- maintenance and repairs
- utility bills, like gas, water and electricity
- rent, ground rent, service charges
- council tax
- services you pay for, like cleaning or gardening
- other costs involved in letting the property, e.g. like phone calls or advertising.

If you let a furnished residential property, you can also claim ten per cent of the net rent as a wear and tear allowance for any furniture and equipment you provide.

If you own the property with someone else, the net income must be split between the owners, who will each pay tax due at the appropriate rate, after taking into account any allowances or losses.

If you make a loss on letting out a property, you can carry this forward to a later year and offset it against future profits. If you let out more than one property, a loss for a year on one property can be set against a profit on another. However, you cannot set an overall loss off against income from other sources, such as employment or investment income – it must be carried forward against future profits from your property letting business.

In each tax year, half your expected tax liability will normally be due on account on 31 January and 31 July, with any balance due payable the following 31 January. However, payments on account may not be required in the first year of letting or if letting income is small in relation to your overall taxed income.

Letting residential property: interest

Interest on a mortgage or other loan you take in relation to property letting is an allowable deduction for tax purposes.

The loan does not have to be matched with a particular property, so if you let several properties, interest on a loan for a property you had sold would still be deductible, provided you continued to let other properties.

Interest may sometimes be deductible on loans used for other purposes, including the interest on any loan up to the value of the property when it was first let.

For example, if a property was bought as a private home for £400,000, with a £200,000 mortgage but was let out later on, when its value had increased to £500,000, a further mortgage of up to £300,000 could be taken out and interest on the full £500,000 would be allowable.

Letting residential property: repairs

The money you spend on repairs for wear and tear is an allowable expense for income tax purposes, provided the work done does not represent an improvement.

HMRC does not normally regard a repair as an improvement simply because more modern materials are used, e.g. when single glazed windows are replaced by double glazing.

However, if a landlord decided to convert the loft of a property as part of replacing the roof, that would be seen as an improvement.

As a general rule, HMRC views replacing part of an asset as a repair but replacing all of it as an improvement. Money you spend on improvements, additions or extensions to a property is regarded as capital expenditure and added to the value of the property for capital gains tax purposes.

Capital Gains Tax on residential property

When you sell your home (main residence) there is no Capital Gains Tax (CGT) to pay, as any capital gain is covered by principle private residence (PPR) relief.

In assessing whether a property is a main residence, HMRC will look at issues including whether:

- it is used for receiving utility and other bills
- it appears as your address on the electoral roll
- it is used by your bank.

You are entitled to CGT relief when you sell a property provided it was your main residence during the time that you owned it.

If the property was not your only main residence during your ownership, you will be taxed in proportion to the periods when it was not your main residence and therefore did not qualify for PPR. However, some periods of absence do qualify for PPR:

- the last 18 months of ownership
- an absence of not more than three years, where you did not live in another property qualifying for PPR
- if you were working abroad and you did not occupy another property qualifying for relief
- an absence of not more than four years when your employer required you to live elsewhere and you did not live in another property qualifying for relief.

Capital Gains Tax: nominating a residence

You can only have one main residence for PPR purposes. If you own two properties, you can nominate one that you would like to be treated as your main home.

By doing this it is possible to minimise the tax charge on both properties by switching your PPR between them. The election must be made in writing to HMRC.

In the case of married and civil partnership couples both partners must sign the election for this to be effective.

The election must be submitted to HMRC within two years from the date of acquiring the second property.

Capital Gains Tax: gardens and grounds

If your garden and grounds cover up to 5,000 square metres, any gain on their sale is also exempt from CGT.

If they cover more than 5,000 square metres, you may be entitled to PPR relief if HMRC considers the garden and grounds are necessary for "the reasonable enjoyment" of the relevant property as a home, taking into account its size and character.

If you sell part of a garden that originally covered up to 5,000 square metres to a third party for development, your gain should be covered by the PPR exemption.

However, if you carry out the development yourself, you will pay income tax on the profit from the construction, although the gain on the value of the land (from garden to a building plot) is likely to be covered by PPR relief.

Capital Gains Tax: selling let property

You may need to pay Capital Gains Tax (CGT) if you sell a property you have been letting at a profit.

It may be possible to reduce CGT by transferring part of an interest in the property to a spouse or civil partner, to maximise the use of annual exemptions and lower rate bands.

Where a taxable gain arises on a property that was a private residence and was also let out at some point, a maximum lettings exemption of up to £40,000 is available.

Furnished holiday lettings

To qualify as a furnished holiday letting (FHL) and the tax benefits that come with it, the property must furnished in a way that makes it suitable for normal occupation, be it in the UK or European Economic Area (EEA) and commercially let, which means let with a view to making a profit. Lettings to friends or relatives at zero or nominal rents are not commercial.

The property must also pass three further tests to qualify as furnished holiday letting:

- availability: it must be available for commercial holiday lettings to the public for at least 210 days in a tax year
- letting: it is commercially let to the public for at least 105 days in the tax year
- occupation: it must not be let for periods of longer-term occupation (more than 31 days) for more than 155 days during the year.

Furnished holiday lettings (FHL): tax issues

If your property qualifies as an FHL, it will be treated as a business for capital allowances purposes.

This means that your spending on fittings, furniture and equipment (and certain integral features, e.g. heating or plumbing systems) each year, up to a certain limit, can be written off for tax purposes in the year in which you spent the money.

This annual investment allowance stands at £500,000 until 31 December 2015 after which it is due to return to £25,000 a year.

As commercial assets, qualifying FHLs are eligible for certain CGT business reliefs, including entrepreneurs' relief, which reduces CGT payable on capital gains on the disposal of the property to ten per cent (up to a lifetime limit of £10 million).

If you dispose of an FHL, you can also offset any capital gain made against the cost of a replacement business asset acquired within three years of the disposal.

However, claiming business property relief for inheritance tax purposes is likely to be more problematic. The relief is only likely to be available where the services provided are at a substantially higher level than those provided on a standard let property.

Any loss made from a qualifying UK FHL may only be offset against income of the same FHL. Likewise, a loss in an EEA FHL can only be offset against profits of the same FHL.

Non-resident landlords

If you let out UK property (residential or commercial) and live abroad for six months or more each year, HMRC regards you as a non-resident landlord, even if you are UK resident for tax purposes.

If you are a non-resident landlord, you can choose to receive your rent:

- in full and pay tax due through self assessment – HMRC will not approve your application to receive rent in full unless you are up to date with all your UK tax obligations or you do not expect to have any UK tax liability in the year in which the application is made
- with basic tax already deducted by your letting agent or tenant (after allowing for any expenses they have paid), who will give you a certificate at the end of the tax year saying how much tax they have deducted. If you do not have a letting agent and your tenant pays you more than £100 a week in rent, they will deduct the tax from their rent payments to you.

Landlords may still be entitled to UK personal allowances (which can be used against letting income) despite being non-resident. The main categories of those entitled are British and European Economic Area citizens. An annual claim form will normally have to be submitted to HMRC.

Capital Gains Tax and non-residents

From 6 April 2015, non-UK tax residents (including offshore companies, offshore partnerships and offshore trustees) must pay CGT on gains from the disposal of UK residential property after 5 April 2015.

The rate is 20 per cent for companies outside ATED-related CGT (see next section) 18 per cent or 28 per cent for individuals and partners and 28 per cent for trustees.

If you own property personally, you may be able to claim an exemption if you (or your spouse or civil partner) spend at least 90 days a year in your UK property and it is your main residence for CGT purposes.

Annual Tax on Enveloped Dwellings (ATED)

ATED (previously known as the Annual Residential Property Tax) is an annual tax payable by companies that own high value residential property in the UK.

ATED is levied where the property was valued at more than £1 million on 1 April 2012, or on acquisition if later, and is owned, completely or partly, by a company, a partnership where one of the partners is a company, or a collective investment vehicle, e.g. a unit trust or open ended investment company.

The tax is payable at the rates below.

Property value	ATED rate 2014-15	ATED rate 2015-16
£1m-£2m	N/A	£7,000
£2m-£5m	£15,400	£23,350
£5m-£10m	£35,900	£54,450
£10m-£20m	£71,850	£109,050
£20m+	£143,750	£218,200

The disposal of properties liable for ATED also attracts capital gains tax at 28 per cent, based on the difference between the sale price and the property's value in April 2013.

Conclusion

Careful tax planning can deliver significant benefits to property owners and investors navigating complex regimes, by identifying potential pitfalls and maximising the reliefs available.

For more information on how Haslers can help you, please contact our property tax specialists.

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