



CLEMENCE HOAR CUMMINGS LLP
CHARTERED ACCOUNTANTS



Guide to Residential Property Letting

How is tax calculated and when is it due?

The amount on which tax is charged is the net rental income for each tax year (i.e. for each tax year ending on 5 April). Net income consists of the gross rent attributable to the tax year in question.

If rent is charged for a period which overlaps the tax year end, this would normally be apportioned accordingly. For example, if letting commenced on 1 October 2015, at £12,000 per annum, the amount assessable in 2015/16 would be £6,000 (6/12). Similarly, if an expense of £1,200 for an annual period were paid on 1 December 2015, the amount allowable in 2015/16 would be £400 (4/12).

If the property is jointly owned, the net income is then split in the relevant proportions and assessed separately on each individual, at the appropriate tax rate, after taking into account any allowances or losses which may be due.

For each tax year, half of the expected tax liability will normally be due on account on 31 January and 31 July, with any balance due payable the following 31 January. The expected tax liability is based on the previous year's final liability. For example, in 2016/17 Payments on Account would be due on 31 January 2017 and 31 July 2017 (based on the 2015/16 liability), with any balance payable on 31 January 2018.

Payments on Account may not be required in the first year of letting, or if letting income is small in relation to an individual's overall taxed income.



Wear and Tear Allowance (WTA)

From 1 April 2016 the government has replaced the Wear and Tear Allowance (WTA) with a new Replacement Furniture Relief (RFR).

At present, landlords of fully furnished property can claim an annual deduction based on 10% of their rents to compensate them for periodic replacement of furnishings. This deduction is given even if no actual expenditure is made. If actual expenditure is higher than the 10% WTA no additional relief is given.

As WTA is based on rents received, landlords where property values (and therefore rents) are higher, are receiving an unfair advantage, as the amount of relief they are claiming will be inflated even though their actual expenditure will be the same across the UK.

This measure will only affect landlords of fully furnished property. Owners of holiday let property are also unaffected as the WTA is not available to these businesses.

The new Replacement Furniture Relief (RFR)

Landlords of fully, partly or unfurnished residential property can claim for the actual cost of replacing furnishings.

The new RFR will not be available to furnished holiday lets businesses.

Replacement items that would be available for RFR include:

- Moveable furniture of furnishings, such as beds or suites
- Televisions
- Fridges and freezers
- Carpets and floor coverings
- Curtains
- Linen
- Crockery or cutlery
- Beds and other furniture

Fixtures that are part of the building and would not normally be removed if the owner sold the building would not qualify for the RFR. These fixtures would include:

- Baths
- Washbasins
- Toilets
- Boilers
- Fitted kitchen units

Additional considerations:

- The new relief will only apply to replacement costs. The initial cost of furnishing a property would not be included.
- The RFR will be based on the replacement cost less any proceeds from the sale of the replaced item.
- Any improvement cost would be excluded from RFR. For example, if a washing machine was replaced by a washer/dryer that cost £600, only the replacement cost of a similar washing machine, say £400, would be allowed.

Repairs

Expenditure on repairs is allowable as a revenue expense for income tax purposes, provided that the work carried out does not represent an improvement.

HMRC will normally accept that repairs do not constitute an improvement merely because more modern materials are used, such as when a single-glazed window is replaced by a double-glazed window.

An example of an improvement would be work carried out on a roof, where instead of simply restoring the roof to its original condition, new windows were installed as part of a loft conversion.

Expenditure in relation to improvement, additions or extensions to a property is capital, and is added to the cost of the property for capital gains tax purposes.

As a general rule, the replacement of part of an asset is a repair, but the replacement of an entire asset is likely to be capital.



Interest

Interest on a mortgage or other loan incurred for the purposes of property letting is an allowable deduction for tax purposes.

The loan need not be matched with a particular property, so if several properties are let, you do not need loans to be secured on all of them.

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

For example, if a property is purchased as a private residence for £400,000, with a £200,000 mortgage, but is let out some time later, when it is worth £500,000, an additional mortgage of up to £300,000 could be taken out, and interest on the full £500,000 would be allowable.

From 6 April 2017 new rules are going to be introduced over a period of three years to gradually restrict the relief given for loan interest. For 2020/21 and onwards all finance costs will only be given as a basic rate tax deduction.

Losses

If more than one property is let, a loss for a year on one property can be set against a profit on another.

An overall loss cannot be set against income from other sources, such as employment or investment income, but must be carried forward against future profits from the property letting business.

Any losses not utilised at the time when property letting ceases will normally remain unrelieved.

Pre-letting expenses before a property is let on commercial terms, or expense incurred in periods between letting on commercial terms, will normally be deductible from future rents.

Where a property is occupied rent-free or at a low rent, perhaps by a relative, you cannot offset the loss against other rental income.

Tenancy Deposit Scheme

A landlord may not take a deposit in respect of an assured shorthold tenancy unless it is covered by a Tenancy Deposit Scheme.

A Tenancy Deposit Scheme is designed to:

- Safeguard tenants deposits
- Facilitate the resolution of disputes arising in connection with such deposits.

There are two different types of schemes namely Custodial Schemes and Insurance-based Schemes. The landlord or agent must give the tenant details of how their deposit is protected within 14 days of receiving a deposit.

If you require further details, please do not hesitate to contact us.



Rent a room

Income arising from the letting of furnished accommodation, which is part of an individual's main residence is exempt from tax, provided that the rent (before any deductions for expenses) does not exceed £4,250 in the tax year in question. This limit is reduced to £2,125 when someone else also received income from the property.

From 6 April 2016 the rent a room limits increased to £7,500 and £3,750 respectively.

The property must in fact be used as a main residence at some point in the relevant period for the exemption to apply. For example, if an individual goes overseas on 1 December 2015 for 18 months and decides to let part or all of the house from that date for a year, rent a room relief will not be due for 2015/16, because the property was not in use as a main residence

between the start of the period (1 December 2015) and the end of the tax year (5 April 2016).

If the gross rent does exceed £4,250 in a tax year, one can either elect to be assessed on the amount by which the gross rent exceeds £4,250, or alternatively a statement of income and expenses can be drawn up and the net income assessed in the normal way.

Similarly, if expenses exceed income, one can elect for the exemption not to apply so that tax relief can be obtained for the loss.

Rent a room relief only applies to residential, not commercial, letting.

Furnished Holiday Lettings

Furnished Holiday Lettings attract various tax reliefs provided certain conditions are met.

What are Furnished Holiday Lettings (FHL)?

Certain conditions must be satisfied if rental income, rental expenditure and capital expenditure are to be treated as falling within the FHL rules. A property must be furnished accommodation, let on a commercial basis with the view to making a profit and should be situated in the European Economic Area (EEA).

What tax advantages are afforded to FHL?

Under the FHL rules, landlords are treated as though their qualifying FHL business is a trade for capital allowances and Landlords Energy Saving Allowances (LESA) along with certain capital gains tax reliefs, including business asset roll-over relief and entrepreneurs' relief.

FHL income is also treated as part of net relevant earnings when calculating tax relief on an individual's pension contributions.

FHL as with any other property businesses, also has the potential

to be eligible for Inheritance Tax (IHT) Business Property Relief, although claims are often unsuccessful as availability of this relief does require a high burden of proof on the taxpayer to show trading activity over and above that of a landlord.

Losses:

Any loss made from a qualifying UK FHL may only be offset against income of the same FHL.

Qualifying tests:

You must satisfy all three of the following tests if a letting is to qualify:

1. The availability condition (availability test/threshold) – the accommodation is available for commercial letting as holiday accommodation to the public for at least 210 days.
2. The letting condition (occupancy test/threshold) – during the period the accommodation is commercially let as holiday accommodation to the public for at least 105 days.
3. The pattern of occupation condition – the accommodation must not be let for periods of longer-term occupation for more than 155 days during the year.

Gains on Disposal

Capital Gains Tax (CGT) may be payable when a property which has been let is sold at a profit.

CGT will be due where a sale takes place within 18 months of the date when the property was last used as the owner's private residence.

Where a chargeable gain arises on a property which has been a private residence and was also let out at some point, a lettings exemption of up to £40,000 (maximum) is available.

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

Gains on properties within Annual Tax on Enveloped Dwellings (ATED) (see following pages) are liable to CGT, and gains realised by any non-residents on any other UK residential property are also liable to CGT.

A property can be subject to both ATED-CGT and non-resident-CGT and different calculations are required for each version of tax. The rate of tax depends on several factors and the maximum is currently 28%.



Main Residence Exemption

Most people are aware that when they sell their main residence no Capital Gains Tax is due as the gain is covered by the Principle Private Residence (PPR) relief. This is a valuable relief which benefits many people and with careful tax planning it can go further than you may think.

An individual's residence is a place where one lives. However, where an individual has more than one residence and a notice is not made, HMRC will consider which attracts the relief as a matter of fact. It is not automatically accepted that the main residence is where the individual spends the majority of their time. HMRC will look at various criteria, including but not limited to the following examples:

- the address used for utility and other bills;
- the address used on the Voting Register;
- address used with your bank.

If your property includes more than one building, particularly if it includes several out buildings, whether the out buildings are included within the definition of dwelling house will depend upon their relationship to the main property and whether they can be considered a single entity.

New rules have been introduced if you are or have been not resident in the UK for tax purposes.

These restrict the ability to claim the main residence exemption. Please speak with us if you need more information.



Garden or Grounds

Garden or grounds will include any enclosed land surrounding or attached to your dwelling house for the purposes of enjoyment of the property.

If your garden and grounds exceed half a hectare, (1.25 acres in old money) it may not all qualify for the relief. However, larger gardens or grounds may qualify but only if they are appropriate to the size and character of the property and required for reasonable enjoyment of it.



Periods of Occupation

You are entitled to relief on a disposal of a property to the extent that it was your only, or main, residence during the period of ownership and that there has been some period of occupation of the property, (ignoring any periods before 31 March 1982).

If the property was not your only, or main, residence for the entire period of ownership then the gain must be apportioned between periods when it did qualify as your PPR and when it did not qualify for PPR.

Nominating a Residence

You can only have one main residence for PPR purposes. If you own two properties, it is possible to 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

Certain periods of absence qualify for relief such as:

- last 18 months of ownership;
- a period of absence not exceeding three years, where you did not occupy another residence;
- a period of absence during which you were working abroad where you did not occupy another residence qualifying for relief;
- and a period of absence not exceeding four years where you were required to reside elsewhere by your employer where you did not occupy another residence qualifying for relief.

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.

Private Letting Relief

Private Letting Relief is given on the sale of a property which was your main residence and had been let as residential accommodation.

The amount of the Private Letting Relief is up to £40,000.



Sale of Part of the Garden

Relief should be available where a part of the garden or grounds is sold before the sale of the main dwelling house. However, where the grounds are in excess of half a hectare and they are disposed of separately it may be difficult to demonstrate that they are required for the reasonable enjoyment of the property.

The PPR relief is one of the most valuable capital gains tax reliefs, however, the operation of the relief is not always as straightforward nor its availability a foregone conclusion. Tax planning can help enormously in identifying potential issues and maximising the available relief.





Non-resident landlords

The scheme which operates for non-resident landlords is that a return must be submitted, and tax accounted for to HM Revenue & Customs (HMRC), on a quarterly basis, payment being due 30 days after the end of each quarter.

Where there is a letting agent, the amount subject to tax is the rent less expenses for that quarter, with possible adjustments when expenses have exceeded rent in any quarter. If there is no letting agent, the tenant should deduct tax at the basic rate from the gross rent and remit this to HMRC, unless annual rent is less than £5,200, in which case rent may be paid over gross.

It is, however, possible to apply to HMRC for exemption from the scheme, so that the landlord can receive the gross rent. For an application to be accepted, it must be shown either that all UK tax obligations have been met (or that there have been no UK tax obligations) before making the application, or that it is not expected that there will be any UK tax liability for the year in which the application is made.

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.

If you are not resident in the UK and dispose of UK residential property you must report the disposal to HMRC within 30 days of the conveyance of the property. This also applies to gifts (other than to a spouse or civil partner), in which case the disposal is deemed to have been made at its current open market value. This additional reporting requirement is still required even if you are registered to submit a tax return.





Our Taxation Services

At Clemence Hoar Cummings, we have specialised in looking after the personal taxation affairs of private individuals.

We have considerable experience with clients in the property industry and have links with a number of property management agents. Our understanding of the agent's responsibilities, particularly with regard to taxation, enables us to liaise closely with them to provide the maximum benefit to their clients.

Through giving taxation services to landlords, we have developed our services both to UK-resident and overseas individuals, and

act for landlords from many different countries, who let residential property in the UK.

Due to the requirements of the HMRC scheme for non-resident landlords, it is most important that expert advice is sought in this area.

By using the most up-to-date technology, we are able to provide a highly efficient service in a cost-effective way.

Our firm is built on the principle of integrity, objectivity and technical excellence.

Annual Tax on Enveloped Dwellings

ATED applies to an interest in a UK residential property where a company, or a partnership with a company as a member, is entitled to the interest. An ATED return must be filed at the beginning of the tax year.

Initially it applied to properties worth over £2m, but from April 2015 this was reduced to £1m. The starting point dropped to £500,000 in April 2016.

There are a number of exemptions and reliefs available; in particular where the property is held for rental or trading stock. However, a return still has to be filed to claim the exemption otherwise penalties will arise.

How Can We Help?

Our services include:

- Dealing with HMRC notification and all relevant forms on commencement of letting
- Preparing an annual lettings account
- Submitting the account with your tax return to HMRC and, if appropriate, agree the tax liability
- Taking advantage of any tax-saving opportunities
- Advising on payment of any liability
- For non-resident landlords:
 - Preparing any additional forms/claims to UK allowances
 - Prepare any application for exemption from tax deduction scheming and liaising with your managing agent to avoid or minimise retention of tax from your net income.





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