The Landlord's Guide to Tax

GREAVES WEST & AYRE
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As well as providing an income stream, renting out property can be a great investment. However it can also complicate your tax affairs. In light of several recent changes to legislation, this leaflet attempts to broadly outline a landlord's tax obligations.

Firstly you need to work out whether your rental property comes under the category of a Furnished Holiday Let, a Long Term Let or indeed the 'Rent a Room' scheme.

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A – Furnished Holiday Lets

What is a Furnished Holiday Let (FHL)?

A FHL is a property which is furnished by the landlord and is let-out with the intention of making a profit from short term lets and which fulfils each of the following conditions:

1. The property must be available for let for at least 210 days per year.

2. The property must be let for at least 105 days per year.

3. If the property is occupied by the same person(s) for more than 31 days, the total number of days of these 'longer term lets' must not exceed 155 days.

What if I do not let the property for 105 days?

As long as the other conditions are met and you can prove that you genuinely intended to let the property for at least 105 days, you can elect for a 'period of grace' to apply for one year. This election can be made again the following year if, once again, you do not manage to let the property for 105 days. However, if the condition is not met for three consecutive years the property is no longer considered to be a FHL.

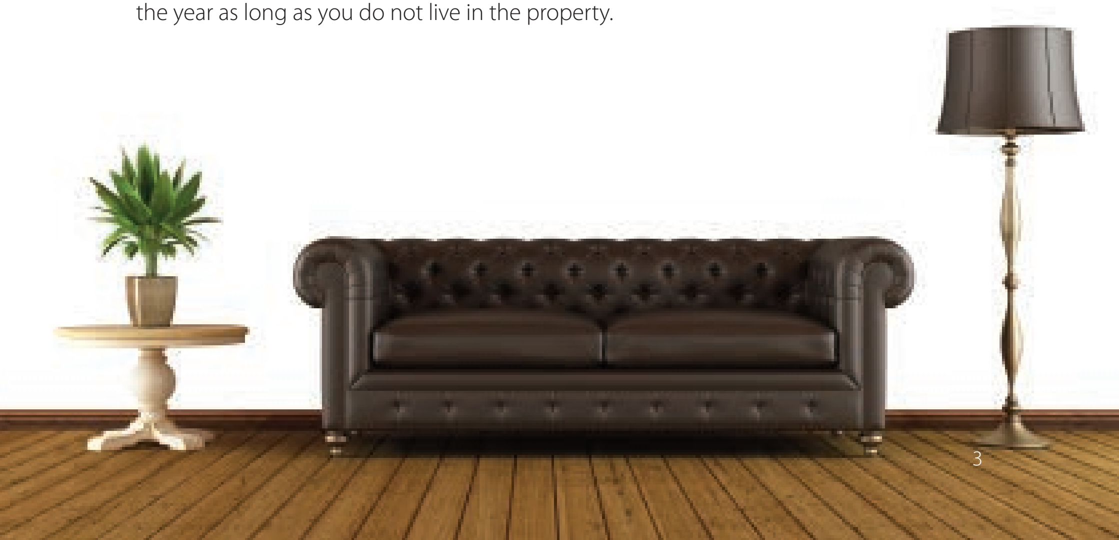
If you have multiple FHL properties you can elect for the number of days required to be averaged over all properties. For example, if you have two properties, one let for 100 days and the other for 110 days, then the letting condition is met.

Can I use the averaging and 'period of grace' together in the same year?

Yes.

What if I do not let the property for the full year?

If the property is only used as a FHL for part of the year and is closed for the rest of the year, all expenses relating to the property may be deducted for calculating your profit for the year as long as you do not live in the property.



What if only part of my property is let as a FHL?

If you only let part of your property as a FHL, or use the property privately for some of the year, then the expenses you may deduct to calculate your profit must be allocated proportionally.

How is my profit from FHL taxed?

Profits from a FHL business are subject to income tax if run by individuals, or corporation tax if run by a limited company. The profit from a FHL business is calculated by taking all rents received in the year and deducting any expenses which are 'wholly and exclusively' for the FHL business and are not 'capital' costs. If you make a loss from a FHL in one year, this can be offset against profits made from the FHL in the future.

What happens if I do not make a profit?

The most important thing is that you can prove that you intended to make a profit. If you make a loss in one year it does not mean that your property is no longer a FHL. However, if you make continual losses it is unlikely that the property will qualify as a FHL.

What tax reliefs are available to me as a FHL landlord?

Capital allowances are available on the cost of capital items e.g. fridges, freezers, furniture etc which are purchased for the property, which may reduce the amount of profit you pay tax on.

One particular type of capital allowance, the Annual Investment Allowance (AIA), provides full relief for the first £200,000 of these costs. However, this is shared across all other businesses you may have.

Capital gains tax reliefs also apply to FHL businesses so if a gain is made when a property is sold, either tax could be charged at a rate of 10% or the liability could be deferred.

Finally, any profits from a FHL business will count towards your 'relevant earnings' meaning that it may be possible to make tax-efficient pension payments from these profits.

B – Long Term Lets

If you own a property (or properties) which you let out, or intend to let out, on a longer term basis the tax position is different than it is for FHLs.

What are the main differences?

Firstly there are no conditions to be met to qualify. For example there is no minimum number of days the property needs to be let for and there are no consequences of making a loss in several consecutive years.

Also, while losses made can only be carried forward against future profits of the property business, excess capital allowances can be offset against any other income you may have.

Any costs incurred in relation to the let property, e.g. letting agent's fees, insurance, rates and utilities, can be deducted from your rental income to calculate your profit. Capital allowances are not available on most capital costs, but deductions are available for the cost of items purchased by the landlord for use in the property. For example, the cost of items such as fridges, cookers, bedding, crockery and furniture which are bought by the landlord solely for the use of the tenant in the property may be deducted, subject to certain conditions.

Have there been any recent changes to tax on residential lettings?

Yes. There have been three changes to the way in which profits for rental businesses will be calculated from the 2016/17 tax year onwards. These concern the replacement of domestic items, the replacement of tools and the deduction of finance costs from profits.

What changes have been made concerning the replacement of domestic items?

In the past, a wear and tear allowance of 10% of the net rent was given to cover the cost of replacement furnishings. Since April 2016 this is no longer available. However, as noted above, the cost of replacing certain items which the landlord provides to the tenant for use in the property, can be deducted from rental income. Any costs incurred in disposing of the old items can also be deducted from rental income, less any proceeds received from the sale of the old items.

The replacement items must be similar to that which they have replaced. If any element of the new item represents an improvement, for example replacing a washing machine with a washer-dryer, then the replacement relief will be restricted accordingly.

What effect this change will have on your profits will depend on how much you spend replacing furnishings in your properties in the year, and will be specific to each individual case.

What changes have been made concerning the replacement of tools?

The cost of replacing or altering tools can now only be deducted from trading profits if the expected life of the tool is less than two years. If the expected life is greater than two years, then the deduction may have to be spread over a number of years.

What changes have been made concerning finance costs?

Previously finance costs, e.g. interest on mortgages, loans and overdrafts, could be deducted from taxable profit as an expense. This meant a higher rate taxpayer could claim income tax relief of up to 45% on mortgage interest payments, so for example an interest payment of £100 only cost £55 after tax relief.

Over the next four tax years, this relief will be phased out gradually until all landlords receive the basic 20% tax relief on mortgage interest only. For a higher rate tax payer the actual cost of a £100 interest payment will become £80 after tax relief so it is possible that profit after tax from some rental businesses may not cover mortgage payments.

This change will only affect individuals, not companies and does not apply to FHLs.

C – Rent a Room Scheme

The rent-a-room scheme applies to individuals receiving income from providing furnished accommodation, including the provision of meals, cleaning and laundry, in their only or main residence. For example, where a room in an individual's home is let out but the rest of the property is occupied by the owner.

So long as income from renting out a room does not exceed a certain limit, currently £7,500 per property *, then rent-a-room tax relief is automatic and you don't need to do anything.

Where the rent-a-room income from a property exceeds £7,500 for a tax year before the deduction of any expenses or capital allowance, the excess of rent-a-room income above the limit of £7,500 before the deduction of any expenses or capital allowances is chargeable to tax. Alternatively, you can elect to tax the total income less expenses and capital allowances.

* Figure accurate at January 2017

How can GWA help?

Whether you are a new landlord with one property or have a portfolio of properties, we can review your business structure and income streams and recommend any changes which could be made in order to maximise the tax relief available to you. We can also advise you of how the recent changes imposed by HM Revenue & Customs will affect your tax liability.

What should I do now?

Contact a Partner at Greaves West & Ayre for further information or to arrange a complimentary initial meeting to discuss how these changes affect you and your business.

Telephone **01289 306688** or email **berwick@gwayre.co.uk**

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