

HARRIS
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Residential Property Letting

Tax Guide



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 UK200Group

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 and Customs, on a quarterly basis, payment being due thirty 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 HM Revenue and Customs, unless annual rent is less than £5,200, in which case rent may be paid over gross.

It is, however, possible to apply to HM Revenue and Customs for exemption from the scheme, so that the landlord can receive the gross rent. For 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, Commonwealth and European Economic Area citizens. An annual claim form will normally have to be submitted to HM Revenue and Customs.

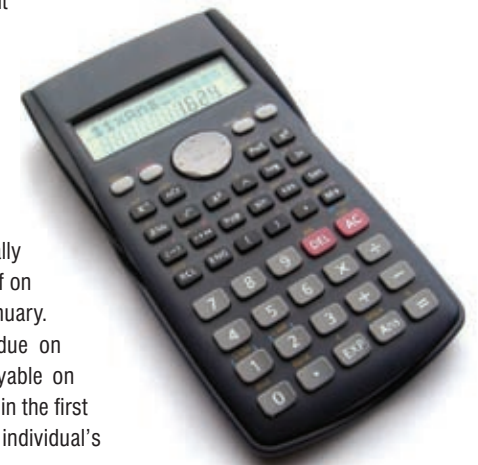
How is tax calculated and when is it due?

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, less allowable expenses (see following page).

If rent is charged, or expenses are incurred, for a period which overlaps the tax year end, this would normally be apportioned accordingly. For example, if letting commenced on 1 October 2007, at £12,000 per annum, the amount assessable in 2007/2008 would be £6,000 (6/12). Similarly, if an expense of £1,200 for an annual period were paid on 1 December 2007, the amount allowable in 2007/2008 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 in the relevant year, and half on the following 31 July, with any balance on the following 31 January. For 2008/2009, therefore, Payments on Account will be due on 31 January 2009 and 31 July 2009, with any balance payable on 31 January 2009. 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.



Allowable expenses

- Accountancy expenses
- Advertising
- Agent's letting fees
- Bad debts
- Bank charges
- Caretaking
- Cleaning
- Council tax
- Debt collection
- Electricity
- Energy-saving insulation and draught-proofing
- Gardening
- Gas
- Ground Rent
- Insurance
- Interest
- Inventory
- Legal fees
- Maintenance charge
- Management charge
- Postage and stationery
- Repairs
- Security
- Telephone
- Water rates
- Wear and tear (furnished accommodation)

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.

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 2007 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 2007/2008, because the property was not in use as a main residence between the start of the period (1 December 2007) and the end of the tax year (5 April 2008).

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.



Flat Conversion Allowance

The government offers a special tax incentive, the flat conversion allowance, as part of its drive to regenerate town and city centres.

This allows you to make an immediate claim against your taxable income for the cost of converting qualifying properties back into residential flats. Provided you keep the flats for a qualifying period after the work, the taxman will not reclaim the allowance.

To qualify, the flats must be in a property built before 1980 and of no more than five floors. The ground floor must be in business use and the upper storeys must originally have been constructed primarily for residential occupation, although in the year prior to conversion they must have been empty or used for storage.

You cannot include the cost of the property prior to conversion, of any extensions and of furnishing the flats in the qualifying expenditure. The following is an example of how the allowance might work in practice.

Sunita earns £100,000 a year from her portfolio of rented properties. She buys a three-storey property in Birmingham city centre, with a shop on the ground floor. She spends £60,000 converting the two upper floors into flats.

This cost is offset against her income, which means that she only pays tax on the £40,000 remaining, cutting her tax bill this year by £24,000. If she owns the flats for a further seven years after the conversion, the money will not be clawed back.

The only drawback is that she cannot claim this same expenditure in her capital gains tax computation when she eventually sells the flats.

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.

HM Revenue and Customs 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 improvements, 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, interest on a loan for a property which had been sold would still be deductible, provided other properties continued to be let.

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.

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 relief is a valuable relief which benefits many people and with careful tax planning it can stretch ad may go further than you may think.

An individual's residence is a place where one lives. HM Revenue and Customs (HMRC) consider whether a property is a residence is a matter of fact, they will look at:-

- your address with your local tax office;
- 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 outbuildings 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.

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 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 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 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.

Certain periods of absence qualify for relief such as:

- last three years ownership;
- a period or periods of absence not exceeding three years, where you did not occupy another residence qualifying for relief;
- 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.

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 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 a maximum of £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 Relief, 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.

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.

Gains on disposal

Capital gains tax may be payable when a property which has been let is sold at a profit.

No capital gains tax will be due where a sale takes place within 3 years 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 Capital Gains Tax 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.



Tenancy Deposit Scheme

Please note that from 6 April 2007, a landlord will not be able to 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 will be two different types of schemes namely Custodial Schemes and Insurance-based Schemes.

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



Our Taxation Services

At Harris Lipman, we have specialised in looking after the personal taxation affairs of private individuals for over 50 years.

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 Revenue and Customs 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 principles of integrity, objectivity and technical excellence.

How Can We Help?

For an inclusive fee, our Landlord's Tax Service will:

- Deal with HM Revenue and Customs notification and all relevant forms on commencement of letting
- Prepare an annual lettings account
- Submit the account to HM Revenue and Customs and, if appropriate, agree and tax liability
- Take advantage of any tax-saving opportunities
- Advise on payment of any liability
- For non-resident landlords:
 - Prepare any additional forms/claims to UK allowances
 - Prepare application for exemption from tax deduction scheme and liaise with your managing agent to avoid or minimise retention of tax from your net income

Please contact **Barry Lewis** for more information
and a fee quote on: **020 8446 9000**

