Buying UK property

Stamp Duty Land Tax (SDLT) must normally be paid by the purchaser of the property within 30 days of completing the purchase. The rate of the tax is determined by the value of the property and SDLT is payable on its full value at the rate of the band into which it falls.

Where the purchase price includes fixtures such as carpets, the purchaser is responsible for establishing a ‘just and reasonable’ apportionment of the sale price between the property and the fixtures.

Letting property in the UK

The letting of property in the UK is treated for income tax purposes in the same way as a UK property business. Where more than one property is rented out, the letting of all the properties is treated as a single business, which allows a loss made on one property in a year to be effectively set against profits made on others. No distinction is made for these purposes between property let unfurnished and furnished, except for the special rules which apply to furnished holiday lettings (see overleaf).

Make sure record keeping is good

Accounts should be prepared for the business in accordance with generally accepted accounting principles, although in most cases this should simply mean making sure that all rental receipts have been recorded and only expenditure of a revenue nature has been deducted in arriving at profits.

Receipts

Rents should be included on the basis of the sum actually due for the tax year. This means that any rent paid in advance that relates to a period after the end of the tax year should be brought into account not when it is received but in the following tax year. If you exclude such a receipt in year 1 make sure you remember to pick it up when you prepare your figures for year 2.

Expenses

You can claim expenses which are revenue in nature. Capital items cannot be claimed directly against income although some other relief may be available. You must also show that the expense is incurred ‘wholly and exclusively’ for the purpose of the letting business so expenses which have a personal element to them must usually be apportioned.

Typical expenses that can be claimed will include:
- advertising for tenants (but not for sale)
- agents’ fees in relation to the letting but not the purchase or sale
- expenditure on maintaining common areas of a building
- fees in respect of finance arrangements
- interest on borrowing to fund the purchase (don’t simply claim the total sum payable to the lender in the year as this will probably include some capital repayment as well)
- expenditure on loft and cavity wall insulation can be claimed up to April 2015 (there are some restrictions on this so you need to check carefully)
- any expenditure on services such as gardening or cleaning that you agree to provide.

Expenditure on the building

There may be a particular issue in dealing with expenditure on the fabric of the property. A repair can be deducted from income but where there is a clear element of improvement that takes the property beyond its original condition, then the repair will be regarded as capital and cannot be claimed against income.

Common items of repair that can usually be claimed will include:
- exterior and interior painting and decorating
- re-pointing
- damp and rot treatment
- mending broken windows, doors, furniture and equipment such as cookers
- replacing roof tiles, flashing and gutters.

Where expenditure is clearly of a capital nature and results in an improvement to the property it may be possible to claim the cost of it in calculating the capital gain when the property is sold. Improvement expenditure is deductible against the gain, provided it is still reflected in the state of the property at the time of disposal.

There are many issues for the prospective buyer to take into consideration before deciding to plunge into the buy to let property market. Good impartial advice is needed from lawyers, banks and surveyors. This briefing assumes that the specialist advice has been taken and will concentrate on the tax aspects involved in the purchase, letting, sale and passing on of buy to let residential property. It will also look at the options available for holding property.
Expenditure on furniture and fittings

The capital allowance rules that give some deduction for plant and machinery do not apply to the rental of residential property.

Where a property is let on a furnished basis there is an optional allowance towards the cost of furniture. HM Revenue & Customs (HMRC) allow by concession a deduction of 10% of the net rents to cover the wear and tear on furnishings such as carpets, beds, settees etc. There is no requirement to demonstrate actual expenditure on the replacement of these items.

As an alternative, where the property is let furnished the landlord can claim a renewal allowance when furniture and fixtures such as baths etc are replaced. The allowance cannot cover the original cost of the item, nor can it include any improvement element in the replacement. This latter relief is also available on fixtures where a property is let unfurnished.

Capital gains on the sale of the property

When the property is sold there may be a liability to capital gains tax (CGT) on the disposal. The gain is calculated by deducting from the sale proceeds:

• the original cost of purchase
• any indexation allowance where the property was originally purchased before 1998
• the incidental costs of purchase and sale such as legal costs and estate agents’ fees
• any improvement expenditure which is still reflected in the state of the property.

Any gain will then be reduced by what is known as taper relief. Residential property (except furnished holiday lettings) will qualify for non-business taper relief, which is calculated by reference to the average for all the properties you own, in order to satisfy the test.

Advantages include:

• a loss on furnished holiday lettings can be set against other income of the same year including non property income
• a loss made in the first three years of letting may be carried back up to three years
• income from this source can be used to calculate entitlement to tax relief on pension contributions
• capital gains made on the sale of one furnished holiday let can be ‘rolled over’ against the cost of buying another similar property purchased up to a year before or three years after the date of sale
• if a property is gifted, a claim can be made to ‘hold over’ the gain so that it does not become due until the recipient sells it
• taper relief in calculating the gain is based on the business taper rate so that after one year of ownership 50% of the gain is removed and after two years the gain is reduced by 75%
• for inheritance tax purposes it may be possible to claim a reduction of up to 100% in the value of the property passing on death or on a chargeable transfer (this is subject to conditions which HMRC impose).

If you own properties that are let as furnished holiday lets in addition to other properties you are required to keep the activities separate for the purposes of calculating income.

Alternative routes for holding property

So far this briefing has assumed that the property is owned by individuals who are liable to income tax and CGT in the UK, which can mean a liability of up to 40% on both income and gains. Obviously some reduction in liability can be created by having joint ownership with individuals who are either not liable to tax or pay at a rate below 40%. Other routes are available to hold property but there are issues which need to be carefully considered.

Using a company

Rental income in a company will usually be taxed at the small companies rate (currently 20%) and then 21% from 1 April 2008). This seems to be attractive when set against a potential 40% rate for an individual. If rents are significant this may be an option to consider although there are additional compliance problems to deal with, not least with Companies Act requirements.

From a tax point of view it must be remembered that income has to be extracted from a company by an individual either as salary or dividend and that this may trigger a tax liability. It is also important to remember that when a property is sold by a company, taper relief is not available. The company can claim indexation allowance based on the cost of the property which may not be as attractive. In addition the gain has to be extracted from the company.

Using a trust

There may be estate planning opportunities to consider in using a trust to hold rented property. Although a trust will be liable to income tax and CGT at a rate of 40%, the assets in the trust may be effectively placed outside any individual’s estate for IHT purposes, which may give some very significant tax savings over a long period.

There are many issues to consider here and this is an area where specialist advice is needed. Please talk to us if you would like to discuss any of the matters raised in this briefing.

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