vanmali & co.
chartered certified accountants

25a High Street, 2nd Floor, Daventry
Northants NN11 4BG

Tel: 01327 87 97 99
Fax: 056 031 53377

Email: manoj@vanmaliandco.com
www.vanmaliandco.com

The landlords' guide to tax

If you're renting out property, you may feel confused about your tax obligations. Here are some of the key facts.

Although letting out property can be a great investment and provide you with a regular income, it can also make your tax affairs much more complicated. You'll probably need to pay tax when you buy the property, on any income you earn as a landlord and when you sell the property.

This guide explains the principal tax liabilities faced by landlords.

When you're buying the property

If you're buying land or property, you'll need to pay Stamp Duty Land Tax – more commonly known as Stamp Duty. The amount you pay is calculated as a percentage of the property's value.

When you're working out your budget for buying a property, it's essential you factor in the cost of Stamp Duty as this sum often totals thousands – even tens of thousands – of pounds.

Income tax

Profits from renting out a property form part of your income and are therefore subject to income tax in the same way as your other earnings.

The rate of tax you pay depends on your total taxable income. If you're a basic rate taxpayer, you'll pay 20%, while higher rate taxpayers pay 40%.

It may be worthwhile setting up a separate account for your rental income. This way, your finances as a landlord won't become confused with any other income and expenses.

Remember, only **profits** from renting out property are liable for income tax. To calculate your profits, you'll need to take your total rental income and deduct any "allowable expenses". This sum is the amount that will be subject to income tax.

What expenses can you offset against rental income?

HMRC considers any costs that are essential to performing your duties as a landlord or maintaining the property to be "allowable expenses". As mentioned earlier, offsetting these expenses against your rental income could significantly reduce your income tax bill.

Allowable expenses include:

- Interest on a mortgage taken out on the property.
- Buildings and contents insurance.
- Professional/legal fees.
- Council tax.
- Travel costs to collect rent.
- Maintenance.
- Advertising the property for rent.

Until 2015, you can also claim relief via the Landlords Energy Saving Allowance. Under this system, you can claim for the cost of loft, floor, wall insulation and draught proofing at the property. The maximum you can claim is £1,500 per property.

Capital versus revenue expenses

When calculating your expenses, it's essential you understand the difference between revenue and capital expenses.

Revenue expenses relate to the day-to-day running and maintenance of the property and can be offset against your income tax bill.

Capital expenses are those that increase the value of a property, such as renovations or adding a conservatory. Such costs can't be deducted from your income tax bill – though you may be able to offset these against any capital gains tax when selling the property. See below for more information on capital gains tax.

Tax and furnished properties

If you let out the property on a furnished basis, you can claim a “wear and tear” allowance, which allows you to make a deduction equal to 10% of the net rent per year. To calculate the net rent, take the amount of rent you receive and minus any costs you pay that a tenant normally would – council tax, for example.

Alternatively, “renewals allowance” enables you to claim tax relief on the cost of replacing any furniture at the property – though you need to deduct any profits you make if you then sell the furniture.

You can’t claim both wear and tear and renewals allowance on the same property so it’s wise to consider your options carefully and decide which would have the most benefit.

Selling the property

When the time comes to sell, you’ll probably be liable for capital gains tax on any profit. As you no doubt know, this is a tax you pay whenever you dispose of an asset, such as a building, land or lease.

Every year, you’ll have an annual tax-free allowance, which means you can make a certain level of profit before the tax kicks in. During the 2013/14 tax year, this allowance is £10,900.

Basic rate taxpayers pay capital gains tax at 18%, while this figure increases to 28% for those in the higher rate bracket. Even if you have relatively modest earnings from your salary, profits from the sale of a property could push you into the higher band.

Reducing capital gains tax

Like income tax, you can offset some of your expenses against your capital gains tax bill. These include:

- Solicitors and conveyancing fees.
- Estate agents fees.
- Expenses incurred when improving the property.
- Advertising the property for sale.
- Stamp Duty.

If you make a loss when selling the property, you may be able to deduct this from any other capital gains during that tax year or in the future.

Bear in mind, you won't pay capital gains tax on your main residence. This is known as private residence relief. If you have lived in the property you're renting out at any time, you may be able to claim tax relief for the last three years of ownership.

Imagine you owned a house for 10 years. During this time, you lived in it for two years and let it out for the remaining eight years. You would qualify for tax relief on five years of home ownership (the two years of your residence, plus the additional three years). This would mean only half your profit from the sale would be liable for capital gains tax.

There are a number of other possible deductions from your capital gains tax bill so you might want to get independent financial advice at this stage.

Filling in a tax return

As a buy-to-let landlord, you'll normally need to fill in a tax return to declare rental income to HMRC.

If your total income from rental property is above £15,000 per year, you'll need to fill in a full tax return – though you may be able to complete a four-page return if your rental earnings fall below this threshold.

You can also use your tax return to declare any capital gains or losses generated through the sale of the property.

Getting financial advice

Tax affairs for landlords can be extremely complex. This guide is intended to provide you with the basics, but it may be worth seeking professional advice from a tax expert based on your individual circumstances.

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

Vanmali & Co Ltd
25A High Street
Daventry, NN11 4BG

Tel: 01327 879799
Email: manoj@vanmaliandco.com