Dow Schofield Watts
Private Client Tax

# Renting a UK Property

## Tax Factsheet

An individual letting a UK rental property pays income tax on their net rental profits at their marginal rates, this can be up to 45% for additional rate taxpayers.

### Key Facts:

- From April 2017, landlords will automatically be required to use the cash-basis when preparing their rental accounts each tax year.
- Most expenses incurred wholly and exclusively for the purpose of renting out a property are deductible. Deductions may also be able to be made for travel, finance costs and the replacement of domestic items.
- New restrictions on mortgage interest relief and lower corporation tax rates mean incorporating a rental property portfolio may beneficial when looking to reduce your tax liability

### Cash Basis v Accruals Basis

From 6 April 2017, landlords running unincorporated property business must prepare their rental accounts using the cash basis unless they elect for it not to apply. There are a few instances where the cash basis does not apply by default, most notably if rental receipts for the year worked out using the cash basis, are greater than £150k.

In any other circumstance, assuming the landlord does not elect to opt out, the cash-basis should be used to calculate annual profits.

The cash basis is much simpler than the accruals basis and simply looks at money in and money out. Sales are accounted for when payment is received and expenses are deducted when paid. Under the accruals or earnings basis, income and expenditure is matched to the period in which the income was earned or expenditure incurred, receipts and payment don't therefore have to be made to be taken in account when calculating annual profits.

It is down to the individual whether they prefer to use the cash or accruals basis, whatever the reason an election must be made within the normal self-assessment time limit i.e. by 31 January 2019 for the 2017-18 tax year.

### Deductible expenses

Broadly speaking, when calculating rental business profits, an individual can deduct any revenue expenses incurred wholly and exclusively for the purpose of the rental business.

Typical deductible expenses include:

- Accountancy fees
- Agent management fees
- Buildings and contents insurance
- Cleaning
- Council tax when the property is empty and available to let
- Gardening
- Ground rent
- An element of mortgage interest
- Legal and professional fees incurred in respect of the property rental
- Provision of services – gas, electric, water
- Repairs and maintenance charges
- Cost of travel to properties

## Travel expenses

Unincorporated landlords can choose to use a fixed rate mileage deduction or make a deduction for actual running costs and claim capital allowances.

Individuals are not eligible to claim a fixed rate mileage deduction if they have historically claimed capital allowances.

Using the fixed rate deduction scheme, the rates per business mile that can be claimed are:

| | Flat rate business mile |
|---|---|
| First 10,000 miles | 45p |
| After 10,000 miles | 25p |
| Motorcycles | 24p |

If a landlord chooses to deduct actual running costs they will be able to deduct travelling expenses incurred wholly and exclusively in respect of servicing the property business. This includes the cost of travelling from the individual's home to the let property and back, but only if the journey was exclusively for business purposes.

Other running costs such as road tax and taxi fares can be included as allowable deductions, but, again, only so far as they relate to the property business – they will therefore needed to be pro-rated for any element of private use attributable to the cost.

## Mortgage interest

In the summer 2015 budget, George Osbourne announced the government were to phase in restrictions on the level of relief landlords could claim in respect of mortgage interest.

By April 2020, landlords will only receive a basic rate deduction from their income tax liability when it comes to loan interest paid on their property, this means that reliefs will be drastically reduced for higher rate taxpayers with substantial mortgages on their properties.

The changes are being introduced gradually as follows:

- 2017-18: 75% of finance costs deducted in full with 25% limited to a basic rate tax deduction.
- 2018-19: 50% of finance costs deducted in full with 50% given as a basic rate tax deduction.
- 2019-20: 25% of finance costs deducted in full with 75% given as a basic rate deduction.
- 2020-21: all finance costs limited to a basic rate tax deduction.

## Repairs & Maintenance

When considering repairs to offset against rental income, it is important to distinguish between revenue and capital expenditure. Technically, a repair is defined as 'the restoration of an asset by replacing subsidiary parts of the whole asset'.

This is a tricky and subjective area, but effectively, an expense is unlikely to be deemed a repair if the resulting work creates a significant improvement in the asset beyond its original condition.

Typical examples of repair costs might include: exterior and interior painting and decorating; mending broken windows, doors etc; replacing roof slates and gutters, damp and rot treatment.

## Replacement of domestic items

The wear and tear allowance was abolished in April 2016 and replaced with Replacement of Domestic Items relief.

Under this new relief, tax deductions are given for:

- The cost of the replacement item
- Less the cost of any element of improvement
- Less any proceeds of sale of the old item
- Plus any costs of disposing the old item

Domestic items include: Moveable furniture such as beds, sofas, carpets, curtains and household appliances such as fridges, freezers etc.

## Non-resident landlords

Non-UK resident landlords must pay income tax on their UK rental property income. They are subject to 20% withholding tax on their UK rental income unless they make an application to HMRC for rents to be paid gross.

This basic rate tax credit means that they essentially make a 'payment on account' towards their income tax liability. If the individual is a higher rate taxpayer, they will pay the additional 25% tax on their profits when they complete a submit their annual tax return.

## Property Allowance

The property allowance is a new addition to the 2017-18 tax year. From 6th April 2017, individuals will not need to declare rental profits if they fall below the £1,000 threshold.

Whilst disclosure is not required, full records of income must still be maintained. This allowance can be useful for individuals who occasionally rent out a property, for instance via AirBnB.

Partial relief is available if receipts are greater than £1,000 in that the individual can choose to deduct the £1,000 allowance against rental receipts rather than deducting actual costs and expenses. This partial relief applies for income between £1,000 and £2,500 gross – anything above the £2,500 threshold should be reported under the normal property rules.

If you own a property jointly, you are each eligible to utilise the allowance against your share of the rental income – the allowance does not need to be split between landlords.

## Rent-a-room

Rent-a-room relief applies where rent is received by a landlord for letting out a room in their own home, for example if they were to take on a lodger.

Under rent-a-room, income is exempt from income tax if gross receipts in the tax year are less than £7,500 (previously £4,250). If the income is exempted, the landlord can't then claim the expenses associated with the rental.

Where income exceeds the £7,500 limit, the excess receipts can be taxed on an alternative basis that may provide a lower tax bill. The taxpayer can take the lower of (a) the actual net profit from the letting arrangement or (b) the excess gross receipts and use this as their taxable rental income.

## Losses

When a property business makes losses, the landlord can carry them forward to offset against future business profits.

Losses can be pooled together and utilised in aggregate against an entire portfolio of properties, however losses from one rental business can't be carried across to another rental business if it has a different legal capacity i.e. from a personal rental business to a partnership. Equally, losses from furnished holiday lets must be kept separate.

Losses will be restricted if a property is let under uncommercial terms e.g. at a nominal rent to a relative.

## Incorporation

With the reduction in mortgage interest relief for higher rate taxpayers and increasingly low corporation tax rates, it may be worth considering incorporation as an avenue for mitigating or reducing your tax exposure from rental income.

The mechanics of incorporating a property portfolio need to be carefully considered and structured; our team have significant experience dealing with all aspects of property matters, including incorporation, and would be happy to discuss your own personal position and options available in more detail.

***This factsheet is based on law and HMRC practice at July 2018.***


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