

ROTHERHAM TAYLOR
LIMITED
Chartered Accountants & Registered Auditors

RESIDENTIAL LANDLORDS TAX GUIDE

YOUR FORW**7**RD
THINKING ADVISERS

HOW IS TAX CALCULATED?

Tax is charged on the net rental profit for each tax year (i.e. for each tax year ending on 5th April).

“ Net profit consists of the gross rent received in a particular tax year after the deduction of any tax allowable expenses. ”

The default position is for rent to be taxed based on when it is received during the tax year. If the property is jointly owned, the net profit 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 available.



WHEN DOES TAX NEED TO BE PAID?

For each tax year, if you owe more than £1,000, half of the tax liability will normally be due on account on 31st January in the tax year and 31st July following the tax year, with any balance due payable the 31st January following the tax year.

For example, in 2022/23, Payments on Account would be due on 31st January 2023 and 31st July 2023, with any balance payable on 31st January 2024.

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 PAYE income.

TAX DEDUCTION FOR 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.

“ HMRC 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.

REPLACEMENT OF DOMESTIC ITEMS RELIEF (RDIR)

As a landlord, you can claim for the cost of replacing furnishings. However, RDIR does not include properties that are rented out as furnished holiday lets, as these are able to claim capital allowances instead.

The relief only applies to replacement costs and cannot be claimed against the initial cost of furnishing a property. If you are able to resell any items that you are replacing, the proceeds from their sale are deducted from the amount of RDIR you claim.

Replacement items covered by RDIR include:

- Moveable furniture such as beds or sofas
- Televisions
- Fridges and freezers
- Carpets and floor coverings
- Curtains
- Linen
- Crockery and cutlery

Fixtures that would not normally be removed if you sold the property are not covered by RDIR, for example:

- Baths
- Boilers
- Toilets
- Fixed kitchen units
- Sinks



OTHER EXPENSES YOU CAN CLAIM

As a landlord, there are other expenses you can claim but it is important to understand those costs that are allowable as well as those that cannot be reclaimed.

Examples of allowable expenses include:

- Accountancy, legal and professional fees relating to the rental business
- Water rates, council tax, gas and electricity
- Insurance, such as landlords' policies for buildings, contents and public liability
- Costs of services, including the wages of gardeners and cleaners
- Letting agent fees and management fees
- Rents (if you're sub-letting), ground rents and service charges
- Direct costs such as phone calls, stationery and advertising for new tenants
- Vehicle running costs (only the proportion used for your rental business) including mileage rate deductions for business motoring costs

“ However, with each of these expenses comes a number of important caveats so it is important to seek professional advice before processing your expenses claim to ensure you do not fall foul of HMRC's complex rules. ”

MORTGAGE INTEREST RELIEF

The amount of allowable relief against finance costs, including mortgage interest, has been gradually reduced over the last few years.

Under the current rules, landlords can no longer deduct all of their finance costs from their property income to arrive at their property profits, as was previously the case, but must instead receive a basic rate deduction from their income tax liability for their finance costs.

Due to these rules, since 2020/21 all financing costs incurred by an unincorporated landlord will be given as a basic rate tax reduction.

CLAIMING FOR 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 your property letting business.

Any losses not utilised at the time when property letting ceases will normally remain unrelieved.

VACANT PERIOD EXPENSES

Where a property is occupied rent-free or at a low rent, perhaps by a relative, you cannot offset the loss against other rental income.

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, providing they would have been allowable if a tenant was in the property.

RENT A ROOM

Income arising from the letting of furnished accommodation, which is part of your main residence is exempt from tax provided that the rent (before any deductions for expenses) does not exceed £7,500 in a tax year.

This limit is reduced to £3,750 when someone else also received income from the property.

“ The property must be used as a main residence by the landlord at some point in the relevant period for the exemption to apply. ”

If the gross rent does exceed £7,500 in a tax year, you can either elect to be assessed on the amount by which the gross rent exceeds £7,500, or calculate the profit as normal and be assessed in the normal way.

Similarly, if expenses exceed income, you 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.



FURNISHED HOLIDAY LETS (FHL)

Furnished Holiday Lettings attract various tax reliefs provided certain conditions are met.

Certain conditions must be satisfied if rental income, rental expenditure and capital expenditure are to be treated as falling within the FHL rules. A property must be furnished accommodation, let on a commercial basis with the view to making a profit and should be situated in the European Economic Area (EEA).

What tax advantages are available to FHL landlords?

Under the FHL rules, landlords are treated as though their qualifying FHL business is a trade for capital allowances and Landlords Energy Saving Allowances (LESA) along with certain capital gains tax reliefs, including business asset roll-over relief and business asset disposal relief.

FHL income is also treated as part of net relevant earnings when calculating tax relief on your pension contributions.

FHL, as with any other property businesses, also has the potential to be eligible for Inheritance Tax (IHT) Business Property Relief (BPR), although claims are often unsuccessful as availability of this relief does require a high burden of proof on the taxpayer to show trading activity over and above that of a landlord.

Losses:

Any loss made from a qualifying UK FHL may only be offset against income of the same FHL.

Qualifying tests:

You must satisfy all three of the following tests if a letting is to qualify:

- 1 The accommodation is available for commercial letting as holiday accommodation to the public for at least 210 days.
- 2 The occupancy rate is at least 105 days during the commercial letting period.
- 3 Pattern of occupation must be taken into consideration. While you can rent out your property for a longer term (defined as 31 days or more), there are limits. For example, the total of your 'longer lettings' cannot exceed 155 days in a year.

CAPITAL GAINS TAX ON DISPOSAL

Capital Gains Tax (CGT) may be payable when a property which has been let, is sold at a profit.

If the property is not your main residence, CGT is payable within 60 calendar days of completion of the sale and a CGT return will need to be submitted to HMRC within this time.

Failure to complete the return and pay any CGT owing within 60 days will result in a late filing penalty and interest.

CGT may also be due where a property is sold more than nine months after it was last used as a main residence.

Private Lettings Relief

Private Letting Relief (PLR) may be available on the sale of a home if you lived in your home at the same time as your tenants.

This allows you to claim relief of the lowest of the following:

- The same amount you got in Private Residence Relief
- £40,000
- The same amount as the chargeable gain you made during the period you let out part of your home

This relief does not cover any part of the chargeable gain you make while your home is empty.

Since 6 April 2020, PLR has only been only available where a home remains the individual's main residence during the period of letting.

Other CGT considerations

- It may be possible to reduce CGT by transferring part of an interest in a property to a spouse or civil partner, to maximise the use of annual exemptions and lower rate bands.
- Gains on properties within Annual Tax on Enveloped Dwellings (ATED) (see below) are liable to CGT.
- Gains realised by any non-residents on any other UK residential property are also liable to CGT.

A property can be subject to both ATED-CGT and non-resident-CGT and different calculations are required for each version of tax. The rate of tax depends on several factors and the maximum is currently 28 per cent.

ANNUAL TAX ON ENVELOPED DWELLINGS (ATED)

ATED applies to an interest in a UK residential property, where a company, or a partnership with a company as a member, is entitled to the interest. An ATED return must be filed at the beginning of the tax year.

“ ATED initially applied to properties worth over £2m, but now applies to companies that own UK residential property valued at more than £500,000. ”

There are a number of exemptions and reliefs available; in particular where the property is held for rental or trading stock. However, a return still has to be filed to claim the exemption otherwise penalties will arise.



NON-RESIDENT LANDLORDS

A landlord who lives abroad for more than 6 months of the tax year is considered to be a non-resident landlord by HMRC.

The default scheme which operates for non-resident landlords, is that tax must be deducted from the rent before it is paid to the landlord by either the letting agent or the tenant. This tax must be paid to HMRC within 30 days of each quarter end and a report sent to HMRC by 5th July following the end of the tax year.

To get your UK rental income paid gross, without deduction of UK tax, you can apply using the NRL1 form.

Non-resident Capital Gains Tax (CGT) rules

Since April 2015 non-residents have been required to pay CGT on the sale of UK residential property, and this was extended to the sale of all UK property from April 2019.

The rules are complex, but generally there are three ways for a non-resident to calculate the gain or loss from the sale of UK property:

- 1 The '**normal**' method – calculating the gain over whole period of ownership
- 2 The '**time apportionment**' method – calculating the gain over the whole period of ownership and then time apportioning the gain from the relevant rule change date
- 3 The '**rebasing**' method – calculating the gain from the relevant rule change date. This involves using the relevant rule change date market value instead of the original purchase price and only claiming for capital expenses incurred since that date.

If you purchased the property after the relevant rule change date, only the normal calculation method is available. However, you may be entitled to the UK annual CGT exemption (£12,300 for 2022/23) to offset against any gain made.

MAKING TAX DIGITAL FOR LANDLORDS – MTD FOR ITSA

VAT-registered businesses already have to comply with HM Revenue & Customs' new Making Tax Digital (MTD) record-keeping and reporting rules.

Soon, sole traders, private residential landlords and others who currently report their income via self-assessment forms will also need to comply with MTD requirements.

When will landlords need to comply with the new MTD rules?

MTD is being introduced in phases. Its roll out has slipped back several times but the latest indication we have for the introduction of Making Tax Digital for Income Tax – known by the acronym 'MTD for ITSA' – is 6 April 2024.

That may sound a long way off – but it will fly by so it's important to make changes and have the right software in place well ahead of the deadline.



Who will be affected?

You will need to comply with the MTD for ITSA rule changes if you're registered for Income Tax self-assessment and have a gross self-employed or rental income (not profit!) of more than £10,000 a year.

It's also important to know that the £10,000 income doesn't need to solely come from rental income – so if you have a part-time, self-employed job and some rental income that together totals £10,000 or more, you will need to be MTD compliant from April 2024.

Ordinary business partnerships with more than £10,000 a year of gross income will be impacted by MTD for ITSA changes from 6 April 2025.

How will record-keeping and returns change?

You'll have to start using digital record-keeping and reporting software from April 2024.

There are a few exemptions but 'a preference for paper bookkeeping and doing things the traditional way' is unfortunately not one of them! Failure to comply may result in costly penalties.

You'll need to send your returns digitally to HMRC each quarter. You'll get up to a month after the end of each quarter to do this. Late submissions or payments may result in penalties.



What special digital software will be needed?

HMRC is not providing its own MTD for ITSA software; instead different solutions will be available from various third-party software providers.

At Rotherham Taylor, we recommend Xero or in some cases Excel. We have already helped many VAT-registered businesses make the switch from paper record keeping to digital VAT returns.

“ The good news is that most cloud software providers will also have MTD for ITSA software available. We also offer full training and can walk you through the entire process. ”

If you prefer you can ask the team at Rotherham Taylor to take care of all your MTD for ITSA reporting obligations.

ABOUT ROTHERHAM TAYLOR

Based in Preston with an office in London, Rotherham Taylor, are forward-thinking advisers providing a full range of accounting and tax services to personal and corporate clients, nationally and internationally.

We have extensive experience of working with clients with property interests, enabling us to provide expert advice to residential landlords and property investors.

Contact us today to find out more about how we can help you.

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