Landlords Tax Secrets Revealed!

Tax busting tips to help boost your property profits!

By

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1. About the Authors

Some words about the authors of this unique guide, bringing together a property tax specialist and a property investor!

1.1. Arthur Weller - The Property Tax Specialist

Arthur Weller is a tax specialist who advises other accountants. He is one of the most knowledgeable and respected tax specialists in the country.

He is also the lead technical tax specialist and design consultant for www.taxinsider.co.uk/tax_consultancy_arthur.html.

Arthur is based in the northwest and qualified in 1997 as a certified accountant in a small firm of accountants. They specialised to a degree in property, and he worked for some years in their tax department.

He then moved on to a medium-sized firm, where he was the technical manager in the tax department.

In 1998 he passed the exams of the Institute of Taxation, and in June 2000 he left to set up his own tax consultancy.

Arthur works mainly in an advisory capacity for accountants in all areas of taxation. He also runs a telephone help line, giving phone advice on all areas of taxation to accountants around the country.

Much of his work has been focused in the following areas:

- property taxation (Arthur is regarded as a property tax specialist);
- capital gains tax;
- stamp duty;
- income tax;
- company tax;

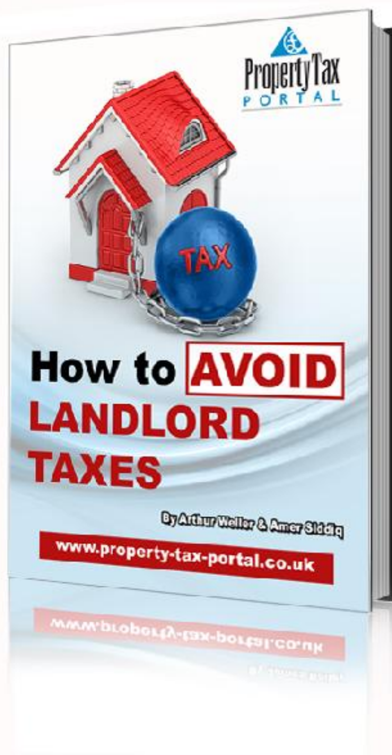
1.2. Amer Siddiq - The Landlord

First and foremost Amer Siddiq is a UK landlord/property investor. He is passionate about all aspects of property investment and over the last nine years has grown a portfolio in the northwest of England

As well as growing a portfolio and speaking in public at various property investment events, Amer has also brought to market a number of websites to help investors to better manage and grow their portfolios whilst reducing their taxes.

This includes www.propertyportfoliosoftware.co.uk, which provides property management software for landlords to help them get better organised.

1.3. How to Avoid Landlord Taxes



If you enjoy the landlord tax saving tips and strategies in this guide then you may want to consider our guide ‘How to Avoid Landlord Taxes’.

How to Avoid Landlord Taxes

- **196** pages of easy to read information
- Over **100** tax saving case studies
- Includes FREE:
    - Guide ‘101 Ways to Beat the Taxman’
    - Three month of Property Tax Insider magazine
    - Rental Income and Tax Management software

To learn more visit:

www.property-tax-portal.co.uk/avoid_landlord_taxes.shtml.

Knowing Your Property Tax Strategy

2. Understanding your Tax Liabilities

Over the past few years property investment has become a very profitable way to make money.

Unfortunately there are very few people who consider the tax implications of their investment strategy before they decide to invest. Instead they take a view that they will address the tax issues when they decide to dispose of the property. This can be a very costly mistake as some simple planning can help to avoid large tax bills in the future.

The table below gives an indication of the tax that may be due if you follow any of the popular strategies outlined below.

Strategy	**Description**	**Income Tax**	**Capital Gains Tax**
Buy-to-let	Probably the most popular investment method and a strategy for long-term investment. Income tax will be due on the annual rental profits and CGT due when the property is disposed of.	Yes	Yes
Develop & Sell	This is typically classed as a short-term (i.e. 3-6 months) investment and only Income Tax is due if you are trading in properties in this way. All property development related expenditures can be offset against the final selling price.	Yes	No
Develop & Rent	Another typical long-term investment, where the property is developed and then rented out. All expenditures made developing the property can be offset when the property is disposed. However rental profit will be subject to annual income tax.	Yes	Yes

Buy & Sell	If your are a master or want to become a master of buying undervalued property and then re-selling at a higher price then you will be classed as a property trader and will typically be subject to Income Tax only.	Yes	No
Buy-let-live	A good investment strategy to make use of some very significant tax breaks if you are sitting on large capital gains. This strategy only really applies to investors who intent to hold only a small number of properties during their life-time i.e. (3-6 properties). Again income tax will be due on rental profits and CGT when the property is disposed of.	Yes	Yes (but is dramati-cally reduced)
Buy-live-let	Probably the most tax efficient way to avoid capital gains tax for the small investor. This increasingly popular strategy involves letting your previous main residence when buying a new home or moving abroad. Again income tax will be due on rental profits and CGT when the property is disposed of.	Yes	Yes (but is dramati-cally reduced)
Rent-a-Room	If you decide to rent-a-room that is part of your main residence then you can receive an annual rental income, to the value of £4,250 and not have any income tax liability. Ay income above this amount will be subject to income tax. CGT is not due if you sell your main residence which has been classed as your only home during the whole period of ownership.	Yes (if claiming rent-a-room relief and income is greater than £4,250)	No (if tenants live with the family owning the property)

	Please Note: if the tenants renting do not live together with the family, then there can be CGT on that part of the house rented out.		
Furnished Holiday Lets	If you let a furnished property as a holiday let, then you will be subject to income tax on any rental profits. There are number of very generous tax breaks available for those investing in Furnished Holiday Lets.	Yes	Yes

How to Slash your Property Income Tax

Before we look at the different income tax saving strategies, it is important to understand what is meant by the term **income tax** and when property investors and landlords are liable to pay it.

3. Income Tax Liabilities for Investors/Traders

Anybody investing in property is liable to pay income tax on any profitable income that is generated from their properties.

There are two main categories of people who invest in property, and both are liable to pay income tax. The characteristics of each are detailed in the following sections.

3.1. Property Investor

If you invest in property for the long term, i.e., you have buy-to-let properties, then you will be referred to as a **property investor** (more commonly known as a landlord). This is because you are holding on to a property for the long term.

If you are letting your investment properties, then you will be liable to pay income tax annually on the rental profits.

It is also likely that you will have another source of income, unless you have a large portfolio of properties where the rental income funds your lifestyle.

3.2. Property Traders/Dealers

If you are investing in property for the short term, i.e., 6–12 months, and intend to sell with the aim of generating a dealing profit, then you will be referred to as **property dealer** or **property trader**.

Property dealers and traders are liable to pay income tax when they sell the property.

You will find that most full-time property developers or renovators are classed as property dealers/traders.

3.3. Income Tax Rates

You can use the following link to view the income tax rates for previous years:

http://www.hmrc.gov.uk/rates/it.htm

The current rates of income tax for the 2012–2013 tax year are detailed in the table below:

INCOME TAX 2012–2013		
Rate	***Band***	***Description***
Nil	£0 to £8,105	The first £8,105 of each individual's income is Tax Free.
20%	£8,106 to £42,475	The next £34,370 is taxed at 20%.
40%	£42,476 to £100,000	The next £57525 is taxed at 40%.
60%	£100,001 to £116,210	The next £16,210 is taxed at 60%. This is because of the withdrawal of the Personal Allowance.
40%	£116,210 to £150,000	The next £33,790 is taxed at 40%.
50%	> £150,000	Anything above £150,000 is taxed at 50%

The above table assumes that non savings income is more than £2,710. It also assumes the personal allowance is £8,105.

3.4. Income Tax Calculation Case Studies

Here are some case studies to illustrate how the tax liability is calculated for property investors and property dealers/traders.

3.4.1. Income Tax Calculation for Property Investors

The case study below illustrates the income tax liability for a basic-rate taxpayer.

Income Tax Calculation for Property Investor (1)
John works as a local government officer and receives an annual salary of £20,000. He buys a property close to his local hospital for £95,000. He receives a monthly rental income of £600. The property is let for the whole 2012–2013 tax year, which means that he has received an annual rental income of £7,200. In the tax year he has also incurred property-related expenses of £2,000.

These expenditures are made up as follows:

Expense	Amount
Interest repaid on mortgage	£1,200
Plumbing (to fix water leak)	£150
Annual gas safety inspection	£100
Central heating maintenance contract	£300
Replacement door fitted	£250
Total Expenditure	£2,000

This means that John's taxable rental profit is £5,200 (i.e., £7,200 – £2,000).

On this amount he is liable to pay tax at 20%. This is because his £5,200 rental profit falls into the basic rate band.

Therefore his tax liability is **£1,040** on the £5,200 profit.

The following case study illustrates how the rental income from the property pushes John into the higher-rate tax band.

Income Tax Calculation for Property Investor (2)

This is the same scenario as in the previous case study. The only difference is that John has an annual salary of £42,000.

John's tax liability on the £5,200 profit is now calculated as follows.

The first £475 is taxed at the basic rate of 20%.

The remaining £4,725 is taxed at the higher rate of 40%. This is because the rental profit has taken his total income into the higher-rate tax band.

Therefore his tax liability is as follows:

(£475 × 0.2) + (£4,725 × 0.4)
£95 + £1,890

= £1,985

John's tax liability is **£1,985** on the £5,200 profit.

4. Owning Properties as a Sole Trader

Holding a property in a sole name can be tax beneficial under certain circumstances.

In this section we will get to grips with why people hold properties as a sole trader and will learn about some of the tax benefits and drawbacks of owning properties in this way.

4.1. Buying Properties as a Sole Trader

A **sole trader** is an individual who buys properties in his or her sole name.

Although it is still a very common way to purchase properties, it is not necessarily the most tax efficient.

In most cases, properties are usually purchased as a sole trader for non-tax-related reasons.

Here are the two most common non-tax-related reasons why you might decide to buy property as a sole trader.

a) You don't have a partner who you can invest with.

b) You don't want to invest with anybody else; that is, you can't trust anybody, or you want total control over your investment.

If you have invested for either of these reasons, then you can still make tax savings.

4.2. When is it Tax Efficient to Buy Property as a Sole Trader?

The ideal scenario for buying a property as a sole trader is if you have no income.

The reason for this is because you can utilise your annual, tax-free personal allowance.

In simple terms, the further your income is from the higher-rate tax bands, the more you will save in income tax by having the property in your sole name. This is especially true if your partner is a higher-rate taxpayer.

The following two case studies illustrate these points.

Sole Trader With No Income

Joanne is a married woman but does not work. Her husband is a high-flying executive who earns £70,000 per annum.

Upon the death of a relative, Joanne is left £100,000. She uses the entirety of this inheritance to purchase an investment property.

She makes £600 rental profit per month. (She bought the property with cash, so therefore she has no outstanding mortgage or other costs in the 2012-13 tax year).

This means that she makes an annual rental profit of £7,200.

She is not liable to pay any tax on this amount as it is within the annual personal income tax allowance of £8,105.

Had Joanne bought the property in joint ownership with her husband, then he would have been liable to pay tax at 40% on his share of the investment. If his share of the property was 50%, then he would have an annual tax liability of £1,440.

This means that over a 10-year period, Joanne will see a minimum tax saving of £14,400 by owning the property in her sole name.

Property Investor With No Income, but Partner Works

Lisa is a married woman and earns £15,000 per annum as a store sales assistant. Her husband is a hotel manager and earns £45,000 per annum.

They decide that they want to start investing in property and purchase a property for £45,000.

They take tax advice before investing and are told that they will pay less annual income tax if the property is purchased in Lisa's sole name.

This is because she is not a higher-rate taxpayer.

5.3. When is it NOT Tax Efficient to Buy Property as a Sole Trader?

Try not to buy property as a sole trader if you are a higher-rate taxpayer i.e. paying tax at 40%, 50% or even 60%, especially if you can invest with a partner who is a lower-rate taxpayer.

If you are a higher-rate taxpayer, then you will have to pay income tax on any rental income at the higher rate as well.

It would be very poor tax planning on your end if you ended up paying 40%, 50% or 60% tax on all rental income, especially if you had a partner who could make use of the nil rate band or the 20% tax band.

5. Offsetting Interest Charges

In this section you will learn about the different types of interest repayments that property investors may come across.

More importantly, you will understand when each of these types of interest can and cannot be offset against your rental income.

5.1. Interest on Mortgages

It is probably fair to say that this is the most common type of interest that is associated with property investors.

This interest relates to the amount you pay back to your mortgage lender that is above and beyond the initial amount that you borrowed.

It does not matter if the mortgage is a 'repayment' or an 'interest only' mortgage. The fact that interest repayments have been made means that they can be offset.

This is illustrated through the following case study.

Interest on Mortgages

John buys an investment property for £100,000.

The finance for the property is made up from a £20,000 deposit (provided from his personal savings) and an £80,000 buy-to-let mortgage (provided by a High Street Bank).

In the first year of the mortgage he pays £2,500 in mortgage interest. This entire amount can be offset against his income from the property.

This means that if he received £5,500 income from his property, he would only be liable to pay tax on £3,000.

5.2. A note about 'interest only' and 'repayment mortgages'

As mentioned in the above tax tip, you are able to claim interest relief regardless of whether you have an 'interest only' mortgage or a 'repayment' mortgage.

5.2.1. Interest Only Mortgage

With an **interest only** mortgage you do actually only pay the interest that is charged on the amount that has been borrowed. The actual amount i.e. the capital amount remains the same and is usually due in one lump sum at the end of the mortgage term.

Interest Only Mortgage
Louise buys a property for £125,000 where her mortgage lender provides £100,000 on an interest only mortgage over 25 years. Her monthly interest repayment is £500. She is able to offset the entire amount against the rental income. However at the end of the mortgage term, she will still owe the £100,000 that has been borrowed.

5.2.2. Repayment Mortgage

With a **repayment** mortgage you pay both the interest and the capital amount on a monthly basis. However you are only able to offset the amount that has been charged in interest. You cannot offset the capital repayments.

Repayment Mortgage
Same scenario as in the previous example. However this time Louise goes for a repayment mortgage of £100,000. This means that her monthly repayments will be higher because she is repaying both the interest and part of the capital amount borrowed. She makes monthly repayments of £650, where £400 is the interest repayment and £250 is capital repayment. She is only able to offset the interest part of the repayment i.e. the £400. She is not able to offset the capital element of the repayment mortgage.

5.3. Interest on Personal Loans

If you take out a personal loan that is used 'wholly and exclusively' for the purpose of the property, then the interest charged on this loan can also be offset.

The important point to note here is that personal loans *must* be used in connection with the property.

Following are some typical property investment scenarios detailing when the interest charged on a personal loan *can* be offset against the property income.

5.3.1. Loan Used for Providing Deposit

Most buy-to-let mortgage lenders require you to provide a 20% deposit before they will lend you the remaining 80% in the form of a mortgage.

If you don't have the 20% deposit, then it is likely that you may well need to finance the deposit by getting a personal loan.

If you do take out a personal loan for the 20% deposit, the interest charged on this loan can be offset against the property income.

If you are considering doing this, or have already done this, then what this means is that you have a 100% financed investment property, where interest charged on both the mortgage and the personal loan can be offset against the rental income.

Interest on Personal Loan Used For Deposit

Ali is desperate to buy his first investment property after seeing his pension fund plummet and his house value almost double within 5 years.

Unfortunately, (due to his lavish lifestyle), he has no savings of his own but is in a well paid job, earning £40,000 per annum.

He sees an investment property advertised for £100,000, but his mortgage lender requests a deposit of £15,000.

He sources this deposit by acquiring a personal loan at a rate of 9% per annum.

The bank then agrees to finance the remaining £85,000.

This means that Ali has a 100% financed investment property. Therefore he is able to offset the interest charged on both his loan and the BTL mortgage against his rental income.

5.3.2. Loan Used for Refurbishments/Developments

Periodically, you will need to refurbish or even develop a property.

Imagine that you have just purchased a property that needs totally re-decorating and modernising. If you take out a loan for this kind of work, then the interest charged on the loan can be offset against the property income.

Alternatively, you might decide to embark on a more expensive property extension, e.g., to build a conservatory.

Again, the same rule applies here: The interest charged on the loan can be offset.

Interest on Personal Loan Used for a Refurbishment

Karen buys an investment property for £100,000. She manages to pay the 15% deposit from her own personal savings and the remaining finance is acquired on a BTL mortgage.

Before letting out the property she decides that a new bathroom suite will greatly increase the chances of the property getting let quickly. She prices a replacement bathroom suite at £2,000.

Unfortunately she has already stretched her personal savings account by funding the deposit for the property.

Therefore she applies for, and is successful, in obtaining a £2,000 personal loan at an interest rate of 10%.

Because the personal loan is used to replace the bathroom suite in the investment property she is able to offset the entire interest charged on the loan against her rental income.

5.3.3. Loans Used for Purchasing Products

If you purchase goods from retailers where finance is available and these goods are used in your property, then the interest charged can also be offset.

This is more likely to happen if you are providing a fully furnished property, e.g., a luxury apartment.

If this is the case, then you may decide to buy the more expensive items on finance.

Such items are likely to include

- sofas, dining table & chairs, beds;
- cooker, washing machine, fridge/freezer;
- carpets, flooring, etc.

If you are paying for these products over a period of time (e.g., 6, 12, or 18 months), then any interest charged by your creditor can be offset against your rental income.

Interest on Buy-Now-Pay-Later Loans

Continuing from the previous case study.

Once the bathroom suite has been replaced she decides that the property should be offered fully furnished.

She decides to buy some new kitchen furniture in a sale and buys it on a buy-now-pay later scheme where interest is charged at a rate of 27.9%.

Again she is able to offset the interest charged on the loan against the rental income.

5.3.4. Loans to Continue the Running of Your Business

There may be occasions when you need to borrow money because your need to pay some bills or employees but do not have sufficient funds in your account.

In such circumstances you may decide to apply for a short-term loan to make these payments. Again the interest charged on the loan can be offset against the property income.

Interest on Loan for Paying Bills & Employees

Alexander has a large portfolio of properties but has incurred a cash flow problem. This is because he has just paid for a major refurbishment on one of his properties by using funds in his property account, rather than acquiring some sort of finance.

This decision means that he is unable to pay his employees (who work in his property business) their end of month salaries and some property related utility bills that are due.

He applies for a short-term loan of £5,000 to make the necessary payments and interest is charged at 8%.

His is able to offset the interest charged against the income from his properties because it is incurred for the purpose of his property business.

5.3.5. Interest on Overdrafts

If you have a separate bank account set-up for your property investment business then you may decide to apply for an overdraft rather than a personal loan.

If you decide to do this then as long as the overdraft is used for the purpose of the property business then you can offset the interest charged on the overdraft.

Interest Charged on Overdrafts

Using the previous example.

Instead of applying for a loan, Alexander decides to request a one-year overdraft limit on his account of £5,000. His application is successful and he is charged an interest rate of 7.5%.

Whenever he uses his overdraft facility and interest is charged, he is able to offset it against his rental income.

5.4. Interest on Re-Mortgages

If you have a mortgage on your investment property, then it is highly likely that you will consider moving to another lender at some point.

The main reason for this is because you will be trying hard to find a better mortgage deal!

As interest rates have been falling over the past few years, more and more people have been re-mortgaging their investment properties to capitalise on the better deals and to help grow their property portfolios.

Below are some pointers about re-mortgaging.

a) If you re-mortgage your outstanding mortgage with another lender, then you can *still* offset the interest repayments.

Interest on Re-Mortgages

Timothy has an outstanding mortgage balance of £50,000 on his investment property. He decides to move his mortgage from the Nat West to LloydsTSB as they are offering a lower rate of interest.

Timothy can still offset the entire interest charged by LloydsTSB on the £50,000 re-mortgage.

b) If you re-mortgage for a lower amount, then you can still offset the whole mortgage interest.

Re-mortgaging for a Different Value

Imagine the same scenario as in the previous example, where Timothy has an outstanding balance of £50,000 on his investment mortgage.

However, he inherits £20,000 from a family member, so he decides to use this toward lowering his mortgage liability.

Therefore he only re-mortgages to the value of £30,000 with LloydsTSB.

Again, the entire interest charged on the £30,000 can be offset against the property income.

c) If you re-mortgage for a greater amount, then generally speaking you can only offset the additional amount if it is used for the purpose of an investment property (however you may be able to exploit paragraph 45700 (see **Error! Reference source not found.**).

As property prices have sharply risen over the past few years, investors have been re-mortgaging their properties for higher values.

This is known as **releasing equity.**

If you have released equity or are considering doing this, then you need to follow the guidelines given above regarding the interest charged on personal loans.

You need to ask yourself,

'Is the additional equity release being used for the sole purpose of my property business?'

This can be illustrated through the following case study.

Releasing Equity

Timothy has an outstanding balance of £50,000 on his investment mortgage.

However, his property value has appreciated considerably, so he decides to re-mortgage with LloydsTSB for £80,000.

This means that he is releasing additional equity out of his current property to the value of £30,000.

He decides to use the equity release in the following way:

£20,000 is used to fund a new property investment, and it provides the deposit for his next buy-to-let investment. £10,000 is used to pay for a new car for his wife.

Now, Timothy can *only* offset the interest charged on both the outstanding mortgage balance of £50,000 and the £20,000 he is using as a deposit for his next purchase.

This is because this combined amount of £70,000 is used 'wholly and exclusively' for his property investments.

However, he *cannot* use the interest charged on £10,000 for buying the car as this cost is not associated with his property investments.

d) Generally speaking, because it is possible to obtain a lower rate of interest on your residential mortgage, more and more investors are deciding to increase the borrowing on their main residence and using this to reduce the investment mortgages.

Releasing Equity from Main Residence

Jack and Louise have a residential mortgage on their private residence for £100,000. The interest rate is fixed at 4.5%. They also have a BTL investment property. The outstanding mortgage on this property is also £100,000 but the interest rate is at a higher rate of 6.5%.

Because their main residence has a value of £300,000, they release £100,000 equity from their main residence, at the same rate of 4.5%, and pay off the outstanding debt of £100,000 on the investment property.

Again the interest charged on the £100,000 equity release can be offset against the rental income off the investment property.

5.5. Purchasing a Property with Cash and Then Re-mortgaging

Serious property investors are always looking for deals.

When one comes their way, it is sometimes not feasible to apply for finance. This is because the administration and paperwork will take too long, and this is likely to result in the investor losing out on the deal.

In such scenarios the investor will end up buying the property through their cash reserves, and they will then re-mortgage the property to release the invested funds.

The question then arises as to whether the interest charged on the re-mortgage is tax deductible.

In Arthur Weller's opinion, the mortgage interest is tax deductible in such scenarios. This is because the property was bought with the *intention* to take out the mortgage soon afterward.

In such scenarios the purchaser will only pay cash originally because this is a better way to execute the purchase.

Cash Purchase and Then Re-mortgaging

John has inherited £100,000 from his father's estate.

He is presented with the opportunity to purchase a property at £100,000, but he must complete the purchase within two weeks. By purchasing within two weeks, he will save £25,000 off the original asking price of £125,000.

John knows that it will take too long to apply for a BTL mortgage, so he pays for the property in cash.

Two months later, he re-mortgages the property using a standard BTL mortgage.

In this scenario, John can offset the interest on the re-mortgage as it was always his *intention* to fund the investment by a mortgage.

6. Getting to Grips With the Term 'Wholly and Exclusively'

This section will address the term 'wholly and exclusively.'

If you have ever read and tried to digest the Property Income Manual, then you will have noticed that this phrase is consistently mentioned in the guide.

By the time you have finished this section, you will know how to test if an expense satisfies this rule and whether it can be offset against your property rental income.

6.1. Understanding the Term 'Wholly and Exclusively'

HMRC state,

'You can't deduct expenses unless they are incurred wholly and exclusively for business purposes.'

To put it simply, this statement means that if you incurred an expense that was not used for the purpose of your property, in any way at all, then you cannot offset the cost.

Whenever you incur a cost for your investment property, always ask yourself,

'Has the cost been incurred wholly and exclusively for the property?'

If you can answer **YES** to this question, then it is highly likely you will be able to offset the cost against your property rental income.

6.2. What If Cost is Not Wholly and Exclusively Incurred for Property?

Sometimes you may incur a cost that is not used 'wholly and exclusively' for your property. However, a portion of the cost has been incurred for your property.

For such situations HMRC provide the following guideline:

> **'Where a definite part or proportion of an expense is wholly and exclusively incurred for the purposes of the business, you can deduct that part or proportion.'**

What this effectively means is that you need to determine what part or proportion of the cost is attributed to your investment property. This is because you cannot offset the entire cost.

The following case study will help to illustrate this guideline.

Where Costs Are Not Wholly and Exclusively Incurred for Property

Bill has an investment property.

The bathroom is looking rather 'tired,' so he decides to re-tile it completely. He goes to a local tile shop, where they have an offer of 12 square metres of tiles for £240.

However, he only requires seven square metres for his investment property.

After some serious head scratching he appreciates that the deal is an excellent value for the money and too good to miss. He therefore purchases the tiles.

He decides to use the extra 5 square metres of tiles in his own house.

This means that the entire cost has not been incurred wholly and exclusively for the property. However, a portion of the cost, i.e., 7/12ths, has been incurred wholly and exclusively for the property.

He may therefore offset £140 (i.e., 7/12ths of £240) against his rental income.

6.3. Costs of Maintenance and Repairs

Once you have purchased and successfully let your property, any maintenance costs incurred that help prevent the property from deteriorating can be offset against your rental income.

It is very likely that at some point you will have to carry out some maintenance work to keep your property in an acceptable state of repair.

When this happens, you will be able to offset the cost against your property income as long as it satisfies the following condition.

- **It is not a capital improvement.**
  A capital improvement is when work is carried out that increases the value of the property.

Maintenance Cost

John is informed by his tenants that water is leaking from the upstairs bathroom into the downstairs living room.

He calls a plumber to repair the damaged bathroom water pipe and also hires a painter/decorator to redecorate the damaged ceiling.

The entire cost of the work is £300, and it can be offset against the rental income.

6.4. Typical Maintenance/Repair Costs

The following list details typical maintenance/repair costs that you are likely to incur and which you can offset against your rental income:

- repairing water/gas leaks, burst pipes, etc.;
- repairing electrical faults;
- fixing broken windows, doors, gutters, roof slates/tiles, etc.;
- repairing internal/external walls, roofs, floors, etc.;
- painting and redecorating the property;
- treating damp/rot;
- re-pointing, stone cleaning, etc.;
- hiring equipment to carry out necessary repair work;
- repairing existing fixtures and fittings which include:
    - radiators,
    - boilers,
    - water tanks,
    - bathroom suites,
    - electrical/gas appliances,
    - furniture, and furnishings, etc.

6.5. Capital Improvements

If you carry out a capital improvement then you *cannot* offset this cost against your rental income.

This is because it is not classed as maintenance or repair work.

Capital Improvements

After years of owning his investment property, Fred applies for, and gets approval to add, a conservatory.

The cost of the conservatory is £20,000.

Because the conservatory has increased the value of the house by £30,000, it cannot be offset against the rental income.

Again, the cost will be offset against any capital gain that he makes when he sells the property.

REMEMBER: If you have made a capital improvement, then this cost can be claimed when you sell your property.

7. Replacing Your Fixtures and Fittings

This section will help you to understand what is meant by the term **fixtures and fittings** and when you can offset the replacement of them against your income tax.

7.1. What are Fixtures and Fittings?

These are items that are classed as being an integral part of the property. If a new tenant moves into a property, then they will expect these items to be in the property.

Examples of fixtures and fittings include

- windows, doors, light fittings;
- kitchen units;
- bathroom suites;
- gas central heating systems and radiators or hot water supply tanks;
- gas fires, etc.

The most important point to understand about fixtures and fittings is that any cost incurred in repairing them or replacing them with a like-for-like product can be offset against the property rental income. This is regardless of whether the property is un-furnished, partly furnished, or fully furnished.

For the remainder of this section we will focus on the replacement of fixtures and fittings.

Two important conditions must be satisfied before you can offset the cost of replacing fixtures and fittings. These are the following.

a) The cost must be a 'replacement' cost. In other words, it cannot be for the installation of fixtures and fittings that were not previously in the property.

b) The cost must be for a similar, like-for-like product.

If both these conditions are met, then the cost can be deducted from the rental profits.

7.2. Replacing Fixtures and Fittings

Whenever you decide to replace existing fixtures and fittings, they are likely to fall into one of the following three categories:

a) like-for-like replacement;
b) like-for-like replacement but with capital improvements;
c) replacement with superior fixtures and fittings.

Each of the above scenarios is treated differently when it comes to calculating your income tax bill, and each is illustrated in the following sections.

7.2.1. *Like-for-like replacement*

If you replace existing fixtures and fittings with similar like-for-like products, then the entire cost can be offset against the income tax bill.

Replacing With Like-for-Like (1)

Alex has been renting out his buy-to-let property for seven years and decides that it is now time to change the bathroom suite.

He finds a similar bathroom suite of comparable quality that costs £500. The cost of having the old suite removed and the new one fitted is also £500.

This means that the entire project costs £1,000.

This whole amount can be offset against the annual rental income.

7.2.2. *What If It Is Not Possible to Replace With Llike-for-Like?*

HMRC appreciate that it is not possible to replace with a like-for-like product in all instances. This is especially true if you are replacing something that is several years old as a like-for-like product may no longer be available.

In such circumstances, it is possible to replace with a superior item, especially if it is of a similar cost.

Replacing With Like-for-Like (2)

Alex also decides to replace the wooden, single-glazed windows as they are starting to rot. The windows are more than 10 years old.

The cost of replacing with similar single-glazed windows is £3,500, and this includes the fitting and removal of the old, rotten windows.

However, the cost of replacing the windows with UPVC double-glazed windows is actually cheaper and costs £3,400. This price also includes the fitting and removal of the old windows.

Although the UPVC double-glazed windows are of a superior quality, HMRC accept that these types of windows are the ‘standard’ in all new build properties.

Therefore it is possible to use these as replacements and offset the entire cost incurred.

7.2.3. Like-for-Like Replacement but with Capital Improvements

If you replace the existing fixtures and fittings with a like-for-like product but also make a capital improvement, then you can only offset the cost of the like-for-like replacement.

Replacing With Like-for-Like but with Capital Improvement
Alex also decides to replace the kitchen units. The cost of replacing the kitchen units with like-for-like replacements is £1,600. However, he has some additional space that he wishes to utilise, so he orders an additional three units at a cost of £600. Alex is able to offset the cost of the £1,600 like-for-like replacement against his rental income. However, the additional three units are treated as a capital improvement, and this cost cannot be offset against the rental income. Instead, the cost of the additional units can be offset against any capital gain arising when the property is sold.

8. Other Ways to Reduce Your Income Tax Bill

In the strategies to date you have learned about the common costs that can be offset against the rental income.

In this section you will now become familiar with numerous other typical costs that a property investor is likely to incur and that can be offset against the rental income.

8.1. Rents, Rates, and Insurance

The following costs are incurred by property investors when the property is let or when the property is empty and between lets.

8.1.1. Rents

The most common type of rent that an investor is likely to incur is ground rent. Landlords are liable to pay this rent on any leasehold property/land, and therefore any such expenditure can be offset against the rental income.

8.1.2. Rates

If you decide to pay any of the following rates on your property, then they can be offset against the rental income:

- water;
- electricity;
- gas;
- council tax;
- service charges;
- TV licence;
- telephone line rental;
- satellite TV charges, etc.

8.1.3. Insurance

Any insurance premiums that you pay for your properties or products/services relating to your property can also be offset against the rental income.

The most common premiums you are likely to pay will include the following:

- building insurance;
- contents insurance;
- insurance cover for service supplies such as
    - gas central heating,
    - plumbing insurance,
    - electrical insurance;
- insurance cover for appliances such as
    - washer/dryer,
    - fridge/freezer,
    - television, etc.

8.2. Can I Offset Pre-trading Expenditure?

This is a bit of a grey area as far as taxation goes.

The rules for pre-trading expenditure are quite complex, but in theory you can claim expenses incurred in the seven years before commencement of the rental 'business.

The expenses are treated as incurred on the first day the rental 'business' starts.

Having said that, HMRC will want to examine these expenses closely with a view to establishing whether they were incurred 'wholly and exclusively' for the purposes of the 'trade.'

Again in theory HMRC can disallow any expense which has a duality of purpose, but in practice they will usually allow a split to be made.

They will also examine the expenses to see whether they are capital or revenue in nature.

Below is a list of some common types of pre-trading expenditure you are likely to incur before you buy your property:

- travelling costs (see section Travelling Costs);
- the cost of purchasing dedicated trade/magazines for helping you to find your property;
- the cost of telephone calls when phoning estate agents/property vendors, etc.

The important point to note is that each occurrence of a pre-trading expenditure must be incurred wholly and exclusively for the property.

8.3. Carrying Over Rental Losses

Any rental losses made on a property can be carried forward into the next financial year.

Sometimes you will incur a rental loss on your property investment. Rental losses can be incurred intentionally or unintentionally. The important point to note is that any losses can be carried forward into the next year and can be used to reduce your tax liability for that year.

Carrying Over Rental Losses

After three years of owning his two-bedroom buy-to-let property, John decides to replace the bathroom suite. The cost of replacing it with a like-for-like replacement is £2,500.

His rental income for the property is £4,800 annually, but after all his annual expenses are deducted, e.g., offsetting interest payments, the cost of the replacement bathroom suite, etc., he is left with a £1,000 rental loss.

This loss can be carried forward and offset against his rental income the following year.

8.4. Travelling Costs

You are likely to incur travelling costs when you use either your car or public transport for travelling to and from your property.

Both methods are detailed below.

8.4.1. Car Usage

You can claim for the cost of travel to and from the property, provided the trip was wholly for a business purpose.

This is normally done using the 'apportionment' method. The apportionment method involves keeping a log of the annual car mileage and all the expenditures that have been incurred on the car (including petrol receipts).

You determine how many miles were for the purpose of your property business and then apportion the expenditure accordingly.

You must be able to prove the trip was purely for a business purpose, though!

Therefore it important that you keep a log of the mileage that you have done for the purpose of your property. For each trip, make sure you keep a log of the following:

- the date the trip was made;
- the purpose of the trip (e.g., visit tenant, carry out maintenance repairs, etc.);
- the miles that were travelled.

Please note that you are not only restricted to claiming for usage of petrol. You are also able to claim the business (property usage) proportion of insurance, repairs, servicing, MOT, AA membership etc

8.4.2. Public Transport

If you use a bus, train, or even aeroplane (for overseas investors) to travel to your property, then you can again offset the cost, as long as the trip is wholly and exclusively for the purpose of the property.

Please note that you must keep your receipts as proof of your trip.

If your visit is dual purpose, i.e., you are going on holiday but are also looking at the property market, then you cannot claim the cost.

8.4.3. Travelling Costs for Overseas Property

With the growing trend of overseas investors, a common question asked is:

Can I offset the cost of travelling overseas to look at potential investments against my UK rental income?

The answer to this is that you **cannot** offset the overseas travel cost against the UK properties, as the expense is not connected with them.

Travelling Costs for Overseas Property
Jennifer has a portfolio of properties in the UK but now decides to invest in Spain. She arranges a trip to Spain to look at a number of investment properties. The total cost of the trip is £500. She cannot offset the cost of the trip against the income from her UK properties.

8.5. General Property Costs

If you have a portfolio or properties and incur expenses then it may not be possible to attribute the cost to a single property. This is because the expenditure may have been for all of the properties.

A good example of this is when purchasing decorating materials for a property. In such circumstances you can either:

- apportion the cost against the properties, or
- have a separate listing of generic expenses to add on at the end when you combine all the incomes and expenditures.

Either way is fine, as it makes no difference to the tax position, though practically the latter option may be easier and simpler to implement.

8.6. Storage Costs

A cost incurred by an increasing number of investors is storage costs.

The cost of renting storage space is allowable against rental income. The reason is that it fulfils the principal criteria of "wholly and exclusively", as the cost was incurred for the purpose of your property business. If you never had rented property then you would not be incurring such costs.

Storage Costs
John owns 5 properties which are all fully furnished. However he finds a new long-term tenant for his property who has his own furniture and furnishings. John decides that he will empty the property and store the furniture in rented storage. The cost of rental storage is £450. This amount can be offset against the rental income as it has been incurred 'wholly and exclusively' for the purpose of the rental business.

8.7. Other Common Landlord Expenditures

Below is a list of other common costs that a landlord will incur that can be offset against the rental income:

- safety certificates, e.g., gas and electrical safety;
- stationery, e.g., stamps, envelopes, books;
- computer equipment;
- bad debts;
- legal and professional costs, e.g., accountancy costs;
- service costs, e.g., window cleaner, gardener;
- furniture/appliance rentals;
- advertisement costs;
- letting agent costs;
- books, magazines, etc;
- security/smoke alarms;
- telephone calls, including mobile telephone bills (but make sure you have an itemised bill to prove the calls made);
- bank charges (e.g., interest charged on property bank account).

In the above case study the owners have been successful in that the limited liability of the company has saved them from being personally responsible for the costs.

If this had not been in place, then the costs would have fallen on them, which would have resulted in them having to sell their own houses to meet the claim.

How to Slash Your Property Capital Gains Tax

9. Understanding Capital Gains Tax (CGT)

Before we look at the different ways to cut your capital gains tax saving strategies, it is important to understand what is meant by the term **capital gains tax (CGT)** and when property investors are liable to pay it.

In this section you will become familiar with CGT and how it is calculated when you decide to sell your property.

9.1. When You Are Liable to Pay CGT

A property investor is likely to incur a CGT liability in the following two situations:

a) when a property is sold at a higher price than for which it was purchased;

b) when a property, or part of a property, is transferred to a non-spouse.

Properties and other assets can be transferred between husband and wife freely, without triggering a CGT liability.

Both of the above situations are illustrated in the following case studies.

CGT Liability When Selling a Property

Maria purchases a buy-to-let property in January 1998 for £100,000. She rents it out for five years and then sells it for £210,000.

This means that she has made a capital gain of £110,000, upon which she is liable to pay CGT.

CGT Liability When Transferring a Property

Maria purchases a buy-to-let property in January 1998 for £100,000. She rents it out for five years and then gifts the property to her mother.

She receives no payment from her mother for the property.

Although Maria has received no payment for the property, she is treated as having transferred the property to her mother at 'market value,' which is £210,000. Therefore, again, Maria is liable to pay CGT on the £110,000 profit.

Property dealers/traders are not liable to pay CGT. When they sell a property, the profit is classed as a dealing profit, and therefore they are liable to pay **income tax** on the profits.

9.2. Why Exchanging Contracts Can Defer Your Tax Bill

There is a common misconception that the tax date for a sale of a property is the completion date of a property. This is not true. The tax date for CGT purposes is actually the date the contracts are exchanged.

Exchange of Contracts

Terry decides to sell his property and advertises it for £220,000 in January 2012. An offer is accepted in the first week of February.

Terry knows that if he exchanges contracts before the 6th April 2012, then any tax that is due will need to be paid by 31st January 2013.

However if he delays the exchange of contracts till the 6th April, then the sale will be considered to have fallen in the 2012-2013 tax year and therefore no tax will be due until 31st January 2014.

He draws out the sales proceedings so that the exchange of contracts is done on the 6th April and the completion a couple of days after.

9.3. Changes to the CGT Rate

October 2007

In the October 2007 pre-budget report, Chancellor Alistair Darling announced that a flat rate CGT rate of 18% would be introduced from April 6th 2008.

March 2008

The announcement in the October 2007 pre-budget report was confirmed in the March 2008 budget and became effective from 6th April 2008.

What this meant was that any property sold from 6th April 2008 would only pay a flat rate capital gains tax of 18%, regardless of the size of profit.

It was no surprise that a number of commentators referred to the March 2008 budget as a budget for the **property investor!**

June 22nd 2010

In the 22 June 2010 Budget Chancellor George Osborne announced new CGT rates. Capital gains made on disposals from 23 June 2010 onwards are added to the taxpayers other income.

Any gains falling below the higher rate threshold are taxed at 18%. Any gains falling above the threshold are taxed at 28%.

Trusts pay capital gains tax at only one rate – 28%.

9.4. How Your CGT Bill is Calculated

Calculating the tax liability on the sale or transfer of a property is not easy.

Given the property price increases over the past few years alone, investors are sitting on significant capital gains.

It is important to realise that a number of reliefs and strategies are available to reduce any CGT liability you may have. The most significant of these are detailed in the remainder of this guide.

However, listed in the table below are the typical reliefs/reductions that can be claimed when a property is sold/transferred.

If applicable, these can be offset against the capital gain made on the property and can be used to significantly reduce any tax liability.

Relief/Reduction	Description
Buying and Selling Costs	Typical purchase costs include • solicitor' fees; • mortgage booking fee; • survey costs; • cost of searches, e.g., land, mining, etc. Typical selling costs include • agency fees; • solicitor' fees; • redemption penalties, etc.
Capital Costs	If you have made costs of a capital nature, then these can also be offset. A capital cost is one that has increased the price of the property. Examples of capital costs include the building of conservatories, additional bedrooms, loft conversions, garage conversions, etc.
Indexation Relief	This relief was available for qualifying for property that was sold before April 6th 2008.

Private Residence Relief	This relief is based on the period that the property was classed as your PPR.
Private Letting Relief	This relief is a very generous relief that can reduce your capital gain by up to an additional £40,000.
Allowable Losses	If you have incurred capital losses, then these can be offset against any capital gain made when you dispose of your property.
Taper Relief	This relief was introduced in April 1998 and was a replacement for indexation relief. However it can only be claimed for property sold before 6th April 2008.
Personal CGT Allowance	For the 2012–2013 tax year, this allowance is £10,600.

10. Avoid CGT by Using 'Private Residence Relief'

In this section you will become familiar with the extremely powerful **private residence relief**.

This allowance on its own can wipe out tens or even hundreds of thousands of pounds off your chargeable capital gains.

10.1. What is Private Residence Relief?

This relief is available to you if you have lived in a property that has been classed as your **main residence** for a period of time.

This relief is not available to you if you are a property dealer and purchased a property with the sole intention of making a dealing profit, i.e., you did not make it your main residence.

The technical name for a person's main residence is **principle private residence (PPR)**.

If you have lived in a property that has been your PPR, then you are not liable to pay any capital gains tax on the price appreciation that is attributed to the period when you lived in the property.

There are two types of residence relief that are available, and both are described and illustrated in the following two sections.

10.1.1. Full residence relief

If the property has been classed as your PPR throughout your period of ownership, then you can claim **full residence relief**.

If you can claim full residence relief, then this means that you will have no CGT liability. This is regardless of the capital profit you have made on the property.

Every homeowner who has occupied their property since the first day of ownership up until the time of sale is entitled to use this relief.

Full Residence Relief

Alex buys his first home in May 1990 for £65,000. He lives in it from the day of purchase up until the day he sells it in June 2001. The selling price is £150,000, which means that he has made a capital profit of £85,000.

He is not liable to pay any tax on this profit as he is able to claim full residence relief because the property was his main residence during his period of ownership.

10.1.2. Partial residence relief

You are able to claim **partial residence relief** if your property has been your main residence for a period of time but not for the whole period of ownership.

If you are claiming partial residence relief, then the amount of relief you can claim is determined by dividing the periods when the property was classed as your PPR by the total periods of ownership.

For example, if you purchased a property, let it out for 7 years and then lived in it for three years before selling it then you will be able to claim 3/10 partial residence relief. This is because you owned the property for 10 years, but it was your main residence for three of those years.

You are most likely to claim partial residence relief if

- you have a second home;
- you are a property investor who has let a property after having previously lived in it.

10.2. How Long in a Property Before It Can Be Classed as My PPR?

This is one of the most commonly asked tax questions.

The reason for the popularity of this question is because if you can prove that a property was genuinely your PPR, you can make use of some very generous tax reliefs. You will see in the following strategies exactly how you can use these reliefs to your advantage to reduce or even wipe out any tax liability.

HMRC have not given any specific guidance as to how long you need to live in a property before you can claim that it has been your principle private residence.

However, as a general rule of thumb, you should try to make it your permanent residence for at least one year, i.e., 12 months.

The longer you live in a property, the better chance you have of claiming residence relief.

HMRC are not necessarily interested in how long you lived in the property. They are *much more* interested in whether the property really was your home and whether you *really* did live in the property!

If you want to claim this relief, here are some pointers that will help you to convince the taxman that a property genuinely was your private residence.

a) Have utility and other bills in your own name at the property address.

   Typical bills will include
   i. gas bills;
   ii. water rates;
   iii. electricity supply bills;

iv. council tax bills;
v. TV licence, etc.

b) Make the property address your voting address on the electoral register.

c) Be able to demonstrate that you bought furniture and furnishings for the property. Keep receipts and prove that bulky furniture was delivered to the property address.

d) Have all bank statements delivered to the property address.

By following the above guidelines, you will be in a good position to convince the taxman that a property was genuinely your home.

11. Using Landlord Software to Manage Your Taxes

A message from Amer Siddiq, founder of:

www.propertyportfoliosoftware.co.uk

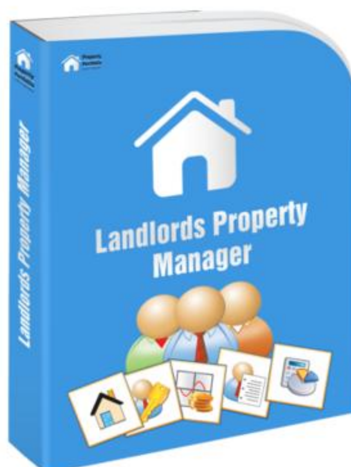
When I began investing in property, I naturally looked around for a software solution to help me to get better organised. I quickly realised that there was nothing suitable available and so I designed my own tool based on my personal experiences and input from other very experienced landlords.

My aim was to design an easy to use solution to overcome the five biggest property management challenges faced by landlords with growing portfolios:

- Getting better organised: cutting the time spent handling paperwork
- Staying legal: keeping track of safety certificates and legal documents
- Tenant management: accurately tracking tenant payments
- Income tax management: Knowing what is due and when
- Maintaining and growing a positive cashflow

Landlords Property Manager is the result - the award winning solution on the market that is the only official landlord software recommended by the Residential Landlords Association (RLA) and is the recognised software tool for the National Landlords Association (NLA).

Features include:



Property Manager - Fast management and full control of all property management tasks. Accurately track all property related income and expenditures.

Early Warning System - Generates reminders and notifies you of outstanding rental or loan payments.

Tenant Manager - Manage your tenants, track your rental income and produce your legal documents. You can also upload and store your own documents within the software itself, helping you keep organised.

Finance Manager - Central control of all your mortgages and property related loans.

Income Tax Calculator - The only solution on the market that also calculates your rental income tax.

Report Manager - Over 15 one-touch property management reports to help you analyse your portfolio, including Profit and Loss, Cash Flow Analysis and Portfolio Income Assessment.

Support Manager - A wealth of support resources to keep you running night and day. Gives you one click access to support resources from within the software.

To learn more about our powerful and easy to use property management software for landlords, visit:

www.propertyportfoliosoftware.co.uk.

12. A Final Reminder - The Golden Tax Rules

The challenge to you as a property investor will no doubt be how to grow a profitable portfolio. One of the easiest ways you can make money in property is to pay less tax.
44.1.1. Education…education…education
Whether you are starting out in property investing or are an experienced landlord with a sizeable portfolio, there is one thing that you should always do - educate yourself to make sure you are:

a) complying with the ever changing legal requirements

b) learning how to make your investments more profitable

c) making sure you keep up-to-date with tax changes that may affect your tax liability.

Although there is never a substitute for taking professional advice, you should keep yourself updated so that you can discuss these opportunities with your adviser at your next appointment.

12.1. Prevention is better than cure

There is a proverb ‘prevention is better than cure’ (believe it or not this was first said by the famous medieval philosopher Erasmus) and he probably was not thinking about tax when he said it, but it most certainly applies.

Planning for a tax situation you are likely to face is much better than trying to get out of a tax problem that you have unknowingly (or even knowingly) fallen into. It is certain that trying to get out of a tax problem will cost much more in specialist/consultancy fees and there is never a guarantee that you will get out of the problem.

<u>* THIS IS THE END OF THIS GUIDE ***</u>**

<table>
<tr><td colspan="2">To learn more landlord tax saving strategies, tips and loopholes visit:</td></tr>
<tr><td>
</td><td>www.taxinsider.co.uk</td></tr>
<tr><td colspan="2">To learn more about our powerful and easy to use property management software for landlords, visit:</td></tr>
<tr><td>
</td><td>www.propertyportfoliosoftware.co.uk</td></tr>
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