BUY TO LET PROPERTIES AND TAX

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Recent tax changes for Buy to Let properties have two major implications for landlords. Firstly, landlords need to take the changes into account when completing their tax returns. Secondly, and possibly more importantly from the landlord's point of view, their profit could be affected.

This guide is correct at the time of publication and we recommend landlords consult an accountant about their personal situation.

Income Tax

Mortgage/loan interest

It's never been possible to claim the repayment element of your mortgage but, since 6 April 2017, there are restrictions on how you can claim the interest on any loans (and any other finance costs such as arrangement fees).

There are two changes rolled into one:

1. Instead of claiming finance costs as a letting expense you will, instead, claim a deduction which will reduce the tax due on rental properties. This can be claimed in the appropriate section of your tax return.

2. Unfortunately, there will no longer be additional relief for higher rate taxpayers. The deduction will be limited to a maximum of 20% of finance costs.

Mortgage/loan interest (continued)

For example:

- If you are a 45% tax payer and claimed £10,000 interest expense in 2016/17, you would have saved £4,500 tax. By 2020/21, you will only have a deduction of £2,000 tax so you will be £2,500 worse off.
- If you are a 40% tax payer and claimed £10,000 interest expense in 2016/17, you would have saved £4,000 tax. By 2020/21, you will only have a deduction of £2,000 tax so you will be £2,000 worse off.
- If you only pay tax at 20% then you will pay the same amount of tax but you will claim a tax deduction in the appropriate part of the tax return instead of with your other letting expenses.

The changes are being phased in gradually over three years and the deductions for finance charges are gradually being restricted:

2017/18: 75% at your highest rate of tax with 25% at basic rate (currently 20%)
2018/19: 50% at your highest rate of tax with 50% at basic rate
2019/20: 25% at your highest rate of tax with 75% at basic rate
2020/21: 0% at your highest rate of tax with 100% at basic rate

As always, the transitional years are more fiddly to calculate but do delay the full impact of the changes.

In real terms, this means:

1. Your taxable profits will be higher so you may pay more tax
2. You may pay tax even though you have no net cash after paying out loan interest and repayments
3. You should review your BTL properties in the light of this increased taxation and the effect on your cash flow

Other expenses

There are plenty of other expenses that you can claim from the list below:

Buildings insurance (not contents unless it is a furnished property)	**Light and heat**	**Cleaning**	**Gardening**
Security	**Rent and ground rent**	**Service charges**	**Council tax while vacant**
Repairs and maintenance (not improvements which are claimed against capital gains tax)	**Replacements**	**Redecorating**	**Small tools**
Legal e.g. preparation of rental contracts (legal costs on purchase and sale are claimed against capital gains tax, profit and loss on obtaining finance is not allowed as a finance cost)	**Accountancy fees**	**Debt collection fees**	**Other insurances**
Advertising	**Letting agents' fees**	**Travel**	**Advertising for new tenants**

Accruals vs cash basis

Rental accounts are relatively easy to prepare for a single property, although you may still prefer the reassurance of using an accountant to look after your affairs.

Previously, both income and cost had to be included in rental property accounts on an "accrued" basis i.e. in the tax period they were incurred rather than when they were actually paid or received. Since 6 April 2017, the default is the "cash" basis for those with rental income below £150,000pa. This is usually much simpler as it means that you include receipts and payments when the money moves and ignore anything that is still owed. If this is your only business income then it is easier to manage as you can just keep a separate bank account for your property transactions.

You can still opt to use the accruals basis if you prefer.

Repairs or improvements?

Repairs and improvements are both allowable costs but it is an important distinction as tax relief is claimed in one of two ways depending whether building work is repairing or replacing pre-existing materials or whether it is an improvement.

Repairs and maintenance usually include:

- Painting and decorating
- Re-pointing existing brickwork
- Damp or rot treatment
- Repairs to existing equipment, windows, doors, etc.
- Replacing a roof

Capital items are work which improves the property such as an extension. These costs can be claimed to reduce your capital gains tax when you come to sell the property.

Sometimes it is hard to tell if an item is a replacement or an improvement so, if you're unsure, do take advice.

Furniture and fittings

Another recent change is the removal of the 10% wear and tear allowance to cover furnishings (beds, sofas etc) or appliances. Since 6 April 2016, it is only possible to claim the actual cost of repairing or replacing these items. This means that you now need to keep your receipts etc.

Capital gains tax

When the time comes to sell, hopefully your property will have increased in value. Unlike selling your main home, this increase in value is taxable as a capital gain.

The good news is that you can claim the costs of purchasing, selling and improving the property.

If the property was your main residence at any time then there may be reliefs available. You may also qualify for up to £40,000 letting relief per owner. You can find more information on capital gains tax **(including letting relief) here.** Letting relief is complex and if you wish to see whether you qualify for this relief, your best option is to seek advice from a qualified accountant.

Your taxable gain will be:

Selling price	X
Less purchase price	X
Less purchase costs	X
Less selling costs	X
Less any improvements	X
Capital gain	X
Less any tax reliefs	X
Taxable gain	X

Capital gains tax (continued)

There is an annual capital gains allowance for each individual owner to offset net gains/losses in the year of disposal. Everything above this allowance is currently taxed at 18% or 28% depending on your normal tax rate.

If you are thinking of selling a property that has significantly increased in price then it may be worth taking individual tax advice early in the process and definitely before the sale itself as there may be actions that can be taken in order to minimise your tax burden.

Furnished holiday lets (FHL)

Special rules apply when letting out a holiday property in the European Economic Area (EEA). These rules may well change following our exit from the EU and/or EEA.

To qualify as a FHL, the property must be:

- Available to let commercially for at least 210 days in the year
- Actually let at a commercial rate for at least 105 days per year
- Any letting periods over 31 days long can't be included in the 105 days and the total of all such longer lets must be less than 155 days per year.

If you own a FHL then these properties must be accounted for separately from your other properties, however, there are additional reliefs available. The rental income is a useful way to part fund what may be your own holiday home.

Stamp duty

When you purchase a property you will probably pay stamp duty land tax (SDLT). The rate you pay will depend on the price you pay for the property, excluding any carpets, curtains and free standing furniture etc at the market value (the amount that you would pay for these on the open market and not an artificially constructed value).

From 1 April 2016, the rate of stamp duty was increased by 3% on second properties which may be a second home or a buy to let property.

Companies also pay SDLT on all property purchases.

Differences for companies

If you decide to use a limited company to hold your property portfolio, you will pay tax on profits as corporation tax. This rate is currently 19% on all profits.

You will potentially have to pay further tax when you want to take the profits out of the company as salary (PAYE/National Insurance) or dividends (dividend tax).

There is no annual allowance for a company's capital gains on sale.

Using a limited company may give you opportunities for tax planning but there will also be higher admin and accountancy costs. There are also different inheritance tax rules when transferring shares in a property company rather than transferring the properties themselves.

Differences for trusts

There may be Inheritance Tax (IHT) advantages if your property is held in a trust.

If you are thinking of using a limited company or a trust then it is worth taking professional advice.

You can find out more information on IHT and Trusts here.

Next steps

This guide is intended as a brief overview of the main ways that your residential property investment will be taxed and is correct at the time of publication. Next steps for landlords might include:

- Ensure you understand the impact on your business and income now and in the future.
- Take a look at the suggested sources throughout the guide.
- Consider appointing an accountant if you don't already have one. The more complex your income and the larger your portfolio, the more likely this is to be beneficial. **ICAEW** or **ACCA** are great websites for searching for accountants near you.
- Be aware that according to your situation, other taxes may apply and there are special rules for non-UK residents.

Published date: August 2018

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