

# Are You Letting Property?

In 2008 HM Revenue & Customs started a consultation regarding lettings due to the large increase of buy to lets seen in recent years. This has led to a campaign to collect unpaid tax on income from property.

Their main concern is that people are over claiming the interest paid on borrowings as a tax deduction against the rental income. No doubt they also believe that not everyone is reporting their rental income. The campaign will involve enquiring into tax returns in order to reclaim unpaid tax along with interest and penalties (which can be as much as 100% of the underpaid tax).

The Revenue has many sources of information such as the land registry (so they know if you own another house), electoral register (so they know your main address), statistics on the rental market (so they have an idea if your rent looks low or the costs look high) as well as more subtle methods such as picking up your details whilst investigating another tax payer, perhaps a tenant.

There is no guaranteed way to avoid an investigation. However, there are ways of reducing the risk such as having your tax return prepared by a tax adviser. If you are investigated a tax adviser can help you through what can be a lengthy ordeal. A tax adviser can also help make sure you claim all the costs you are entitled to and correct the Revenue if they are wrong in their assessments.

The main issues you should be aware of are:

## **Income Tax**

Your rental income has to be reported on a tax return form to the Revenue. When you start letting you are legally required to inform the Revenue by the 5 October after the end of the tax year in which the letting commenced.

The tax return covers a tax year which runs from 6 April to 5 April. The current tax year is 6 April 2009 to 5 April 2010 (and referred to as the 2009/10 tax year) so if your rent starts between these dates you need to let the Revenue know by 5 October 2010.

You also have a legal obligation to keep adequate records which will enable the Revenue to confirm the rental income and allowable expenses. There can be severe implications for not keeping the supporting information. In most cases a property managed through a letting agent is ideal as this provides a monthly statement of the rent and expenses. However, if you pay for any expenses personally you need to ask for and keep an invoice.

Rent is taxed on the accruals basis which means that the taxable figures are based on what you are due to receive and pay in the tax year - not what you have actually received or paid (cash basis). This means that if you are due an amount of rent but have not received it by the end of the tax year you will still be taxed on it. This would mainly affect those who receive rent in arrears. If a tenant defaults on the rent then you can claim bad debt relief and will not be taxed on that amount. For expenses you can make a deduction for them if the work has been performed even if it is not yet paid for.

Most expenses you incur will in all likelihood be allowable. However, there is a divide between repairs, which can be offset against the rental income, and improvements. This area can be complex and is often challenged by the Revenue so professional advice should be sought if you are unsure. Generally if something is replaced and the new item is of similar quality then the Revenue will accept it as a repair, whilst a completely new addition or replacing something with an item of much higher quality is normally regarded as an improvement.

Other common categories of expenses include:

### **Mortgage or Loan Interest**

In most cases this is straight forward as the amount borrowed is set up as a mortgage against the property. Assuming the amount borrowed is less than the value of the house when bought all the interest on the mortgage will be allowable against the rents. Care must be taken to distinguish between the capital and interest elements of mortgage payments – the capital element cannot be taken as a deduction.

This area can become complicated where multiple houses and loans are involved or when refinancing happens. In these case you should seek professional advice.

### **Furnished Lets**

The cost of furnishings and other items provided by a landlord in a property are not a deductible expense the first time they are bought. Instead you are given a choice on whether to claim a wear and tear allowance or claim a deduction when items are replaced. The wear and tear allowance is calculated as 10% of the rent after deducting any expenses the tenant would normally be expected to pay such as council tax and water rates. You cannot claim both and you may want to discuss which option to use with a professional adviser as once chosen it cannot be changed.

Other areas of importance are:

### **Non Resident Landlords**

If you are letting a property in the UK those rents are taxable whether you live in the UK or not. To avoid the complications that arise trying to collect tax from landlords who live abroad the agent or the tenant have a legal obligation to deduct basic rate tax (currently 20%) from the rent and pay this directly to the Revenue. This tax can only be claimed back by completing a tax return.

If the non resident landlord has a good track record with the Revenue they will often agree to waive this collection method though a tax return may be required if any tax is due. This exemption has to be applied for.

### **Rent-a-room Exemption**

If you let a room in your own home then you may be entitled to claim the rent-a-room exemption. This automatically gives you a tax free amount up to £4,250. However you cannot claim any expenses if this relief is used.

### **Capital Gains Tax**

Capital gains tax is likely to be payable on any rented property when it is sold. However there are ways of deferring the tax and, depending on the circumstances, there may be some valuable tax reliefs available.

**Please contact us now if you need any advice or assistance in respect of this fact sheet, or if you would like us to deal with your tax affairs on your behalf.**

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