

# CLIFFORD

# TOWERS

## CHARTERED ACCOUNTANTS

1ST FLOOR SUITES UNITS 8-9 WEBB ELLIS  
BUSINESS PARK WOODSIDE PARK RUGBY  
WARWICKSHIRE CV21 2NP

TELEPHONE 01788 577613

FACSIMILE 01788 565109

9 HIGH STREET STONY STRATFORD  
MILTON KEYNES MK11 1AA

TELEPHONE 01908 564701

FAX 01908 260393

[www.cliffordtowers.com](http://www.cliffordtowers.com)

# Taxation matters affecting property letting

Bricks and mortar have always been a popular form of investment. Despite the recession, property values have consistently risen and income yields have been maintained. Some want to hold property to generate an income and see capital growth, others want a more immediate profit and engage in the process of buying, 'doing up' and selling on. This Briefing will consider a variety of property related tax issues relating to income and sale.

## Buy to let – income tax issues

The receipt of rents from land and property, whether commercial or residential, is treated as a property business for income tax purposes. A person must maintain separate accounts for a UK property business and an overseas property business.

A UK property business consolidates all the letting in the UK, with income and losses on individual properties being effectively netted off to leave an overall profit or loss. Losses can generally only be carried forward and deducted from the profits of the same business for future periods. Similar principles apply for the overseas property business.

However, income from Furnished Holiday Lettings (FHL) has special rules which are not covered further in this Briefing. If this is an area of interest to you please contact us for further information on the specific tax implications of this type of letting.

## What is a profit or loss?

In terms of rental income, profits or losses for each type of business are to be calculated in the same way as trading profits for tax purposes. Rent includes licences, rent charges and any other annual payments in respect of the land. This begs the question as to how many people fully understand the tax rules of computing trading profits and raises a number of issues which HMRC have highlighted over recent years. It is not possible to consider all of the relevant rules

but certain common areas of difficulty are now looked at.

## Wholly and exclusively

The first general rule for a cost to be allowed against income is that the expenditure must be incurred wholly and exclusively for the purposes of the business. This means that if a cost has a dual reason for being incurred e.g. a personal reason as well, then none of the cost is allowable for tax purposes. If part of the cost is clearly for the business but part is not, then the cost can be apportioned. The rules are tight and care should be taken to ensure that costs can be shown to be 'purely business'.

## Capital or revenue

The second general rule to meet for costs to be allowable for tax is that they are revenue and not capital, which is defined as expenditure to create an asset or advantage for the long-term benefit of the trade. One good example which distinguishes the two principles is where a loan is being used to finance the acquisition of a property. The interest costs of buying a buy-to-let property are a day to day 'running cost' and are allowable. However, the capital element of any repayment falls foul of the 'enduring benefit' point and is not allowable.

## Legal and other professional fees

Such costs fall into the general bracket of capital/revenue as above. This means that the costs associated with buying

a property or creating a lease are not allowable. However, the costs of evicting a problematical tenant, renewing an existing lease or pursuing arrears of rent should normally be allowable.

## Repairs

Repairs are allowable but the whole issue of whether a cost is a repair or not can be complex as evidenced by a number of tax cases over the years. A number of basic principles do however apply.

The first principle is that the replacement of an 'entire asset' is not a repair. What constitutes the 'entire asset' can be an area of contention with HMRC. The main distinction in the context of a buy-to-let property will be to look at



whether the item replaced appears to be a free-standing asset in the property or a fixture of the building. A boiler or water filled radiator installed in a residential property as part of a space or water heating system is considered to be a fixture as it will have become part of the property. Therefore, the replacement of such an item would not be the replacement of the whole building and should qualify as a repair. However, a fridge freezer in the kitchen is not part of the building but is an entire asset in its own right and its replacement is not a repair.

The second principle, which may not always be relevant, is that buying an unusable asset and spending money to get it back into a usable state is not allowable. This contrasts with the situation of rectification work between tenancies. The fact the taxpayer had repairs carried out just after they acquired the asset does not, of itself, mean that the cost of the repair is not allowable but the issue of 'usability' can be important.

The third principle is that an alteration or improvement is not a repair and will not be allowable. A good rule of thumb is whether the character of the asset has changed. If it has, then the cost is not allowable.

#### HMRC example

A fitted kitchen is refurbished. All the existing base units, wall units and sink etc. are stripped out and replaced, as is the fitted cooker and hob. New units of an equivalent quality are installed. Finally the kitchen is re-plastered and re-tiled. The new kitchen is slightly different but it does the same job as before. This is a repair and allowable expenditure.

If at the same time additional cabinets are fitted, increasing the storage space, or extra equipment is installed, then this element is a capital addition and not allowable (applying whatever apportionment basis is reasonable on the facts).

As you can see, the whole area of repairs is difficult. Good records are essential where large costs are involved. Please speak to us if you are considering significant 'repairs'.

#### Capital allowances

Many businesses receive capital allowances to recognise the depreciation of machinery, vehicles, etc. Whilst capital allowances may be due on vehicles used for the purposes of a property business, there are no capital allowances due for equipment and furnishings used in a dwelling. This means that there are no allowances available for equipment used in buy to let residential properties.

However, historically HMRC allowed some tax relief for expenditure on equipment and furnishings in property which was let, by way of a concession.

In simple terms, where a taxpayer lets a furnished residential property, a deduction could be claimed for either:

- a wear and tear allowance of 10% of the 'net rent' from the furnished letting, designed to cover the depreciation of equipment and furnishings or
- the net cost of replacing a particular item of furniture, but not the cost of the original purchase, known as 'the non-statutory renewals basis', subject to a number of detailed rules.

In April 2011, wear and tear was put into 'proper law' and though reasonably generous only applies to a dwelling which contains sufficient furniture, furnishings and equipment for normal residential use. Further, in April 2013 the non-statutory renewals basis was withdrawn with no replacement.

This means that where a dwelling is let partly furnished, there are no capital allowances, no wear and tear and no renewals basis. That is, potentially no relief for fixtures and fittings other than repair costs, which makes the definition of a repair above even more important.

#### Travel costs

If the taxpayer runs the business themselves from home, then the cost of travelling between home and the let property is allowable provided the journey is exclusively a business one. The costs of travelling between different properties, solely for the purposes of the business, will also be allowable. Costs of travelling include expenditure such as fuel, road tax, bus fares, etc.

However, HMRC do raise an important point as to who runs the business. Where a letting agent carries out all (or virtually all) the duties relating to the letting activity, the business 'base' is likely to be the agent's office, and travelling expenses from the taxpayer's home will not normally be allowable.

#### Buy to let – Capital Gains Tax (CGT) issues

The disposal of a property which has been let will generally be chargeable to CGT at either 18% or 28%. There are no special reliefs. Where an overseas property is sold the gain may alternatively, or additionally, be subject to tax in the country in which the property is located. The precise CGT position for the individual also depends on their UK tax status (residence and domicile), so please contact us for further advice depending on your particular circumstances.

#### Buy to let – Inheritance Tax (IHT) issues

Although the letting of property is classed as a business for income tax purposes there is a marked reluctance on the part of HMRC to allow any preferential IHT reliefs in respect of property which is let. The problem lies in the interpretation of the law which disallows Business Property Relief (BPR) where the business is one of making and holding investments.

Case law suggests that even where there is significant active management involvement by the owner, that this is generally not sufficient to move the activity away from being regarded as an investment.

#### To hold personally or in the company – that is the question

The main short-term issue is that income may only be subject to corporation tax at 20% but then the shareholders have got to get the cash out of the company, so there may be another tax charge on them. There may also be issues for both CGT and IHT to consider and the decision is never simple, so please talk to us so that we can fully consider the implications for you.

#### And finally – commercial property letting

It may be thought that somehow commercial letting would be treated differently to residential letting but many of the issues are the same:

- most of the rules relating to income and expenditure above apply
- although letting may well constitute a business, it will often never be a trade and therefore Entrepreneurs' Relief and BPR will never be available.

One major difference is that capital allowances are available on equipment in let commercial property, so the rules on wear and tear do not apply. However, these rules can also be complex and there are special rules which relate to equipment fixtures in such properties which need special attention, both when buying existing buildings and when incurring new expenditure.

Unfortunately, tax is rarely simple, so if you would like help with your property business affairs, do not hesitate to get in touch.