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hints from the experts

197 LANDLORD TAX QUESTIONS ANSWERED



This is an excerpt from Lawpack's book *197 Landlord Tax Questions Answered*.
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About Arthur Weller



Arthur Weller is a Chartered Tax Advisor (CTA) who operates his own tax consultancy. He is known throughout the tax industry for his ability to resolve the most complex of tax issues and has over 10 years experience in this field.

Arthur is based in the northwest of England 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, capital gains tax, stamp duty, income tax, company tax, tax repercussions of going abroad, tax investigations and generally dealing with the Inland Revenue.



Arthur is co-author of the guide **How to Avoid landlord Taxes** and has contributed heavily to a number of other products that are available through www.property-tax-portal.co.uk.



Arthur has also provided the technical tax expertise for the UK's leading landlord software – **Landlords Property Manager**.

This software has been designed and developed by www.propertyportfoliosoftware.co.uk.

1. What Expenses Can I Offset Against Rental Income?

Question: I have just purchased my first buy-to-let property and have managed to successfully let it out. However I am unsure as to what expenses I can offset against my rental income.

Answer: Remember the golden rule: ***If you have incurred a revenue expense for the purpose of your property, then you can offset it against the rental income.***

This means that you can continue to lower your tax bill - *legitimately*. Most investors are aware that they can offset mortgage interest, insurance costs, rates, costs of decorating/repairs, wages and costs of services.

However, so many investors fail to claim the following costs, which when added together can provide a significant tax saving:

- Costs incurred when travelling back-and-to the investment property
- Advertisement costs
- Telephone calls made (or text messages sent) in connection with the property
- Cost of safety certificates
- Cost of bank charges (i.e. overdraft)
- Advisory fees e.g. legal and accountancy
- Subscription to property investment related magazines, products and services

2. Switch Property With Your Spouse

Question: My husband works full-time and I have the more difficult job of looking after the home and children, yet receive no income. Would it be better for me to own the property in my name?

Answer: If you have a spouse who is a lower rate (or even nil rate) taxpayer and you are a higher rate taxpayer, then consider moving the greater portion of the property ownership into their name. This means that a greater part of the profit will be attributed to the lower (or nil rate) taxpayer thus meaning that any tax liability could be significantly reduced.

This is a very powerful strategy if your spouse does not work, as any tax liability can be legitimately wiped out. Please note that in order to use this strategy your partner must be trustworthy as legally they will 'own' a greater share of the property.

3. Can I Claim Private Letting Relief?

Question: I have a property that I have been letting out for the past four years, ever since I purchased it. Can I claim private letting relief even if I have not lived in the property?

Answer: It is important to understand that private letting relief can only be claimed if a property has both been let out and also been lived in.

Therefore, as the situation currently stands, you will not be able to claim private letting relief. However, if you make the property your primary residence then you will be able to claim the relief.

4. Any Tax Due For Unemployed Person?

Question: My wife owns our only buy-to-let property. There is no outstanding mortgage on the property and therefore it generates a monthly profit of £375. Is there any tax due on this profit, as she received no other income?

Answer: As you have mentioned that your wife receives no other income then there will be no tax due on the rental profits. This is because over the year she will make a profit of £4,500 (i.e. £375 * 12), and this amount is within the annual personal tax allowance, which for the 2012-2013 tax year is £8,105.

5. What Is My Stamp Duty Liability?

Question: I am in the process of purchasing a property. The estate agent has said that stamp duty is due at 1%. I thought that there was no stamp duty due on the property as it is in an exempt area. How can I check the amount that is due?

Answer: Your solicitor should be able to advise whether stamp duty is due or not on the property. However, you can also check yourself by entering the postcode of the property into the following page: <http://www.hmrc.gov.uk/so/dar/dar-search.htm>

This will tell you whether the property is in a qualifying area and whether any stamp duty is due.

6. What Is The Most Amount Of Tax?

Question: Is there a maximum amount of tax that can be paid on the sale of a property? In other words, does one stop paying tax when a certain threshold is breached?

Answer: Tax continues to be paid as long as the profit is taxable. In other words there is no threshold level at which you stop paying tax.

7. Can I Defer Capital Gains Tax?

Question: I am about to sell a buy-to-let property that has made a £40,000 gain. But I am looking to re-invest this money back into another two more properties. Because I have re-invested the money can I defer paying any tax that is due on the £40,000 profit?

Answer: This is a very commonly asked question and one which is often misunderstood by too many people. Once you have disposed of the buy-to-let property then you are liable to pay capital gains tax. This is regardless of whether you have re-invested the profits or spent the money.

There are only two exceptions to this. One is 'Furnished Holiday Lets'. The other is if the property is the subject of compulsory purchase (or compulsory acquisition by a lessee).

8. I Am A Pensioner; Do I Still Need To Pay Tax?

Question: I am a pensioner and I have a property which I have rented to tenants for the past 15 years. Do I still have to pay tax on the property?

Answer: Yes, you do have to pay tax on the rental income from the property.

If it is your own house, rent-a-room relief may be applicable.

If the income is small, taking into account all your other taxable income, it may be covered by your age-related personal allowance, and, if applicable, married couple's allowance.

Therefore, after doing your sums, you may find that the rental income does not cause you to pay any or much taxation.

9. Can I Change My 'Intention' To Help Reduce Tax?

Question: What would the tax treatment be if I were to buy a house with a view to doing it up and selling it for a profit, but then change my mind and decide that I would like to live there as my main residence.

In 1, 2 or 3 years time when I sell the property, would I still have to pay tax as a developer or would I be allowed to claim PPR? I only ask this because the initial intent and the intent is one of the ways the IR use to determine which category you fall into.

Answer: ICTA 1988 sec 776 says that if a property is acquired with the intention of selling on at a profit, then that profit shall be subject to income tax, i.e. without the benefits of capital gains tax reliefs.

Paragraph 9 there says that this does not apply to a situation where it was the individual's private residence.

However, it refers you to TCGA 1992 sec 224 paragraph 3, where it says that if the acquisition was for the purpose of realising a gain, then principal private residence relief shall not apply.

This is not a clear cut matter. However, if there was a genuine change of mind it is quite possible that the Inspector would accept that the principal private residence relief should apply.

10. The Most Tax Efficient Way To Take Out A Mortgage

Question: I own a property outright and want to rent it out once I've bought another, slightly bigger one. Tax-wise am I best taking out a mortgage on my original property and

then using the cash as a deposit on my investment, or simply taking out the mortgage on the second property?

Answer: You are better off, tax wise, taking out the mortgage on your original property when you start to rent it out. This is because page BIM45700 on the Revenue manuals (Example 2) explains that in such circumstances the interest payable to the lender can be offset against the rental income, so that income tax is only paid on the net figure. (The tax writers explain that this applies when the amount of the loan is no greater than the market value of the house when it started to be rented out. If the loan exceeds this figure (e.g. in a case of re-mortgaging later on), the excess interest is not allowable.)

11. What Is Rent-A-Room Relief?

Question: I am thinking of letting out a single room in my home to a lodger. I have heard there is some sort of relief available for this. What is it and how do I claim it?

Answer: If you decide to let a room in your main residence, you can receive a rental income of up to £4,250 and have no tax liability. In order to claim this allowance, the property must satisfy the following conditions:

- you must also live in the property
- the room you are letting out must be fully furnished

All that is necessary to claim this relief is to tick the rent-a-room box at the beginning of the land and property page of the tax return.

12. Can I Offset The Rent I Am Charged?

Question: My wife and I have lived in our property for 10 years. I am a member of HM Forces and in the summer we are posted away and have to live in Army married quarters. The rent for this is approx. £200pm. We will be renting our house out whilst I am posted. Can this £200 be offset against any income tax liability as I have no choice in the matter, and I did not plan to rent out my house to make profit, although it will produce a profit of £300pm.

Answer: The income of £500pm and the expense of £200pm are two separate items. The income is Schedule A rental income and should be declared in the Land and

Property section of the Self Assessment tax return. The expense of £200pm is an allowable expense and should be entered in box 17 on page 1 of the Employment section of the Self Assessment return. (See the Revenue manuals page EIM31816.)

13. What Is My Inheritance Tax Liability?

Question: If you inherit a property valued at £400,000 and which has an outstanding mortgage of £320,000. Are you still liable for IHT on values over £325,000 even though there is only capital of £80K in it?

Answer: Inheritance tax is due on the net value of the estate. So if the only two items attributable to the estate are a property valued at £400,000 and an outstanding mortgage of £320,000 then the net value of the estate is £80,000. Since this is below 2012-2013 £325,000 threshold there is no IHT.

14. Can I Offset Property Losses Against Other Income?

Question: I have bought a property to let out and it is possible that in the first, and perhaps the second, year I will make a loss after accounting for insurances, mortgage interest and loan interest used to get a deposit. Can I offset that loss against my earnings from employment during the same period? If so which IR form do I need to use?

Answer: The answer is 'no'. The losses cannot be offset against your employment income. However, they can be carried forward and offset against future rental income profits that are generated from the property business.

If you have been making losses then it is important that you register those losses with the HMRC. The reason for this is because any losses can be carried forward and offset against future profits. For example, if in one tax year you made a £1,000 loss and then the following year you made a £1,000 profit, there is no tax liability as the £1,000 loss has been carried forward and wipes out your future gain!

However, if you have any other properties that are being rented out in the same tax year at a profit, then the loss from the loss-making property can be set off against the profit from the profit-making property.

15. Is Property Now Classed As ‘Business Income’?

Question: I’m told that property income is now deemed business income. Although it is investment income it is now deemed income for class 2 National insurance contributions.

I note that you do not mention this in your various replies because surely this should be advised to property investors as they would if the income exceeds the class 2 income limit be liable for a fine if they do not notify the authorities within 3 months of starting. Your views would be appreciated.

Answer: Property letting will rarely be regarded as self-employment for NI purposes, although if the extent of the landlord's involvement in managing the lettings and looking after the properties is substantial (which might be particularly relevant for furnished holiday lettings), it is possible that the activities will constitute a business, in which case Class 2 NICs will be payable.

Class 4 NICs are only payable where income is taxed as trading income. Even though rents are now treated as being from a business in calculating property income, this is not the same as saying that a business actually exists, and it does not alter the NI position.

16. Is There A Limit To The Amount That Can Be Claimed?

Question: Is there any limit to the amount you can borrow and still qualify for full tax relief on an interest only mortgage?

Answer: There is no limit providing all the borrowed funds are used ‘wholly and exclusively’ for the rental business. Where this is not the case, e.g. the taxpayer has a property that he is renting out and re-mortgages in order to withdraw capital from his business, to use for non rental business purposes, then the amount of allowable interest is limited to the extent that the loan matches the value of the property when it first started to be used in the rental business.

Where the loan is greater, the interest on the excess is not allowable (unless as stated previously the funds are used for the rental business). Please see the following article for further information on this: [Use your investment properties to reduce the mortgage on your private residence and still offset the interest charged against your rental income.](#)

17. Can I Offset The Cost Of Buying A Vehicle?

Question: Is it possible to offset the cost of buying a vehicle for use in your letting business, and if so, what would be the best way of doing this?

Answer: Here is a quote from the Revenue manuals page PIM2210:

Capital expenditure on providing the means to travel (usually a car or van) isn't deductible in computing rental business profits; nor is a depreciation charge. But plant and machinery capital allowances may be available. These allowances are deducted in computing the business profit or loss. The 'wholly and exclusively' rule applies to these allowances but, as with revenue expenditure, the landlord can claim the business proportion of the allowances. Plant and machinery allowances on cars costing more than £12,000 are also further restricted. For detailed guidance see PIM3000 onwards and the Capital Allowances manual.

18. What CGT Liability For Property That Is Partly PPR?

Question: Please could you tell me what capital gains tax (CGT) each party would pay if there was a 50/50 ownership at sale, but it was one of the owner's primary residence?

Answer: If A and B own a property 50:50, then the sale proceeds and the base cost of the property are divided in two, and two separate CGT calculations are made, one for A and one for B. If it is A's principle private residence, then A will be exempt from any CGT, but B will be liable in the normal way on B's half. This kind of scenario can occur in a divorce situation, when A stays in the property, and B moves out.

Sometime later the property is sold, but since moving out it is no longer B's PPR. The last three years of ownership of B will be deemed to be occupied and therefore eligible for PPR relief, because previously B actually occupied the property.

The HMRC's Extra Statutory Concession D6 may be relevant here.

19. Can Interest Be Claimed As A Business Expense?

Question: I have taken out an interest only mortgage on my PPR in order to finance my property development business and enable me to acquire property as a "cash buyer"

prior to mortgaging on a Buy-to-let mortgage. Can this interest be claimed as a business expense?

Answer: If you have released equity out of your main home, i.e. increased the borrowing, and this additional money was used for buying further properties then the interest charged on the additional borrowing can be offset. This is because the additional loan has been used for the purpose of your property business and therefore the interest can be offset.

Consider the following case study:

Ali is desperate to buy his first investment property after seeing his own house value almost double within 5 years. 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 releasing an additional £15,000 of equity from his main home. The bank then agrees to finance the remaining £85,000.

This means that Ali has a 100% financed investment property. It also means that he is able to offset the interest charged on both his equity release of £15,000 and the BTL £85,000 mortgage against his rental income.

20. Should I Move Into Previously Rented Out Property?

Question: If I buy a 2nd property and rent it out for a couple of years, is any tax due on it if I then sell my primary residence and move into this 2nd property making it my primary residence for the next 10 years before selling it?

Answer: If you sell your first (primary residence) property and if it has been classed as your main residence then there will be no tax due on this property. If after two years you then move into the previous rented property then you may well have a small CGT liability in the future.

However a huge chunk of the tax liability will be avoided because you will benefit from private residence relief. However you will also receive another favourable tax relief i.e. private letting relief.

The latter relief along with your annual CGT allowance could well wipe-out any CGT liability. However in the case that a CGT liability still remains, it is likely to be nominal when compared with the gain you have made on the property.

21. Can I Offset Money Paid To The Tenant?

Question: Having bought an investment property with a sitting tenant paying a low rent, I paid the tenant £20,000 to vacate and have now rented the property to a new tenant for 10 years at a much higher rent. Can I claim this premium as an expense against rental income or only as capital expenditure once the property is sold?

Answer: Firstly, from the High Court case *Wateys London Ltd. v Pike* (1982) quoted by the HMRC's Business Income Manual page BIM35545, it can be seen that this is capital expenditure, not revenue.

Secondly, in order to be allowable expenditure to offset against the sale proceeds when the property is sold, as enhancement expenditure under TCGA 1992 sec 38 paragraph 1(b), it must be reflected in the state or nature of the asset at the date of disposal (HMRC Capital Gains Tax Manual page CG15180).

Page CG71262 there says that if, after obtaining vacant possession, the landlord granted a new lease on essentially the same terms, the benefit would not be there at the date of disposal, and therefore the expenditure would not be allowable.

However, in this case, the new rent is much higher, so, by implication, this payment to the old tenant should be an allowable capital expenditure when the property is sold.

22. Can I Select Any Property As My PPR?

Question: I currently live with my parents and have purchased two investment properties that are currently rented out. Am I able to nominate one of the let properties as my principal private residence to benefit from the PPR relief?

Answer: PPR is only available to the owner of a house if he occupied it as his only or main residence. An intention to occupy it is not sufficient.

It is not necessary to have lived in it as the only or main residence for all the period of ownership, but for at least part of the period of ownership it must have been the only or main residence.

The HMRC say in IR Interpretation 73 that "it is the quality of occupation rather than the length of occupation which determines whether a dwelling-house is its owner's residence".

23. Should I Contact HMRC Myself?

Question: I have had a BTL property for nearly 2 years. I am in PAYE employment so rarely get a tax return to complete. Can I wait till I get a tax return to complete before declaring it or would that be counterproductive?

Answer: If a taxpayer receives any taxable income in a tax year of which the HMRC is unaware, then they have a legal duty to inform the HMRC about this by 5 October.

So, for example, if any income was received between 6 April 2009 and 5 April 2010, then the individual must inform the HMRC by 5 October 2010. If the amount was £15,000 or less than a 'short' tax return will be all that they need to complete.

24. Is There A Tax Efficient Way To Make Gifts?

Question: What are the implications where parents make regular (monthly) financial gifts to their adult 'children' and is there a tax efficient way to make such gifts?

Answer: A gift from a parent to a child is a potentially exempt transfer (PET) as far as Inheritance Tax (IHT) is concerned. If the parent survives seven years after the gift, it will be disregarded as far as IHT is concerned.

However, if it is a regular small amount, it is likely to fall under the 'Normal expenditure out of income' rules, in which case it is exempt from IHT and is not a PET. To fall under these rules, the gift must be "part of your normal expenditure, and must not, taking one

year with another, reduce your available net income (after all other transfers) below that required to maintain your usual standard of living".

The following may be possible: the parent could gift a proportion of a property to the child, e.g. 10% of a buy to let property that they are receiving rental income from. If the child is over 18, for tax purposes, it will be the child's income.

Since only 10% is being gifted, maybe there will not be any CGT on the transfer, because the gain is covered by the annual exemption. The income will be taxed on the child, instead of the parent, thus saving income tax.

25. Can I Offset These Losses?

Question: In year one, I earned income from a house sale, but made a loss from a house sale in year two. Can I offset the loss incurred in year two against income earned in year one, or alternatively any income that is earned in year three?

Answer: It is possible to carry losses forwards and not backwards in different tax years. This means that if there has been any tax due when the profit was made from the first house sale, then tax will still need to be paid. The losses that have been incurred on the sale of the second property should be registered with the HMRC and can be offset against any future profits.

However, if the sale of the first property was on or after 6th April in one year and the sale of the second property was on or before the 5th April in the following year then you can offset the losses from the second sale against that of the first sale as they both fall in the same financial tax year.

Consider the following two case studies:

Case Study 1: Alex Sells Property A on 10th April 2005 and makes a £40,000 pre-tax profit. He also sells Property B on 5th April 2006 for a £40,000 loss. The 2005-2006 tax year runs from 6th April 2005 to 5th April 2006. This means because both properties have disposed within the same 2005-2006 tax year Alex can offset the losses against from Property B against the gains from Property A and therefore incurs no tax liability.

Case Study 2: Alex Sells Property A on 10th April 2005 and makes a £40,000 pre-tax profit. He also sells Property B on 10th April 2006 for a £40,000 loss. The first property has been sold in the 2005-2006 tax year, but the second property has been sold in the 2006-2007 tax year, as it is after 5th April 2006.

This means that he cannot offset the losses from property B against the profit from property A. Therefore if Alex is a 40% tax payer then he will be liable to pay tax of £16,000 on the £40,000 profit.

26. Is There A Difference When Offsetting Interest?

Question: When offsetting mortgage interest payments, does it matter if the mortgage is 'interest only' or a 'repayment mortgage'?

Answer: No, it does not matter. The interest charged on both mortgages can be offset against the rental income. What this means in reality is that if you have an 'interest only' mortgage then the **full** mortgage payment will be offset.

However, if you have a 'Repayment' mortgage then only the 'interest repayment' part of the mortgage will be offset. You will not be able to offset the capital part of the repayment. This means that you need to find out from your bank for each payment what part was 'interest' and what part was 'capital'. In most cases you find this out when the mortgage lender sends you your end of year complete mortgage statement.

27. Can I Offset The Cost For Extending The Lease?

Question: I have purchased a property for £95,000 in the year 2000. Afterwards I was living in the property for two years and have gradually renovated the place. I also bought a lease extension to increase the lease from 74 to 164 years. Before letting it out two years after purchasing it, I re-mortgaged and the property was valued £170,000.

When I sell the property, will I be liable for a CGT, even though I increased the value through my renovation? Also, can I offset the cost for the lease extension (£15,000)?

Answer: Firstly, if the property renovations have been of a 'capital nature', i.e. they have increased the value of the property, they can be deducted from the final selling cost.

Secondly, the cost of the lease extension is an allowable expense for CGT purposes – see the HMRC Manuals page CG 71401.

Thirdly, because you lived in the property, principal private residence relief and private letting relief will be available to reduce the gain.

Probably the CGT annual exemption will also be available.

28. Can I Give A Family Member A Financial Gift?

Question: Can I give a family member a financial gift and account for it within my self assessment returns?

Answer: You can certainly give a family member a financial gift. However you do not account for it on a self-assessment return, unless it is an asset that would be assessable to capital gains tax (CGT) had you disposed of it to a third party.

As far as income tax is concerned, it has no impact. This is because I assume it is a pure gift, and not in return for any work performed.

As far as Inheritance Tax (IHT) is concerned, it is a Potentially Exempt Transfer (PET), and falls out of any IHT calculations if the donor survives for seven years. The HMRC do not need to be informed of PET's during lifetime.

As far as CGT is concerned, if it is a non-cash asset that is worth more at the time of disposal than at the time of acquisition, then it is quite possible that the donor is liable to CGT on the gift, even though he/she receives nothing from the recipient in return for the gift.

29. Any Tax If I Keep My Rental Income In Dubai?

Question: I am a British citizen residing in the UK. I have recently bought an apartment in Dubai. I am hoping to rent it out. I have a bank account already opened over in Dubai. If I keep the rental income in Dubai, will I still have to pay tax on this money in the UK?

Answer: Even if you keep the money in Dubai, you will still need to pay income tax on this money in the UK. And if you sell this property and make a gain, you will have to pay UK CGT on the gain. However, double taxation relief may be available to mitigate the effect of Dubai income tax – see the HMRC Manuals page DT 6151.

30. How Do You 'Gift A Property In Stages'?

Question: How do you 'gift a property in stages' to use annual CGT exemptions?

Answer: Gifting a property in stages is the same as gifting a whole property. Your solicitor will draw up the required documents for the conveyance of a percentage of the property and register the transaction with the Land Registry.

In order to calculate what percentage to transfer, you need to look at the present market value of the property, its acquisition cost, any principal private residence, letting and taper relief available, and choose a percentage that reduces the gain to approximately the annual exemption available.

31. How Will A Discretionary Trust Reduce IHT?

Question: What is the best way to protect from IHT liability for the children for property being transferred upon death, but does not want give up on its control during the life time. The estate is worth over 1 million at the moment. Would a trust be suitable and can you suggest how this should be set up and any implications that should be considered before embarking on such a move.

Answer: This question is a bit scarce on detail. It doesn't say whether it is an individual, or husband and wife who are transferring. It doesn't say whether the home that the transferor is presently living in is a significant part of the £1M estate, or whether other property makes up the bulk of the estate.

Generally, the way to take assets out of the estate without losing control is to put them into a discretionary trust (DT). However, a transfer into a DT is liable to inheritance tax (IHT) at the lifetime rate of 20% if more than the nil rate band (currently £325,000) is transferred (taking into account transfers made in the previous seven years). If both husband and wife transfer, £650,000 can be extracted from the joint estate, and if they survive for seven years, then they will have solved a major part of their IHT problem.