A GUIDE TO SELF ASSESSMENT AND LANDLORD TAX

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Chapter 1 - The Basics

If you are in receipt of rental income, you must consider your tax implications, and ascertain the correct approach as to how and if this needs to be reported. In a lot of cases, it will mean you need to submit a self assessment tax return.

So what is a self assessment tax return?

In a nutshell, it is a form which is submitted to H M Revenue and Customs (either on paper or online), and reports your taxable income so as to ascertain whether you have paid sufficient tax throughout the year, or if you have paid too much. Not just those who receive income from an investment property may be required to submit a tax return; there can be other individuals with this same requirement, such as if you are self employed or a Minister of Religion.

Unfortunately, with the UK tax system, there are a plethora of "ifs," "buts" and "maybes," however, for the purposes of this feature, we shall try and keep things as simple as possible, and will of course need to make assumptions every now and again. HMRC have the tendency to produce guidance that somewhat baffles new landlords, however, if you are in any doubt, it is always highly recommended to seek professional assistance.

It is important to note that if you need to report rental profits on your tax return, this does not make you self employed. Income from property is treated as an investment, however, if you venture into property trading, then this would be treated differently. Property trading can include examples such as buying a property, with the sole purpose of refurbishing it and selling it on soon after.

There is a common misconception amongst those landlords we have dealt with under the HMRC Let Property Campaign, whereby there has been undeclared rental profits in the past. The common misconception is that as they pay tax through their employment income, they believe they did not need to inform HM Revenue and Customs they were receiving rental profits.

To help clarify matters here, let's say you were an employee with no other source of income other than your £35,000 salary, and you would not be filing a tax return. Now let's say your employer generously offered you a £15,000 pay rise. Although your pay has increased, your tax would increase too. This methodology thus correlates to receiving taxable property profits, in that additional tax needs to be paid; this would either be achieved through a self assessment tax return or in some cases, via an adjustment to your PAYE coding notice.

Typical types of income which you may need to report under self assessment on your tax return include the following:

INCOME
Employment(s) income and PAYE deductions, referring to a P60 or P45 for instance.
Other employment benefits, such as medical insurance, car/fuel benefit.
Casual earnings
Pension income, referring to a P60 for instance.
Rent from property letting
Bank or building society interest received and dividends received
Self-employment income
Foreign, investment and trust income
Child Benefit, if applicable, and other taxable state benefits, such as jobseeker's allowance

CAPITAL GAINS
Details relating to the sale of property
Details relating to the disposal of stocks, shares, unit trusts etc

OUTGOINGS
Gift aid or charitable covenants
Pension contributions
Student loan repayments
Underpayment restrictions on your PAYE coding notice (covered later on in the feature series)
Expenses incurred in letting property
Self-employment expenses

Moving back to the investment property aspects, before we go any further, it is important to note that you are taxed on rental PROFITS not income. Your profits are the rental income you receive, less expenses incurred, assuming it is correct to claim these costs.

If your property is let to tenants and you are in receipt of taxable profits of over £2,500, or you are in receipt of rental income before expenses of over £10,000, then most landlords will have to report this via a self assessment tax return each year. Within this tax return, you will also need to fill in the property pages. If the property is owned jointly, you would report your share of the rental income and expenditure on your separate tax return. The joint owner would then report their share separately if required.

All your taxable income, not just rental income and expenditure should be reported via a self assessment tax return. Once this is completed, if a shortfall of tax arises, a payment needs to be made to HM Revenue and Customs. However, should you have paid too much tax, a refund can be requested from HMRC.

There is a common misconception that if you are employed, profits below £2,500 are not taxable. This is NOT the case. It still needs to be reported, but instead, under certain conditions, the profit may just be reported to HMRC and any necessary tax collected, and may mitigate the need to submit a self assessment tax return. .

Self assessment registration should be actioned by 5th October following the first tax year end date where the rental income was first received.

So what is a tax year?!

HMRC operate on a tax year basis, and do not operate on a calendar year basis. Therefore, a tax year runs from 6th April one year, to the 5th April the next. We are currently in the month of June 2016, referred to as the 2016/17 tax year, and this runs from 6th April 2016 to 5th April 2017.

As a further example, if your letting activities commenced in December 2015, you would need to report your rental income and expenditure for the period from when letting commenced up until 5th April 2016. This would need to reported via your self assessment tax return for the 2015/16 tax year, which is due for filing by 31st January 2017. This first year would just be a "part period" for the rental business, as the following tax return you would prepare i.e the 2016/17 tax year, would report on the rental income you received from 6th April 2016 right through to 5th April 2017.

You may either register for self assessment online by following this link: https://online.hmrc.gov.uk/shortforms/form/SA1?dept-name=&sub-dept-name=&location=43&origin=http://www.hmrc.gov.uk , or alternatively by filling out a form named SA1 which may be downloaded here: http://www.hmrc.gov.uk/sa/forms/sa1.pdf

The form is relatively straightforward and is mainly a questionnaire of your basic credentials:

Title
Name and Address
National Insurance Number
Unique Taxpayer Reference *(only applicable if you were registered for self assessment in the past. This can therefore be ignored if you are registering for the first time)*
Telephone Number

It will also ask why you are registering for self assessment. As a landlord, you would therefore select the option: "I have been getting income from land and property in the UK."

You will also need to enter the date on which letting to tenants commenced, and it is very important to ensure this detail is entered correctly. HM Revenue and Customs now have a very detailed database of landlords, and it is therefore imperative to ensure absolute correctness to ensure any future problems are mitigated. If you choose to instruct a tax advisor to manage your tax affairs, they will request this SA1 form, along with an "authorising your agent" form, which allows them to deal with HM Revenue and Customs on your behalf.

Once you have registered for self assessment, HM Revenue and Customs will issue you with a Unique Taxpayer Reference (UTR) number.
Once this has been received, if you wish to file online, you may register to complete your tax return online by visiting here: https://online.hmrc.gov.uk/registration/individual or of course, you may file your tax return in paper format.

Chapter 2 – Payments, Deadlines, And Tax Codes

Once a tax year ends, the two main deadlines to bear in mind, following the 5th April tax year end date are:

- 31 October – Due date to file your self assessment tax return if filing on paper.
- 31 January – Due date to file your self assessment tax return if filing online.

If there are any tax liabilities arising on your self assessment tax return, these must also be paid by 31st January.

It is important not to miss these deadlines, as the penalties for both late filing and payment are harsh.

Tax liabilities may be paid in the form of a cheque, or alternatively, payment may be made online.

The easiest way to make payment to HMRC is online. They offer a facility on their website to make payment online. In order to make payment, as well as of course having your card details to hand, you will also need to quote your Unique Taxpayer Reference (UTR) number, which would have been issued to you following your self assessment registration. The payment link on HMRC's website may be found here: https://www.tax.service.gov.uk/pay-online/self-assessment

Alternatively, if you would rather pay by post, and if you do not have a payment slip, please see the link here: http://www.hmrc.gov.uk/payinghmrc/payslip-sa.htm. Again, you will need to quote your Unique Taxpayer Reference (UTR) number. This webpage allows you to generate your own payment slip to include with a cheque payment:

When you complete your self assessment tax return, should you owe less than £3,000, and you receive PAYE income (such as a salary or a pension), you may be able to add the tax liability to a future PAYE coding notice. In order to achieve this however, your tax return must be filed by a less publicised deadline, which is 30th December.

For instance, if you owed tax of £950 on your 2015/16 self assessment tax return, and assuming you met the other conditions, then you may be able to add this liability to your future tax code, which would come in to operation from 6th April 2017 onwards. If you are one of the millions who are paid salary at the end of the month, then the end of April 2017 would be your first payslip being adjusted.

The tax liability would then be spread over the course of the 2017/18 tax year, and your net pay each month would thus be reduced. It is a matter of preference, and it does save having to find a lump sum payment of the aforementioned £950 on 31st January 2017.

Should you complete your self assessment tax return and calculate a refund owing to you, then this may simply be claimed by making the correct entry on your tax return. You may opt to have the repayment sent out to you via a cheque, or alternatively, you may enter your bank details, and any refund can be repaid electronically.

It is of utmost importance to ensure:

1. Your self assessment tax return is <u>filed</u> on time; and
2. Any tax liabilities are <u>paid</u> on time.

Failure to complete either of the above, could result in penalties.

Starting off with late **filing**, if you are just one day late, there is a penalty of £100. Once the filing becomes 3 months late, then the £10 a day penalties commence, for the next 90 days. If the return remains unfiled, and you reach the 6 month point, then in addition to the aforementioned penalties, a further penalty is due of either 5% of the tax owed, or £300, dependent on which value is the greatest. Reaching the 12 month point of filing your tax return late will result in the exact same penalty as the 6 month version being imposed, but as an additional charge. However, reaching this late period may result in much heftier fines.

Next, there is a separate regime if you are late in **paying** your tax liability. If you do not make payment to settle your liability within 30 days, then a 5% penalty is imposed, based on the tax which should have been paid. This same percentage charge is imposed additionally again at the 6 month point, as well as the 12 month point.

Therefore, you can see how the penalties for late filing and late payment can stack up very quickly indeed.

It is worth pointing out however, that if you have liabilities relating to past years, then you may be able to benefit from more favourable penalties by registering under the HMRC Let Property Campaign.

Of course, there may be a genuine and acceptable reason why your self assessment tax return was filed late. If this is the case, then it may be necessary to file a form named SA370, which allows you to appeal against penalties imposed by HM Revenue and Customs. The form can be found here:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/491142/SA370_Appeal.pdf

Appeals are considered on a case-by-case basis, and typical reasons they may accept an appeal would be for reasons such as a family bereavement or serious condition, or, for instance as we encountered recently, our client's records were destroyed by a recent flood. They would not accept frivolous reasons, such as you just did not understand your tax return!

For an appeal to be successful, HMRC would expect your tax return to be filed within two weeks of your reasonable excuse coming to an end.

In the past, you have no doubt come across HMRC produced documents named PAYE coding notices. These determine what your tax code should be, so that your employer or pension provider deducts the correct amount of tax throughout the year. These are attached to a specific tax year again.

Assuming you are entitled to a UK personal allowance, your last P60 from your employer or pension provider may have shown a tax code of 1060L. In the 2015/16 tax year, the personal allowance was £10,600 (with some variances, such as dependent on age), and the 1060L code is a reflection of this. If your code was different from that, then HM Revenue and Customs would have made a coding adjustment.

With reference to the theory earlier in this chapter, let's say when you completed your 2015/16 tax return, you owed £200 in tax. Let's then say that you were able to add this to a future tax code, as your tax return was filed by 30th December 2016. You would be issued with a new PAYE coding notice for the 2017/18 tax year, which "collects" this tax owed by reducing your monthly salary.

Assuming the individual is exposed to a rate of 20% of tax, their 2017/18 PAYE coding notice would contain an adjustment of £1,000 to collect this amount owed. This is because £1,000 x 20% is the aforementioned £200. As mentioned before, the tax code would originally have been 1060L representing the personal allowance of £10,600. With the scenario above, the PAYE coding notice would therefore change to 960L, as the £10,600 has been reduced by £1,000. Given the personal allowance has essentially been adjusted, this therefore shows that your net pay would decrease each month to collect the tax owed.

There are quite a number of other adjustments that may be made to a PAYE coding notice, such as if you have a company car, if you receive a state pension, or if you incur non-reimbursed job expenses. You tax code may also be adjusted for profits arising on your investment property. In this latter instance, of course, should you have a much reduced profit when your tax return is prepared compared to the value on your PAYE coding notice, then you may have paid too much tax throughout the year, and could be due a tax refund. If your PAYE coding notice contains an adjustment for expected property profit, you are entitled to request that HMRC remove this. Should this a requirement, either your tax advisor can carry out this action for you, or alternatively, you may telephone HM Revenue and Customs, and they will be able to organise this change for you.

As previously highlighted, one of the most common tax codes is where it ends with the letter L. There are several other types of common tax codes, for instance, BR, D0, D1, 0T. These are summarised as follows:

BR = This code may arise if you have more than one employment, or more than one pension provider. It means that all your income is taxed straight at 20%. Your main source of income would normally therefore have the personal allowance attached to it.
D0 = This is pretty much exactly the same as the above as far as methodology is concerned, but applied whereby you are in the 40% tax bracket. Therefore, your additional source of income is taxed at source at the rate of 40%.
D1 = Again, similar to D0, but instead taxed at the rate of 45%.
0T = This generally occurs whereby a new employment commences, yet, your employer does not have sufficient details in order to provide you with a tax code. Commonly this occurs in the absence of a P45.

Another occurrence which can be more confusing is being issued with a "K" code. Generally speaking, this is where deduction adjustments on your PAYE coding notice exceed your personal allowances. For instance, if a personal allowance of £9,440 in the 13/14 tax year was adjusted for £10,000 expected property profit, then this would create a K code situation.

If you receive a PAYE coding notice, it is strongly advisable to either review this yourself, or forward it on to your tax advisor to check for accuracy. Mistakes can be made by HM Revenue and Customs, and therefore, it is crucial to make sure you are happy with the code being applied to your employment or pension.

Chapter 3 – Payments On Account

"Payments on account" may fall due in addition to the tax you owe when completing your self assessment tax return.

This is quite a complex area, and if you are in any doubt on this chapter, it is strongly advised to seek professional assistance here. Nevertheless, for the purposes of this guide, we shall keep things as simple as possible and stick to the basics.

When completing your self assessment tax return, if you owe over £1,000, you may need to make additional "payments on account."

These are payments in advance, which go towards potential tax owed under self assessment in the following tax year.

As a for instance, if when you prepare your 2015/16 tax return you discovered that payments on account fall due, in addition to the tax liability owed under self assessment, then these additional payments will fall due on 31st January 2017 and 31st July 2017.

There are circumstances where payments on account do not fall due if you owe over £1,000, the main reasons being if more than 80% of tax arising under self assessment is covered by tax deducted at source (such as from employment income) or given the fact capital gains tax and student loans not being included in the payment on account computation.

To illustrate payments on account in action, let's assume that an individual owed £1,500 when completing their 2015/16 self assessment tax return, and that given the circumstances, they also need to make additional payments on account towards the following tax year.

Therefore, the payments they would be required to make would be as follows:

£1,500 by 31/1/17 – to cover the tax owed under self assessment in the 2015/16 tax year.
£750 by 31/1/17 – first payment on account towards the 2016/17 tax year.
£750 by 31/7/17 – second payment on account towards the 2016/17 tax year.

You will note that each of the advance payments represent 50% of the tax owed the prior year.

The following year, you will need to submit a 2016/17 self assessment tax return.

Note, you have already paid £1,500 towards any tax arising under self assessment in this year. Depending on circumstances, payments on account may continue the following year, or they may cease.

With regards the above example, if for instance when you come to prepare your 2016/17 self assessment tax return, if you owed just £500, then you would be in a refund position.

This is because 2 payments on account totalling £1,500 have already been in advance towards this tax year. Therefore, a refund of £1,000 would arise.

However, you may be able to claim to reduce payments on account, if, for instance, your property profit was unusually high in the 2016/17 tax year. Payments on account may be reduced via a form named SA303 which may be found here: http://www.hmrc.gov.uk/sa/forms/sa303.pdf

As stated though, if you are in any doubt, please seek professional assistance in this area.

Chapter 4 – Filling In Your Tax Return

There are numerous sections which make up the tax return; employment pages to report your salary in the tax year being one example. However, we shall be focusing on the Income from Property pages which form part of the overall self assessment tax return. There are two pages with various boxes to be filled in, of which some may or not be applicable to you dependent on the circumstances. It is important to note that your standard BTL property income and expenditure is reported separately to transactions relating to a Furnished Holiday Let.

The tax return should include the total income and expenditure for all your properties should you have more than one. You should also enter on the tax return how many properties you are reporting on. There are also other sections to complete if the property is let jointly, if you are claiming rent a room relief, or if property income has ceased.

For the purposes of our tax feature moving forward, we shall focus on standard BTL properties as opposed to Furnished Holiday Lets, although with regards the latter, you may wish to seek further advice here.

Focusing on box 20 initially, when completing your 2015/16 tax return, this is where you need to enter the total rental income received between 6th April 2015 and 5th April 2016. If the property is let fully furnished, if your tenants pay you an amount for the usage of the furniture you have provided, then this would also need to be reported here. If for instance, you are a non-resident landlord, and has been deducted from your rental income by say, the letting agent, it is important that box 20 is the rental income before tax is deducted. To ensure completeness, you would then ensure that box 21 includes the amount of tax that has been deducted by, again say, the letting agent.

It is important to note that if your rental income before expenditure is less than £15,000 in the tax year, they you may opt for either the cash basis or the strict basis to record your income, assuming it is reasonable to do so, and assuming it is consistent i.e you use the same method for expenditure. If your rental income before expenditure exceeds £15,000 then you must adopt the strict method. Essentially, the main differences in these two terminologies are as follows:

Cash basis – The recording of rental income and expenditure based on actual amounts received and paid on the dates in question.
Strict basis – Also known as the accruals basis, this would be based on when the income and expenditure actually arose.

As an example, let's say your plumber carried out repair work in your buy to let property on 31 March 2016 at a cost of £300. The payment for the work carried out was made on 10 April 2016. Under the cash basis, the cost would be claimed in the 2016/17 tax year, given this was the tax year when the payment was made. Under the strict (accruals) basis, the cost related to the 2015/16 tax year, and therefore would be claimed in the 2015/16 tax year accordingly. This would also be applied to rental income, with the relevant amounts apportioned as necessary.

Next, we explore boxes 24 and 25 of this same self assessment section, which are two expense types that are incurred when letting a property to tenants. First of all box 24. This is the box that HM Revenue and Customs title as: "Rent, rates, insurance, ground rents etc." Some of the most common expenses a landlord will incur which will need to be totalled and inserted into this box are ground rent, buildings insurance, council tax, utility bills and water rates. As explored in the previous feature, these may need to be apportioned depending on whether the cash or accruals basis is used for recording your income and expenditure on your self assessment tax return. Similarly to the rental income, the costs included should relate to the period from 6th April one year, to 5th April the following year. Therefore, if you are preparing the 2015/16 tax return, the expenses included should relate to the period from 6th April 2015 to 5th April 2016.

Box 25 is the second box we shall explore, and serves the purpose to report repair and maintenance costs incurred during the same reporting year as highlighted above. Repair costs can become quite a detailed and complex area, as it needs to be ensured that the correct treatment is chosen. All costs fall in to either the revenue or capital classification. The former may be claimed against your rental income, whereas the latter must be retained instead for future use against a potential capital gain on sale of the property.
A typical example we often use here at RITA4Rent is that if a bathroom was painted, then generally this would be an allowable cost against your rental income. If, however, an extension was built to house a new bathroom, then this would be deemed a capital cost, and therefore could not be claimed against rental income, but instead claimed against a future capital gain on selling the property.
Care should also be taken where costs are incurred before the tenancy. As an example, if work was carried out prior to a first let, and the work was required to ensure the property was habitable for tenants, then this would usually be deemed a capital cost.

As with all areas of self assessment, there are again a plethora of ifs, buts and maybes, and in the avoidance of doubt, it is always best to seek professional assistance. One such anomaly, is the replacement of single glazed windows with double glazed alternatives. In the past this would have been deemed a capital improvement and not claimable against rental income, although, HMRC now accept that technological improvements have been made in building standards. In light of this, HMRC would now accept a claim in this instance, with reference to their guidance in PIM2020 and therefore this example cost may be offset against rental income.

Moving on, Box 26 should include finance charges, such as mortgage or loan interest on a BTL property and the costs incurred on obtaining the finance, such as mortgage arrangement fees, broker fees and so forth. Please note, there have been very important changes to this, which are covered later on in this guide. However, this text upcoming is still applicable for the 2015/16 and 2016/17 tax year. The changes detailed later on in this guide are applicable from the 2017/18 tax year onwards. Therefore, in this section of the guide, we shall continue as the position currently is, as opposed to what is going to happen.

A common misconception of new landlords is to offset the mortgage payment in full, which is fine if you have an interest only mortgage, but care must be taken where a repayment mortgage is in place. In this instance, you will need to refer to your mortgage statement, so as to determine the amount of mortgage interest incurred within the mortgage payments you have made. With regards the further costs such as arrangement fees, it is worth making clear that these facilitated the borrowing, and that generally most "purchase" costs, such as solicitors fees and stamp duty, would not be classed as allowable deductions, and would instead be retained for future use against a potential capital gain on sale of the property.

For a lot of landlords, the bulk of Box 27 on the Property Income pages of the self assessment tax return, will consist of letting and management agent fees. Should you wish to instruct a tax advisor to manage your affairs, the fees they charge may be offset against rental income using this box too. Although HMRC title this box "legal, management and professional fees," as previously highlighted, you must be especially careful with regards legal fees, so as to ensure you only claim revenue costs and not capital expenditure.

Box 28 should include costs of any services provided to your tenants, such as if a cleaner was engaged, a gardener or similar. Of course, should the tenant make a contribution or fully incur this cost, then the relevant income should be reported in box 20.

Box 29, which really is the dumping ground for any other allowable revenue costs which do not fit into any other category. Typically, this will include expenses such as your printing, postage, stationery and telephone costs, along with travel costs such as mileage, claimable at 45p per mile. With regards the latter, it is worth making clear that should you instruct a letting agent to manage the property, the journey start point should be their offices as opposed to your home. This can make quite a difference if, say, the landlord lives in Manchester, and the letting agent is in London where the property is located. Of course, should you manage the property yourself, then the "offices" would be treated as located at your home, and the full mileage may be claimed.

Next we explore box 29, otherwise known as the Wear and tear allowance. Similarly to finance costs, there have been important changes to this, which will be featured later on in this guide. Although these changes will not come into force until the 2016/17 tax year, and so we shall again continue this guide position currently is, as opposed to what is going to happen. Wear and tear allowance may be claimed if the property you let is fully furnished. A let property may be classed as such, if there is sufficient furniture for the tenant to benefit from normal occupation. In general, here at RITA, we would take this HMRC guidance definition to mean a tenant could just move in to the property, bringing with them just a suitcase of belongings and possessions.

Typical furniture which may be provided by the landlord, may include a couch, a bed, cupboards, white goods such as a fridge, curtains and so on. There is a somewhat lack of full clarity from HM Revenue and Customs as to what exactly defines a fully furnished property. Therefore, it is of crucial importance to make the correct and accurate decision, so as to ensure that it will stand up to scrutiny should HMRC make an enquiry.

Wear and Tear allowance is calculated as 10% of the net rent received. With reference to part 7 of our feature, we did mention that box 24 may need to be considered when ascertaining the wear and tear allowance deduction. For instance, usually the tenant will pay for the council tax. Let's say then, in this case, if the rental income was £11,000 in the year, then £1,100 could be included as the wear and tear allowance to reduce the tax liability. This is because £11,000 x 10% = £1,100. If however, the tenant did not pay for the council tax, and the landlord paid this at a cost of £1,500 per annum. The result would be a wear and tear allowance claim of £950. This is because £11,000 - £1,500 x 10% = £950.

If the property you let is not fully furnished, you may not claim the wear and tear allowance. From 6th April 2013 onwards, a big change affected those landlords letting unfurnished and part-furnished properties; Extra Statutory Concession B47 (ESCB47) was withdrawn. Prior to this, landlords of with these types of properties could claim the renewals allowance when there was a replacement of movable assets such as fridges, washing machines and other furniture. There is an anomaly though in the case of say, a fitted kitchen. If say, a washing machine was an integral part of the property's fitted kitchen, the like-for-like replacement here may be claimed as a revenue repair cost.

Chapter 5 – Record Keeping And Sales

Of course, this guide really just scratches the surface, and if you are in any doubt with regards your tax affairs, it is strongly advisable to contact a specialist property tax advisor to assist. We would be delighted to help should you wish to discuss matters further.

We have featured an introduction to the tax system, discussed payments, and what needs to be reported and when.

One key issue yet to be mentioned is record keeping, and here at RITA we cannot emphasise enough the importance of this.

As you may be aware, RITA4Rent offer an invaluable and free mobile app to aid with record keeping. This can be found at both the Android PlayStore and the Apple AppStore by searching for RITA4Rent.

Adequate record keeping helps simplify matters when you come to prepare your self assessment tax return each year, as well as helping you keep a track of income and costs for your own planning purposes.

You should also keep your records too should HMRC enquire into your tax affairs, as this will help facilitate the overall process.

Another key reason to keep adequate records is that throughout the lifecycle of the lettings business, you will more than likely incur capital costs. As discussed before, these are the costs which you may not claim against rental income, but you should retain them for future use against a capital gain.

When you come to sell your investment property, this is when a potential capital gain may arise. It is important to note that date of the sale per your tax return and your calculations, is the date contracts are exchanged, not the completion date.

This therefore created potential interesting tax planning opportunities if you plan to sell the property near the tax year end of 5th April.

In its simplest form, a capital gain is worked by taking your sales proceeds, then deducting the purchase cost and any other allowances and costs.

It is the latter word of this last sentence which crucially links back to the Record Keeping spreadsheet. Costs incurred at the start of the property business (and during) may have been retained for future use, such as

- Stamp duty
- Solicitors fees
- Estate Agent Commission
- Improvements to the property

It will therefore be much easier to fill in the Capital Gains Tax pages of the self assessment tax return when you report the sale of the investment property.

Please note, that capital gains are usually chargeable at the tax rate of either 18% or 28% depending on the level of your other taxable income. Taxpayers have an annual exemption currently of £11,100. This is essentially the gain which may arise, where tax would not fall due. Then the excess is charged as previously stated.

If a capital loss is generated on sale, it is important to register this, so as to benefit from this in the future.

It is worth seeking professional assistance if you are selling an property which has been both let to tenants, and has been your main home in the past, as you may be entitled to favourable reliefs and a reduced capital gains tax bill.

Finally, it would also be highly recommended to seek professional advice if you are a non-resident landlord as the rules here are complex.

Chapter 6 – Important Recent Tax Changes

As we have touched upon earlier in this guide, a number of big changes have been announced in recent times, which affect landlords' tax positions.

The government has been relentless in attacking landlords, bringing wave after wave of changes. It has been said that the Government are trying to level the playing field and penalise wealthier landlords, however, unfortunately, the changes are much more far reaching and affect a great deal of landlords with varying degrees of income levels.

There are so many variables and new laws, including the usual fact with tax that there is so many ifs buts and maybes, that it is impossible to cover everything. However, we shall provide an overview of the key areas. There is no one-size-fits-all solution available to landlords and it is strongly advisable to seek advice on your own position, and see the best route forward for your circumstances.

Changes to Stamp Duty Land Tax

Announce recently, and following consultation, one big and very recent change involved stamp duty land tax, and the additional surcharge imposed on buy to let investors. So much was this a worry to landlords, that it has been reported that 40,000 BTL mortgages were completed in March 2016 as investors rushed to beat the deadline. That was a 140% increased compared to March 2015!

The stamp duty changes affect landlords who purchase residential property, with the surcharges affecting those who own two or more residential properties at the end of the day of the transaction, and are not replacing their main residence. Please note, that given the devolution to Scotland, these stamp duty changes relate to purchases in England, Wales and Northern Ireland.

A comparison of the previous rates, and new rates, are summarised below:

Purchase Price	Previous SDLT rate	New SDLT rate
£0 - £125k	0%	3%
£125k - £250k	2%	5%
£250k - £925k	5%	8%
£925k - £1.5m	10%	13%
£1.5m +	12%	15%

These new surcharges do not apply to mobile homes, caravans, houseboats or non-residential properties, nor do they relate to standard residential properties which are less than £40k. Purchases via a limited company will also be a target for the new stamp duty surcharges. As previously touched on, this is a basic summary, and the guidance notes on the stamp duty changes are vast. Therefore, it is strongly advisable to seek professional advice on your own scenario.

Restriction of Finance Costs

This is easily one of the most controversial announcements in recent times affecting landlords.

From April 2017, a 4 year equal phase-in will commence, and mortgage interest will no longer be deductible when calculating your rental profits. This is applicable to residential property, and so you will not be affected if you operate a Furnished Holiday Let, or a commercial lettings business. This is because this activity is classed as a "trade," whereas the Government are attacking the so called property "investment" target.

The changes will not affect those with property in a limited company, but will affect Limited Liability Partnerships as well as unincorporated partnerships.

Therefore, we shall use a landlord named Mrs Jones as an example. She has rental income of £75,000, repairs/insurance/prof fees of £20,000 and mortgage interest of £50,000.Under the old rules her profit would be £5,000 but once the new rules are fully phased in, her profit will be £55,000.Under the new rules, the above profit will be taxed at her income tax rates.

From there, a "reducer" will be applied to the tax owed as calculated above, at the value of 20% multiplied by the mortgage interest paid.

There is a popular misconception that this only affects higher rate taxpayers. However, as well as affecting those, it can also affect those who were previously basic rate taxpayers, but who are now higher rate due to the change in determining profits.

In addition, there are far reaching consequences, in that given there is an inflated rental profit, this could impact, but not limited to:

- Child Benefit
- Child Tax Credits
- Student Loan Payments

Another point to bear in mind, is that the changes do not just affect mortgage interest, but also finance costs. This includes costs such as mortgage arrangement fees, broker fees and similar.

As previously mentioned, the Government say they are trying to assist landlords by offering a four year phase in, and this is due to commence in April 2017.

The finance costs will be restricted as follows:

- 75% for the tax year ended 5th April 2018
- 50% for the tax year ended 5th April 2019
- 25% for the tax year ended 5th April 2020
- 0% from tax year commencing 6th April 2020.

Great care will need to be taken where losses are involved, and therefore to be clear, the tax "reducer" is calculated as the 20% of the lower of:

- Mortgage interest and finance costs not deducted from income
- Profits less any losses brought forward
- Total income (less savings and dividend income) exceeding the personal allowance

There are many strategies landlords are carrying out in an attempt to limit the damage of these changes, such as:

- starting up a limited company
- transferring property to a spouse
- making additional pension contributions
- increasing gift aid donations
- finance cost acceleration
- paying mortgages off early
- diversifying portfolio
- conversion of property to a different type

However, advice is strongly recommended, as some of these actions may result in other tax implications, and it is a case of looking at your own individual circumstances, ascertaining your future goals, and mapping the most strategic path to achieve those.

Incorporation has become a growing consideration for a number of landlords, despite its huge number of pros and cons, but they are generally attracted to the fact that the above finance cost restrictions do not apply. It has also helped that mortgage lenders have seen this growth, and more products are becoming available.

Whilst a company may be suitable for future purchases, there lies a problem in moving personally owned property into a company in potentially triggering an immediate capital gain.

This is due to the fact that a company is a separate legal entity, and therefore any such transfer would be classified as a "sale". However, the recent Ramsey case did give some landlords a glimmer of hope with regards mitigation, but again, professional advice is essential here.

There are several advantages of setting up a company. For instance:

- Companies are not affected by finance cost restriction changes
- Lower rate of tax, compared to higher rate tax under self-assessment
- Potential indexation allowance claimable
- Favourable rates of capital gains tax compared to 28% for some disposals of personally owned residential property at higher rate
- There can be benefits as far as passing on property to children

There are also several disadvantages such as:

- Companies do not receive an annual exemption nor personal allowances
- For those owning property personally, there can be benefits when selling the property, if you have lived there. This is the complete opposite for company owned property, and there can be quite serious consequences if you reside in a company owned property
- Lower tax rates, but this is based on profits. You still need to extract this money from the company, which has tax implications, such as salary/dividends etc. Also, the dividend changes which have recently come into force may affect you
- Greater costs for accountancy fees and more compliance requirements
- Can sometimes be harder to obtain finance, although as stated earlier, this is starting to improve

Wear and Tear Allowance

Earlier in this guide, we touched upon wear and tear allowance, which has historically been a vital claim for landlords with fully furnished property. This area has been the subject of yet another big change recently announced by the Government.

If you let any of your rental properties out as fully furnished in the 2015/16 tax year, you can claim a 10% wear and tear allowance. HMRC's definition of fully furnished is: "one which is capable of normal occupation without the tenant having to provide their own beds, chairs, tables, sofas and other furnishings, cooker etc". This is calculated as 10% of the net received. Net rent is the rental income received, less any expenses which would normally be borne by the tenant, such as council tax and utility bills. Wear and tear generally works out beneficial, as the allowance can be claimed, even when furnishings are not purchased.

However, HMRC announced the wear and tear allowance is abolished from 6th April 2016 and introduced a new system effective in the 2016/17 tax year onwards. This system will be that instead of claiming a flat rate allowance, you will be able to claim the cost of replacing the furnishings but not the initial cost.

We are therefore recommending and advocating rigorous inventory controls and systems, to ensure claims will stand up to HMRC scrutiny. The HMRC guidance states that the replacement has to be like-for-like or the nearest modern equivalent, with them also allowing costs incurred in disposing of the furnishings, but also accounting for any proceeds received for the replacement of the furnishing. It is important to note that this is NOT applicable to furnished holiday lets, given their special tax treatment, and as such, they continue to benefit from the capital allowances regime.

As this new system came into force in April 2016, it will not affect those tax returns being completed now, but it will affect the 2016/17 tax year, of which tax returns can be completed from 6th April 2017 up until the tax deadline of 31st January 2018.

We hope this guide has been helpful, but to emphasise again, the above is very much scratching the surface, as there is simply too much to cover. If you require any individual tailored advice, and for any of your property tax needs, please do not hesitate to contact RITA4Rent on Freephone 0800 1 22 33 57, via email: clients@rita4rent.co.uk or by visiting our website www.rita4rent.co.uk

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