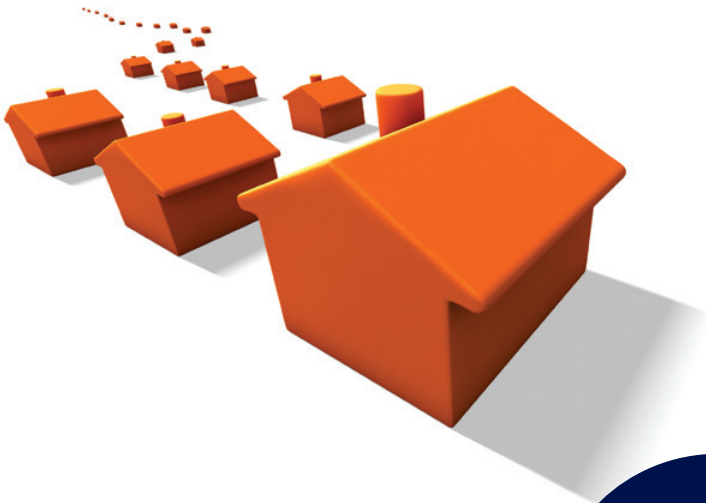




**Mortgage
Advice Bureau**

Doing what's right for you

Tax saving tips for landlords



**A buy to let
tax guide**

**NEW
EDITION
2012**

Written by Taxwriter Ltd for Mortgage Advice Bureau

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Introduction

With low interest rates and demand amongst tenants rising (due to the lack of new house builds and the fact that lenders are retaining a very cautious approach to first time buyers by demanding significant high levels of deposit) we believe that demand for the rental sector is likely to remain and potentially grow in the future.

When making a buy to let investment decision, landlords need to be aware of the tax issues and obligations facing them not only as property investors but also as individuals with other businesses, careers and investments. Many factors can affect the returns in both capital and income and it is important to start with the right purchasing structure and to make use of all the available tax reliefs at the appropriate times.

Tax is an increasingly complex area and it is essential that landlords seek advice from a specialist taxation and accountancy adviser. This will ensure a strategy is devised which best suits your individual needs.

This booklet does not cover every tax aspect of buy to let. It sets down the basics and provides pointers for tax saving ideas. To minimise your own tax liabilities it is essential to take tax advice that is tailored to your individual situation.

1. What is a property investment business

As an owner of a buy to let property you are normally taxed on the annual profits you make from letting your property under the tax rules for UK property income.

The income tax rules for property income treat a letting business (known as a property investment business) much like any other business, such as say a retail shop, with similar rules for deducting expenses and accounting for receipts (see chapter 3). Special tax rules apply when you let property as furnished holiday accommodation, and the profits or losses from those holiday lettings must be kept separate from your other property income (see chapter 6). Different tax rates and reliefs apply if you let property through a company (see chapter 4). There are a number of differences between a property investment business and a normal trade, which can be advantageous. With a property investment business:

- Your annual profits are not subject to national insurance;
- Any profit made on disposal of a property is taxed as a capital gain so your personal annual exemption can be deducted; (see chapter 7).
- A residential letting business does not have to be VAT registered, although there are exceptions (see chapter 10).

There are also disadvantages of the property income tax rules:

- Losses cannot generally be set against other income;
- Expenditure connected with aborted sales or purchases of property is not deductible;
- Gains made on sales of property cannot be reduced by entrepreneurs' relief unless the property is sold in association with the disposal of a trading business;
- The value of the properties will be subject to inheritance tax on death;
- It is difficult to transfer the business without high tax charges, as roll-over relief or hold-over do not apply to the value of the property.

A typical property investment business will hold the properties for the long term and cover the expenses with the rents received. If you prefer to hold your properties for a shorter period, with a view to creating a quick profit on sale after refurbishment or development, your business is likely to be taxed as a trade rather than as property income. This creates a number of tax advantages and disadvantages (see chapter 5).

You do not have a choice as to whether your property business is taxed as property investment business or a trade. The facts of how you make your money determine the tax treatment.

What is property income?

In income tax terms 'property income' is the rents you are due to receive less the expenses that can be set against those rents for tax purposes (see chapter 3). It does not include the profit you make when selling the property and it does not take into account the costs of buying, selling or improving the property.

All of the income you receive from your property in the UK, both residential and commercial, is combined and taxed as one property investment business. So a loss on one property can be relieved against profits made from another in the same tax year. Overseas property, and furnished holiday lets are treated as separate businesses (see chapters 6 & 9).

Deposits collected from tenants are not part of your property income unless they become non-returnable under the tenancy agreement. Only include the retained deposit in your property business accounts when the funds are used to cover the costs the deposit was designed to pay for such as renewal of furniture, repairs or legal fees.

When does the property letting business start or finish?

It is important to determine when your property letting business starts or finishes, as the costs you incur outside this period may not be tax deductible (but see pre-letting expenditure opposite).

Top Tip

Don't forget to exclude the deposits you receive from new tenants when you tot up your property income for your tax return.

Start date

Your property letting business starts as soon as you have acquired your first property and it is available for letting. This means it is in a condition where it can be let, subject to cleaning, furnishing and drawing up tenancy agreements and inventories. If the property is in such a poor state that it cannot be let, it cannot be treated as part of your property letting business. However, once your property letting business has started, any later expenditure leading up to the letting of the second and subsequent properties is part of the property letting business and can be deducted, as long as it qualifies as tax deductible (see chapter 3).

Pre-letting expenditure

Pre-letting expenses, such as advertising or repairs, can be deducted from the rents you receive in the first tax year if two conditions are met:

- the expenses are classified as revenue costs rather than capital and
- the costs are incurred within seven years of the date on which you first let the property.

The expenses connected with renovating a property to bring it into a habitable condition are capital costs so are not deductible. However, if the property is a flat located over business premises, which is then let for a modest amount, the renovation costs may qualify for the special flats over commercial premises capital allowance (see chapter 12).

The Tax Inspector may query hefty repair and maintenance costs incurred before letting began. To get a deduction for these costs you need to show that the property was in a fit state to be let before the sprucing-up began. Whether you could let it at a rent acceptable to you is another matter.

Example

You buy a fairly run-down property that has been let as student accommodation, but you would like to let it in the more up market sector as family accommodation. Before you attempt to let the property you have it deep-cleaned, decorated, and get minor repair jobs done such as replacing locks. This work should all qualify as revenue expenses as the property was in a fit state to let before the work was done, as it had been let immediately before you purchased it. If you undertook more extensive works before letting, such as removing internal walls and refitting bathrooms and kitchens, the Tax Inspector may well classify the expenditure as improvement costs which cannot be deducted from the rents.

Finish date

Your property letting business finishes when you no longer have any properties available for rent, and you are not looking for tenants. This may be because you have decided to occupy the last property yourself, or you are keeping the property empty prior to sale.

2. Who is taxed and when is the tax payable?

Jointly held property

The person or persons who own the property are taxed on the property income, in relation to the proportion of the property they own. The tax law assumes that a married couple (or civil partners) share the income from a jointly held property equally, i.e. 50:50 what ever their actual ownership, unless an election on form 17 has been made (see chapter 4). If you own a property jointly with your spouse, and have not made this election, you should each report half of the income and expenses on your individual tax returns.



Warning

A couple can only divide the property income from a property between them if they both actually own a share in the let property (see chapter 4).

Top Tip

A married couple (or civil partners) who are living together can transfer a property from the sole ownership of the higher earner to the sole ownership of the lower earner or the joint ownership of both, so all or part of the property income is taxed at a lower rate. There is no capital gains tax to pay on such a transfer, but Stamp Duty Land Tax may be due if the property is mortgaged.

Tax return

If you hold properties in your own name all of the income and expenses from those let properties should be shown on the UK property pages of your personal self-assessment tax return. This applies even if you don't make a profit each year from the letting. If you let property located overseas, the total rents and expenses must be shown on the foreign income pages of your personal tax return.



Warning

HM Revenue and Customs (HMRC) periodically write to landlords who have not declared the income or gains from their properties on their personal tax returns. HMRC ask for details of the income and expenses from property for the previous six years. If you receive such a letter, you are not obliged to reply, but if you don't reply you may face a formal tax investigation.

If your let property is located overseas, the total rents and expenses must be shown on the foreign pages of your personal tax return. Where your let properties are owned by a company, the profits or losses from that letting business must be reported on the company's annual corporation tax return.

Record keeping

As a landlord you are required to maintain complete records of all expenses incurred and the income received from your let properties. This means not only hanging on to every relevant receipt, but also keeping details of any personal assets you used for the letting business.

For instance, note down the date and distance of all journeys you make concerning your property business, the time spent using your own computer and the portion of your own home used to store or process related paperwork. HMRC also want you to record the dates of each individual letting.

Deposits should be recorded separately, with precise dates of when they were received and returned. Only non-returnable deposits should be included as income in your property business accounts.

Top Tip

Keep a separate bank account for your property letting business and pay all the rents into this account and all the expenditure out of it. If the Tax Inspector ever asks you to prove the figures in your accounts it makes answering his questions much easier when the property related costs are not mixed up with your personal expenditure.

Top Tip

If you use an internet-only bank account remember to print off your bank statements regularly, at least once a quarter. The bank will only provide access to those statements for a limited period and the statements may contain the only record of the rents paid into that account.

All the records relating to your property business must be kept for five years after the final tax return filing date. So documents relating to the tax year to 5 April 2011 should be retained until 31 January 2017. Sale and purchase contracts and receipts relating to property improvements should ideally be kept for four years after the end of the tax year in which the property is sold, just in case the HMRC ask about the capital gain shown on your tax return.

Warning



If you fail to retain tax-related paperwork and this leads to an incorrect statement in your tax return, you could be charged a penalty of up to 100% of the tax lost. In addition if your records are examined before you submit your tax return, and are judged to be not sufficient to produce the figures needed for your return, you could be fined up to £3,000.

When is the tax payable?

Self-assessment

Under the self-assessment system the income tax you are due to pay on all your different types of income is added together, so there is no separate payment date just for your property income. Any tax already deducted, say under PAYE, or from your bank on interest, is set against this total and the balance is paid in up to three instalments:

- A 31 January within the tax year;
- B 31 July after the end of the tax year; and
- C 31 January after the end of the tax year.

The instalments A and B are known as payments on account, and are estimated amounts based on half the total tax you paid for the previous tax year. They are only due if the amount of tax you had to pay for the previous tax year exceeded £1,000, and was not collected under PAYE. If the current year's tax bill is higher than the previous year's total, you must pay the extra tax due at instalment C.

You can see that instalment C coincides with the first instalment A, for the next tax year. This means that when you start your property letting business, you may have to pay 150% of the annual tax due on 31 January following the tax year in which your letting commences. This is because you won't have paid any tax on account (instalments A and B) within and after the end of the tax year, as in the previous tax year you had no property income.

Top Tip

Put aside about one quarter of your profit from your properties in a savings account each month, so when the income tax bill arrives you have the funds to hand. If you already have substantial earnings from other sources you may need to put aside 40% or 50% of your profits to pay the tax due.

PAYE

The tax due on your property income can be collected through your PAYE code for the next tax year. After you submit your tax return showing taxable property income, HMRC may automatically adjust your PAYE code so the tax due on property income is collected directly from your monthly salary. Using this tax collection method the Government gets your money in monthly instalments and you lose the cash flow advantage of paying the tax in three stages (see above). However, using the PAYE system to pay tax on your property income is optional, if you don't want this to happen ring the HMRC office that issued the PAYE code and object. They must then alter your PAYE code back to its original form.

If the gross rents from all your properties amounts to less than £10,000 per year AND you pay the tax on your property income through PAYE, you may not be asked to complete a self-assessment tax return form. This will save you time and money. You will pay the same total amount of tax whether or not you pay the tax due on your property income directly out of your earned income under PAYE, or over three instalments under self-assessment. However, if you let more than one property, or have very variable costs or income, you should complete a tax return each year to ensure you receive full tax relief for all the eligible expenses.

Income Loss

If the expenses connected with your let properties exceed the rents received in the tax year, you have made a loss, and will pay no tax on your property income for that year. The loss does not reduce the tax you pay on your other income for the same year. Say in the following tax year, your rents exceed expenses, the previous year's loss from your let properties will reduce the tax payable. The loss is carried forward in this way until you do make a profit from your lettings business.



Warning

The loss from your property letting can only be used to reduce profits from the same property business in a future year if you have declared that loss on your tax return for the year it arose.

If the loss in your property accounts is created by capital allowances on equipment used for the property letting business, or exceptionally when allowances have been claimed for renovating empty flats or business premises (see chapter 13), that loss may be set against your other income for the year.

Capital Gain

When you sell your let-property you would expect to make a profit after deducting the purchase cost and selling expenses. You must declare this profit on the capital gains pages of your tax return, and pay capital gains tax on the amount your total gains for the year exceed your annual capital gains exemption (£10,600 for 2011/12). If you have special non-domiciled status you may not have this annual exemption available if you also claim the remittance basis in respect of your foreign income. See chapter 7 for further discussion of capital gains tax and how to reduce it.

Capital Loss

You may be forced to sell your let-property for less than you bought it for, which means you make a capital loss. This loss cannot be set against your property income or against your other income. It can only be set against a capital gain you make in the same tax year or in a future tax year.

Corporation tax

If you hold your let properties through a company, that company will generally have to pay corporation tax on its profits nine months and one day after its accounting year end. A company can pick any date for its year end, although changing the date frequently is not permitted. Companies that pay the main rate of corporation tax, generally those with taxable profits that exceed £1.5 million, must pay corporation tax in four instalments, starting six months into the accounting period. Companies pay tax at different rates to income tax paid by individuals and can claim different tax reliefs (see chapter 4).

3. Tax allowable expenditure

Capital and revenue

You need to sort your expenses into one-off costs such as those connected with buying or selling your let property, known as capital costs, and other expenses that are likely to be repeated as tenants change, which are known as revenue costs. The capital costs cannot normally be deducted from rents received but the revenue costs can.

Types of revenue costs

The range of items that can be deducted from rents received include the following:

- Legal fees for drawing up tenancy agreements or collecting debts, but not those connected with acquiring properties;
- Letting or managing agents' fees;
- Accountancy fees for drawing up the property business accounts;
- Advertising for tenants;
- Gardening, cleaning, and security services where relevant;
- Motor expenses for travelling to the property (see below);
- Ground rent and service charges for leased property;
- Wear and tear or renewals allowance (if the property is let furnished);
- Maintenance and repairs (see below);
- Buildings and contents insurance;
- Interest paid on loans used to fund the property business (see below);
- Water rates and council tax;
- Heating and lighting costs.

You can only deduct the last two items from the rents received if the letting agreement does not make the tenant responsible for paying these charges. The liability to pay council tax normally falls on the individual residing in the property, but if the property is empty or is a property in multiple occupation (see below), the landlord may be required to pay the council tax. If the tenant pays the council tax or utility bills then you cannot also claim a tax deduction for those same costs.

Timing

Revenue costs should generally be deducted from the rents received for the year in which the expense was incurred. However, if you have an obligation to pay an expense in the future you can take that future cost into account if it is certain that you will have to pay it.

Example

You buy a leasehold flat in a block of flats in January 2011 and let it immediately. The flat management company asks all the owners to contribute to the cost of repairing the fire-escape on the outside of the building. Your share is £2,000 but it is not payable until the work is completed in September 2011. You can include your share of the fire escape repair cost in your property letting accounts for the year to 5 April 2011, as it is certain at that date that you will have to pay this cost.

Repairs or improvement

All properties need some maintenance from time to time. Sometimes the work required is quite substantial such as replacement kitchen units or windows. HMRC may ask whether the total amount spent on the property is for repairs or improvements. The difference is that the cost of repairs can be set against the rental income, but an improvement adds to the value of the property so you can only get tax relief for that expense when you sell the building.

It is not the quantum of the cost that determines whether the item is a repair or an improvement, but the nature of the work. If you replace a rotten old wooden conservatory with a new one of the same size built using modern materials, the cost should qualify as a repair. However if the conservatory is a completely new addition to the property it will count as an improvement, and the cost cannot be deducted from the rents.

The boundary between a repair and an improvement can also move over time. The windows in a house built over 30 years ago are likely to be single glazed, but if you need to replace a window the standard modern equivalent will be a double glazed unit. HMRC now accept that landlords can deduct the cost of double glazed windows where those windows replace single glazed ones.

Top Tip

If you have not reclaimed some repair costs in the past as you thought HMRC would argue about them you can go back and amend your own or your company's tax return up to one year after the deadline for submitting that tax return.

Installing insulation

If you install wall, floor or loft or hot water insulation in your let properties you would not normally get a tax deduction for the costs as this work is regarded as a property improvement rather than a repair. However, you can claim a special tax deduction of up to £1,500 of the costs of insulating each residential property, where those costs are incurred before 6 April 2015.

As long as the insulation is fitted to a finished property, not while it is under construction, you can claim this special tax deduction for the work completed before you let the property for the first time. This tax deduction cannot be claimed where you let the property as furnished holiday lettings, or it is part of your home (see chapter 6).

Furnished property

If you let your property furnished, as opposed to unfurnished (see below), you can claim either:

- a wear and tear allowance of 10% of net rents (that is the rental income received less any expenses paid by the landlord which would normally be borne by a tenant); or
- a renewals allowance towards the cost of replacing an asset.

The wear and tear allowance is designed to cover movable items such as furniture, furnishings, electrical goods and kitchenware.

Top Tip

The wear and tear allowance must be calculated per property. Calculate the net rents for each let furnished property individually in order to work out the 10% allowance.

What constitutes 'furnished' depends on the expectations of the tenant. HMRC consider a property as furnished when it is 'fully furnished', as opposed to 'partly furnished'. A partly furnished property would generally include only white goods such as cooker, fridge and washing machine. An unfurnished property would normally include some minimal furnishings such as carpets and curtains.

Interest and loans

The rules for getting a tax deduction for interest paid against your property income are very flexible. It doesn't matter if the interest is paid on a personal loan, a mortgage, or even an overdraft, as long as the cash borrowed is fully used to fund the letting business in some way.

If you extend the mortgage on your own home to release funds to buy or repair a let property you can offset the interest on the extended portion of the mortgage against the rents received from the let property. To allow HMRC to see where the capital has come from you need to attach a balance sheet for your property letting business when you complete the profit or loss figures on your tax return.

Extracting capital

How much capital can you take out of your letting business and still get deduction for the interest? The key is how much the property was worth when it became part of your letting business.

If you remortgage the let property taking out some of the surplus capital that existed when the letting started, you can use that capital as you please. HMRC previously discouraged this action by arguing that as the increased loan was not used to originally buy or improve the property, the interest could not be deducted from the rents received. However HMRC now treat a letting business just like any other business as illustrated in their Business Income Manual at paragraph 45700.

Example

Alan owns a flat which he bought ten years ago for £125,000. He has a mortgage of £80,000 on the property. He has been offered a job abroad and decides to keep his flat and let it out while he is away. His flat had a market value of £375,000, when he started his property letting business.

The opening balance sheet of his letting business shows:

Mortgage	£80,000	Property at market value	£375,000
Capital account	£295,000		
Total	£375,000	Total	£375,000

He borrows a further £125,000 on the flat, and withdraws that sum for his own use.

The balance sheet at the end of Year 1 shows:

Mortgage	£205,000	Property at market value	£375,000
Capital account brought forward	£295,000		
Less: capital taken out	£125,000	£170,000	
Total	£375,000	Total	£375,000

Although Alan has withdrawn capital from the business the interest on the mortgage loan is allowable in full because it is funding the transfer of the property to the business at its open market value at the time the business started. The capital account is not overdrawn.

As long as you don't take more capital out of the business than the available capital, the interest paid on any mortgage or loan used in the letting business will be tax deductible.

Available capital = Value of property when first let - Loans outstanding

All properties let by one person in the UK on the same basis are treated as being part of one property business, so if you own several let-properties you can add together all the values of the properties as they stood when they were brought into your letting business.



Warning

HMRC do not permit you to revalue a let property while it is part of the letting business and take out the perceived increase in value (due to the revaluation) as surplus capital.

Capital Allowances

You cannot claim capital allowances for furniture and fittings used in a let residential property, as these items are covered by the 10% wear and tear allowance, discussed earlier. However, you can claim capital allowances for equipment used to run your lettings business and maintain the properties. There are special rules for furnished holiday lettings (see chapter 6).

So what can you claim? It depends on whether you are responsible for the maintenance or if you outsource that task to a letting agent. Office equipment used predominately for your letting business can qualify, as can a vehicle used for travelling between the properties and for moving furniture etc. If the properties have gardens, tools such as lawnmowers and hedge trimmers will qualify. External maintenance such as painting and gutter cleaning will inevitably require the use of extendable ladders, which are not cheap.

Capital allowances on equipment purchased after 5 April 2010 are given at 100% of the cost, subject to a cap of £100,000 for the business each year. This cap is due to drop to £25,000 for equipment purchased after 5 April 2012. Equipment can include vans but not cars. Capital allowances for cars are restricted according to their CO2 emissions. However, very low emissions cars can qualify for a 100% allowance.

Your own time

If you manage the property yourself, and do all the maintenance, rent collecting, and tenant vetting personally, can you deduct an amount from the rents for the cost of your own time?

No, unless you let the property through a company and employ yourself through that company, you cannot deduct the cost of your own time from the rental income you receive.

Other wages

You can deduct wages paid to a member of your family who doesn't own a share in the property but who undertakes property related tasks for you.

This can be a useful way of distributing some of the rental profits around the family without transferring a share in the property to your spouse or partner. If your spouse has no other income, a property managing fee of up to £7,072 (for 2011/12) will be covered by their annual personal allowance, and will be free of tax and national insurance. There is also a tax saving if your spouse pays tax at a lower rate than you do.



Warning

The amount paid to your spouse or family member must be reasonable, and the wage must actually be paid, not just accrued in your property business accounts.

So how much is a reasonable wage? Start with a typical fee for a commercial managing agent and discounted it by say 50% as you are not paying an expert, unless your relative happens to be an experienced property agent. Keep records of the time spent by your assistant on the property business, so if HMRC ever ask, you can justify the hourly rate amount paid. Where the amounts paid exceed £102 per week (for 2011/12) you should operate PAYE and prepare payslips. If you let properties through a company, that company must pay wages of at least the national minimum wage rate; currently £5.93 per hour for those aged over 21.

Your travelling costs

You may well have to make a number of journeys connected with your property letting business, once you have purchased the property. If you manage the property yourself the journeys may be quite frequent as you deal with the coming and going of tenants and check repair work. The cost of these journeys can be set against your rental income, if they are wholly connected with the letting and anything else you did on the same trip, such as personal shopping, was merely incidental.

Journeys by public transport are easy to cost as the price of the ticket, but if you drive in your own vehicle you need to keep accurate mileage records. An easy way to charge your own motor expenses as a property cost is to simply calculate 45p per mile for each property related journey, for the first 10,000 miles each tax year. This is acceptable to HMRC where your lettings business has a turnover of less than £73,000. A more elaborate, but fairer method is to keep track of all the costs you incur to keep your car running in the tax year (TC); repairs, servicing and fuel, and record the total mileage (M) as well as the property related journeys (P); then apply this formula:

Cost of property motoring = $TC \times P \div M$

Houses in Multiple Occupation (HMO)

An HMO includes any purpose built building or converted flat whose occupants do not form a single household. From 6 April 2006 an HMO which contains three or more storeys and which is occupied by five or more persons forming two or more households (i.e. unrelated tenants), must be licensed by the local authority. The fee charged for an HMO licence varies significantly across the country, but the cost of the licence is tax deductible. Additional requirements for features such as fire exits or wash-hand basins, may also vary from area to area.

4. How should you own your property?

Jointly held property

Let property can generate a useful income stream for a spouse who has little or no other income to soak up their annual tax-free income tax allowance (currently £7,475), but you do need to arrange the property ownership correctly to gain the maximum tax advantage.

In England and Wales you can own property as joint tenants when you own an equal interest in the whole property, or as tenants in common where you own separate and identifiable shares, say 10% and 90% of the property. There are different rules for Scottish properties and those located overseas.

When a legally joined couple (married or civil partners) own property as joint-tenants any income from that property must be split equally between them for tax purposes. If the property is held in unequal shares as tenants-in-common the couple can make a declaration on the HMRC form 17 to have the property income taxed in the proportion that reflects each partner's beneficial interest in the property. Without the form 17 declaration a married couple will be taxed on an equal share of the property income from a jointly owned property. This election is not reversible, so once you have elected to be taxed on your actual share that's it, unless your actual ownership changes.

If you want to split the property income in unequal shares instruct your solicitor to acquire the property as tenants-in-common. Where you already own the property as joint tenants it is quite simple to change to tenants in common, but there can be a Stamp Duty Land Tax charge where the property is mortgaged.

A gift of a share in a property between husband and wife (or civil partners), who are living together is not subject to capital gains tax at the time of the gift. The recipient takes on their share of the property at the value paid by the other partner. The transfer between spouses is also generally exempt from inheritance tax. When the property is sold any capital gain arising must be split according to the proportional ownership, so think ahead.

Top Tip

Where a let property is owned by one spouse, a transfer into joint ownership can save income tax on the annual profits, and capital gains tax on the eventual sale, as both spouses will be able to set their annual capital gains exemption against the capital profit made.

Partnership or LLP

If you let a number of properties an alternative solution is to form a partnership or Limited Liability Partnership (LLP) to collect the rents and allocate the net income between you. Just holding a property in joint names does not constitute a partnership. To prove you have a genuine partnership you should have a partnership agreement drawn up.

Top Tip

Where you have a genuine partnership you can share the annual profits and losses from that business in any ratio you and your partners agree on. This ratio may be varied from year to year which is very handy for tax planning.

Company

You can hold your let properties through a limited company. If you already have a trading company that has accumulated some surplus funds, investing in buy to let property can make commercial sense, providing the company can secure a mortgage for the balance of the purchase price.

Before you make the decision to invest the company's money, or to form a new company to hold buy to let properties, some serious number crunching and crystal-ball gazing is required to work out the potential tax savings.

First compare the tax rates and allowances available to you and the company (all rates apply for 2011/12 tax year unless otherwise stated):

- The company will pay corporation tax on its income and gains with no tax free allowances;
- The first £7,475 of your total personal income is generally tax-free (or more if you are aged over 64);
- You also have £10,600 as an annual exemption to set against your capital gains;
- The company will pay tax at 20%, 27.50% or 26% on profits and gains, depending on the total level of its taxable profits for the year;
- You will pay tax on your property income profits at 20%, 40% or 50%;
- You will pay tax on capital gains at 18% or 28%, after deduction of your annual exemption;
- The company cannot deduct an annual exemption from its gains, but it can claim indexation allowance which increases the cost of the property by the RPI rate of inflation in the period since it was acquired.

If your home country is not the UK, and you have the special tax status known as non-domiciled, you may not benefit from a personal allowance or annual exemption to set against your UK income or gains.

Extracting profits from the company in the short term can generate additional corporate and personal tax charges.

Lenders are aware of the tax advantages of holding property within a company and there are several mortgage products on the market specifically designed for property letting companies. But don't rush into anything, running a limited company is a long term commitment and needs careful planning.

As a corporate landlord you may find it easier to open trade accounts with suppliers. If your company is already VAT registered due to its existing trade, it may be able to reclaim the VAT charged on the property related purchases. This VAT advantage applies where the VAT on the property related items is not more than £7,500 per year, and does not exceed more than 50% of the total VAT on all purchases made by the business. Letting residential property, other than as holiday accommodation, is exempt from VAT so great care is needed over VAT returns when the company also makes other sales bearing standard rate VAT.

5. Trading or investment

The property income discussed above is generated by holding and letting your properties for the medium to long term, as a fairly passive investor. If you intend to turn over your properties more frequently, or manage other people's properties for reward, HMRC may say you are actively trading. This may apply to activities such as:

- Managing properties owned by others, collecting rent, etc;
- Buying and selling properties within short periods; or
- Buying and renovating, then selling on those properties.

Example

You buy a dilapidated house for £150,000 and spend £50,000 over four months on repairs and modernisations to the bathroom and kitchen, with the intention of selling the property as soon as possible for a profit. In this situation you are a property developer and the profits you make are trading profits, not property income.

If you are considered to be trading, rather than just investing in let property, it will have the following tax consequences:

- All the gains made on selling properties will be subject to income tax (or corporation tax if the properties are held within a company);
- You will not be able to set your annual capital gains exemption against the gains made from selling properties (see chapter 7);
- The main residence exemption and letting exemption will not be available (see chapter 7);
- National Insurance contributions will be due on the profits if this business is run in your own name or through a partnership;
- You may need to register for VAT; and
- Any rents you receive may be taxed as incidental trading income.

The tax advantages of having your property business taxed as trade are:

- The value of your business should attract a 100% exemption from inheritance tax as business property (see chapter 8);
- You can get tax relief for indirect or abortive expenses connected with buying and selling properties;
- Any losses you make by trading in your own name can be set against your other income;
- If you trade through a company, the shares of that company may qualify for entrepreneurs' relief when you sell them.

6. Furnished holiday lettings

Letting property as furnished holiday lettings (FHL) attracts favourable tax treatment, (see Advantages of FHL below). However, those rules are being tightened from 6 April 2012, or 1 April 2012 where the property is let through a company.

To qualify as a FHL property the accommodation does not have to be in a tourist area but the pattern of lettings must satisfy these three conditions:

- 1 The property must be available for commercial letting as holiday accommodation for at least 140 days a year, 210 days from April 2012.
- 2 It must be actually let as holiday accommodation for at least 70 days a year, 105 days from April 2012; and
- 3 It must not normally be let for a continuous period of more than 31 days to the same tenant in seven months of the year, and those seven months include any months in which it is actually let as holiday accommodation.

“Holiday accommodation” means letting to the general public for periods which do not normally exceed a month, but this can include letting to business people for short periods as well as to tourists. The seven months of short lettings in condition 3 do not have to be a continuous period. The property may be let to one tenant in the other five months of the year.

If you let more than one property as FHL, you can average the days let across all your holiday properties to determine if the average let days per property meets the qualification threshold across your entire FHL business. This averaging exercise can allow all your properties to qualify as FHL where some properties easily meet the letting requirement and others do not. Properties in the UK cannot be averaged with properties let outside of the UK.

As the number of let days required is to increase from 70 to 105 per year from April 2012, there is a special election to allow a property to qualify over one or two difficult years. The property must be available for letting for the full 210 days per year, but if it met the letting condition for one year but failed for the next year, you can elect for it to be treated as passing for the failed year. You can elect in this fashion for up to two consecutive years.

Example

Your holiday cottage is let as holiday accommodation for the following days per year:

Tax year	Letting days required	Actual days let	Election needed?	Qualifies as FHL?
2011/12	70	77	Not applicable	Yes on days let
2012/13	105	84	Yes	Yes on election
2013/14	105	77	Yes	Yes on election
2014/15	105	110	No – qualifies.	Yes on days let

Advantages of FHL

FHL businesses attract the following special tax reliefs:

- Profits from the FHL business are treated as earnings for pension contributions;
- Capital allowances can be claimed on fittings and equipment used within the property as well as on

- equipment used for running the FHL business;
- A capital gain made on the disposal of a property that has been used for FHL can attract:
 - entrepreneurs' relief where all or part of the FHL business is disposed of;
 - rolled-over relief when another business asset is purchased (within certain categories), so no tax is paid until the replacement asset is sold; or
 - hold-over relief when a FHL property is given away, so no capital gains tax is paid until the recipient disposes of the property.

Warning

The above tax reliefs all have complex conditions attached. Ask a specialist tax adviser to confirm whether a particular tax relief may be available before you finalise any large transaction.

Disadvantages of FHL

The disadvantages of letting as FHL as opposed to standard six month residential lets are:

- The turnover of tenants is much higher;
- Advertising and cleaning costs are higher;
- Losses can only be set against future profits of the same FHL business.
- You may have to register for VAT
- Business rates will be charged on the property in place of council tax (see below).
- HMRC may ask you to pay class 2 national insurance contributions (£2.50 per week for 2011/12).

Overseas properties

Properties let as holiday accommodation in other EEA countries can also qualify as FHL businesses if the pattern of lettings discussed above is met. The EEA countries comprise all of the 27 member states of the European Union plus Liechtenstein, Norway and Iceland.

However, your FHL business based on UK properties must be kept completely separate from the FHL business using properties in other EEA countries. Those two businesses must be reported separately on your tax return and the losses cannot be set-off against profits from another FHL business.

Top Tip

If you have let a property as holiday accommodation in another EEA country before April 2010, and been taxed on the profits in the UK, you may be able to claim additional tax reliefs to reduce those taxable profits. However, there are tight deadlines for submitting such claims, so ask for tax advice on this matter without delay.

Local taxation

Residential property is normally subject to council tax. However, properties that are available for short term letting for more than 140 days per year are subject to business rates rather than council tax. This would apply to all properties that qualify as FHL properties.

If the rateable value of your FHL property is less than £18,000 (£25,500 in greater London) you may qualify for small business rates relief. Different thresholds for this business rate relief apply in Wales and Scotland. Business rates are not charged on properties in Northern Ireland, where the old rates system applies to both domestic and business properties.

7. Capital gains

What is a gain?

When you dispose of a property, the capital gain is the difference between the net amount you receive from the sale and the total amount you paid out to acquire the property, although further exemptions or reliefs may reduce the taxable gain. If you give away a property, or sell it at a discount to someone connected with you (such as a family member), the sale proceeds will be deemed to be the market value of that property.

Capital gains are taxed in your hands at either 18% or 28%, depending on the level of your net taxable income for the tax year. If entrepreneurs' relief applies to the gain it is taxed at 10%, subject to a lifetime limit of £10 million.

Companies pay corporation tax on all capital gains at the rate that applies to their other trading profits. This rate depends on the level of profits and the number of connected companies. Most small companies currently pay tax at 20%, but rates of 26% or 27.5% can apply.

Allowable expenses and exemptions

The following expenses and exemptions may reduce the taxable gain on the disposal of a property:

- Solicitors' and estate agents' fees on the sale and purchase
- Stamp Duty Land Tax paid on purchase
- Cost of improvements
- Your annual exemption (£10,600 in 2011/12)
- Capital losses
- Main residence exemption (see below)
- Lettings relief, (if the main residence exemption has also applied (see below))
- Entrepreneurs' relief, if the property qualified as FHL (see chapter 6) or was sold with a trading business.

Main residence election

The dilemma with let properties is that you invest in them partly to realise a profit on sale, but that gain is subject to capital gains tax. The value of your own home also increases at a similar rate but that gain is protected from capital gains tax by what is known as the main residence exemption.

The big advantage of the main exemption is that it not only exempts from tax the gain made on a property while you live in it but also the gain made in the last three years of ownership, whether or not you still live there. So if you can get a let property classified as your main residence at some point when you own it, at least three years worth of the gain will be exempt from tax, plus the gain for the period when you actually occupied it as your main residence.

If you occupy more than one property, perhaps a town flat and a country home, you can elect which should be treated as your main residence for tax purposes. You can only have one main residence at any one time and you must actually spend some of the year living in at least part of the property you elect to be your main residence. A husband and wife, or civil partners, can only have one tax free main residence between them.

A property that is fully let cannot be your main residence. You need to make the main residence election within two years of acquiring your second or subsequent home, but once the election is made you can change it at any time. Living in a property for some time before or after it is let can help your tax position on the sale of that property, but the gain on your other home will be exposed to tax while it is not your main residence.

Example

You bought a holiday flat in Dorset on 1 September 2003 but continued to live for the most part in your own home in London, and elect before 1 September 2005 for your London house to be your main residence. The flat is let continuously from 31 May 2004 until 1 June 2010 when you decide to spend the summer in the country so move into the Dorset flat on 1 July 2010, and at the same time change your main residence election to make the flat your main residence. You return to live in your London house from 1 October 2010, changing your main residence election back to the London property. You sell the Dorset flat on 1 September 2011 making a capital gain of £80,000, which is an average gain of £10,000 per year of ownership.

As the Dorset flat was your main residence for three months in 2010, three months worth of gain: £2500 is exempt from capital gains tax. Also the last three years worth of gain; £30,000 is tax free. Of the remaining £47,500 of gain, £32,500 is exempt under the letting relief (see below).

If you had not made the main residence election within two years of buying the flat in September 2003, you would not have been able to alter that election in favour of the flat in July 2010 and alter it back again in October 2010. The full gain of £80,000 made on selling the flat would then be subject to capital gains tax, after deduction of your annual exemption.

Letting relief

The capital gains tax you pay on a property sale can be cut if the property has been let as residential accommodation. But this will not apply to a let-property unless you lived in the property, or part of the property, as your main residence either before, during or after the time it is let out. Letting relief cannot apply to a buy to let property that you have never lived in yourself.

The tax relief is restricted to the lower of three amounts:

- the part of the gain exempt because it was used as your main home;
- the gain attributed to the let period; and
- £40,000 per owner.

Example

In the example above you occupied the property for 3 months and let it for six years. The gain is £80,000 or £10,000 per year of ownership. The taxable gain is calculated:

Capital gain before tax relief	£80,000
Exemption for main residence for 3 months, plus last 3 years of ownership	£32,500
Relief for letting restricted to lower of: <ul style="list-style-type: none">• Exemption as main home £32,500;• Letting period: £60,000 and;• maximum relief £40,000.	£32,500
Gain chargeable	£15,000

Entrepreneurs' relief

This relief reduces the tax rate payable on a capital gain to 10%, before deducting losses or your annual exemption, but it will generally only apply where the property was used for a trade or qualified as furnished holiday lettings, but not to other let properties. The relief can only be claimed by individuals or trustees, not by companies.

Entrepreneurs' relief for gains on property will generally be restricted to the following circumstances:

- Where the property has been let as furnished holiday accommodation (see chapter 6);
- Where the property is sold as part of a trading business;
- Where the property was used by the trading business at the time that business ceased and the property is disposed of within three years of the business ceasing.

Questions to ask to check you have included all reliefs

When you sell a residential let property ask yourself these questions to make sure you have deducted all the available reliefs and taken advantage of all exemptions due to you.

- 1 On what date were contracts exchanged for the sale of the property? It is the exchange date when the agreement to sell the property became unconditional, not the completion date, that determines the period in which the disposal is taxed. The rates of CGT changed on 23 June 2010, so it is crucial to get the date of disposal correct. Your personal rate of capital gains tax may also vary in different tax years, according to your total income level.
- 2 What were the costs of the sale and purchase, including stamp duty, estate agent's and solicitor's fees? All of these costs can be included in the capital gains computation, but only if you know what they were.
- 3 Who owned the property at the date of sale? Splitting the gain over two or more owners can mean each person's share of the gain is covered by their annual exemption and no capital gains tax is payable. Remember to report only your own share of any taxable gain on your own tax return.
- 4 How was the property owned: as tenants in common or joint tenants? If it was held as joint tenants then the property was certainly owned in equal shares. If it was held as tenants in common, check exactly what share you owned. Remember to split the gain along the actual ownership ratio of the property.
- 5 Do you own other let properties? A property letting business brings together all the rental income and expenses from UK properties into one pool. This means interest paid on a mortgage for an empty property can be set against the income from other properties in the same year, while the property letting business continues. Interest cannot be capitalised and deducted from the sale proceeds of the property.
- 6 Have there been any improvements or substantial repairs made to the property, which you have not claimed as deductions from rental income? The cost of improvements should be deducted from the sale proceeds to calculate the gain.
- 7 Did you ever live in the property as your main home so it qualified as your main residence? If you did occupy it and elected for the property to be your main residence when exactly did you move out and change the main residence election?
- 8 Have you calculated the letting relief available if the property was your main residence at some point?(see above).
- 9 Was the property let as furnished holiday lettings? If it was, entrepreneurs' relief may reduce the rate of tax charged on the taxable gain.

8. Inheritance Tax

Inheritance tax (IHT) is charged at 40% on everything you own when you die, excluding value that falls in the nil rate band, (frozen at £325,000 since 2009). This nil rate band may be doubled for widows or widowers. Any value you leave to, your UK domiciled spouse or civil partner, charities, political parties, or for the national benefit is also exempt from IHT. That leaves the value of all your other possessions, including the home you live in and your buy to let properties, which is potentially subject to IHT.

Example

Charles never married and owned the following properties and other assets when he died on 1 March 2012. He made no Will and so died intestate. As a result no tax exempt gifts were made on his death. The inheritance tax due on his death is calculated as:

Own property	£300,000
Let property (net of mortgage)	£160,000
Cash	£8,000
Premium Bonds	£2,000
Quoted shares	£20,000
Total value of estate	£490,000
Less Nil rate band	£325,000
Taxable estate	£165,000
Inheritance tax due at 40%	£66,000

All the beneficiaries of Charles' estate agreed that his estate should be divided in a different manner so they signed a deed of variation to alter the arrangement set by the intestate law to allow his let property to pass directly to a charity. The inheritance tax payable on his death is reduced to £2,000, saving tax of £64,000:

Total estate	£490,000
Less tax exempt gift to charity	£160,000
Net estate	£330,000
Less Nil rate band	£325,000
Taxable estate	£5,000
Inheritance tax payable at 40%	£2,000

One way to reduce the potential IHT charged on your let properties is to organise the business so your property business is treated as a trade (see chapter 5 above). In this case the value of your property business should attract 100% business property relief, which will wipe-out the value for inheritance tax purposes.

Business property relief can also apply to properties let as holiday accommodation if certain additional services are also provided which are over and above that which would normally be provided by a landlord. A holiday park that provides entertainment, catering and laundry services may well qualify, but a single FHL property is unlikely to qualify for this tax relief.

Top Tip

On death all the assets, including any properties should be valued on an “as is basis,” taking into account the tenancies in place. A property with a sitting tenant will normally sell for much less than a property sold with vacant possession. The lower the value at the date of death the less inheritance tax will be payable.

9. Overseas issues

Overseas property owned by UK residents

Letting overseas property

When you invest in property abroad you generally need to declare and pay tax on any income from that overseas property in the country where you belong. If you normally live in the UK, you are taxed in the UK on your foreign property income and any profit you make on the sale of that property.

There are exceptions to this general rule if you do not normally live in the UK; in tax terms you are non-resident, or if the country you regard as your permanent home is not the UK; in tax terms you are non-domiciled. The tax rules for UK residents who are non-domiciled are very complex and are outside the scope of this guide.

The rental income from your overseas property may also be liable to tax in the country where the property is situated, as well as in the UK. You should inform the tax authorities where the property is located of the rental income. You may be asked to complete a local tax return for that country, in which case you should take local tax advice. If you use a property letting agent he may be required to deduct withholding tax from the rents as a down-payment against the local income tax due.

If you have paid foreign tax on your rental income and there is a double taxation treaty between the UK and the country where your property is situated that covers this type of income, you will get the foreign tax paid treated as a part-payment of your UK tax liability. Unfortunately you can't reclaim foreign tax if your UK tax liability on your overseas rental income is lower than the foreign tax paid.

The income and expenses from your foreign property need to be reported on the foreign pages of your UK tax return. But be aware that other countries have different rules for determining which expenses can be deducted for tax purposes. Each type of foreign tax can only be offset against its equivalent UK tax. For example foreign land taxes similar to the UK local authority rates will not be available to offset against UK income tax although you may get a deduction against the rental income received.

You will also have to calculate the rental profits over the local tax year which is likely to be the calendar year, rather than the year to 5 April. This means you may need to draw up two sets of property accounts for different periods.

Losses made on letting overseas property cannot be carried back to offset against your other UK income, but they can be used in the same year or carried forward to set against other foreign letting profits.

Gains on overseas property

When you sell your overseas property you will be liable to pay UK capital gains tax on the profit made. You may also be liable to pay tax on the profit in the country where the property is situated. If there is a double taxation treaty in place you may be able to set the foreign capital gains tax against any UK capital gains tax due.

Top Tip

If you actually live in your foreign property for a while, you can elect for it to be treated as your main residence for UK tax purposes. This will protect a proportion of the gain from UK capital gains tax that arises on the sale.

UK capital gains tax on an overseas property can be avoided if you are prepared to become non-resident for the tax year in which the property is sold. However HMRC are wise to this move, and insist that you stay out of the UK for at least five full tax years before a capital gain on a foreign asset can be ignored by the UK tax system.

Holding the overseas property in a foreign registered company will not necessarily remove the capital gain from UK tax. There is a special tax rule that looks through a non-resident company to tax any gains the foreign company makes on the shareholders of the company, where a shareholder holds at least 10% of the company.



Warning

Take UK and local tax advice before setting up any special structure, such as a company to hold an overseas property. Such a property-holding company could affect the tax payable by your UK trading company.

UK property owned by landlords who live overseas

Non-resident landlord scheme

Any managing agent or tenant, who pays more than £100 per week in rent to a landlord who is not resident for tax purposes in the UK, must withhold income tax at 20% from that rent and pay over the tax deducted to HMRC. However, if the landlord has gained approval from HMRC under the non-resident landlord scheme, HMRC can authorise the agent or tenant to pay the rent gross, without deduction of tax.

Non-resident landlord scheme

Landlords

To receive approval under the non-resident landlord scheme the landlord must show that:

- their UK tax affairs are up to date; or
- they have not had any UK tax obligations before they applied; and
- they do not expect to be liable to UK income tax for the year in which they apply.

Agents

A property agent acting for a non-resident landlord must also register with HMRC within 30 days of taking rent for the UK property. The agent must complete an annual information return by 5 July each year. Some letting agents are not aware of their obligations under the non-resident landlord scheme.

Further information about the non-resident landlords scheme can be found on the HMRC website:
http://www.hmrc.gov.uk/cnr/nr_landlords.htm

10. VAT and SDLT

VAT

Letting of residential property is exempt from VAT, so you are not permitted to charge VAT on the rents, unless the property is let as holiday accommodation when you may be obliged to charge VAT (see below).

VAT can apply at every rate possible to property transactions, for example:

- Standard rate (20%) on repairs carried out by a VAT registered trader (see below);
- Reduced rate (5%) on the renovation of an empty property (see chapter 12);
- Zero rate (0%) on alterations to listed buildings;
- Exempt when a second hand residential property is sold;
- Standard rate where option to tax applies, on the lease or sale of commercial buildings;
- Outside the scope of VAT when the building is sold as part of a trade.

Holiday accommodation

VAT at the standard rate will apply to income from letting holiday accommodation if the owner is, or should be, VAT registered. This covers all holiday and hotel accommodation, not just furnished holiday lettings.

You need to register for VAT if the rental income from your holiday lets plus any other VATable sales you make exceeds £73,000 in any 12 month period. This is the compulsory VAT registration threshold from 1 April 2011. If you are already VAT registered the amount charged for letting out holiday accommodation must have VAT at the standard rate added to the basic cost.

Top Tip

If you are dealing with a property transaction which is in any way unusual, get expert VAT advice. That does **not** mean ringing the VAT national advice line: ask a VAT specialist.

Repairs

The costs of repairing and improving the let property will normally carry VAT, but you cannot reclaim this VAT if the rents from your property are exempt from VAT. However, if you hold let properties through a trading company that is VAT registered and normally charges VAT at the standard rate on its other sales, it may be possible to reclaim VAT on the property maintenance costs. This is the case if the total VAT on the residential property costs does not exceed the following limits for the whole business:

- £625 per month on average, which is £7,500 a year; and
- 50% of the total VAT the business has to pay on all its purchases.

Stamp Duty Land Tax (SDLT)

SDLT must be paid by the purchaser of land or property within 30 days of the effective date of the purchase. This is normally the completion date, the day on which the funds are handed over. But beware of taking possession of a property before the completion date, as this will bring forward the due date of payment of SDLT.

As the purchaser you must self-assess how much duty is due, but your solicitor will help you complete the land transaction forms that report the purchase to HMRC. Penalties are imposed if the form is late, and interest is due on any duty paid late. You cannot register a property with the Land Registry until the SDLT is paid.

How much

SDLT applies to purchases of residential properties at the following rates:

Freehold property value	Rate of SDLT on full consideration
Up to £125,000	Nil
Up to £250,000	Nil (for first time buyers)
£125,001 to £250,000	1%
£250,001 to £500,000	3%
£500,001 to £1,000,000	4%
Over £1,000,000	5% from April 2011

First-time buyers are eligible to pay SDLT at 0% for properties worth up to £250,000 purchased before 25 March 2012, where that property is to become their only or main home.

For the rates of SDLT applicable to commercial properties, see chapter 11: Commercial property. Once a SDLT threshold is reached the SDLT applies to the full cost of the property, not just the slice of value above the threshold.

Example

If you agree to buy a property at £250,100 you will pay SDLT of £7,505 (3% x £250,100 rounded to the nearest £5). If you negotiate the price of the property down to £250,000 you will save £5,005 by reducing your liability to SDLT down to £2,500 (1% x £250,000).

If the asking price for the property you wish to purchase is set at just over one of the SDLT thresholds you can save SDLT by negotiating the price down below the threshold or agreeing with the seller that part of the purchase price represents removable fixtures and fittings, on which SDLT is not due. Such fittings may include:

- carpets and underlay;
- curtains and curtain tracks;
- light fittings and ceiling fans;
- kitchen white goods such as dishwasher and fridge;
- garden furniture; and
- TV satellite dish.

HMRC are alive to such avoidance of SDLT and will examine transactions which fall just shy of the SDLT boundaries particularly carefully. Any agreement for the purchase of fixtures and fittings should be drawn-up very carefully with realistic values attached to fittings.

Exempt from SDLT

There are a number of exemptions from SDLT but those you are most likely to meet are:

- Gifts of property
- Zero carbon homes

Gifts

If you make a gift of a property there is no SDLT payable on the value of that property. However, if the property has a mortgage attached that is also transferred, the transfer value of that debt is subject to SDLT.

Example

Lionel gives a property worth £283,000 to his civil partner Kevin. The property is subject to a mortgage of £183,000. SDLT of £1,830 is payable being 1% of the debt transferred.

Zero-carbon homes

Sales of new zero-carbon homes made between 1 October 2007 and 30 September 2012 are exempt from SDLT if the following conditions apply:

- The transaction is the first sale of the property;
- The home has been granted a certificate to show it has zero carbon emissions from all energy use in the home over a year;
- The purchase price is £500,000 or less.

If the purchase price is more than £500,000, the SDLT will be reduced by £15,000.

11. Commercial property

Letting commercial properties can involve less management than residential lets for the following reasons:

- The leases tend to be drawn up for longer periods, so there is less turnover of tenants;
- The tenant is normally responsible for repairs, renovation and insurance.

Pension schemes

Pension schemes can invest directly in commercial property or in trusts or funds that hold a range of properties, such as Real Estate Investment Trusts (REITs). You can use your own self-invested pension plan (SIPP) to purchase a commercial property, which may be let to your business. The SIPP can borrow up to 50% of its net assets to make the purchase, but expert advice will be required for such a transaction. Residential property cannot be placed in a SIPP.

VAT

The VAT issues concerning commercial property can be quite complicated, for example:

- The purchase price of a building may or may not have VAT attached, depending on the age of the building and whether the previous owner has made what is called an option to tax election;
- Where the building costs over £250,000, the capital goods scheme may restrict the VAT that can be reclaimed if the building is sold within 10 years.

Top Tip

Take expert advice on VAT matters whenever you consider a lease or purchase of commercial property.

SDLT

Stamp Duty Land Tax applies at the following rates for commercial properties:

Freehold property value	Rate of SDLT on full cost
Up to £150,000	Nil
£150,001 to £250,000	1%
£250,001 to £500,000	3%
over £500,000	4%

The threshold at which SDLT starts to apply for commercial property is higher than for residential property but commercial property tends to be more expensive. SDLT also applies to rents, where those rents are quite substantial or the lease is long term, both of which will tend to apply to commercial letting rather than to residential lets.

Top Tip

The formula for calculating the SDLT due on rents payable under leases is complicated, but there are a number of interactive tools on the HMRC Stamp Office website to help you: <http://www.hmrc.gov.uk/sdlt/calculate/calculators.htm>

12. Distressed property

If you are inclined to rescue dilapidated properties and spend time and money renovating them for sale or rent, you may be able to take advantage of a number of special tax reliefs.

Dwellings to be combined or split

Your builder may be able to charge you VAT at only 5% if you are converting a building to a different number of dwellings or converting a commercial building into a residential one. For instance the conversion of a large house into three flats should qualify for the reduced 5% VAT as there was one dwelling before the conversion and three afterwards. However, the transformation of a pub with a flat above it into one large house must be charged at the full standard VAT rate as there is one dwelling before conversion (the flat) and one afterwards (the house).



Warning

The VAT law is very complicated so it is best to ask your builder to get a ruling in writing from the VAT office of HM Revenue and Customs before the work starts.

Homes to be renovated

The 5% rate of VAT can also apply where the number of dwellings in the building does not alter but the property has been empty for at least two years before the work begins. This reduced rate of VAT applies to building materials used in the renovation, but not to the labour costs.



Warning

Items installed as part of the renovation that are not building materials will not qualify for the reduced rate, e.g. carpets and appliances.

Empty means not lived in, but if the property has been used for storage it counts as having been empty.

Top Tip

Collect evidence that the building was unoccupied for at least two years. A letter from the local council Empty Properties Officer may suffice.

If the building becomes occupied before the renovations are completed the occupier must be the person who acquired the property either solely or jointly, and the person who is the customer for the renovation services. Also the renovations must be completed within **one year of** acquisition of the property.

Listed buildings

VAT is charged at the zero rate on the approved alteration or enlargement of a listed residential building. Listed building consent will be needed from the appropriate planning authority for the alteration prior to the commencement of the work. If consent is not granted and the alterations are carried out, the VAT on the work will be charged at the standard rate as it will not be 'approved'.

Work on repairs or maintenance rather than alterations is charged at the standard rate even if the work has been included in a listed building consent.

Top Tip

- Listed building consent can be very general so provide plans and estimates at the time consent is applied for to prove that the consent covered the work in question.
- Retain evidence that the work done required consent to be given.
- If the job expands or changes apply for consent to cover the changed work.

Flats above commercial premises

If you own a property that was built before 1980, which is used for a commercial purpose on the ground or lower floors, you may be able to claim a 100% capital allowance for converting unused space on the upper floors into flats. The flats created must be quite modest, with no more than four rooms and have access separate from the commercial area below.

There are a number of other strict conditions which may limit the usefulness of this tax relief which is due to be withdrawn in 2012. In particular this tax allowance cannot be claimed for:

- Conversion of warehouses into penthouse flats;
- Creating bed-sits with shared bathroom facilities;
- Creating a 'granny flat' in part of a larger house;
- The residential part of a larger project, to, say, refit the whole building or precinct;
- Converting a building designed as wholly retail or office premises into flats.

Top Tip

- The person who owns or leases the building should incur the expenditure.
- The flats need to be held for seven years or more after conversion, or the tax allowance will be clawed back.

Renovation of business premises

This is a similar tax allowance to that which applies to the renovation of flats above commercial premises (see above). You can claim a 100% allowance for the capital costs of renovating an empty property to bring it back into use for business purposes, if the following conditions apply:

- The expenditure is incurred after 10 April 2007 and before 11 April 2012;
- The property is situated in a designated assisted area, or in Northern Ireland;
- The property has been unused for at least 12 months before work commences;
- When last used, the property must have been used for a trade or profession or as offices, but not as a dwelling.

There are a number of excluded trades for which the empty buildings will not qualify even if they are situated in an assisted area; these include ship building, fishing and the coal industry.

13. Summary

We appreciate that finding the best buy to let mortgage to suit you has become more complex. That means the role of a mortgage adviser is becoming more important than ever, and with today's lower interest rates, you'll want to make sure you are on the best mortgage deal possible.

Buy to let deals to suit you

Whether you are looking for ways to save money by remortgaging your existing loans or looking to purchase additional property, contact your adviser who will have access to a range of buy to let mortgages by searching the whole market. This means we can get you the right deal so ultimately you receive the best returns from your investment. It certainly makes sense to go direct to a mortgage broker, rather than direct to a specific lender, as you'll get much more choice.

Simple and straightforward

Advisers will help you plan your portfolio by understanding your strategy both now and in the future. They'll look at both your aspirations and exit strategy – then they'll work out a mortgage payment plan designed for individual needs. They'll also take care of all the paperwork for you.

To get plans moving, contact your local adviser today.

Contact details are on the attached business card.

Disclaimer

1. Please note that this guide is intended as general guidance only for individual readers and does NOT constitute accountancy, tax, investment or other professional advice. Mortgage Advice Bureau accepts no responsibility or liability for loss that may arise from reliance on information contained in this guide.
2. Please note that tax legislation, the law and practices by the UK Government and tax authorities are constantly changing and the information contained in this guide is only correct as at the date of publication.
3. This guide only covers UK taxation, foreign tax implications are beyond the scope of this guide.
4. Please note that Mortgage Advice Bureau has relied wholly on the expertise of the author in the preparation of the content of this guide. The author is not an employee of Mortgage Advice Bureau but has been selected by Mortgage Advice Bureau using reasonable care and skill to write the content of this guide.

Details correct as at September 2011.

Remortgaging may reduce your monthly payments but you may have to pay an early repayment charge to your existing lender.

There is no guarantee that it will be possible to arrange continuous letting of the property, nor that rental income will be sufficient to meet the cost of the mortgage.

Your property may be repossessed if you do not keep up repayments on your mortgage.

A fee of up to 1% of the mortgage amount may be charged depending on individual circumstances. A typical fee is £95. enquiries@mab.org.uk

