

technical factsheet 139

Income from Property

This is a brief summary of the taxation implications of income from property.

Rent a room relief – income tax

Where a home owner lets part of his main residence to a lodger, rental income is only chargeable to income tax to the extent that it exceeds £4,250. There is no limit to the number of rooms, but only £4,250 in total is exempt. This figure has remained unchanged since 1997-98. HMRC state that income from property that is within the total exemption is to be disregarded for tax return purposes.

Buy to Let

Letting property, a 'business of letting' for income tax purposes, is not a trade, but is treated as one for many tax purposes.

The income tax rules in Section 272(2) ITTOIA 2005 apply; these include the 'wholly and exclusively' rule. Expenses available include:

- advertising for tenants
- rent collection costs
- bad debts
- agents' charges for management
- accountancy fees for accounts preparation
- repairs to property
- 10% wear and tear allowance (i.e. 10% of net rental income, excluding rates, water rates and council tax if paid by the landlord) etc will be deductible for income tax.

Capital expenditure is not allowable, neither are capital allowances on plant installed in the property (except for furnished holiday letting).

Interest paid

Interest paid on loans used to buy the land or property used in the rental business, for improvements or alterations, repairs etc. will be deductible, together with incidental costs of arranging loan finance, as Section 272 ITTOIA 2005 imports the rule applicable to a trade.

Example

Fred bought a property for £200,000 with a £150,000 buy to let mortgage. The property is now worth £300,000 and Fred is now able to borrow a further £50,000 on his buy to let mortgage.

Fred draws out £50,000 from his capital account. The interest on the whole £200,000 is deductible from his letting profits as the capital account is not overdrawn.

He is replacing his original capital with tax-deductible borrowings.

Example

Fred shows increased value in his balance sheet and borrowed £100,000, total borrowing now £250,000. He withdrew £50,000 as before and used £50,000 to acquire further rental properties. Interest on the whole £250,000 would be deductible, as his capital account would be overdrawn, but the excess was used for the purposes of the 'business of letting' and would meet the 'wholly and exclusively' test.

Balance sheet after revaluation

		£
Mortgage		250,000
Revaluation reserve		100,000
Capital b/f	£50,000	
Drawings	<u>£100,000</u>	<u>(50,000)</u>
		<u>300,000</u>
Property		<u>300,000</u>

Using the home loan

People often use the equity in their own home to fund buy to let properties. It does not matter what the borrowing is secured upon, provided the interest is incurred wholly and exclusively for the purposes of the business of letting.

Joint accounts

It may be the case that the buy to let property is in one person's name but the main residence is in joint names. HMRC usually normally allow relief for the home funded interest provided the letting business bears the cost of the interest. It is advisable to ensure that money passes from the business account to the joint account to fund the interest.

Example

Mr George has a main residence valued at £800,000 with a mortgage of £40,000. He decides to invest in a buy to let property and funds the £60,000 deposit by borrowing against his home, increasing the mortgage to £100,000. The mortgage is a flexible account and has no rigid schedule of repayments.

The account balance fluctuates between £90,000 and £105,000 each month. There will be no restriction on the interest relating to the £60,000 buy to let element as this is deemed to remain intact, under Section 29 ITTOIA 2005.

Example

Two years later Mr George receives a bonus at work and receives £40,000, which he pays into his account at a time when the balance was £80,000.

Now that the balance has fallen below £60,000, there will be a permanent restriction on the interest allowable, so interest will only be given on interest on £40,000 in future (unless further investments in rental properties are made or the property is revalued).

These rules are general to the computation of profits for a rental business for either individuals or corporate bodies and relate to the rules that have replaced S 354 ICTA 1988.

When dealing with partnerships and limited companies, the rules relating to S 359 'Loan to buy machinery and plant', S360 'Loan to buy interest in close company' and S362 'Loan to buy interest in partnership' still apply.

Losses

Losses can only be set off against other income from UK property (if they are losses from UK property) or overseas property if they arise from overseas property. The two exceptions are losses arising from capital allowances which can be offset against other income or furnished lettings losses(see below).

Furnished Holiday Letting

Furnished holiday lets are treated as a business of letting, but certain advantages, for example loss relief provisions and capital gains tax reliefs are more advantageous than for ordinary letting.

To qualify the property must be let on a commercial basis and with a view to profit.

In any tax year:

- the property must be available for letting to the general public not less than 140 days in the tax year; and
- the property must be actually let to members of the public for a period of 70 days in the tax year.

Letting to any person for a period of more than 31 days does not count towards the 70 days, but is a period of 'longer occupation'.

HMRC's Property Income Manual acknowledges that close season lets may produce no profit, but normally contribute to the cost of maintaining the property.

Even when friends and family are charged a reduced rent as long as following their occupations there would remain an excess of income over expenditure, then the time that they are present would count towards the qualifying 70 days.

Qualification as furnished holiday let is important as the total mortgage interest for the tax year is allowable, not just a proportion.

Holiday accommodation is standard rated for VAT. If the owner has a significant portfolio of properties, his total turnover may exceed the compulsory registration threshold.

Where the property is situated in another EC country, local VAT must be charged, if that country's threshold is exceeded. Spain, for example, has no exempt threshold.

Losses

Losses on furnished holiday letting are available against general income. They should therefore be included on the land and buildings supplement of the self assessment tax return.

Entrepreneurs' relief

Entrepreneurs' relief is available to individuals, trustees and partnerships for disposals on or after 6 April 2008. Prior to that, business taper relief was available. It is not available to companies, but shares in a qualifying company may qualify for the relief, if owned by an individual etc.

Entrepreneurs' relief is not normally given for residential property, but is available for furnished holiday let properties.

Note:

1. HMRC announced on 22 April 2009 that all treatment may also apply to properties within the European Economic Area (EEA), provided that the qualifying conditions are met.
2. The special tax treatment of furnished holiday lettings was due to cease on 5 April 2010. However, this proposal was reversed on its passage through parliament and so the favourable tax treatment afforded to furnished holiday lettings remains.