

Tax Aspects of Property Investment

Income arising from land and buildings is generally treated as investment income unless it is from furnished holiday lettings or from property development or provision of services such as hotels and guest houses, in which case it would be classified as trading income.

From an accounting and tax point of view, all rental income (except furnished holiday lettings) is treated together as from one *Schedule A business*, regardless of the terms of letting. Profits and losses are calculated using the same general accounting rules as for trading, including accruals to cover the timing differences of rent or expenses in advance or arrears. A cash basis is allowable for total annual rents under £15,000.

Allowable expenses

Expenses allowable in calculating income include interest incurred on loans used towards the purchase of the property (adjusted for any part private use), business rates or council tax, rent payable to a higher landlord, insurance and management expenses including advertising for tenants, and maintenance, repairs and redecorations. Management expenses can also include costs of travelling exclusively for property letting purposes.

Expenses on improving the property (such as extensions or installing central heating) and those which were necessary to bring newly acquired property to a state where it could actually be brought into use all form part of the capital cost of the property.

Allowances for equipment

In general it is not possible to claim capital allowances for plant and machinery in a dwelling house. By concession, an allowance is available to cover the wear and tear on items such as suites, beds, carpets, curtains, linen, crockery, cutlery, cookers, washing machines and dishwashers. For such items it is possible to claim either the cost of replacement (but not the original purchase) or instead to claim a global annual wear and tear allowance of 10% of the rents received on furnished lettings (excluding items such as council tax and water rates which would normally be payable by the tenant). In addition to this 10% allowance it is also possible to claim a deduction for the cost of renewal of fixtures such as baths, washbasins and toilets.

For commercial properties, capital allowances may be claimed in respect of plant and machinery supplied by the landlord. The landlord may also claim industrial or agricultural buildings allowance, where appropriate for the business of the tenant. The allowances are calculated in the same way as for trades, and are deducted as an expense.

Rent a Room relief

Owner occupiers and tenants who let furnished rooms in their only or main residence may claim rent-a-room relief. This is available both for Schedule A businesses and where substantial services are also provided, for instance guest houses and bed and breakfast businesses where the rent would be chargeable as trading income. No tax is payable for gross annual rents (for accommodation and related goods and services) up to £4,250 (£2,125 each for a couple). Where rents exceed £4,250 you can choose to pay tax on the excess, or on the total rent less expenses in the normal way.

Furnished holiday lettings

Schedule A businesses which comply with the relevant conditions can qualify for some very important tax concessions. Furnished holiday lettings are treated for tax purposes as if they were trades. Unlike other domestic lettings, the expenses can include capital allowances on furniture and kitchen equipment. The income counts as *relevant earnings* for pension contribution purposes, and there are other advantages relating to the disposal of such properties (see below).

Other considerations

Where there is mixed use of property, business rates may well be payable as well as council tax, unless the business use does not materially detract from the private use. Non-domestic properties, such as commercial premises and boarding houses, are in any event subject to business rates. Provision of bed and breakfast in your own house is not caught if there are no more than six guests. Staff accommodation is counted as domestic and therefore subject to council tax.

Value Added Tax on land and buildings is a complicated area. Generally sales of commercial buildings less than three years old are standard rated, sales of new residential properties are zero rated and most other sales or leases are exempt. The VAT provisions on property letting are particularly complex.

There is no charge to Stamp Duty Land Tax (SDLT) if residential property is purchased for £125,000 (£150,000 in Disadvantaged Areas; £250,000 for first time buyers) or less, or on non-residential property for £150,000 or less. Property which is not exempt is charged at a rate of 1%, 3%, 4% or 5% as appropriate.

Special incentives

Support for disadvantaged areas is actively being encouraged, and investment in Enterprise Zone properties can be extremely tax efficient, so long as the prices are not artificially inflated. However the Enterprise Zone allowances will be withdrawn in 2011.

Landlords installing loft insulation, floor insulation, cavity wall insulation, hot water system insulation and draught proofing up to 5 April 2015 may claim an income tax deduction of up to £1,500 per property (Landlord's Energy Saving Allowance).

Initial allowances of up to 100% are available for expenditure by property owners and occupiers on the renovation or conversion of empty or underused space above qualifying shops and other commercial premises to provide residential flats for leases of not more than five years.

Disposal of properties

If the purchase and sale of properties amounts to a trade then, of course, property disposals will be taxed as income in the normal way.

In all other cases, disposals will be subject to the normal rules for the calculation of capital gains. Most let properties will not qualify for Entrepreneurs' Relief; however, furnished holiday lettings count as business assets and so the relief will be available.

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The situation may be complicated where a principal private residence has been let other than during the last three years of ownership or during a period of allowable absence. In these circumstances, the associated lettings relief of up to £40,000 could be brought into play.

Furnished holiday lettings may qualify for rollover relief or gifts relief. In some circumstances they may also trigger inheritance tax business property relief, in which case they would pass free of any inheritance tax charge.

Whilst some of the principles of property taxation may seem relatively straightforward, there are many traps for the unwary, and professional help is definitely advisable. Please contact us for more information.