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The Landlord Guide to Taxes

Guide to Stamp Duty Land Tax

Despite fears over property prices in the wake of the UK's recent Brexit, property prices remain high and some cities, such as Liverpool and Bristol, are even outstripping London for their rate of growth. This continues to make it very difficult for first time buyers to get on the housing ladder. Much of this has been blamed on the explosion in the buy-to-let property market which is something the new stamp duty rates, that came into effect in April 2016, hope to address.

As of 1st April 2016, anyone purchasing an additional property will be liable to an increased rate of stamp duty of 3%. The changes are an attempt by the Government to curb the buy-to-let property market: whose growth is seen as pushing up property prices and making it a lot harder for first time buyers to get on the property ladder. The tax duty rises will be followed by reductions in mortgage interest relief in April 2017, something that is also likely to hit landlords.

The new rates will apply to all properties, including holiday homes, off-plan purchases and buildings in the process of being converted into a dwelling. Commercial properties, however, won't be affected.

New Stamp Duty Tax Rates

Stamp duty currently falls into bands based on the value of your existing residential property. Up to £125k of this is at a zero rate, but increases to 2% on property values between £125k - £250k. If you were to buy a second property this initial zero rate band would be set at 3%, with anything between £125k - £250k incurring 5% in stamp duty.

Below is a table of all banding, for both existing residential rates and additional properties.

Band	Existing Residential Rate	Additional Property Rates
£0 - £125k	**0%**	**3%**
£125k - £250k	**2%**	**5%**
£250k - £925k	**5%**	**8%**
£925k - £1.5m	**10%**	**13%**
£1.5m +	**12%**	**15%**

Bear in mind that these rates are charged on a tiered basis so you are only paying it on value that falls above the previous band, but below the next band. So for example if you purchased an additional property worth £500k you would pay 3% on the first £125k, 5% on the property value between £125k and £250k and 8% on the remaining property value above £250k.

This has been worked out below and compared to the stamp duty rates on a single property.

Existing Residential Rate

0% on the first £125,000 = £0 3% on the next £125,000 to £250,000 = £3750 5% on the final £250,000 = £12,500

= £16,250

Additional Property Rates

3% on the first £125,000 = £3,750 5% on the next £125,000 to £250,000 = £6250 8% on the final £250,000 = £20,000

= £30,000

Who is affected by the new Stamp Duty Rates?

Although the new stamp duty rises were designed specifically to hit buy-to-let landlords, they cover anyone buying a second home. So if you have one property and are replacing it then the new stamp duty rates won't apply. If you have more than one property, then the rates will apply to all additional properties bought unless you are replacing your main residence.

If you are buying a new main residence and you have not yet sold your previous main residence, the new rates will apply but you will be eligible for a refund up to 36 months after purchase. Caravans, mobile homes and houseboats are exempt from the rules, as are properties worth less than £40,000. Social landlords and registered charities will also be exempt from the new stamp duty rates.

Separated married couples who have not yet divorced will also be exempt from the rules and not treated as one unit when purchasing a property.

Finally, if you inherit 50% or less of a property 36 months prior to the transaction date of a property purchase, you will not be liable to the new rules either: as this will not be considered an additional property.

Are there ways to reduce the Stamp Duty surcharge?

There are very few opportunities for relief on the new stamp duty rates. As mentioned, main residences sold within 36 months after the purchase of a new main residence will be liable for a refund of new stamp duty. This means 'flipping' your main residence to your new property won't help you avoid the new rates as you will still have to sell the first property to get a refund.

There are some instances where the new stamp duty rates can be avoided. These include purchasing more than one property (and profit from a rental income), in which case the average property price will be used; something that can significantly reduce the final stamp duty bill. Purchases of mixed use properties (i.e. shops and flats) may also incur lower rates.

Tax changes: mortgage interest relief

As well as the changes to Stamp Duty tax, landlords, as of April 2017, will be unable to balance their buy-to-let mortgage interest payments against tax. Osborne labelled mortgage interest relief 'unfair' because, he said, landlords were able claim the relief while private home owners were not. This has caused a rumble for landlords - forcing some property owners to sell up immediately. Regardless of these changes, only "19% of existing landlords plan to sell some or all of their portfolios in response to the tax changes."

Whether landlords are looking to set up through letting agents or going it alone, it has not seen landlords back down from the current tax changes. Government has even claimed that property "is still a very attractive investment opportunity" regardless of all the changes.

It is not all doom and gloom with the new changes, as new furnishings will "no longer be depreciated at a flat rate of 10% per annum". Ultimately, furniture charges can now be deducted

against the overall investment for the year. These changes may seem daunting, but with slight positives. It means that landlords are able to see decreases in taxes such as mortgage interest tax, between the years of 2017 to 2020.

Landlords are being urged to act now so they can limit the amount of additional tax they'll have to pay from April 2017 when changes to landlords' income tax are introduced.

The government has at long last published guidance on how the changes, announced by former Chancellor George Osborne in 2015, will work.

From April 2017, landlords will be taxed on their rental income before the deduction of mortgage or loan interest payments. This will be phased in over a 4 year period;

Tax Year	Percentage of finance costs deductible from rental income	Percentage of basic rate tax reduction
2017 to 2018	**75%**	**25%**
2018 to 2019	**50%**	**50%**
2019 to 2020	**25%**	**75%**
2020 to 2021	**0%**	**100%**

How will this impact tax credits and other benefits?

Landlords will then receive a tax credit for the interest payments, but for higher rate tax payers this will be gradually reduced down to the basic rate of income tax by 2020.

What this means is that many landlords with loans will pay more tax and, if you're currently a lower rate tax payer, you might be bumped into the higher tax bracket and lose some means-tested benefits, including child benefit, too.

There's been a lot of talk since the changes were announced of landlords pushing up rents to compensate for the additional tax, but this might not be realistic in areas where the market can't sustain a rise.

Tax advice to help you minimize the effect of the new tax rates

There are other steps you might be able to take to avoid or reduce the additional tax:

Consider setting up a company to buy property as these will still be allowed to claim full tax relief on interest payments after April 2017. However, you should take advice from a tax consultant before going down this route as it might not be the best option for you, depending on your individual circumstances.

If you already own a Buy-To-Let as a private individual, you could transfer it to a limited company but you might have to pay capital gains tax on the difference between the original purchase price and its current value as you will be effectively 'selling' it to the SPV (Special Purpose Vehicles). The company will have to pay stamp duty too as it is 'buying' the property from you.

Note: if you are switching ownership of a property you might have to change your mortgage provider: and company mortgages are harder to find and tend to charge a higher interest rate.

If you're a higher rate or additional rate tax payer, or these changes risk tipping you into the higher tax bracket, and you own the property with a lower rate tax payer, you can transfer more of the rent to them to limit your overall tax bill.

Married couples who jointly own rental property will need to obtain a Form 17 from HMRC to "declare their beneficial interest in the joint property income" if they want to avoid automatically being taxed on a 50:50 split.

However, changing the split could have implications on other taxes, such as capital gains tax and inheritance tax, so you should take advice from a tax expert beforehand.

Switch to fully furnished holiday lettings. These are exempt from the tax changes so you can still claim full mortgage interest tax relief. In order for your property to qualify as a holiday let, it must be available to let for at least 210 days a year and it must be actually let for at least 105.

Obviously, this only makes sense in areas where there is high demand for short-term or holiday accommodation.

Make sure you check with your local authority to see if any special rules apply to holiday lets in your area as you might need planning permission.

The second tax increase for landlords is the ending of tax relief on dividends. This will affect any landlord who operates their buy-to-let portfolio through a company. Many do this because, until now, it's been a way to reduce their personal tax liability.

Most paid themselves both via a combination of basic salary and dividends. That way, as long as they didn't exceed their personal tax threshold of £10,800 then they didn't pay tax at all (or much less than normal) on their income.

This meant that a director of Property Company could, for example, reduce their personal tax liability from 40% to approximately 15%.

But this loophole has now been closed. Instead, the first £5,000 of income from dividends is tax free while payments over that will be taxed. There will be three bands, 7.5%, 32.5% and 38.1% depending on how much the dividends you pay yourself are.

Tax returns

A gentle warning to all landlords – beware the power of the receipt. These easily-lost slips of paper have a vital role in reducing the amount of tax you pay each year, but not in the way you think.

Making Correct Expense Claims

The trick is to allocate each expense to the correct type of tax claim. The folks at HMRC have made it clear: each expense must be claimed either against 'income' or 'capital' – an important differentiation.

Income Expenses

HMRC allow landlords to offset the costs of running a buy-to-let property against their tax bill each year. This means repairs – for example interior or exterior painting; damp rot treatment; replacing broken windows and replacing roof tiles blown off during a storm and any fees. In other words, those incurred in the day-to-day management of the property.

Capital Expenses

Capital expenses, on the other hand, is really for the big items – such as the cost of buying the property or any improvement you make to it such as adding a dormer extension or converting a garage into a bedroom. These are expenses that can't be claimed against income tax but can be deducted from your Capital Gains Tax bill when you sell the property.

Avoiding Trouble with HMRC

Landlords who get into trouble with the HMRC tend to be those whose repairs cross the line and become improvements. For example, if a bathroom radiator needs replacing you must substitute it with a similar model. Putting in a gleaming, upmarket chrome towel rail is not a valid expense to claim against your buy-to-let income. Or if some guttering falls off the side of the property – don't think you can replace all the guttering and claim it as a repair. In both cases these are capital improvements and not related to income.

Flipping between Wear and Tear and Renewal

You cannot claim for both renewal and wear and tear – for example, if you've already claimed your 'wear and tear' allowance, you cannot then claim for a new bed. HMRC aren't keen on landlords switching between claiming renewals against their income one year and then switching to 'wear and tear' the next, either.

So if you have a portfolio that's full of student lets or other types of property that have a high turnover of tenants, low rent and heavy use, then it's probably better to not claim the 10% wear and tear allowance and claim for renewals instead.

If you have a property and you have the sort of tenants who stay for a year or two and you only need the occasional expense, like a lick of paint or replacement white goods, then it's better to claim wear and tear. You need to plan ahead based on your portfolio.

Wear and Tear Tax Allowance

Landlords with fully furnished properties are also given a **'wear and tear'** tax allowance to cover the cost of replacing worn out or broken pieces of furniture, appliances and kitchenware.

This means that, assuming you have provided enough **essential furniture in your property** – including beds, a sofa, dining table, chairs and appliances - you can knock 10% off your rental income (minus any utility bills you've included in the rent) before tax.

The 'wear and tear' allowance is only available for rental income earned up to April 2017, so the last chance to **claim it is in your 2015/16 tax return**, which should have been submitted on paper by 31 October 2016, or by 31 January 2017 if you do it online.

For income earned after April 2017, the 'wear and tear' allowance has been abolished, but landlords will still be able to deduct the cost of replacing items of furniture (but not the cost of buying the original items). You'll have to keep receipts as proof of your expenditure. Also, you'll only be able to claim the cost of a like-for-like item, not an upgrade.

Self-assessment tax return deadlines 2017

To send your paper self assessment: 31st October 2017 (www.gov.uk/self-assessment-tax-returns).

To fill your tax return online: Midnight 31st January 2018 (www.gov.uk/log-in-file-self-assessment-tax-return).

Make sure you take full advantage of deductible costs when filling in your landlord self-assessment tax return. Allowable expenses for tax deduction include anything you spent money on which was related to the day-to-day running of your buy-to-let property.

Other Expenses Landlords can Claim Tax Allowance for

Other expenses that can be deducted from your pre-tax income include:

Letting agent fees

Any money you spend on advertising, either with a high street agent or an online agent, can be deducted. This includes administration fees, such as the cost of tenancy agreements and deposit protection if you pay for this separately.

Legal fees

You can claim legal fees for lets of a year or less, as long as the fees are of a revenue nature and relate to your rental business (not the purchase of property, for example, which is capital expenditure). This also applies to renewing a lease that is for less than 50 years.

Accountants' and solicitors' fees

Accountancy expenses from preparing rental business accounts and agreeing taxation liabilities can be deducted as well as solicitors' and court fees for evicting a tenant.

Insurance

This includes buildings and contents insurance, as well as landlord and rent guarantee insurance.

Maintenance and repairs

You can claim for property repairs or maintenance during or between tenancies. Be aware, you cannot claim for improving the property; it must be like for like.

Utility bills

Expenses related to gas, water, electricity and broadband are all allowable deductions.

Charges

Charges related to ground rent, cleaning, gardening or service charges payable to a freeholder can be deducted, along with council tax.

Direct costs

You can also claim for any direct costs you incur related to your letting of the property including phone calls, stationary and mileage.

Differentiating Between Repairs and Improvements

When it comes to maintenance, repairs are tax deductible but not improvements, so you can claim the cost of replacing rotten windows, for example, but not the cost of an extension. Improvements are classed as capital expenditure and should be deducted instead from the capital gains tax you have to pay on any profit you make when you sell your property.

Admittedly, the difference between a "repair" and "improvement" is something of a grey area. Basically, if you replace like-with-like, it's considered a "repair", but if you replace an item with something more fancy, it's an "improvement". For example, if you rip out an old kitchen and replace it with the same number of units and similar appliances, HMRC might allow you to claim the cost on your income tax return, but if you add more units and/or upgrade the appliances, these elements should not be deducted from your income tax bill.

Running Your Rental Business

You can deduct the cost of running your rental business from your pre-tax income. This could include office costs, travel costs and phone bills, but only those that have been incurred solely for business purposes.

Lots of landlords manage their rental property from their homes, for which HMRC has a simple process for working out your tax allowance, which you can find at www.gov.uk/simpler-income-tax-simplified-expenses/working-from-home.

If you make a loss on your rental business, you can't deduct this from any other taxable earnings, unless you're offering holiday lets. However, you can carry forward the loss and deduct this from your future rental income before working out the tax due.

As you can see, taxation is quite a complicated issue, and this piece is intended for general guidance only. We recommend that you take further advice from a qualified accountant. Remember, their fees will be tax deductible!