Umesh Modi

Property investment - buy to let

The stock market has had its ups and downs. Add to this the serious loss of public confidence in pension funds as a means of saving for the future and it is not surprising investors have looked elsewhere.* Umesh Modi *explains…

The UK property market, whilst cyclical, has proved over the long-term to be a very successful investment. This has resulted in a massive expansion in the buy-to-let sector.

Buy-to-let involves investing in property with the expectation of capital growth with the rental income from tenants covering the mortgage costs and any outgoings.

However, the gross return from buy-to-let properties - ie the rent received less costs such as letting fees, maintenance, service charges and insurance - is no longer as attractive as it once was. Investors need to take a view on the likelihood of capital appreciation exceeding inflation.

Factors to consider

Do

- think of your investment as medium to long-term.
- research the local market.
- do your sums carefully.
- consider decorating to a high standard to attract tenants quickly.

Don't

- purchase anything with serious maintenance problems.
- think that friends and relatives can look after the letting for you - you're probably better off with a full management service.
- cut corners with tenancy agreements and other legal documentation.

Which property?

Investing in a buy to let property is not the same as buying your own home. You may wish to get an agent to advise you of the local market for rented property. Is there a demand for say, two bedroom flats or four bedroom houses or properties close to schools or transport links? An agent will also be able to advise you of the standard of decoration and furnishings which are expected to get a quick let.

Agents

Letting property can be very time consuming and inconvenient. Tenants will expect a quick solution if the central heating breaks down over the bank holiday weekend! Also do you want to advertise the property yourself and show around prospective tenants? An agent will be able to deal with all of this for you.

Tenancy agreements

This important document will ensure that the legal position is clear.

Taxation

When buying to let, taxation aspects must be considered.

Tax on rental income

Income tax will be payable on the rents received after deducting allowable expenses. Currently allowable expenses include mortgage interest, repairs, agent's letting fees and an allowance for furnishings. Changes were announced in the previous budget which impact on the allowable expenses for landlords.

Restriction loan interest relief for 'buy to let' landlords

New rules have been introduced which restrict the amount of income tax relief landlords can get on residential property finance costs to the basic rate of income tax. Finance costs include mortgage interest, interest on loans to buy furnishings and fees incurred when taking out or repaying

Umesh Modi

mortgages or loans. No relief is available for capital repayments of a mortgage or loan.

Landlords will no longer be able to deduct all of their finance costs from their property income. They will instead receive a basic rate reduction from their income tax liability for their finance costs. To give landlords time to adjust, the change will be introduced gradually from April 2017, over four years. The restriction in the relief will be phased in as follows:

- in 2017/18, the deduction from property income will be restricted to 75% of finance costs, with the remaining 25% being available as a basic rate tax reduction.
- in 2018/19, 50% finance costs deduction and 50% given as a basic rate tax reduction.
- in 2019/20, 25% finance costs deduction and 75% given as a basic rate tax reduction.
- from 2020/21, all financing costs incurred by a landlord will be given as a basic rate tax reduction.

This restriction will not apply to landlords of furnished holiday lettings.

Replacement of furnishings

A new relief enables all landlords of residential dwelling houses to deduct the costs they actually incur on replacing furnishings, appliances and kitchenware in the property. The relief is available for expenditure incurred on or after 1 April 2016 for corporation tax and on or after 6 April 2016 for income tax.

This measure gives relief for the cost of replacing furnishings to a wider range of property businesses as previously there was no tax relief for the replacement of furnishings in partly furnished or unfurnished properties.

Examples of eligible capital expenditure are:

- furniture.
- furnishings.
- appliances (including white goods).
- Kitchenware.

But would exclude items which are fixtures.

However, the relief is limited to the cost of an equivalent item if there is an improvement on the old item. The deduction will not be available for furnished holiday lettings or where rent-a-room relief is claimed.

The end of wear and tear allowances

The 10% wear and tear allowance which was available to landlords of fully furnished properties has been abolished from April 2016.

Tax on sale

Capital gains tax (CGT) will be payable on the eventual sale of the property. The tax will be charged on the disposal proceeds less the original cost of the property, certain legal costs and any capital improvements made to the property. This gain may be further reduced by any annual exemption available.

CGT is generally charged at 10%, within the basic rate and 20% for higher rates. However 18% and 28% rates apply to chargeable gains arising on the disposal of residential property that does not qualify for private residence relief.

CGT is payable on 31 January after the end of the tax year in which the gain is made.

From April 2019, a payment on account of any CGT due on the disposal of residential property will be required to be made within 30 days of the completion of the disposal. This will not affect gains on properties which are not liable for CGT due to Private Residence Relief.

Student lettings

Buy to let may make sense if you have children at college or university. It is important that the arrangement is structured correctly. The student should purchase the property (with the parent acting as guarantor on the mortgage). There are several advantages to this arrangement.

Advantages

This is a cost-effective way of providing your child with somewhere decent to live.

Rental income on letting spare rooms to other students should be sufficient to cover the mortgage repayments from a cash flow perspective.

As long as the property is the child's only property it should be exempt from CGT on its eventual sale as it will be regarded as their main residence.

The amount of rental income chargeable to income tax is reduced by a deduction known as 'rent a room relief' (£7,500 from 6 April 2016). In this situation, no expenses are tax deductible. Alternatively, expenses can be deducted from income under normal letting rules where this is more beneficial.

Source: Practice Track

This article is based on current legislation and practice and is for guidance only. Specific professional advice should be taken before acting on matters mentioned here. Umesh Modi, BA ACA, is a chartered accountant and tax adviser and a partner at Silver Levene LLP. He can be contacted on 020 7383 3200 or umesh.modi@silverlevene.co.uk