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The Accidental Landlord

In the current housing market, many people want to buy a new home but are unable to sell their old one at the right price. If they decide to let the old property out, they have joined the growing band of "accidental landlords".

Interest on loans

You cannot claim tax relief for the interest on a loan to buy a property you live in, but once you let it out, the interest becomes an allowable deduction from the rent you receive.

If there is any equity in the property at the time you start to let it, then if you are able to release that equity by remortgaging the property, all the interest can be deducted from the rent you receive.

It does not matter what you use this released equity for – you might use it as a deposit on your new home, for example, or even, if there is enough equity available, to fund the entire purchase of the new property.

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MITCHELLS GRIEVSON CHARTERED ACCOUNTANTS

Our mission is to always add value whatever we do for you. We will always carry out our work with the aim of adding value to your business.

This newsletter is designed to ensure you are kept up to date with the latest tax advice. This ensures you are provided with the most up to date information to enable you to stay ahead of the game.

As tax advisers, our objective is to work closely with you to ensure you pay the minimum tax required by law. We will help you understand the tax implications of your actions, in order that you can plan ahead and conduct your affairs in the most tax efficient way.

Please do not hesitate to contact us if you have any queries.

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Mitchells Grievson
Kensington House, 3 Kensington
Bishop Auckland,
Co. Durham DL14 6HX
or
North East Business & Innovation Centre, Wearfield, Enterprise Park East, Sunderland, SR5 2TA

Email: advice@mitchells-online.com
Web: www.mitchells-online.com

Tel: 01388-662133/605785
or 0191-4175071
Fax: 01388-450746

As long as the amount of the mortgage on the old property is not greater than its market value at the point where you let it for the first time, all the interest can be deducted from the rental income for tax purposes.

Capital Gains Tax (CGT)

A gain on the sale of your "only or main residence" (OMR) is exempt from CGT, provided the property has been your OMR throughout the time you have owned it. If, however, you have let the property at some stage, some part of the gain will not qualify for the OMR exemption.

The gain is worked out on a time basis over the whole period of ownership since 1982. If you buy the property in September 1999 for £100,000, and sell it in September 2009 for £250,000, then the gain of £150,000 is deemed to have arisen at a rate of £15,000 per year. If the property was only your main residence from 9/99 to 9/04, then half the gain (from 9/04 to 9/09) will be chargeable.

There are two important reliefs available, however:

- If the property has ever been your OMR, then it is always deemed to be your OMR for the last three years of ownership. In our example, therefore, the period from September 2006 to September 2009 will also be exempt, leaving only the period from September 2004 to September 2006 chargeable to CGT
- If the property has been let as "residential accommodation" during the period when it was not your OMR, there is a further reduction in the chargeable gain. This is the lower of:

1. The gain that is exempt as your OMR – 8 times £15,000 = £120,000 in this example

2. The gain that is chargeable due to the letting - £30,000 in this case

3. £40,000 per owner of the property

In this example, therefore, the chargeable gain of £30,000 is wholly covered by the "letting exemption" and there is no CGT to pay.

In many cases, therefore, whatever the market conditions, it can make good sense from a tax point of view to embrace your status as an "accidental landlord"!

Q&A

Q.1

My partner and I have just bought our first investment property to rent out and plan to invest in further buy-to-let properties in the future. I understand that although this would constitute a 'business' for tax purposes, we will not be regarded as 'trading' and therefore would not have to register as a partnership or as self employed, nor would we have to pay Class 2 or Class 4 NI contributions.

Our bank has opened a business bank account for us; we have signed a partnership mandate and will be using a business name for the purpose of professionalism. The bank have given us a 'trading as' name; is this appropriate or is it irrelevant as long as we record our business profits on the land and property pages of the self assessment tax return?

Also, if we sell a property in the future will we be liable to income tax or CGT if we are not considered to be trading?

A.1

The Revenue make it clear in their guidance in the Property Income Manual page PIM1030 that what you have described in your question is most likely to be called 'jointly owned property' and not a 'partnership'. Consequently you should simply record your share of the rental income and rental expenses on the UK property section of the self assessment return.

If you sell a property in the future, as long as you have owned the property long enough, and received rental income from it, and are not regularly buying and selling properties, then you treat the profit on sale as a capital gain and therefore subject to capital gains tax.

Q.2

If I rent a room on an informal basis to one/ two members of my family, do I need to pay tax and if so what are the rules?

The money received will just be for bills and will not cover my mortgage payments.

A.2

If you comply with the rent-a-room rules then you don't need to pay any tax on the money received for the rooms. You can find these rules in the Revenue Property Income Manual page PIM4000 to 4060. If you don't comply with these rules it is quite likely that you will also not have any tax to pay if the money received only covers your expenses and nothing more. In this circumstance you need to make an accurate assessment of your expenses attributable purely to renting out the rooms.

Q.3

How Can I Avoid Paying Council Tax on my Empty Property?

Have you any suggestions on how to avoid paying council tax on an empty property? We have a property which we do not want to let out for various reasons, and are having to pay with only a small reduction. We do not want tenants. Can you suggest a way we could use the house without paying council tax?

A.3

There are various circumstances in which an empty property is exempt from council tax, e.g. a) Needs structural alteration / major repair,

b) Last used by a charity,

c) Empty unfurnished property for up to six months,

d) Left empty by someone in prison,

e) Left empty by someone in hospital or residential care,

f) Empty following occupier's death,

g) Empty due to occupation prohibited by law etc.

But contrary to the implication of your words, if you use the property you are more likely to be liable to council tax.

Q.4

Am I Liable for Capital Gains Tax?

I bought my flat in November 2002. I lived there for 5 years but then moved in with my fiancé in August 2007 and have rented the flat for the last 2 years. It is the only property I own.

Am I right in saying that, if I sell it within 3 years of moving out, I am not liable to pay CGT? If I keep renting the flat for longer than 3 years, when I eventually sell it, do I have to pay CGT on all the profit I have made since I bought the flat in 2002?

A.4

You are right that if you sell any time until August 2010 you are not liable to capital gains tax. If you sell after that, e.g. August 2011, then you are exempt for the last three years of ownership, as well as the period of actual occupation, so you would be liable for the period from August 2007 until August 2008, in our example. The total gain would be spread over the period November 2002 to August 2011, and the gain attributable to the period August 2007 to August 2008 only would be chargeable.

Arthur Weller
UK Tax Specialist

National Minimum Wage – New Powers and Penalties

The Employment Act 2008 came into force on 6 April 2009, and it contains a number of changes to the way in which the Minimum Wage Legislation is enforced.

The National Minimum Wage was introduced in April 1999, at a rate of £3.60 per hour. There was a "development rate" of £3 per hour for workers under 22, or for those over 22 who were starting a new job with a new employer and were doing a course of "accredited training". From 1 October 2006, the development rate was abolished for those over 22, so that all employees over 22 had to be paid the full rate. In 2004, a special rate for school leavers under 18 was introduced, set then at £3 per hour. The rates are upgraded on the first of October each year, and there are penalties for employers who fail to pay their employees at least the minimum rate. The only deductions allowed from the NMW are for accommodation – if the employee is provided with accommodation by the employer, the a maximum of £31.22 per week can be deducted from his pay in respect of this.

The current rate for the National Minimum Wage is £5.80p per hour, with a lower development rate of £4.83 for employees between 18 and 21, and a rate for school leavers under 18 of £3.57.

Failure to pay employees at these rates will now give rise to an automatic penalty of a minimum of £100 and a maximum of £5,000, and there is also a new right to prosecute offenders in the Crown Court, where unlimited penalties can be imposed for failure to pay the minimum wage, or for obstructing HM Revenue and Customs officials who are carrying out a minimum wage enquiry.

The automatic penalties are calculated on the basis of 50% of the amount of the underpayments, and those underpayments are now calculated using the current rate of the NMW, even if the underpayment arose in an earlier year when the rate was lower.

For example:

The NMW rate for the period from 1 October 2004 to 30 September 2005 was £4.85p per hour, so if an employer paid an employee only £4 per during that period, the underpayment might be £1,657.50p (85p per hour for 37.5 hours per week, times 52). Because of the change in the rules for calculating arrears, however, the calculation would be:

£1,657.50p/4.85 times 5.73 = £1,958.24p

The arrears are divided by the NMW rate at the time, then multiplied by the current NMW rate. The idea is to restore the purchasing power which the employee has missed out on by compensating him at today's rate. The employer would have to pay the £1,958.24p to the employee, and the penalty (at 50% of the arrears) would be £980.

The good news is that if the employer pays the full arrears to the employee, and half the penalty (£490), within 14 days of being served with the notice of arrears, then the other half of the penalty will be cancelled.

Tax Tips

- Do you believe in using "green" technology wherever possible? The Budget announced an extension of the categories of environmentally friendly plant and machinery qualifying for "enhanced capital allowances" at the 100% rate – see Business Note11 (http://www.hmrc.gov.uk/budget2009/bn11.pdf) for details.

- Are you the "senior accounting officer" of a large company? If so, watch out. For accounting periods beginning after the 2009 Finance Act becomes law (probably July or August this year), you will be personally liable for a penalty of up to £5,000 if the accounting systems of the company are below an acceptable standard.

- Are you liable to tax on "pre owned assets"? This is where you are taxed on a notional "rent" for assets you used to own and still have the use of, but have given away. Bear in mind that the tax is charged by applying the "official rate of interest" to the market value of the asset, and there is a de minimis exemption of £5,000. With the "official rate of interest" now down to 4.75%, your pre owned asset charge may have dropped below the de minimis level.

Tax Planning in the Recession - Transferring Assets to the Next Generation

When transferring non business assets such as let-property to children a capital gain arises as a transfer of assets to a connected person is treated as though it is disposed at market value. With a depressed housing and stock market, now might be the right time to transfer to children thus avoiding higher taxes in later years. Capital gains tax on such transfers would chargeable at 18% after use of the annual exemption. Many portfolios are standing at a loss and as such no capital gains would be payable. The same could be said for certain buy to let property.

The tax saving from an inheritance tax point of view could be very good too.

If you made a gift now and then died in ten years the following could happen:

2009 transfer

MV on transfer of property to children £500,000
Less cost of property £200,000

Gain £300,000
Less annual exemption £ 10,100

Taxable gain £289,990 @ 18% = £52,182

Death say in 2019

Value of property £0 (not in estate of deceased as gifted to child)

IHT due @ 40% NIL

If you did nothing and died after ten years the following could happen:

No transfer in 2009

Capital gains tax due NIL

Death in 2019

Value of property £700,000

Maximum IHT due @ 40% £280,000

Increase in taxes due to no gift £227,818 (comparison to transfer in 2009)

Of course there are risks. Should you die within seven years of making the gift then part, if not the whole, of the asset will come back into your estate for IHT purposes. In a worst case scenario you can end up with a double tax charge of both capital gains tax and inheritance tax. The absolute worst case scenario is dying within three years of the gift. With so much inheritance tax potentially being saved this may be a risk worth taking.

If you did nothing and died within two years the following could happen:

No transfer in 2009

Capital gains tax due NIL

Death in 2011

Value of property £520,000

Maximum IHT due @ 40% £208,000

If you did do a transfer now and then died in two years the following could happen:

2009 transfer

MV on transfer of property to children £500,000
Less cost of property £200,000

Gain £300,000
Less annual exemption £10,100

Taxable gain £289,990 @ 18% = £52,182

Death in 2011

Value of property £520,000
Less fall in estate after payment of CGT £ -52,182

Taxable estate £467,818

IHT due @ 40% £187,127

Total CGT and IHT £239,309

Tax loss £30,309 (compared to no transfer in 2009)

To put this ten year hypothetical situation into context you can risk paying an extra £30,309 in tax in order to save £227,818. The same principal would apply for shares.

Combining the Share Portfolio Loss with a Property Transfer

If you were to carry out both exercises as above, you could offset the capital losses made on the share portfolio against the capital gain made on the property transfer, reducing your capital gains tax liability. There is, however, a provision known as 'clogged losses' which restricts loss relief between connected persons, so any transfers to children which create a loss will be restricted to gains made between the same persons. In the ideal scenario one would create a loss with share disposals, which is not so hard to do these days, and then use that loss against the gain on transfer of property.

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