

## Buy to Let Properties

In recent years, 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 that investors have looked elsewhere.

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. Allowable expenses include mortgage interest, repairs, agent's letting fees and an allowance for furnishings.

## **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 and is then taxed at either 18% or 28% or a combination of the two rates. CGT is payable on 31 January after the end of the tax year in which the gain is made.

## **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'. This is £4,250 each year. In this situation no expenses are tax deductible. Alternatively expenses can be deducted from income under normal letting rules where this is more beneficial.

## **Furnished holiday lettings**

Furnished holiday letting (FHL) is another type of investment that could be considered. This form of letting is short holiday lets as opposed to letting for the residential market. The property can be situated in the UK or in the European Economic Area (EEA). It has some advantages but it has other disadvantages which should also be considered.

### ***Advantages***

You will be able to take a holiday in your own property, or make it available some of the time to your family or friends. However, care would need to be taken to adjust the level of expenses claimed to reflect this private use.

Generally however the rules for allowable expenditure are more generous.

The income is regarded as 'trading income' for tax purposes and is treated as earnings for pension contribution purposes. UK and EEA FHL properties are treated as two separate businesses.

For capital gains tax purposes, FHL assets are treated as business assets. Gains on these assets should be eligible for Entrepreneurs' relief, which means that the first £10 million of gain is taxed at the favourable rate of 10%. The gains alternatively could be deferred using holdover relief on a gift or rollover relief where the asset is sold and another 'trading' asset is acquired. If further details on capital gains tax reliefs are required please do get in touch as this is a complex area.

### ***Disadvantages***

Holiday letting will have higher agent's fees, advertising costs, and maintenance fees (for example more regular cleaning).

Owning a holiday property may be more time consuming than you think and you may find yourself spending your precious holiday sorting out problems.

### **Changes to the rules**

As can be seen from the above FHL are treated as trades for certain taxation purposes, which is generally more preferential in terms of loss reliefs and CGT reliefs. The tax treatment of FHL has been advantageous for many years. Provided that certain conditions are met, FHL are treated as a trade. This can be preferable to the tax regime for normal let property in a number of specific areas, as the rules and reliefs for trades are often more generous.

Currently the FHL treatment potentially applies to properties in the EEA but certain conditions need to be satisfied including that the property must be:

- available for letting for at least 140 days a year and
- actually let for at least 70 days.

From April 2011 there will be two types of FHL business; a UK FHL business consisting of properties in the UK and an EEA FHL business consisting of properties in one or more EEA states. FHL losses will only be able to be set against income from the same FHL business.

From April 2012 the property must be available for letting for at least 210 days a year (generally the tax year) and actually let for at least 105 days.

A 'period of grace' will be introduced to allow businesses that do not continue to meet the 'actually let' requirement for one or two years to elect to continue to qualify throughout that period.

If you would like any further advice in this area please get in touch.

### **How we can help**

Whilst some generalisations can be made about buy to let properties it is always necessary to tailor any advice to your personal situation. Any plan must take into account your circumstances and aspirations.

Whilst a successful buy to let cannot be guaranteed, professional advice can help to sort out some of the potential problems and structure the investment correctly.

We would be happy to discuss buy to let further with you. Please contact us for more detailed advice.

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#### **Henley**

North Lea House  
66 Northfield End  
Henley-on-Thames  
Oxfordshire RG9 2BE

Tel: +44 (0)1491 848500

#### **London**

28 Ely Place  
London  
EC1N 6AA

Tel: +44(0)207 2422088

#### **Newbury**

Mill House  
Overbridge Square  
Hambridge Lane  
Newbury RG14 5UX

Tel: +44 (0)1635 35255

#### **Oxford**

Willow Court  
7 West Way  
Botley  
Oxford OX2 8PS

Tel: +44 (0)1865 200500

#### **Reading**

3 Wesley Gate  
Queen's Road  
Reading  
Berkshire RG1 4AP

Tel: +44 (0)118 9590261

#### **Southampton**

Latimer House  
5-7 Cumberland Place  
Southampton  
SO15 2BH

Tel: +44 (0) 2380 221222

