



HM Revenue  
& Customs

# Property Rental Toolkit

2016-17 Self Assessment Tax Returns

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## Introduction

Tax agents and advisers play an important role in helping their clients to get their tax returns correct. This toolkit is aimed at helping and supporting tax agents and advisers by providing guidance on the errors we find commonly occur in relation to property rental. It may also be helpful to anyone who is completing an Income Tax Self Assessment tax return.

This version of the Toolkit was published in May 2017 and is applicable for financial years commencing 6 April 2016 for Income Tax Self Assessment tax returns. Its use is entirely voluntary.

The content of this toolkit is based on our view of how tax law should be applied. Its application to specific cases will depend on the law at the relevant time and on the precise facts.

For further information on using this toolkit and reasonable care under our penalty system see [Tax Agents Toolkits](#).

For guidance on matters not dealt with in this toolkit you should refer to our [Property Income Manual \(PIM\)](#).

## Areas of risk within property rental

A person who owns an interest in land and who exploits that interest to receive rent or other income is normally treated as carrying on a rental business. The legal definition of a person can include a company. There are many similarities between the rental business of a company and a rental business dealt with under Income Tax legislation. However, this toolkit is focused on the Income Tax legislation.

A person can act in different legal capacities. For example, a person could be the owner of a let property, be a shareholder of a company that lets property, be a member of a partnership that lets property, or a trustee of a trust that holds let property. Letting in each of these capacities represents a separate rental business. A loss on one rental business cannot be set against a profit on another.

Profits from UK land or property are treated, for tax purposes, as arising from a business. While the rental business profits are computed using the same principles as for trades they are not trade profits and are subject to a different set of rules. The computation is based on commercial accounts drawn up in accordance with generally accepted accounting practice. For Income Tax purposes the profits or losses should be calculated for the tax year to 5 April so this may require apportionment of accounts figures.

There may be occasions when a person is carrying on a trade of providing services in addition to letting a property. There are also certain letting activities that can amount to a trade. However, these areas can be complex and although they are mentioned in brief they are not specifically covered within this toolkit.

For further guidance see [PIM4300](#).

Lease Premiums are also not covered within this toolkit.

For further guidance see [PIM1200](#).

The main areas of risk for property rental broadly fall into the following categories.

### Record keeping

Keeping accurate and up-to-date records is essential. Poorly kept records can mean that information provided is not accurate and may result in:

- receipts other than rents being overlooked

- expenditure or reliefs being claimed incorrectly - conversely allowable expenses or reliefs may not be claimed or claimed inaccurately
- property disposals being overlooked

For further guidance on record keeping see [Keeping your pay and tax records](#).

## Property income receipts

All income except capital receipts arising from an interest in land is part of the rental business. Even a casual or one-off letting is treated as arising from a property rental business. As with any other business, property income can include payments in kind as well as cash receipts.

Profits or losses from overseas properties and furnished holiday lettings need to be treated separately for tax purposes. Properties let rent-free or at less than market rate should also be considered separately to ensure that any expenses are restricted appropriately. For all other let properties rental receipts and expenses can be combined, so that expenses on one property can be deducted from the receipts on another.

## Deductions and expenses

Rental business expenses must be incurred wholly and exclusively for business purposes and not be of a capital nature.

Difficulties may arise where the cost has a dual purpose, partly private and partly business. A deduction can only be made for the business part where a definite part or proportion satisfies the wholly and exclusively test. Similarly, difficulties may also arise in distinguishing between revenue and capital expenditure. Capital expenses are generally not deductible in computing rental business profits.

From 6 April 2017 new rules have been introduced that limit the mortgage interest that an individual can deduct as an expense of a property business to the basic rate of income tax. The restriction applies to all finance costs of a property business. It is being phased in over 4 years, so the full restriction will only apply from the tax year 2020-2021.

For further information about the restriction and how to calculate the tax relief due in the transition years, please see the guidance on [changes to tax relief for residential landlords](#).

## Reliefs and allowances

The Rent a Room Scheme is aimed at individuals who let furnished living accommodation in their only or main home, for example, by taking in a lodger. Income is treated as tax free up to a certain amount, unless an election is made otherwise. When gross income exceeds that amount there is a choice between paying tax on the actual profit or on the gross receipts less the tax free amount.

For further information about the Rent a Room Scheme see [Rent a room in your home](#).

Capital allowances can be claimed on certain items that belong to the landlord and are used within the property rental business, for example tools, ladders, motor vehicles (subject to any adjustment for private use). Capital allowances cannot be claimed on plant and machinery in a dwelling house unless it is a furnished holiday let - see [Q5](#) and [Q21](#). For further guidance see [PIM3005](#).

For an ordinary property business, i.e. not a furnished holiday letting business, plant and machinery allowances cannot be claimed on furniture, furnishings or fixtures for use in a dwelling house. Instead, replacement of domestic item relief may be available where replacements for items are purchased in a residential property – see [Q18](#).

Plant and machinery allowances can be claimed on plant and machinery in a property which is not a dwelling house see [Q21](#).

## General

There are particular issues relating to property income that will affect the completion of the property pages of the Income Tax Self Assessment return. For example profits and losses, for tax purposes, must be calculated for the relevant tax year (to 5 April).

Any rental business loss is automatically carried forward and set off against rental business profits of the following year. Rental business losses cannot be set against general income except in limited circumstances. From April 2011 furnished holiday letting losses can only be carried forward and set off against furnished holiday lettings profits of the same business.

For further guidance see **PIM4220**.

Losses made in one rental business cannot be carried across to any other rental business the taxpayer carries on at the same time in a different legal capacity.

For further guidance see **PIM1020**.

There are also specific rules for non-resident landlords with UK rental income. For further information see **The Non-Resident Landlords (NRL) Scheme**.

## Using links within this document

[Blue underlined text](#) are links within this document.

**Green bold text** are hyperlinks to external documents on the internet (access to the internet is necessary to view these).

We have a range of services for people with disabilities, including guidance in Braille, audio and large print. Most of our forms are also available in large print. Please contact any of our helplines if you need these services.

**Dealing with HMRC if you have additional needs**

## Giving HMRC feedback on Toolkits

HMRC would like to hear about your experience of using the toolkits to help develop and prioritise future changes and improvements. HMRC is also interested in your views of any recent interactions you may have had with the department.

**Send HMRC your feedback**

Client Name:

Period Ended:

## Checklist for Property Rental Income

### Property income receipts

Yes No N/A N/K

- 1 Have all [gross rents and other receipts](#) from land and property been included as property income as appropriate?

- 2 Have any [deposits received](#) been included as income as appropriate?

- 3 If a [jointly owned property](#) is let, has the profit or loss been divided correctly?

- 4 If there are [overseas rental properties](#), have the profits or losses been treated correctly as income of an overseas property business?

- 5 If there is commercial letting of [furnished holiday accommodation](#) in the UK or EEA have all qualifying conditions been met?

- 6 If [surplus business premises](#) have been let, and the rent receivable treated as a business receipt have all of the conditions been met?

## Deductions and expenses

- 7 Have all items of expenditure on the [improvement of an asset](#) been treated correctly?
- 
- 8 Have any [legal and other professional fees](#) incurred in acquiring an asset been allocated appropriately?
- 
- 9 Has all expenditure on essential repairs to a [newly acquired property](#) been treated correctly?
- 
- 10 If [expenditure incurred prior to the commencement](#) of the rental business has been claimed have all of the conditions been met?
- 
- 11 Have any [capital repayments](#) been excluded from loan interest and other finance charges?
- 
- 12 Has the [finance costs restriction](#) been applied to mortgage interest and other finance costs incurred?
- 
- 13 Have any ['dual purpose' expenses](#) been apportioned in respect of any property used only partly for rental business?
-

## Deductions and expenses continued

- 14 If a vehicle has been used by a landlord for [non-business travel](#), including home to work, has only the business travel been claimed?

   

- 15 Are all expenses claimed by the landlord for [business trips](#) wholly and exclusively for the purpose of the rental business?

   

- 16 Where [wages and salary](#) costs are being claimed, have employment taxes been applied appropriately?

   

- 17 If there have been wages or salaries paid to [relatives or connected parties](#) are the amounts paid commensurate with their duties?

   

- 18 If a property has been [let rent free or at less than normal market rate](#) has any expenditure been restricted accordingly?

   

## Reliefs and allowances

- 19 If [Replacement of Domestic Items relief](#) has been claimed has it been claimed for the right amount on a qualifying item?

### Reliefs and allowances continued

20 If [Rent a Room Relief](#) is being claimed does it meet the conditions for relief?

   

21 Has any income over the [Rent a Room exemption](#) limit been treated as taxable rental income and the appropriate method applied?

   

22 If [capital allowances](#) have been claimed is the expenditure qualifying?

   

### General

23 Has the 5 April [basis period](#) been applied?

   

24 Have any rental business [losses](#) been used correctly and set in full against the first available rental profits?

   

25 Have only appropriate rental business [losses been set against general income?](#)

   

26 If a landlord is [non-resident](#) has tax been deducted from the rental payments?

General continued

27 If [box 21 in the property pages of the Self Assessment return](#) has been completed have the correct figures been included at box 20?

   

28 If there has been a [disposal](#) of a rental property has Capital Gains Tax been calculated appropriately?

# Explanation and mitigation of risks

## Property income receipts

### 1. Have all gross rents and other receipts from land and property been included as property income as appropriate?

#### **Risk**

Land and property income includes all gross rents received before any deductions, for example property management fees. Income also includes other receipts such as grants, ground rents etc.

#### **Mitigation**

Ensure that all property income is identified and includes all rents gross of any fees or expenses paid. Identify any ancillary receipts and ensure these are also included as property income.

For further guidance see **PIM1051**.

#### **Explanation**

Where a property management agent is engaged they often pay the landlord the rents received net of their fees and other expenses including items that may be capital or otherwise not allowable. The gross rents and not the net amount that was paid to the landlord must be included as the property income. Any agent fees and other costs, if allowable, should be claimed as a deduction.

There are certain receipts which are specifically excluded by statute from UK property rental businesses.

For further guidance see **PIM1112**.

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### 2. Have any deposits received been included as income as appropriate?

#### **Risk**

Deposits taken from tenants should be recognised in accordance with generally accepted accounting practice, normally by being deferred and matched with the costs of providing the services or carrying out repairs. Bonds are generally not rental income and are held separately. Deposits not refunded at the end of a tenancy or amounts claimed against bonds should normally be included as income unless they have already been recognised.

Any deposit balance not used to cover the cost of services or repairs and that is repaid to the tenant or licensee should be excluded from the receipts of the rental business.

#### **Mitigation**

In accordance with generally accepted accounting practice, deposits should normally be deferred and matched with the costs of providing the services or carrying out repairs. Review the deposits and bonds held and ensure that they have been included as income where appropriate.

For further guidance see **PIM1051**.

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### 3. If a jointly owned property is let, has the profit or loss been divided correctly?

#### **Risk**

Where two or more individuals jointly own a property any profit or loss is normally divided between them according to their share of the property being let unless a different division is agreed. The share for tax purposes must be the same as the share actually agreed.

Where the joint owners are married or in civil partnership, the profits or losses should be split 50/50 unless they own the property in unequal shares and they make an election to have their share match the share they each hold.

#### **Mitigation**

Establish if rents have been received from a jointly let property. Ensure that the share of the profit or loss shown on the tax return is divided between the owners according to their share of the property unless a different division has been agreed between them.

Where the individuals are married or in a civil partnership ensure the profit or loss is split 50/50 unless an election is made for their share to match the share of the property they each own or the property is a furnished holiday let.

#### **Explanation**

Individuals who jointly own a property should know who is keeping the records and have access to them. They are personally responsible for including their share of the profit or loss in their own tax return even if they agree that someone else will keep the records.

Exceptionally, the joint letting activity may amount to a partnership if the degree of organisation is similar to an ordinary commercial business. If a genuine business partnership exists ensure the share of the partnership profit or loss is kept separate from any other personal letting income. A partnership loss cannot be deducted from a personal rental profit and vice versa.

For further guidance on jointly owned property and partnerships see **PIM1030**.

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### 4. If there are overseas rental properties, have the profits or losses been treated correctly as income of an overseas property business?

#### **Risk**

Profits or losses of an overseas rental property should not be combined with those of a UK rental business. If profits or losses of the UK and overseas rental businesses are combined this may result in profits or losses being calculated incorrectly, for example if the losses from one are set against profits of the other. Special rules may apply to the commercial letting of furnished holiday accommodation in the European Economic Area (EEA), see [Q5](#).

#### **Mitigation**

Ensure that all income and expenses declared on the UK property pages of the return relate to UK properties and that any income and expenses relating to overseas property are declared separately on the foreign pages. Ensure that the losses of one business are not set against profits of the other business.

## Explanation

Rents and other receipts from properties outside of the UK are taxed separately as foreign income even though the profits and losses are computed using trading principles just like those of a UK rental business.

For further guidance see [PIM4703](#).

Where overseas income has suffered foreign tax please refer to [PIM4702](#).

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## 5. If there is commercial letting of furnished holiday accommodation in the UK or EEA have all qualifying conditions been met?

### Risk

Special tax rules allow the commercial letting of furnished holiday accommodation in the UK to be treated as a trade for some specified purposes - more beneficial capital allowances and certain capital gains reliefs. From 2009 the rules have been extended to include Furnished Holiday Lettings of accommodation elsewhere within the European Economic Area (EEA). In addition some of the rules on both UK and EEA furnished holiday letting changed in April 2011 and April 2012.

Furnished holiday lettings are charged under the property income rules although there are some tax advantages available for furnished holiday lettings if specific qualifying conditions are met. For example capital allowances can be claimed on furniture and furnishings in the property as well as plant and machinery. The letting should not be regarded as a furnished holiday letting unless all [qualifying conditions](#) are met.

### Mitigation

Ensure that the property is situated in the UK or elsewhere in the EEA, furnished, let on a commercial basis, with a view to a profit, and that all [qualifying conditions](#) are met. Both the UK and the EEA FHL businesses are entered on the UK property pages but a separate set of entries must be made for each. This is to ensure that any losses are set off only against profit from the UK or EEA as appropriate (see below). The tax return notes explain how to fill in the pages where there are both UK and EEA properties.

For further information on the tax treatments available for furnished holiday letting businesses see [Helpsheet 253 - Furnished Holiday Lettings](#).

### Explanation

All of the following qualifying conditions must be met:

- availability: the property must be available for commercial letting as holiday accommodation to the public for at least 210 days during the relevant 12 month period (increased from 140 days prior to 2012-13)
- letting: the property must be commercially let as holiday accommodation to members of the public for at least 105 days during the relevant 12 month period (increased from 70 days prior to 2012-13)
- pattern of occupation: not more than 155 days must fall during periods of longer term occupation

A letting for a period of longer term occupation is not a letting as holiday accommodation. A period of "longer term occupation" is a letting to the same person for a continuous period of more than 31 days.

For full details on the qualifying conditions and the computation of profits, including the full definition of the relevant 12 month period see [Helpsheet 253 - Furnished Holiday Lettings](#).

Profits or losses arising from furnished holiday letting businesses should be calculated separately from any other rental business profits and losses. Where furnished holiday lettings result in a loss, these losses can only be carried forward and set against the furnished holiday letting profits of the same furnished holiday letting business; for this purpose, furnished holiday lettings in the UK are treated as a separate business to furnished holiday lettings in the EEA.

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## 6. If surplus business premises have been let, and the rent receivable treated as a business receipt have all of the conditions been met?

### Risk

Rent received from letting surplus business accommodation is strictly assessable as property income. However, rents from surplus business accommodation may be included in the calculation of the businesses trading profits if certain [conditions](#) are met.

### Mitigation

Establish whether rents have been received from letting surplus business accommodation. Ensure the conditions below are met before including the rents in the calculation of trading profits.

### Explanation

The conditions that must be met to treat rents from surplus business accommodation as trading profits are:

- the accommodation must be temporarily surplus to current business requirements
- the accommodation must not be trading stock of the trader
- the premises must be used partly for the business and partly let. In other words, rents from a separate property which is wholly surplus must be dealt with as property income
- the rental income must be comparatively small (since otherwise, the tax liability resulting may not approximate to the strict statutory liability)
- the rents must be in respect of the letting of surplus business accommodation only and not of land

**S21 of Income Tax (Trading and Other Income) Act 2005** sets out rules for determining whether the accommodation is temporarily surplus to requirements. These are:

- that the accommodation must have been used for the purposes of the trade within the last three years (or acquired within that period)
- that the accommodation must be let for a term of not more than three years
- that the trader must intend to use the accommodation for trade purposes at a later date

If all the conditions are satisfied the rents from lettings of surplus business accommodation can be included in the computation of trade profits. This treatment must then continue as long as the conditions are satisfied.

For further guidance see **PIM4300** and **Business Income Manual (BIM) BIM41015**.

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# Deductions and expenses

## 7. Have all items of expenditure on the improvement of an asset been treated correctly?

### Risk

When work is carried out to an existing or newly acquired property which results in the asset being altered, improved or upgraded - that is makes it better than it had been before, then such costs are normally capital and should be disallowed in computing the rental profit or loss for tax purposes.

Where any unintentional improvement arises due to the use of new materials, which are broadly equivalent to the old materials, the cost normally remains revenue expenditure. For example, replacing lead pipes with copper or plastic pipes.

See [explanation](#) for further information on repairs.

### Mitigation

Where work is carried out to repair or refurbish a new or existing property, review the expenditure to identify any items that represent improvements rather than repairs. Ensure that the relevant expenditure is allocated appropriately.

Where there are essential repairs made to a newly acquired derelict or run down property, see [Q9](#).

### Explanation

It is important to differentiate between capital expenditure and repairs. Repairs are allowable as a deduction against rental income, whereas any capital expenditure should be claimed, if appropriate, against any future Capital Gains Tax when the property is sold, see [Q27](#).

Repair means the restoration of an asset by replacing subsidiary parts of the whole asset. An example is the cost of replacing roof tiles blown off by a storm. There will not be a repair if a significant improvement of the asset beyond its original condition results - that will be capital expenditure. For instance, there will be a capital improvement if the taxpayer extends the area of the original roof or takes off the roof and builds on another storey.

Examples of common repairs that are normally deductible in computing rental business profits include:

- exterior and interior painting and decorating
- stone cleaning
- damp and rot treatment
- mending broken windows, doors, furniture and machines such as cookers or lifts
- re-pointing
- replacing roof slates, flashing and gutters

Work commissioned on a property may include expenditure on improvements and also separate expenditure on repairs at the same time. In these circumstances the expenditure on repairs remains allowable. Expenditure may be apportioned on a reasonable basis to estimate the amount attributable to the repair element.

For further guidance see [PIM2020](#).

Find out more about [Capital Gains Tax](#).

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## 8. Have any legal and other professional fees incurred in acquiring an asset been allocated appropriately?

### Risk

Generally, fees are capital if they relate to a capital matter, such as the purchase of property. Therefore costs incurred in respect of acquiring, adding to or selling an asset are normally capital, for example fees paid to a surveyor/valuer, planning permission or registration of title on a property purchase.

The incidental costs of obtaining finance that are wholly and exclusively incurred for the purpose of acquiring the property are normally allowable.

### Mitigation

Consider whether any legal or other professional fees have been incurred relating to property. Ensure that these costs are allocated appropriately.

For further guidance see [PIM2205](#) and [BIM45815](#).

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## 9. Has all expenditure on essential repairs to a newly acquired property been treated correctly?

### Risk

If a property is acquired in a derelict or run down state and the price paid for the property was consequently substantially reduced, expenditure incurred in repairing it and putting it into a fit state for letting or use in the business may be capital rather than revenue expenditure.

### Mitigation

Consider the timing and extent of the work carried out on the newly acquired property and any relevant additional factors (see [examples](#)). Ensure any expenditure incurred on repairing the property is allocated appropriately.

### Explanation

Repairs to reinstate a worn or dilapidated asset are usually deductible as revenue expenditure. The fact that the taxpayer bought the asset not long before the repairs are made does not in itself make the repair a capital expense. But a change of ownership combined with one or more additional factors may mean the expenditure is capital.

Examples of such factors are:

- A property acquired that was not in a fit state for use in the business until the repairs had been carried out or that could not continue to be let without repairs being made shortly after acquisition
- The price paid for the property was substantially reduced because of its dilapidated state, except where the purchase price merely reflects the reduced value of the asset due to normal wear and tear (for example, between normal exterior painting cycles).
- The landlord makes an agreement that commits them to reinstate the property to a good state of repair. For example, Mr A is granted a 21-year lease of a property in a poor state of repair that he, in turn, sublets. When the lease is granted Mr A agrees that he will refurbish the property. Mr A's expenditure on making good will be capital expenditure and not normally allowable. In some circumstances Mr A's landlord may be chargeable on the value of the work under the premiums rules ([PIM1200+](#)) and Mr A may qualify for some relief ([PIM2300+](#))

It is not necessary for all these factors to be present for the expenditure to be capital. The underlying principle is that the cost of buying a property in good condition is clearly capital

expenditure. Hence the cost of buying a dilapidated property and putting it in good order is also capital expenditure.

For further guidance see [PIM2020](#).

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## 10. If expenditure incurred prior to the commencement of the rental business has been claimed have all of the conditions been met?

### Risk

Expenditure incurred prior to the commencement of a rental business is allowable if it is incurred wholly and exclusively for the purposes of the rental business and it is not capital expenditure. In addition, the [conditions](#) must be satisfied for the relief to be due on expenditure incurred before the start of the rental business.

### Mitigation

Consider any expenditure on activities that are preparatory to letting. Ensure the expenditure meets the conditions noted below.

### Explanation

The date of commencement is a question of fact. Where the rental business is letting property, the business normally begins when the letting of the first property begins and not on the date the property is purchased. Relief may be due on expenditure incurred before the start of the rental business if it satisfies all of the following conditions:

- it is incurred within a period of seven years before the date the rental business is started
- it is not otherwise allowable as a deduction for tax purposes
- it would have been allowed as a deduction if it had been incurred after the rental business started

Qualifying pre-commencement expenditure is treated as incurred on the day on which the rental business commences.

For further guidance see [PIM2505](#).

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## 11. Have any capital repayments been excluded from loan interest and other finance charges?

### Risk

Only the loan interest is an allowable deduction in computing the rental profit or loss for tax purposes. If the capital payments are not separated from the interest, for example for mortgage repayments, the rental profits will be understated.

### Mitigation

Review the mortgage/loan statements and separate the capital repayments from the interest payments. Ensure that only the loan interest payable in respect of the let property is included in computing the rental profit or loss.

No deduction should be made where Rent a Room Relief is being claimed during a year. For further details on the Rent a Room Scheme, see [Q19](#).

For further guidance see [PIM2105](#).

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## 12. Has the finance costs restriction been applied to mortgage interest and other finance costs incurred?

### Risk

The tax relief that landlords of residential properties get for finance costs is being restricted to the basic rate of Income Tax. This is being phased in from 6 April 2017 and will be fully in place from 6 April 2020. In the tax years 2017-2018 to 2019-2020 a proportion of finance costs will be allowed as a deduction.

The deduction is replaced by a tax reduction, which is calculated as 20% the lower of three sums:

- finance costs - costs not deducted from rental income in the tax year (this will be a proportion of finance costs for the transitional years) plus any finance costs brought forward
- property business profits - the profits of the property business in the tax year (after using any brought forward losses)
- adjusted total income - the income (after losses and reliefs, and excluding savings and dividends income) that exceeds your personal allowance

There are transitional rules for tax years 2017-2018, 2018-2019 and 2019-2020.

### Mitigation

Establish the finance costs incurred for the property business, apply the capital and wholly and exclusively rules before you consider this restriction, see [Q11](#) and [Q14](#). For the transitional years calculate the amount of interest allowable as a deduction, from 2020-2021 this amount will be nil.

Calculate the tax reduction to be applied, this is 20% of the lower of the three sums listed above. The tax reduction is applied in the calculation after the tax liability for property income is worked out, reducing the tax paid by the reduction amount. Note that the tax reduction cannot be used to create a tax refund.

For further guidance see [PIM2106](#).

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## 13. Have any 'dual purpose' expenses been apportioned in respect of any property used only partly for rental business?

### Risk

Where any expenses are in respect of a property that is used partly for the rental business and partly for private or non-business, expenditure should be apportioned accordingly. For example, loan interest where only part of the property has been let or only part of the loan has been used for the purposes of the rental business.

Expenditure relating to life insurance policies (for example a mortgage protection policy) on business loans and mortgages is not wholly and exclusively for the purposes of the business, and therefore is not an allowable deduction against rental income for tax purposes. The incidental costs of arranging business finance are normally allowable but the cost of monthly life insurance premiums are not.

### Mitigation

Establish the amount of any non-rental business related expenditure and ensure that this is excluded in computing the rental profit or loss. A review of payments made to financial institutions may identify non-business payments, for example life insurance premiums.

Ensure any 'dual purpose' expenses have been apportioned appropriately.

## Explanation

Strictly, if an expense is not incurred wholly and exclusively for the purposes of the rental business, it may not be deducted. In practice though some dual purpose expenses may include an obvious part which is for the purposes of the business, for example, loan interest if the property is partly let. In these circumstances expenses should be apportioned and only the business part should be claimed in computing the rental profit or loss.

For further guidance see [PIM2010](#) and [BIM45815](#).

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## 14. If a vehicle has been used by a landlord for non-business travel, including home to work, has only the business travel been claimed?

### Risk

If a vehicle is used by a landlord for rental business and non-business travel, the full amount of any running costs, including fuel, insurance, etc paid by the business/landlord may not be wholly and exclusively for the purposes of the rental business. If the costs are not properly apportioned to reflect the business/non-business elements, the deduction claimed will be inaccurate.

Where the business is administered from an office outside the landlord's home, non-business travel will normally include journeys between home and office or let property.

### Mitigation

Ensure there is an adequate record keeping system maintained to establish the proportion of business use each year. Apportion any costs to reflect the business/non-business elements and ensure only the business element is allowed.

For further guidance see [PIM2210](#).

Capital Allowances may also be affected in these circumstances. For further guidance see [Capital Allowances Manual CA27005](#).

For further information on the errors that we find commonly occur in relation to capital allowances for plant and machinery see [Capital Allowances for Plant and Machinery Toolkit](#).

### Explanation

Where there are separate business premises away from the landlord's home there is normally little doubt that the journeys to and from home are, in part, for the private purpose of commuting. The cost of travel from the rental business premises to and from the rental properties, and between the properties, may be allowable provided it was incurred wholly and exclusively for business purposes.

In a rental business, where there are often no separate business premises, identifying the purpose(s) of the journeys can be difficult. In these circumstances consideration needs to be given to the nature of the trade, how the business activities are organised and what purpose(s) the journeys to and from home serve.

For further guidance see [BIM37635](#).

The actual costs of any business journeys (tolls, parking fees etc) and a proportion of the road tax, insurance (provided the insurance covers business use), repairs, finance costs, etc, together with the cost of fuel incurred for the journey will generally be allowable.

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## 15. Are all expenses claimed by the landlord for business trips wholly and exclusively for the purpose of the rental business?

### Risk

If a trip either within the UK or abroad is for a mixed purpose the whole expense of the trip may not be allowable. For example when the landlord owns a foreign property and the purpose of the trip is for both the rental business and a holiday then only those items of expenditure that are solely for the purpose of the rental business can be deducted.

If the sole purpose of the trip is for the rental business the expense will usually be allowable in full notwithstanding any incidental private benefit.

### Mitigation

Consider the purpose of the trip. For example check whether there was any personal travel included within the trip or if the landlord was accompanied by their spouse/partner and/or family. Where the trip was not solely for the purposes of the rental business ensure the appropriate expenses, for example flights etc, are disallowed.

For further guidance see [BIM37610](#).

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## 16. Where wages and salary costs are being claimed, have employment taxes been applied appropriately?

### Risk

Operation of tax under PAYE and National Insurance contributions (NICs) can be overlooked where an individual other than the proprietor is employed full time or part time, for example, to collect rents, provide office assistance, gardening etc.

### Mitigation

Where an individual is employed within the rental business, ensure that PAYE and NICs are operated appropriately on any payments made and these are remitted to HMRC.

Ensure that no deduction is made in computing the rental profit or loss for any drawings paid to the proprietor or partner, including any payment for time spent managing the property.

### Explanation

Failure to operate PAYE may result in the employer (landlord) having to pay HMRC any tax and NICs that should have been deducted from the employees' wages.

Sometimes an employee is engaged partly to manage the rental business property and partly on private work or other work outside the rental business. PAYE and NICs must be operated on the entire remuneration of the employee but it may be difficult to ascertain the correct amount to be included as a deduction against the rental business profits. In such circumstances a fair and reasonable split should be made which takes into account all the facts. Only the part of the wage or salary properly attributable to the rental business duties is allowable as a deduction in computing the rental business profit or loss.

For further guidance see [PIM2080](#).

For further information on [PAYE see Operating PAYE in real time \(RTI\)](#).

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## 17. If there have been wages or salaries paid to relatives or connected parties are the amounts paid commensurate with their duties?

### **Risk**

Where there is a non-business purpose to wages and salaries paid, for example to relatives or connected parties or where the level of payment is determined by the relationship, then the part or proportion of the payment that is not wholly and exclusively for the purposes of the rental business is not an allowable deduction.

In addition if wages or salaries are not paid within nine months of the end of the period of account they should be disallowed.

### **Mitigation**

Establish whether any wages or salaries were paid to relatives or connected parties. Confirm the payments were wholly and exclusively for the purposes of the rental business, for example ascertain the work done and reason for the payment.

Consider whether the wages or salaries paid to the individual exceed a reasonable level of reward for the value of the work undertaken i.e. the commercial rate. Ensure the overall remuneration package including salary, wages, benefits and pension contributions is taken into account when considering whether the amounts were paid wholly and exclusively for the purposes of the rental business.

For further guidance see [PIM2080](#).

### **Explanation**

Where the facts show that a definite part or proportion of the remuneration is not wholly and exclusively for the purposes of the rental business only that part is not allowable.

Where it is not clear whether wages or salaries have been paid for tax purposes or have not been paid at the end of the period of account refer to [BIM47130](#).

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## 18. If a property has been let rent free or at less than normal market rate has any expenditure been restricted accordingly?

### **Risk**

Unless a normal market rate is charged for a property it is unlikely that the expenses of the property will be incurred wholly and exclusively for business purposes and should normally be excluded from or restricted in computing the rental profit or loss.

If the business lets a property below the market rate as opposed to providing it rent free they can deduct the expenses of that property up to the amount of rent received. As a result uncommercial lettings should not produce a loss for tax purposes. Any excess expenses cannot be set against profits from another rental property or carried forward to be used in a later year.

### **Mitigation**

Ensure that all expenditure relating to any property let rent free or below the market rate is excluded from or restricted in the accounts appropriately. Ensure that, for tax purposes a loss is not produced for any uncommercially let property.

For further guidance see [PIM2220](#).

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## Reliefs and allowances

### 19. If Replacement of Domestic Items relief has been claimed has it been claimed for the allowable amount on a qualifying item?

#### Risk

When letting residential property (excluding furnished holiday lettings), plant and machinery capital allowances cannot be claimed on furniture, furnishings or fixtures within the property. Instead, replacement of domestic items relief is available in respect of domestic items purchased to replace an item previously provided for tenants in the property. Items that are not a replacement or are an improvement do not qualify for the full relief.

#### Mitigation

Replacement of domestic items relief is not available for the full cost of an item that is an improvement on the item replaced, unless it is the nearest available equivalent. Otherwise, the relief is restricted to what the cost of replacing the item with an equivalent would have been.

The item the relief is claimed for must actually be a replacement of an item that was previously provided in the property for the tenants' use. An item purchased for the first time does not qualify for any relief.

#### Explanation

Until 2105/16, wear and tear allowance could be claimed in respect of furnished lettings at an amount equal to 10% of net rents received, but this is withdrawn from 2016/17. Instead, the replacement of domestic items relief has been introduced for all residential lettings from 2016/17 onwards.

For further guidance see [PIM3200](#).

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### 20. If Rent a Room Relief is being claimed does it meet the conditions for relief?

#### Risk

Under the Rent a Room Scheme a qualifying individual can be exempt from Income Tax on profits from furnished accommodation in their only or main home if the gross receipts, before expenses, are less than the exemption limit. However they cannot then claim any of the expenses of the letting.

Unfurnished lettings and rooms let as an office or for other business purposes, for example storage, do not qualify. The scheme does not apply to companies or partnerships. Neither does it apply if the home is converted into separate flats that are rented out.

#### Mitigation

Ensure the individual is in receipt of rents from letting furnished residential accommodation in their only or main home and that the gross receipts, before expenses, are below the exemption limit.

#### Explanation

Gross receipts include not only rents but also payments made for the provision of any other goods or services (such as meals, cleaning, laundry etc) in connection with the letting. Rent received from letting other properties should be excluded.

If the gross receipts are below the exemption limit the individual is automatically exempt from tax. However, it is worth considering if an election should be made to have these rents taxed in

the normal way - that is, rents received minus expenses, see [Q20](#). This may be beneficial for a particular year where a loss has resulted, which can then be set against other letting income outside Rent a Room. A fresh election needs to be made every year. No special form is required for the election, making the appropriate entries on the Self Assessment return is sufficient.

Rent a Room Relief applies to a tax year and the exemption limit should be halved when someone else received income from letting accommodation in the same property. This might happen when the property is jointly owned with another person.

For further guidance see [PIM4020](#).

For a flowchart showing when Rent a Room Relief may be due see [PIM4060 Rent a Room flowchart \(2005-06 onwards\)](#).

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## 21. Has any income over the Rent a Room exemption limit been treated as taxable rental income and the appropriate method applied?

### Risk

The Rent a Room Scheme provides two methods to calculate the taxable profits when gross receipts exceed the exemption limit. If receipts in excess of the exemption limit are overlooked or one of the two methods is not applied the rental profits may be incorrect.

The rent-a-room threshold is reduced by half where the property from which the rent-a-room income is received is jointly-owned with any number of people.

The current exemption limit for 2016/17 is £7,500 or £3,750 for a jointly-owned property.

### Mitigation

If the gross receipts exceed the exemption limit ensure one of the methods below is used to calculate the profits. Method A will apply automatically unless an election is made to apply method B.

**Method A:** profits are calculated in the same way as for any property business. Total gross receipts are added together and allowable expenses are deducted appropriately.

**Method B:** profits are calculated by taking gross receipts and deducting the exemption limit. When this method is used the individual cannot claim any other expenses.

Once method B has been chosen it continues to apply unless the individual informs HMRC, within the time limits, that they would like the first method to apply again. For example, when the taxable profit for a particular year is less under method A or where expenses are more than the rents, so there is a loss.

### Example where method B is better

Mrs F lets out a room in her own home. Nobody else lets a room in the house. Her gross receipts for the year are £8,400 with expenses of £1,000, resulting in an actual profit of £7,400.

She is not exempt from tax because her gross receipts exceed the exemption limit of £7,500. The excess of her receipts over £7,500 is £900 (£8,400 less £7,500).

- Using method A, she pays tax on her actual profit of £7,400
- Using method B, she pays tax on the profit of £900 above the exemption limit

In Mrs F's case, method B is better and she elects for it.

For further guidance see our [PIM4030](#).

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## 22. If capital allowances have been claimed is the expenditure qualifying?

### Risk

Capital allowances may be available on qualifying expenditure incurred on plant and machinery but this depends on the type of property income. They are not generally available where the income is from residential property. They may be available in respect of furnished holiday lettings and commercial property.

### Mitigation

Review the type of property income and ensure that capital allowances are not claimed on plant and machinery in a dwelling house that is used in an ordinary or an overseas property business.

### Explanation

Expenditure incurred on the provision of plant or machinery for use in a dwelling house does not qualify for capital allowances for an ordinary or an overseas property business. Consideration should be given to expenditure on plant and machinery in common parts of a building (for example the stairs and lifts) which contains two or more dwelling houses. This may qualify for capital allowances. For further guidance see [CA23060](#).

Expenditure on plant and machinery for use in properties that are not dwelling houses (for example commercial properties) may qualify for plant and machinery allowances. Expenditure on plant and machinery may also be claimed where the property is a furnished holiday let - see [Q5](#).

When the purchaser of a property claims capital allowances on the fixtures acquired with the property, it is important they establish the capital allowances position of the vendor as this will have a bearing on the allowances the buyer can claim. Where a fixture is acquired on or after 6 April 2012 the seller and purchaser may need to use one of three procedures to fix the value of the fixtures (normally within 2 years of the date of sale). In the vast majority of cases the procedure will be for both parties to the sale to make a s198 election. For further guidance see **the section of the capital allowances manual that covers fixtures CA26000+**.

For general information on capital allowances and balancing charges see [Helpsheet 252](#).

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## General

### 23. Has the 5 April basis period been applied?

#### Risk

For Income Tax purposes a rental business basis period is to 5 April each year. If the accounts are not drawn up to 5 April then the two sets of accounts drawn up to some other accounting date should be apportioned to establish the profit or loss for the year ended 5 April.

#### Mitigation

If accounts have not been drawn up to 5 April ensure profits or losses for the two years are apportioned on a daily basis to find the profit or loss for the relevant tax year.

#### Explanation

The charge for Income Tax is on the full amounts of the profits arising in the tax year. This means that a return has to be made to show the income of the year ended 5 April. The exceptions are:

- where the property income belongs to a partnership carrying on a trade or profession

- where the income is actually trading income (and not property income as defined for tax purposes) because the letting activity amounts to a trade

For further guidance see [PIM1010](#).

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## 24. Have any rental business losses been used correctly and set in full against the first available rental profits?

### Risk

Where rental losses are carried forward they must be used in full against the first available rental business profits. There is no provision that allows for a smaller amount to be relieved.

Losses made in one rental business cannot be set against any other rental business that is carried on at the same time in a different legal capacity.

For this purpose, the following are separate rental businesses, and losses in one cannot be set against the profits of the others:

- UK furnished holiday lettings business
- EEA furnished holiday lettings business
- UK property business consisting of properties that do not qualify as furnished holiday lettings
- Overseas property business consisting of properties that do not qualify as furnished holiday lettings

### Mitigation

Ensure that the correct loss figure is brought forward and fully utilised against the first available rental business profits, keeping UK and EEA furnished holiday lettings businesses separate. Where rental businesses are carried on at the same time in different legal capacities ensure that losses made in one rental business are not set against any other rental business.

Losses arising from a rental business can be set against other non-rental income in limited circumstances, see [Q24](#).

### Explanation

Rental business losses are calculated in the same way as rental business profits. So long as the property business continues, losses should be carried forward and deducted from the future profits from the same property rental business, until the losses can be utilised in full.

Expenses incurred on properties let free or below market rate can only be deducted up to the amount of rent received. The excess of the expenses over the receipts cannot be deducted in the rental business and cannot, therefore, create a loss, see [Q17](#).

For further guidance see [PIM2220](#).

Losses cannot be created under the Rent a Room Scheme. So, if the gross rental income is under the exemption limit or the excess income is being taxed under the alternative basis, any actual loss made cannot be relieved unless the individual notifies HMRC within the time limit that rent a room should not apply for that particular tax year - see [Q19](#).

For further guidance see [PIM4040](#) on the Rent a Room Scheme and losses and [PIM4050](#) for time limits for making or withdrawing an election.

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## 25. Have only appropriate rental business losses been set against general income?

### Risk

Property rental business losses should normally be carried forward and deducted from future profits of the same rental business.

Losses from properties that are not qualifying furnished holiday lettings can be set against general income but only in limited circumstances, when they are attributable to capital allowances or agricultural expenses. For more on capital allowances see [Q21](#). In addition the loss relief is restricted to the lesser of:

- the total general income for the year after deducting rental business losses brought forward (to the extent of the rental business income) and after deducting any sideways relief for the previous year's loss
- the amount of the rental business loss made in the year
- the net capital allowances after setting off any balancing charge

Additionally, from 2013-14 there is a further limit on the amount of income tax relief that an individual may claim for deduction from their total income in a tax year. The limit in each tax year is the greater of £50,000 or 25 per cent of the individual's adjusted total income. See [Helpsheet 204 Limit on Income tax Reliefs](#).

### Mitigation

Where property rental business losses are to be set against general income, ensure that these are limited as detailed above and restricted appropriately. Ensure a claim is submitted within the appropriate time limit.

See [explanation](#) and for further guidance see [PIM4220](#).

### Explanation

The amount of the loss attributable to the items detailed above can be set against the general income of the year of loss or the following year.

For example, a loss for 2009-10 can be set against either the general income of 2009-10 or the general income of 2010-11. The end of the year of assessment is 5 April 2010, the claim therefore must be made by 31 January 2012.

For further guidance and examples see [PIM4205+](#).

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## 26. If a landlord is non-resident has tax been deducted from the rental payments?

### Risk

Where the owner of a property lives outside the UK for more than 6 months, their letting agent or tenant should normally deduct basic rate Income Tax from the rental paid to the non-resident landlord, unless the letting agent or tenant has received confirmation from HMRC that the non-resident landlord is approved to receive their rental income gross.

### Mitigation

Establish whether any rents are being paid to or received by a non-resident landlord. If so, ensure the landlord receives a certificate showing the tax deducted by the letting agent or the tenant.

For letting agents or tenants unless either of the [exceptions](#) apply, ensure that basic rate Income Tax has been deducted and paid to HMRC and a certificate of tax deducted is provided to the landlord by 5 July following the end of the year to 31 March.

### **Explanation**

The Non-Resident Landlords Scheme is a scheme for collecting tax from the UK rental income of persons whose usual place of abode is outside the UK.

For further information see [The Non-Resident Landlords \(NRL\) Scheme](#) and [PIM4800](#). The only exceptions are for:

- a tenant making payments direct to an overseas landlord, where the rental payments are £100 a week or less and the tenant has not been instructed by HMRC to deduct tax. There is no such limit for letting agents, who are required to deduct tax from all rents collected on behalf of non-resident landlords unless the second exceptions applies
- a letting agent or tenant holding confirmation from HMRC confirming that the non-resident landlord has HMRC's approval for rents to be received gross

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**27. If box 21 in the property pages of the Self Assessment return has been completed have the correct figures been included at box 20?**

### **Risk**

Where tax has been deducted from, for example a non-resident landlord's UK rents, the amount of tax deducted should be shown at box 21. No other amounts should be included in this box. The gross amount of income, the total amount received plus the tax deducted should be entered at box 20.

### **Mitigation**

For non-resident landlords confirm that a tax deduction certificate has been received detailing the tax deducted by the UK letting agent or tenant. The amount of tax deducted should be entered at box 21. No other amount should be included in this box. Ensure the correct amount is included at box 20.

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**28. If there has been a disposal of a rental property has Capital Gains Tax been calculated appropriately?**

### **Risk**

Where a let property has been disposed of, Capital Gains Tax can be overlooked.

### **Mitigation**

Identify any let properties disposed of and ensure that Capital Gains Tax is calculated and reported on the Capital Gains Tax pages of the tax return.

Ensure previous documentation relating to the purchase of the property and any capital expenditure are retained. This will ensure that the correct expenditure and reliefs are claimed in the Capital Gains Tax computation.

### **Explanation**

Capital Gains Tax is a tax on the profit or gain made on sale or where someone otherwise 'disposes of' an asset. This includes the gift of an asset. Most real property, such as land and buildings, is liable to Capital Gains Tax, which means a capital gains computation is required to work out any gain or loss. Types of property liable to Capital Gains Tax include:

- a rented property or a second home
- business premises, such as a shop or a farm
- land, such as agricultural land

For further information about types of property, reliefs and working out the Capital Gains Tax due, see also **Tax when you sell property**.

For further information on errors that we find commonly occur in relation to Capital Gains Tax on land and buildings see **Capital Gains Tax for Land and Buildings Toolkit**.

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