HMOS & MULTI-LETS ...TAX ASPECTS?

Many investors are turning to HMOs and Multi-Lets as an alternative to the traditional single-let approach to long-term property investment. YPN asked specialist property accountant Stephen Fay ACA, to run through how HMOs and Multi-Lets differ tax-wise to single-let property.

Stephen Fay ACA is a Chartered Accountant specialising in all aspects of property taxation, and has been a property investor since 1999. Stephen combines expert technical tax knowledge with real-life property investment experience to offer property investor clients a unique service. Here, Stephen considers the taxation regime for HMO & Multi-Let investors...

What is a HMO or Multi-Let?

'Multi-Let' is general term used to describe a property that is let out to more than one household, whether these are students, professionals, or singles. A Multi-Let may, or may not, be classed as a 'HMO', depending on the number of bedrooms, stories in the building, and the tenants themselves. The definition can vary between local authorities, and HMO owners must be properly licensed. Properties must meet the new requirements put in place to protect tenants, as failure to obtain a HMO license is subject to criminal punishment.

Why should I invest in a HMO or Multi-Let?

Superior rental profits...

Many HMO & Multi-Let investors make fantastic rental returns on their property, compared to a typical single-let rental income. I often see gross rental yields of 12-15% achieved, with some investors hitting 20%-plus (typical single-let property yields around 6-7%).

If the aim of your property investing is to replace your day-job income, operating just one or two HMOs can propel you a long way towards that goal. I have a number of clients who have 'only' 4 or 5 HMO properties and are, effectively, financially free. Compare that to some of the portfolio figures often heard in property circles ... 30, 40, 50 properties, and more! How much easier is it to manage 5 properties compared to 50?

However, it has to be said that it is sometimes the case for potential capital appreciation to be less than in a non-HMO property

Always think 'net'...

There are additional costs to bear with HMOs and Multi-Lets, (covered later), but the financial model for HMOs is that the extra income far exceeds the extra costs incurred. As in any business, 'think net profit'.

Also, bear in mind that higher profits, all things being equal, means higher tax bills. This, of course, is a natural by-product of making profits! It's surprising how many investors will refuse the opportunity to make higher profits because they don't want to pay higher taxes. Working with a specialist property accountant should eliminate this problem of course!

Tax considerations when setting up a HMO ...

HMOs & Multi-Lets often need refurbishment and structural work to ensure the property has the optimal number of rental units (bedrooms), and is of the right standard for the local market.

Practically, most spending on HMOs is a revenue cost, and so income tax-deductible. Capital items (added to the purchase price) are usually easily identifiable: e.g. adding an extension, knocking down walls, building an annex.

If the spend is a repair of an existing item, even using modern equivalent materials, it is a revenue cost. 'Repair' means general day-to-day works needed to maintain the asset to earn rental income. A repair has to be way beyond simple repair, or an equivalent replacement, to be considered capital.

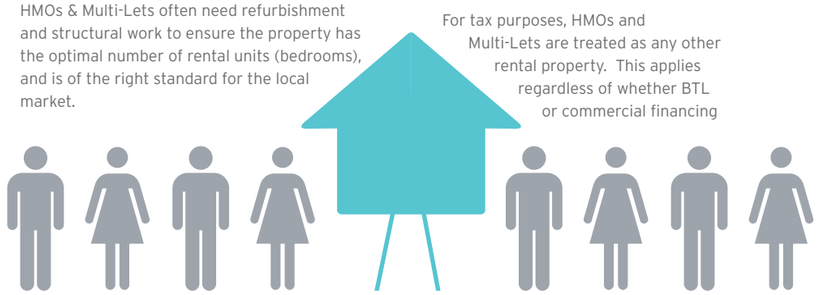
Where capital and revenue work is done simultaneously, a reasonable and fair apportionment is allowed.

It helps to have good records of the spend, summarised and receipted. Photographs are great, as are tradesmen invoices split by capital / revenue ("Build Extension"=£20k, "Decorate Existing Property"=£3k etc), as does retaining the property survey report. Build a file of evidence to support the income tax deduction (your accountant should have templates and guidance on this).

Income tax aspects of HMOs & Multi-Lets...

The basics ...

For tax purposes, HMOs and Multi-Lets are treated as any other rental property. This applies regardless of whether BTL or commercial financing has been used. Rental income and expenses are treated in the same way, and profits are taxed as investment income (or losses carried forward).



Capital Allowances ...

One difference between HMOs and single-let properties is the potential to claim 'Plant & Machinery Capital Allowances' which is income tax relief on qualifying items within the communal areas of HMOs & Multi-Lets. Each year, a proportion of the capital outlay (purchase and capital improvements costs) associated with these communal area assets, is treated as an expense of the rental business.

Unlike normal rental losses, which are only rolled forward for offset against future rental profits, Capital Allowances can be offset against non-property income ... to generate tax rebates which can run into thousands of pounds.

Qualifying assets need to be identified, valued and documented, to enable a claim to be made – contact me for further details, as we have preferential rates with expert surveyors who will provide a report in the HMRC-approved format.

Mixing HMOs & Multi-Lets with single-let properties ...

As a property rental business is treated as a single business for tax purposes, the tax losses made in current and prior years can be used to reduce the tax bill on HMO rental profits. It is often a good strategy for investors with large losses built-up to operate a HMO or two to use up those losses ... and generate tax-free income.

Extra costs in running HMOs & Multi-Lets ...

Typically, HMO landlords will include utilities, broadband and council tax within the rent charged to tenants. All these costs must be separately identified and reported within the investor tax return. However, any additional costs are fully income tax-deductible if incurred 'wholly and exclusively' as part of the property rental business.

Investors also need to decide whether to opt for the Wear and Tear Allowance (allowing 10% of the rent to be deducted from rental profits), or take tax relief as and when furniture is replaced. It is usually better to go for the allowance, unless severe furniture abuse is expected!

Summary... are HMOs & Multi-Lets worth it?

Well-selected and well-managed HMOs & Multi-Lets, in areas of good rental demand, are capable of generating significant rental profits. Although there are extra costs, and a perceived 'hassle-factor' to consider, HMOs and Multi-Lets offer investors the possibility of generating a good income NOW, as well as the future capital appreciation that the general market should provide over time.

To receive our FREE monthly newsletter, simply register via our website at (www.fyldetaxaccountants.co.uk) .
We provide a monthly 'Plain English' tax and financial update to property investors, as well as our views on hot topics, to keep readers 'in the know'.

Capital Gains Tax aspects of HMOs & Multi-Lets ...

Again, as with the income tax regime, the CGT position for HMOs and Multi-Lets is the same as for single-let properties. Although, it is usually the case that there is a much higher level of capital spend to be deducted as properties are often extended and improved. However many investors don't want to sell such an income-generating asset, and so CGT is not an issue!