A 5-MINUTE GUIDE TO TAX-DEDUCTIBLE EXPENSES FOR LANDLORDS

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One of the most common questions asked by clients with investment property is 'what costs can be claimed against income tax on property rental profits?'

YPN readers can download a FREE 'Property Expense Guide' from our website (www.fyldetaxaccountants.co.uk) – along with our essential tools and templates this provides landlords with a useful 'toolkit' to manage their property portfolio.

Clearly, it makes sense to ensure that every possible expense and allowance is claimed before calculating the income tax to be paid on rental profits - as this has a direct impact on the amount of tax figure payable.

It's important to note that HMRC regards your property rental business as beginning on the first day that a property is actually let out. Expenses associated with second and subsequent properties may be claimed even if they are not yet let, since the 'property rental business' commenced when the first property was let.

What expenses can be deducted from rental profits?

The simple answer is that expenses must be incurred 'wholly and exclusively' for business purposes (and must actually be incurred). Expenses must also be 'revenue expenditure' to be claimed as an income tax deduction. This means that the expense is incurred on an ongoing basis in order to earn income (revenue).

Expenses that are not 'revenue' expenses are usually 'capital' expenses (and so are deducted from the capital gain when the property is sold).

The following is a guide to the costs and expenses that a property rental business may incur that are generally tax-deductible (**with some real-life costs that I've seen trying unsuccessfully to be claimed!**)

Interest and finance charges

Interest payable on business borrowings, including mortgages, loans, overdrafts, and credit cards. Interest is allowable on borrowings incurred for the purposes of the property rental business.

Borrowings up to the value of the property when first rented out may be claimed (note: for new acquisitions, this is the purchase price. For properties that were previously your home, this is the valuation on first let – it's worth paying for a RICS valuation to support your interest claim). Interest on additional borrowings is allowable if used for business purposes (e.g. as a deposit on further property).

Mortgage and loan arrangement fees are also allowable as a revenue expense. Note: it does not matter if the borrowing is secured or unsecured (or even on what it is secured) – it only matters if the funds were used for business purposes.

Disallowed costs include:

- **Interest on borrowings for private cars / homes/golf clubs(!)**
- **Interest on late-paid income tax.**
- **Interest on private credit cards & goods on HP**

Motor and travel expenses

Motor expenses are usually best charged at a flat-rate of the 2012 tax year 45p per mile (for the first 10,000 business miles, 25p per mile thereafter) from your home to destination (assuming you run your property rental business from home). This covers the cost of visiting Letting Agents, accountants, solicitors, checking on existing properties etc.

Other reasonable travel costs including train, bus, air and taxi fares can be claimed. Hotel and meal costs can be claimed if an over-night stay is needed (assuming the trip is for business purposes).

Disallowed costs include:

- **Vehicle costs in addition to business mileage (one or the other is allowed!)**
- **Travel costs to view potential property purchases**
- **Holidays! (to "view potential overseas investments"!)**

Repairs & Renewal

To be classed as a 'revenue' expense, the repair or renewal must only restore the property to its previous condition, and not enhance the property value. However, renewals using more modern alternatives, even if seemingly an 'enhancement', are allowed as a revenue cost (e.g. replacing single-glazed windows with double-glazed windows).

When completing refurbishment work that is a mixture of revenue and capital spending, it is worth asking the builder to invoice specific repairs (revenue item) separately to capital improvements (you will need to guide the

builder on this!). Also included are 'incidental' costs such as skip hire, general labour and clean-up costs etc (assuming the costs are revenue in nature).

Disallowed costs include:

- **Cash payments to tradesmen that cannot be substantiated by valid invoices & receipts, or by proper banking records – so ensure that any discount received is VERY substantial!**
- **Capital works on the landlords own home**

Accountancy, book-keeping and taxation fees

Accountancy and tax advisory fees are fully-allowable expenses, as are general book-keeping fees.

Legal fees associated with tenancy matters (including evictions and disputes) and letting agent fees (including tenant-finding and management fees) are allowable expenses. So too are legal fees specifically associated with arranging finance (note: ask your solicitor to provide a separate invoice for the work associated with dealing with the mortgage – this element is then allowable for income tax purposes, even for new purchases).

Disallowed costs include:

- **Tax penalties and interest levied by HMRC**
- **Costs of unsuccessfully defending an HMRC tax investigation**
- **Gifts of wine to your accountant (sadly!)**

Insurance and service charges

Property insurance, including buildings insurance, rent insurance etc are all allowable expenses for landlords. Ground rents and service charges, and council tax, are also allowable.

Disallowed costs include:

- **Medical insurance for landlords**
- **Car insurance for vehicles not used in the rental business**
- **Ground rents & service charges on the landlord's own home**

Advertising & marketing

All kinds of business advertising and marketing are allowable expenses, including newspapers, mail-shots, leaflets, and website costs, provided that these relate specifically to a property rental business

Disallowed costs include:

- **Costs to find motivated sellers (except for property traders)**
- **Marketing that doesn't specifically relate to a property rental business**

Training costs

Generally, seminars, courses and books that are directly relevant to a property rental business are allowable expenses.

Disallowed costs include:

- **Training costs to develop new skills are treated as intangible capital assets - and so are not revenue costs, nor are capital allowances available. Check with your accountant as to the deductibility of training & seminar costs before committing to significant expenditure.**

Other business expenses

A 'provision' may be allowable for income tax purposes before the expense has been paid. This applies if a legal obligation has been incurred, and the amount can be calculated with reasonable accuracy (e.g. a leaseholder is notified of a new roof requirement before the tax year ends, with payment actually due after the tax year end).

Disallowed costs include:

- **Expenditure that has actually been incurred or committed to by the year-end**

Telephone, fax, stationary & other office costs

Technical books and publications relevant to a property rental business are allowable. Business landline, mobile phone (a reasonable allocation may be used between private and business use), fax machine and internet costs are allowable.

Home office costs such as postage, stationary and printing and small computer equipment (including business software).

If you run your property rental business from home, you may claim a proportion of household bills as a business expense.

However, this can affect the Capital Gains Tax position on your home, and so professional advice should be taken. The alternative is to claim a flat amount of £156 per year (2011 rate).

Disallowed costs include:

- **Books and publications that are not specifically property-related (general 'wealth creation' items are disallowed as private expenses)**
- **Excessive home office costs that are deemed 'unreasonable'**

Pre-commencement expenditure

These are expenses that are incurred before a property rental business commences – but may still be claimed as allowable business expenses if they would normally qualify.

Such expenses can be claimed for up to seven years before the business commenced, and are treated as being incurred on 'day 1' of the property rental business commencing.

Summary

Knowing what costs are allowable for tax purposes helps investors to decide whether, and when, to incur discretionary costs. Preparing accurate rental accounts helps to ensure that tax liabilities, and useful rental losses, are recorded correctly. And, of course, knowing what expenses can be claimed will result in lower income tax bills!