Tax Insider
HOW TO BEAT THE TAXMAN AND BOOST YOUR INCOME!

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Is it a phone?

By Sarah Bradford

Many tax exemptions are either so hampered by conditions or are of little practical benefit that their role as a perk is somewhat limited. This makes the opportunity to provide an employee with something tax free that he or she is actually likely to use several times a day all the more valuable. Mobile phones arguably fit into this all too rare category.

Scope of the exemption

An employer can provide a mobile phone to an employee without triggering a tax charge under the benefit in kind provisions provided that certain conditions are met. The legislation provides that no liability to tax arises in respect of the provision of one mobile phone for an employee without any transfer of property in it.

The first point to note is that the exemption is only relevant where the contract for the phone is between the employer and the employee. If the employee has his or her own mobile phone, the contract for which is in the employee's name, and the employer pays the bills on the employee's behalf, the exemption does not apply. The employer is meeting a pecuniary liability and as such tax is in point. However, in this situation, the employee may be entitled to a deduction for business calls.

In the case of a pay-as-you go phone, similar considerations apply. If the phone belongs to the employer and the employer pays for the top-ups the exemption may apply, provided that the other necessary conditions are met. However, if the phone belongs to the employee and the employer merely reimburses the costs initially incurred by the employee, the exemption is not in point, although the employer may be entitled to a deduction for business calls.

The second condition to note is that the employer must retain ownership of the phone. The exemption only applies where the

phone is made available for use by the employee. The exemption cannot be used to provide the employee with a state of the art phone tax-free.

Counting to one

The exemption for mobile phones was revised from 6 April 2007. Since that date it has only been possible to provide one mobile phone to an employee within the scope of the specific exemption for mobile phones. This limit was imposed as an anti-avoidance measure to scupper the development of schemes providing multiple phones to an employee for private use.

Prior to 6 April 2006, there was no limit on the number of phones that could be provided, making it possible to kit out the employee's family and friends tax-free (and probably at a substantial cost to the employer) without any tax liability arising.

It is still possible for an employee to enjoy more than one phone tax-free, provided that the phones were all made available prior to 6 April 2006. The exemption will continue to apply to all pre-April 2006 phones until the phones concerned are replaced by a new phone or upgraded at the employee's request. This may mean that the employee may need to consider whether it is worth forsaking an upgrade in order to continue to benefit from tax-free call charges. Depending on the extent to which the phone in question is used, not having the latest model may be a sacrifice worth making.

The exemption for multiple phones made available prior to 6 April 2006 is not lost if the phone is replaced under a warranty that formed part of the original agreement.

Where a phone is made available to an employee on or after 6 April 2006, the exemption is limited to one phone per employee. Deciding whether an employee only has one phone may not always be as straightforward as it sounds. For example, if an employee has two SIM cards to the same number, one in a handset and one in a hands-free phone in a car, this will only be regarded as one phone. However, two connections to two different numbers represents two mobile phones. The limit on one is really a limit on connections rather than on handsets.

What is a phone

Most people would think that they would know what a mobile phone is, but the answer to the question 'is it a phone' may not always be clear. The definition of what constitutes a mobile phone for the purposes of the mobile phone exemption was revised from 6 April 2006. From this date, for tax purposes at least, a mobile phone is defined as telephone apparatus that is:

- not physically connected to a land-line;
- is not used only as a wireless extension to a telephone that is physically connected to a land-line;

or anything that may be used in such apparatus for the purpose of gaining access to, or using, a public communications service. For these purposes, telephone apparatus is taken as wireless telegraphy apparatus designed or adapted for the primary purpose of transmitting or receiving spoken messages and used in connection with a public communications system.

As with many definitions contained within the tax legislation, one is left to make practical sense of whether a particular item that most people would refer to as a mobile phone is actually one in the eyes of the taxman. What is not particularly evident from the legislation itself is that the revised definition extends the scope of the exemption to a connection provided independently of a mobile phone, This means that the exemption applies if the employer provides the employee with a SIM card and the employee uses that SIM card in his or her own handset, provided that the employer contracts with the provider, meets the cost of the calls and retains ownership of the SIM card. The answer to the question 'Is a SIM cards a phone' may well be yes.

Further complications arise as phones evolve and do more than simply make or receive calls. The vast majority of handsets allow the user to text, take photos, send multi-media messages, access the internet, double up as an MP3 player and provide Bluetooth capabilities. As the list of functions increase as new models appear, it becomes increasingly difficult to determine when a device stops being a mobile phone and starts to be something else entirely. This is important as if a device is not a mobile phone it cannot benefit from the exemption for mobile phones.

Particular problems arise in relation to personal digital assistants (PDAs) such as the BlackBerry. Like whether a Jaffa cake is a cake or a biscuit, popular opinion is divided on whether a BlackBerry is a mobile phone or a computer. HM Revenue & Customs' answer to this question would seem to be `it depends'.

Early BlackBerrys were predominantly mobile phones and benefited from the mobile phone exemption. However, as technology has developed, BlackBerrys and PDAs have additional functions more typically associated with a computer and HMRC take the view that these 'can no longer be considered primarily as a mobile phone'. This is a bit of a disaster from a tax perspective. This means that they cannot benefit from the mobile phone exemption and unless provided prior to 6 April 2006 cannot benefit from the old exemption for computer equipment provided for private use. The only tax-free route is to provide one primarily for business use and keep any private use to a minimum so it can be disregarded as incidental.

Thus whilst an exemption exists for mobile phones, all phones are not equal. While the provision of a SIM card alone will qualify, a state of the art Blackberry will not. With demise of the exemption for computer equipment, the mobile phone exemption is extremely valuable. Care must be taken not to stretch the limits and when providing an employee with what at first sight appears to be a mobile phone, one must ask whether the taxman would agree.

Insider Tax Tips

- Have the 11p increase on a packet of cigarettes, and the ban on smoking in public places from 1 July, made you decide to give up? Keep on puffing until 1 July, because from that date your nicotine patches and chewing gum will cost you less, as the rate of VAT on them will be cut from 17.5% to 5%.
- On the same theme, are you getting your cigarettes (or your booze) sent to you by post from abroad by a kindly friend or relative? The exemption from excise duty on these "Small Non-Commercial Consignments" (that is up to 50 cigarettes or 1 litre of spirits) is being withdrawn from the date of Royal Assent to the Finance Act.
- Do you have an electricity microgeneration facility at your home and do you receive money from selling your "Renewables Obligation Certificates"? If so any money you make will be exempt from tax.
- Are you liable to pay income tax for 2005/06 on a "Pre-owned Asset"? Did you miss the 31 January 2007 deadline for electing for IHT instead? Do you know what I am talking about? If not and if you have the use of any asset you once owned and which you gave away or sold for less than its market value then talk to your tax adviser, because the Budget announced an extension of the time limit for making such an election and it could be beneficial for you to do so.
- If you run a business (in a company or as a sole trader) and you are thinking of significant investment in plant and machinery you need to consider whether to spend the money now (50% first year allowances but only 20% writing down allowance on the balance for 2008/09), or wait until 2008/09 (100% first year allowances on the first £50,000 spent).
- Planning Gain Supplement (the proposed tax on increases in land values as a result of planning permission) was the dog that didn't bark in this Budget. The consultation document was issued in December 2005 and the deadline for responses passed this February. The consultation talked of implementation in 2008 but there is no mention of it in the Budget Notes or in the 2007 Finance Bill published on 29 March. I wonder when we shall hear more about this new tax.

Do companies still save tax? – The 2007 Budget and tax on business profits

By James Bailey

There is supposed to be an ancient Chinese curse – "may you live in interesting times" – and Gordon Brown's farewell performance as Chancellor promises such times for the business community over the next few years.

The headline news, of course, is that the rates of corporation tax are changing. For companies with profits over £1.5 million per year, the "mainstream" rate of CT is to be reduced from 30% to 28% from April 2008.

The bad news, however, is that for small companies (profits under £300,000 per year) the rates are going up to 20% on 1 April 2007, 21% in April 2008, and 22% in April 2009.

This is Gordon's response to what he referred to as "Tax-motivated incorporation" – the transfer of small sole trader or partnership businesses into limited companies in order to take advantage of the lower rates of tax on profits. It was, of course, Gordon who started this, with the introduction of the 10% "starting rate" of CT in 2000, and the reduction of that rate to 0% (on profits up to £10,000) in 2002. Having provided this huge incentive to small businesses to incorporate, Gordon is now tightening the screws – but is it really the end of the road for "tax-motivated incorporation"?

As an illustration of the effect of the changes for 2007/08 and of the scenario in 2009 when the rate of CT for a small company will be 22%, compare the tax position of a sole trader making profits of £50,000 with the same business run through a limited company. Assume that:

- the trader has no other income,
- that he needs to extract all the company's profits to fund his living expenses, and
- that he does this in the most tax-efficient way he can.

When we look at the numbers, it is interesting to compare them with the position as it would have been if Gordon had not put up the rate of CT, so the table includes the tax effect if the 2006 rates of CT had remained unchanged. The comparison with the 2009 rates is of course inaccurate, because it assumes that the rates of income tax and NIC remain unchanged, and we do not yet know what they will be in 2009.

	Sole Trader	Ltd Company (2006 rates)	Ltd Company (2007 rates)	Ltd Company (2009 rates)
Profits	50,000	50,000	50,000	50,000
Admin cost of company	N/A	(800)	(800)	(800)
Salary	N/A	(5,200)	(5,200)	(5,200)
Profit for CT	N/A	44,000	44,000	44,000
Corporation Tax	N/A	(8,360)	(8,800)	(9,680)
Dividend payable	N/A	35,640	35,200	34,320
Income Tax	(11,414)	(1,125)	(1,015)	(795)
National Insurance	(2,635)	N/A	N/A	N/A
Cash in hand	35,951	39,715*	39,385*	38,725*
Tax saving	N/A	3,764	3,434	2,774
Effective rate of tax on profits	28.10%	20.57%	21.23%	23.45%

(includes 5,200 salary)

It seems that there may still be a case for incorporation of some small businesses. In the case of a larger business the savings are still there though less dramatic:

	Sole Trader	Ltd Company (2006 rates)	Ltd Company (2007 rates)	Ltd Company (2009 rates)
Profits	100,000	100,000	100,000	100,000
Admin cost of company	N/A	(800)	(800)	(800)
Salary	N/A	(5,200)	(5,200)	(5,200)
Profit for CT	N/A	94,000	94,000	94,000
Corporation Tax	N/A	(17,860)	(18,800)	(20,680)
Dividend payable	N/A	76,140	75,200	73,320
Income Tax	(31,414)	(11,250)	(11,015)	(10,545)
National Insurance	(3,135)	N/A	N/A	N/A
Cash in hand	65,451	70,090	69,385	67,975
Tax saving	N/A	4,639	3,935	2,524
Effective rate of tax on profits	34.55%	29.91%	30.62%	32.03%

No simple answers

Bear in mind that these examples only deal with one specific situation and that (as was the case before Gordon started to dig deeper into companies' pockets) it is essential to do the sums for your specific circumstances.

For example, if you have other earned income so that you pay tax at the higher rate of 40%, a business with profits of £50,000 would cost you £20,500 in tax and NIC and leave you with £29,500 in your pocket, whereas if you ran it through a limited company and paid all the profits out as dividends, you would have £29,520 after company running expenses and tax – and a saving of £20 is not worth the hassle of running a company.

Well Done, Gordon!! – Changes in property tax in the 2007 Budget

By James Bailey

It is good to be able to bring you news of some positive tax changes for once and there were three particular Budget announcements that are good news if you own property:

Stamp Duty Land Tax – Exchanges of property by "connected persons"

SDLT is charged according to the "chargeable consideration" paid for a property and the rate varies from 0% for properties costing less than £125,000 to 4% for properties costing over £500,000.

Where properties are exchanged the tax is calculated like this:

Turner and Hooch each own a house and they agree to swap houses. Because Turner's house is worth £130,000 but Hooch's is worth £150,000 it is agreed that Turner will also pay Hooch £20,000 – this is known as "equality money".

Turner has therefore paid £150,000 for his new house (the market value of his old one plus £20,000 cash), and so he has to pay SDLT at the 1% rate = £1,500.

Hooch has paid £130,000 for his new house (the market value of his old house less the £20,000 "equality money") and so he too pays SDLT at 1% = £1,300.

There is a nasty trap, however, if Turner and Hooch are "connected persons" – for example if they are brothers or father and son:

Where the parties are "connected" this means that the transfers of the two houses are "linked transactions" and in order to calculate the rate of SDLT the amounts paid on BOTH transactions are added together. £150,000 plus £130,000 gives £280,000 and this gives a rate of SDLT of 3% so

Turner pays 3% on £150,000 = £4,500

Hooch pays 3% on £130,000 = £3,900

This is manifestly unfair and I have seen a number of cases where it meant that family members ended up paying high rates of SDLT for no good reason – after all, exchanges of property are quite common among members of the same family.

The good news is that it was announced in the Budget that this anomaly would no longer apply to exchanges between connected persons so in our example Turner and Hooch would pay the same amount of SDLT (at the 1% rate in this case) whether or not they were "connected persons".

IMPORTANT – This reform will only take effect after the Finance Act 2007 receives "Royal Assent" and becomes law sometime this summer so if you are planning to do such an exchange with a relative or other "connected person" in the near future you might want to postpone it until the Act has been passed!

Overseas Property Owned by a Company

In many cases UK residents who want to own a property in another country (whether as a holiday home or as a letting investment or both) do so through a company incorporated in that country. In some countries this is the only legal way for a foreigner to acquire property and in other countries there are distinct practical and legal advantages to this form of ownership.

What many people in this position may not realise is that they could well be liable for UK income tax on a "benefit in kind" if they or their family use the property. This arises because directors or employees of a company are liable to income tax where they are provided with benefits by the company that employs them – and even if the individual concerned has not been formally appointed as a director the tax charge also applies to "shadow directors" (that is a person who in fact has control over how the company operates).The income tax involved could be quite substantial.

There have been differences of opinion between tax advisers and HMRC as to exactly how this legislation operated and how the charge should be calculated but Gordon Brown has, I am delighted to say, swept away all this confusion by announcing that legislation will be included in the 2008 Finance Bill to remove this charge where all the following conditions are satisfied:

- The company concerned is itself owned by individuals
- The company's only or main asset is the property concerned (it looks as if the exemption will only apply to a single property)
- The company does not have any other activities apart from owning the property
- The purchase of the property was not financed by another company "connected" with the property company

The legislation is not in this year's Finance Bill because the Government wants to consult on the precise details but when it is passed it will be retrospective – it looks as if it will be retrospective without time limits – and HMRC have said they will not seek to tax anyone on this type of benefit in the meantime if the above conditions are met.

It remains to be seen if those who have already paid income tax on a benefit of this type will be entitled to repayments – my guess is probably not – but if you are currently disputing a liability of this type with HMRC, don't pay them anything and tell the inspector to look at Budget Note number 50.

Business Premises Renovation Allowance

This was actually announced in the 2005 Finance Act but it is only now being activated with effect from 11 April 2007.

There is a 100% allowance for the cost of renovating "business premises" which:

- Are in a "disadvantaged area" (that is, Northern Ireland, and other areas designated as development areas by the Assisted Areas Order 2007)
- Have been empty for at least one year

The allowance applies to the owner of the freehold (or a long leaseholder) and is available whether he uses the premises for his own business or lets them to someone else. As usual there is a fair amount of fine print to deal with so if you think you might qualify for the allowance ask your tax adviser to check it out for you.

So I never thought I'd say this but: Well Done Gordon!

…you have removed a disgraceful SDLT injustice, exempted a spurious benefit in kind from income tax and finally introduced a relief you promised us two years ago!

Get Carter!

By Andrew Needham

Lord Carter has undertaken a review of the Governments online services – "so what?" you may well ask! Well, he has recommended that all filing should be done online including VAT returns and so a mandatory filing and paying of VAT returns will now be phased in from 2008.

The schedule for introduction will be:

- Businesses with a turnover greater than £5.6 million and newly registered businesses will have to file electronically for VAT periods starting after 31 March 2008.
- Businesses with a turnover greater that £100,000 with VAT periods starting after 31 March 2010.
- The Government will review the position of businesses with a turnover less than £100,000 in the run up to 2012.

This will obviously impact small businesses that do not use computers or individuals that are not happy using new technology.

More interesting is the fact that HMRC will allow late returns without imposing a penalty (i.e. Default Surcharge) if their software breaks down and you cannot submit your return on time. However, if you have a problem with your software or your service provider breaks down you could still be liable to a surcharge for late submission of your return. We have asked HMRC if a business could submit a paper return when its computer systems break down to ensure the return arrives on time and thereby avoid a surcharge. Helpfully we have been told that electronic filing will be mandatory so they will not accept paper or faxed returns and any that are submitted that way will be ignored and a default surcharge levied - nice!

The Default Surcharge regime works like this: a first late return and you get a warning letter, another late return within 12 months and a penalty of 2% of the tax due is imposed. This grows with each subsequent fault within a 12 month period to 5%, 10%, and finally 15%. Only when you submit 12 months of returns on time (and with full payment if due) can you get back to zero.

In the event of a default surcharge arising a business has the right to have it removed if it can show that it has a 'reasonable excuse'. It seems likely there will be a lot of reasonable excuse cases before the VAT Tribunals following these changes as businesses inevitably try to show that the late returns were as a result of unforeseen computer breakdowns and so outside their control. We would expect the Tribunals to take a reasonable view in these cases particularly if a business has tried to submit a paper return and HMRC have refused it!

Improve VAT Recovery!

There have been rumours that there has been a recent change that has made it more difficult to recover VAT. This seems to be based on changes in the Budget to the authorisation process for partial exemption special methods.

So what exactly is partial exemption and what is a special method? Input VAT cannot normally be recovered on the costs associated with making an exempt supply. If you make a mixture of exempt supplies and taxable supplies you are partially exempt.

The first stage in the process of recovering input VAT is to directly attribute the costs associated with making taxable and exempt supplies. Any purchases directly attributed to making taxable supplies can be recovered in full. The balance of the input VAT (light, heat and other general overheads) cannot normally be directly attributed and so will be the subject of the partial exemption calculation.

Most businesses use what is known as the partial exemption 'standard method', which is laid down in the law (Regulation 101, SI 1995/2518).

The calculation is based on the formula:

Total taxable supplies x100 = %
Total taxable and exempt supplies

This gives the percentage of non-attributable input VAT that can be recovered. The figure calculated is always rounded up to the nearest whole percentage, so, for example, 49.1% becomes 50%. This percentage is then applied to the non-attributable input VAT to give the actual amount that can be recovered.

The standard method does not always give a fair and reasonable result so when that is the case a business is allowed to negotiate a 'special method' with HMRC. In theory you can have any special method you like providing it gives a fair and reasonable result. Before you use a special method you have to have it agreed with HMRC first.

Common special methods use staff numbers, floor area, transaction counts, or purchases, but others can be used if appropriate to your business.

In the Budget, the Government proposed a change to the method of authorising special methods and put it out to a consultation which has now been completed. The proposed change was to introduce a requirement for a business to declare that 'to the best of its knowledge and belief', its proposed partial exemption 'special method' is fair and reasonable before HMRC gives approval for its use. According to HMRC the change means that they would no longer approve a special method without such a declaration from the business and that if subsequently in their view the business 'should have known' the method was not fair and reasonable they would be entitled to set it aside and require the business to recalculate past returns using the standard method.

Too good to be true? – Cashbacks and Tax for Property Purchasers

By James Bailey

We get a lot of questions at Tax Insider about "cashbacks". These inducements to purchasers are becoming more and more common in today's property market and this article looks at some of the possible tax pitfalls they bring with them.

Types of cashback

There are three main ways in which cashbacks are offered:

- Mortgage lender's cashback – where the bank or building society providing your finance pays you a sum of money on completion of your mortgage
- Vendor's cashback – where the vendor of the property (typically a property developer) pays you a sum of money when you complete the purchase of the property
- "Gifted deposits" – where the vendor (or sometimes an agent) gives you the cash for the deposit on the property being sold

Property Trading v Property Investment

The treatment of all the above inducements will depend on how your business works. If you are a property developer or trader buying properties in order to sell them again in the short term then all the above cashbacks will form part of the profits of your trade. This is because as a trader you must include all receipts that come to you in the course of your trade. When you buy a property you are buying an item of trading stock and any receipts associated with that are taxable.

The position is more complicated if you are a property investor buying the property in order to let it out.

There are also some possible complications associated with Stamp Duty Land Tax which apply to both traders and investors.

Cashbacks for the Property Investor

1. Mortgage Cashback

This is the oldest of the cashbacks having been around for more than ten years. The lender pays a cash sum to the borrower when the mortgage completes. Originally these were seen as an inducement to first time buyers – the advertising copy played on the idea that you could spend the cash on furnishing your new home – but they are quite common on all types of mortgage now.

As these have been around for some time their treatment for tax purposes seems well settled – they are not taxable provided they are a single lump sum rather than a series of annual payments and they do not affect the cost of the property for CGT purposes. If you buy a property for £150,000 and get a £5,000 cashback from the mortgage lender the cost of the property to you is still £150,000 when you come to sell it – it is not reduced by the cashback because the cashback came from the mortgage provider and it did not affect the price you paid for the property.

2. Vendor Cashbacks

If the vendor of your buy to let property offers you a cashback the position is more complicated. One thing seems certain – it is going to be taxable in one way or another!

The two most likely ways in which it could attract tax are:

- Reduction of the CGT base cost – if you buy a property for £150,000 but the vendor gives you £10,000 back then at the very least HMRC could argue that the property only cost you £140,000 so that would be the deduction you could claim when you sold it. There is, however, another possibility:
- The cashback could be a "capital sum derived from an asset". The CGT legislation states that if you "derive" a capital sum from an asset even if you do not sell the asset in the process you are treated as if you had made a disposal for CGT purposes. The legislation is commonly used in the case of sums paid in compensation for damage to an asset but the way it is drafted it could catch cashbacks. Under this legislation you would make an immediate capital gain when you received the cashback. There are good arguments for saying that the legislation does not apply to this situation but (as we tax advisers are fond of saying) the position is by no means certain.

3. Gifted deposits

The first thing to be said is that the word "gifted" is misleading. In no sense is the vendor making a "gift" to you. Instead, he is paying you an inducement to buy his property. The same applies if the "gift" comes from an agent acting as a middleman in the transaction.

The same tax considerations apply to these "gifts" as to vendor cashbacks so they could either reduce the base cost or possibly be a disposal giving rise to an immediate capital gain. I could even put up an argument that they are chargeable to income tax – after all you are being paid to act in a certain way (to buy the property) and how is that different from being paid to do some work?

Stamp Duty Land Tax

SDLT is payable on the "chargeable consideration" paid for a property so the question is if you receive a cashback, is the "chargeable consideration" the amount you paid less the cashback or not? This could be particularly significant if the difference meant crossing one of the SDLT thresholds:

Joe buys a buy to let property for £255,000. This is in the 3% band of SDLT (consideration over £250,000). But if Joe receives a £10,000 cashback or a gifted deposit of the same amoun, can he claim that the real price of the property was only £245,000, which would put him in the 1% band for SDLT? The difference is significant - £7,650 of SDLT against £2,450.

The answer is that no-one is certain. I wrote to HMRC a month ago, asking their views on this and so far they have not replied.

HMRC and cashbacks

The buy to let market has grown enormously in the last few years and in a way HMRC seem to be playing a game of "catch-up". There is an old Statement of Practice that deals with cashbacks from such things as credit cards and on retail purchases but it is silent on the matter of cashbacks on property purchases. It could be argued that the same principles apply (which would be good news because in general the Statement says cashbacks are not taxable), but the Statement is full of caveats that each case must be judged on its particular facts and HMRC would have little difficulty in arguing that it did not apply to property cashbacks.

Other issues

In addition to the uncertainty surrounding the tax treatment of cashbacks you need to consider two other important issues:

Commercial reasons for cashbacks

There is famously no such thing as a free lunch so why is the vendor (or the agent) offering you a cashback or a gifted deposit? Is it because the property has been overvalued and the cashback is offered to dissuade you from looking too critically at the market value of the property itself?

Mortgage lenders

Does the mortgage lender know you are getting a cashback or a gifted deposit? If not, would the lender still have offered you the mortgage if they did? This is a very tricky and potentially dangerous area – when applying for a mortgage you are entering into a contract with the lender and if you are not disclosing the full facts you could find yourself in serious trouble!

Conclusion

I am afraid this article offers no clear answers on the tax treatment of cashbacks for buy to let investors. The tax treatment is uncertain and so if you get a cashback offer (and decide to accept it having considered the commercial aspects) the best advice I can offer you is to make sure you disclose the matter fully on your tax return – a tax adviser will be able to suggest an appropriate way to do this for the particular type of cashback you have received.

The Tax Insider Gurus Answer Your Questions

Q If I rent out my current Principal Private Residence and remortgage to fund a deposit on a new property which I live in and then find that after the remortgage the rent no longer covers all the expenses and I therefore need to contribute towards the payments i.e. making monthly losses. Can I offset this loss against future rental profit?

A You can offset the interest on the remortgage against the rental income provided the total of the mortgage loans is not greater than the market value of the property on the day you first let it. If this and the other expenses produce a loss you can set this against rental income from other properties in the same year if you have any or otherwise carry it forward to set against future rental profits.

Q I have only one rental property (multiple occupation) and I intend to sell it. If my tenants decide to give notice because I put the property up for sale I am bound to make a substantial loss in that last year. Since I don't intend to hold future rental properties can I offset the last income loss against CGT?

A I am afraid not. The loss can only be set against income from rentals. If you buy another property and let it then the loss could be offset against the rental income from that property.

Q I am thinking of converting my house into two flats selling off the top floor flat using the proceeds to pay off my mortgage and continue living in the ground floor flat. What taxes would I be liable for?

A The tax position here is quite complicated and you should take advice on it but essentially the exemption from CGT for a main residence will not apply to the extent that the gain you make on the sale of the flat is attributable to the conversion work. There is an example of how this works in the May 2006 edition of Tax Insider Magazine ("Not Always Exempt - Capital Gains Tax and your Home").

Q I have moved three times in the last ten tears and spent four years and three years (conveniently) in each before moving into my current address. How can I prove this? I now rent these properties on private tenancies and continue to pay the mortgages but now have no way of proving I lived there for this period.

A It is a question of fact which property was your main residence at any given time. Presumably you still have correspondence that was sent to you at the properties and there are other types of evidence - the electoral register, for example, or the council tax records and your Self Assessment returns of the rental income. In addition if the properties you were not living in were let then by a process of elimination the one that was not let must have been your main residence.

Q I am taking a lodger in April and the rent will be within the £4,250 allowance. I am on PAYE and haven't filled in a tax form for years. Since there is no tax to pay do I have to fill in a tax form or inform HMRC about it? I will also be renting out a new buy to let property which will be completed in August so I will be telling HMRC at that point about this. Is this the right time to inform HMRC or do I just complete a downloaded tax form?

A On direct.gov.uk it says:
If you don't normally receive a tax return and your receipts are below the tax-free thresholds for the scheme the tax exemption is automatic so you don't need to do anything.
This year you will start to receive other rental income so you will have to complete the 'Land & Property' pages of the self assessment return. When you do so, you can tick the first box on page L1. You should ask for a self-assessment return if one is not sent to you in April 2008.

Q My husband is prepared to loan me money for a buy-to-let property. Can I offset the interest of this loan from the rental income?

A Yes you can offset the interest of this loan from the rental income. However, since the loan is from a connected person I would strongly advise you to draw up proper paperwork before the loan starts showing a legitimate authentic loan agreement. It is essential that the rate of interest can be justified as being a commercial rate. You should also ensure that the interest payments go from a bank account in your own name into a bank account in your husband's name so that you can prove that the payments actually took place should HMRC question you. You should also bear in mind that the interest you pay will be taxable on your husband as income – if, for example, you pay tax at the basic rate and he is a higher rate taxpayer, then paying him interest will cost you more in tax between you.

Answers by James Bailey

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