



## **What Expenses can a Landlord Claim?**

**The aim of this fact sheet is to give an overview of expenses incurred by a residential landlord that can be claimed for Income Tax purposes in a regular property rental business. The list cannot possibly cover every conceivable expense but, hopefully, will provide a useful starting guide for you.**

There is a common notion amongst some landlords that, because they have incurred expenditure on a property they are letting out (or intend to do so), it will be an allowable expense against letting income. Unfortunately, this is not always the case.

Before looking at individual expenses, let us consider why some expenses can be claimed, whilst others cannot.

### **Standard Principles**

The legislation covering the taxation of a property investment business can be found at Income Tax (Trading & Other Income) Act 2005 (ITTOIA 2005) s.272 and states that profits should be calculated 'in the same way as profit from a trade'. If an expense is not incurred exclusively for the purpose of the business, it will not be allowable.

Bearing this in mind, the first question is: **"Was the expense incurred solely for the purpose of the property letting business?"** If the answer is yes, it will be allowable. Whilst if there is a non business purpose behind the expense, no deduction will follow.

In many instances, it will be easy to decide. For instance, paying an agent to manage a property is directly related to the letting business and would be allowable for income tax purposes. Contrast this to maintaining the let property yourself and buying a cheap pair of jeans and a t-shirt solely with the intention of doing some decorating in it. This would not be allowable because HMRC would argue that the jeans and t-shirt *could* (not necessarily would) be worn outside of work. However, the cost of protective work wear such as overalls, gloves and safety boots, etc., should be allowable.

As is usual in tax, a deceptively simple question is unlikely to give a straight forward answer. (I thought the book 'Fifty Shades of Grey' was all about tax issues. How disappointed was I to find out what it was really about!)

The wholly and exclusively rule can be disregarded in instances where it is possible to make a realistic apportionment between business and private use. An example being using your mobile phone: - unless you have two mobiles it is likely that you will make and receive calls both of a business and a private nature. It should be possible to calculate how much cost is business/private to enable a claim to be submitted for the business element.

Make sure that that the same business/private apportionment is not simply applied year on year as this suggests there is no analysis of the calls to determine the true business cost. Records should be kept to justify the apportionment to HMRC in the event of an enquiry.

Even if an expense may be exclusively for the purpose of the property letting business, there is a second hurdle to be overcome. **“How long does the benefit of that expense last?”** This is a **‘Capital v Revenue’** matter for which there is a separate fact sheet. In basic terms, adding a bedroom to a property is a *capital improvement (not allowable\*)* whose benefit will last for many years, if not indefinitely. In contrast, decorating a property is *revenue (allowable)*.

\*The cost of the improvement may be taken into account at the time the property is to be sold if there is an increase in value from the date purchased (a capital gain). The improvement must still be in the property at the date of sale. For instance, if a 3 bedroom dwelling was purchased and the 3<sup>rd</sup> ‘box’ bedroom was converted into an ensuite for the main bedroom, the cost would be an allowable expense against any capital gains when sold a few years down the line. However, if the bedroom was reinstated prior to disposal, neither the initial cost nor the reinstatement cost would be allowable.

One common misunderstanding I have witnessed many times over the years is for a landlord to assume an expense is allowable because there was a legal requirement to undertake the work. “We had to install fire doors throughout the communal areas or the Council would not allow us to rent the house out” is typical for, say, a House of Multiple Occupation (HMO) Licence to be granted. Unfortunately, just because an expense is a legal requirement does not necessarily make it an allowable income tax expense. However, it may qualify as a capital expense and be allowable against Capital Gains Tax (CGT) on the ultimate disposal of the property.

Prior to listing the expenses I want to draw the reader’s attention to the section in the **‘Capital v Revenue’** factsheet titled pre- letting expenditure. This is because, in most instances, the vast majority of repairs/improvements that will be undertaken will be when a property is first purchased and before it is initially let. Consequently, this is potentially, the most acute time when an allowable repair is deemed to be a disallowable improvement.

### **The List of Allowable Expenses**

*Accountancy Fees* – strictly, it is the cost of preparing the rental accounts that is deductible and the costs of filling in a tax return or calculating the tax liability are not but HMRC has long allowed normal recurring accountancy fees – although care should be taken as regards ‘one-off’ fees, such as for dealing with tax enquiries. See <https://www.gov.uk/hmrc-internal-manuals/property-income-manual/pim2205>.

*Advertising for tenants.*

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Agents' Fees for property management, including finding and vetting tenants, and inventories.

Bad and Doubtful Debts – where rent is due from a tenant but, having taken all reasonable steps to recover the debt, a deduction can be claimed if the debt is clearly irrecoverable or it is anticipated it will never be paid.

If the debt is later recovered you should bring in the recovery as a receipt in the year received. Similarly, if a doubtful debt which later looks as if it will be made good, should be brought back in as a receipt when prospects change.

Cost of Collecting Rents / Enforcing Debts.

Cost of Services Provided – such as where the landlord pays for gas, electricity, water rates, broadband/TV package, or annual service charges on an apartment or HMO. Remember such costs need to be deducted from the gross rent in the 10% wear and tear allowance, if applicable.

Capital Allowances on plant and machinery used in the business (but not items physically situated in any let residential property unless it is a "Furnished Holiday Let"). An example would be a lawn mower or the computer and printer used by the landlord.

Whilst residential landlords are unable claim capital allowances apart from in the very limited circumstances indicated above, there is one instance where they can claim. This is in relation to the communal areas of an apartment block or HMO where there are a number of self contained dwellings. Consequently, in respect of, say, a basement, a landlord would be able to claim a percentage of the total cost of air conditioning and lighting or for providing communal washing machines.

See the **Capital Allowances** factsheet for further details.

Cleaning

Council Tax, Rates.

Gardening.

Insurance – Buildings, Contents and Loss of Rents, including claim and/or valuation fees. Note, that in an unfurnished property the contents insurance would normally be the responsibility of the tenant. Therefore, any such cost would fall under 'Cost of services' (see above). Life assurance premiums are not claimable.

Interest & other finance charges – the interest element and arrangement fees on any loan taken out to purchase, extend or improve the property are claimable. If a separate bank account is held for the property business any charges arising are also allowable. The loan does not have to be secured against the let property itself.

There are significant changes to the deduction of loan interest & finance costs on residential property for non corporate landlords in the coming years. From April 2017 these expenses will be disallowed in calculating the taxable rental profit, and then a tax credit equal to 20% of the disallowed cost will be introduced.

The disallowance and credit are being phased in over four tax years, so that the full effect will not be felt until the 2020/21 tax year commencing in April 2020.

The way the restriction works means that it is not just those who are currently 40% taxpayers who will be adversely impacted upon. I have already advised a number of landlords on this matter who are currently well within the 20% tax bracket but, who will become 40% taxpayers once the restriction really begins to bite. Please see case studies for worked examples.

Commercial properties and furnished holiday lets (FHLs) are not affected by the changes.

Lease Premia – when a tenant sub-lets a property, an element of any premium originally paid may be deducted against the income from the sub-let.

Legal and Professional Costs – the initial cost of purchase of the property or any fees for a new lease (for more than a year) are **capital** and not deductible. The cost of *renewing* a lease of less than 50 years' duration is allowable. Other allowable costs include rent arbitration and eviction of unsatisfactory tenants so as to re-let.

Maintenance, Repairs and Decoration are normally all allowable deductions. Repairs to items in the property, as well as the fabric of the property itself, are allowable. Take care to avoid claiming for capital improvements – such as replacing standard quality fittings with items of a significantly higher quality. Particular care should be taken to examine costs when a property has just been purchased & done up prior to letting. Please refer to the separate **fact sheet 'Capital v Revenue'** for further details.

Between Since April 2013 and March 2016 there has been no facility for claiming for the cost of buying or replacing furniture or white goods – see Renewals Basis.



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However, the "Wear and Tear Allowance" continued to apply in *fully* furnished residential property until April 2016, (see below), with a view to offering tax relief for the cost of purchasing and replacing such items.

It should be noted that the cost of **replacing** (or repairing) **fixtures integral to the building** (such as bathrooms, kitchens, central heating or boilers) **can be claimed as repairs**, regardless of whether a Wear and Tear Allowance or a renewals basis claim is applicable. Again, please refer to **fact sheet 'Capital v Revenue'** for further details.

Do not forget to claim for the cost of the annual gas safety certificate.

*Motor and Travelling costs* in relation to running the property business, such as travelling from one's home office to the let properties, to meet agents, or to buy consumables for the business. If there is a substantive non-business purpose to a journey, the cost may not be allowable. <https://www.gov.uk/simpler-income-tax-simplified-expenses/vehicles> provides further details.

*Printing, Postage, Stationery* and other office consumables to the extent that they relate to the property letting business.

*Private / non-Business Use* – Always consider whether or not there is an element of expense that should be disallowed as being for non-business purposes. The non-business proportion is likely to change from one year to the next. The use of the same proportion year after year for, say, use of mobile phone, would prompt HMRC to consider whether proper records are being kept to justify the proportion.

Private use may even extend to using the property itself. This is most likely to be applicable for a furnished holiday let (FHL). Do not forget to disallow a percentage of annual and other costs for periods where you/friends/family are in occupation. For instance if you, (family and/or friends - not paying full market rent) stay in your FHL for 4 weeks in a year, 13% of insurance, rates TV licence and gas and electricity costs should be disallowed.

*Renewals Basis* – ceased on 05/04/16 following an initial change in April 2013 which meant that a claim could only be made for replacing small items such as cutlery, crockery, cushions & bed linen i.e. items requiring regular replacement (perhaps as frequently as annually). Quite frankly, the sums involved were so insignificant as to make claiming hardly worthwhile.

And so to 06/04/16 when the renewals basis and "Wear and Tear Allowance" (WTA) both cease. Until then, a landlord of a fully furnished residential property could have chosen to apply the renewals basis instead of WTA whereas the landlord of an unfurnished or partially furnished property could only claim the renewals basis

From April 2016, the renewals basis is extended back to how it was prior to April 2013, so that it will now cover the replacement (but not the initial cost) of furnishings to include TVs, white goods, carpets and blinds. It has been given a new title – the replacement of furniture allowance – but, essentially, it is just reinstating the old style renewals allowance.

The big difference now is landlords of furnished residential accommodation must claim this relief.

Rent, rates & council tax – if the landlord pays ground rent this will be claimable. Whilst the tenant usually pays the rates or council tax, if the landlord incurs this expense (possibly when there is a void) such costs can be claimed.

Rent and Ground Rent.

Subscriptions to Landlords' Associations and similar. Be aware that training and research are not automatically allowable. As far as seminars and courses are concerned HMRC's position is that expenditure will be allowable if the course merely updates existing expertise or knowledge.

Uncommercial rents - Where properties are let out at less than normal market rent, such as to a friend or relative, the expenditure has not been incurred "wholly and exclusively" for the purpose of a rental business. HMRC will only allow the expenditure, up to the level of the income received: *'If the taxpayer lets a property below the market rate to, say, a relative (as opposed to providing it rent-free), they can deduct the expenses of that property up to the rent they get from it. This means that the uncommercially let property produces neither a profit nor a loss, but the excess expenses cannot be carried forward to be used in a later year'* - <http://www.hmrc.gov.uk/manuals/pimmanual/pim2220.htm>.

Also 'uncommercial lets' can never be pooled with 'regular' lettings to create a loss.

Use of Home as an Office – landlords often overlook the expenditure they incur in running their property business from home. When you are reading this on your laptop, tablet or other such device did you consider the cost of the broadband connection to be an allowable expense? Or the cost of the paper if printing it off? What about the printer and inks?

For some landlords, the expenses may be minimal in which case a standard weekly claim of £4 per week would be appropriate (rather than the £2 per week indicated in this link -

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<http://www.hmrc.gov.uk/manuals/bimmanual/bim47825.htm>). Records do not need to be kept to substantiate such a level of claim.

Landlords incurring greater expenditure – particularly if they have designated a room as their office – would have to be able to substantiate any higher level of expense claimed above the standard £4 per week (in the event of an enquiry).

Please note home as office allowance is meant to help towards the fixed costs of operating from home such as insurance, rates etc. It should be possible to apportion variable costs such as landline & broadband to claim the business element of the total cost.

Wages cannot be paid for the landlord's time and effort. However, a commercial rate can be paid to those assisting in the business such as a spouse or other family member. However, it could be advisable for all but the larger landlord to avoid employing staff because of extra administration involved with running a payroll plus the financial costs of employer NIC and auto enrolment pensions.

If the work is undertaken on ad hoc basis, it is likely that any remuneration paid could be deemed to be self-employment income in the hands of the recipient. They would then be responsible for their own income tax & NIC. They would also need to complete a Self-Assessment tax return on an annual basis (subject to the level of remuneration)

If somebody undertakes work on your let property on a regular basis such as a cleaner or gardener, it is suggested that a fixed monetary rate be agreed for the service and that you do not provide any tools or materials so that they are most likely to be treated as self-employed. If materials are provided to do the job, even if that worker is only with you for one hour or so per week, there is a chance that they will be treated as an employee, with all the tax implications that go with that.

Note that from April 2017 a £1,000 allowance for property income and a £1,000 allowance for trading income will be introduced. The new allowances will mean that individuals with property income below £1,000 or trading income below £1,000 will no longer need to declare or pay tax on that income. Those with income above the allowance will be able to calculate their taxable profit either by deducting their expenses in the normal way or by simply deducting the relevant allowance from their gross income.

This appears to be a very simple way of obtaining an allowable expense for paying a commercial sum to a self-employed family member for doing some work on a let property, possibly gardening over the summer months. (A way of getting a child returning from university to earn their keep over the holidays, springs to mind.) Or, could the beneficial ownership of the property be tweaked so that they receive a share of the rental income? Keep below £1,000 and no reporting to HMRC.

For some landlords, say, with no mortgage interest, this new allowance may prove beneficial to the current regime of calculating rental profits (regardless of paying out to family members). I particularly envisage married couples with one let property and no mortgage, may be better off operating in this way in future, particularly if it avoids completing tax returns.

Wear and Tear Allowance – ceased on 05/04/2016. A deduction was allowed only in respect of fully furnished residential properties equivalent to 10% of the gross rents after any costs which would ordinarily have been the tenant's responsibility i.e. rates, broadband packages etc. Superseded by the replacement of furniture allowance from 06/04/2016.

See 'renewals basis' header for further details.

For the replacement of integral features, see Maintenance, Repairs and Decoration.

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Hopefully this fact sheet will assist you in making sure that you are claiming all the deductions you are entitled to. If you have discovered an expense that you were entitled to claim but have not done so previously, consider revising last year's tax return. You have until 31/01/2017 to correct the 2014/15 tax return.

Expenses can usually be claimed on a property even if it's not actually occupied, provided it is being held out for letting on a commercial basis.

Remember to keep the relevant paperwork 6 years in the event of an HMRC enquiry.

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For & on behalf of Tax Facts Limited

Original November 2015, updated May 2016.

Appendix 1 – Fact sheet - 'Capital v revenue for landlords'

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