

RENT A ROOM FOR TRADERS

This Help Sheet explains how the Rent a Room scheme works. If your trade involves providing furnished accommodation, the notes below will help you to fill in the Self-employment Pages of your Tax Return to take account of the scheme (if it applies to you).

If your provision of furnished rooms does not amount to a trade, do not include the letting income in the Self-employment Pages. Ask the Orderline for the Land and Property Pages, and include the income there.

RENT A ROOM SCHEME

Rent a Room applies only to owner-occupiers and tenants who receive rent from letting furnished accommodation in their only or main home. In general, gross annual receipts (including sums paid in respect of meals, goods and services provided in connection with the use of accommodation) and balancing charges from that sort of letting that do not exceed £4,250 in total will be exempt from Income Tax altogether. However, if you wish you can opt out of this exemption. You might want to do so if you have made losses and want to claim relief for them.

If you receive gross annual receipts in excess of £4,250 you can choose between paying tax on:

- your actual profit from letting worked out in the normal way (that is, gross rents minus actual expenses and capital allowances), or
- your gross receipts (plus any balancing charges) *minus* £4,250 without any separate tax relief for allowable expenses or capital allowances.

The limit of £4,250 is reduced to £2,125 if during the basis period for the year, someone else received income from letting accommodation in the same property. Rent a Room does not apply to income from accommodation used as an office or for business purposes (other than by genuine lodgers such as students who are provided with study facilities in their lodgings).

Rent a Room relief applies to a tax year. To decide whether the Rent a Room conditions are satisfied and, therefore, whether the relief applies, you must look at what happened in the basis period for the tax year. You will need to get advice from your Tax Office or tax adviser if the income from this source is not for:

- a period of 12 months, or
- a period from the date of the commencement of the source to 5 April 1999, or
- a period from 6 April 1998 to the date of cessation of the source.

You should enter the following details on the Self-employment Pages:

- **if your gross receipts including balancing charges are less than £4,250 (or £2,125) and you want to claim exemption from tax on them**
 - enter 'Rent a Room' in box 3.2
 - leave the rest of the Self-employment Pages blank.
- **if your gross receipts excluding balancing charges exceed £4,250 (or £2,125) and you wish to claim Rent a Room relief**
 - enter 'Rent a Room' in box 3.2 and fill in boxes 3.3 to 3.10 as appropriate
 - if your gross receipts are less than £15,000, enter the gross receipts (including sums received for meals, goods and services but excluding any balancing charges) in box 3.11. If your gross receipts are £15,000 or more, enter the gross receipts (including sums received for meals, goods and services but excluding balancing charges) in box 3.16
 - enter £4,250 (or £2,125 if appropriate) in box 3.12 if your turnover is less than £15,000 or in box 3.50 if your turnover is £15,000 or more. Do not fill in boxes 3.17 to 3.49 or boxes 3.53 to 3.59
 - you will need to work out the amount of any balancing charges. Ask the Orderline for *Help Sheet IR222: How to calculate your taxable profits* and enter any balancing charge in box 3.55 as appropriate
- **if you do not want to claim Rent a Room relief**
 - fill in the Self-employment Pages by entering your gross receipts, expenses, capital allowances and balancing charges in the normal way.

Further information about the Rent a Room scheme can be obtained by requesting leaflet *IR150: Taxation of rents. A guide to property income* from the Orderline.

Summary

Under Rent a Room you can be exempt from Income Tax on profits from furnished accommodation in your only or main home if the gross receipts you get (that is, before expenses) are £4,250 or less. But you cannot then claim any of the expenses of the letting.

In addition, receipts over the £4,250 exemption limit can be taxed on an alternative basis, which may produce a lower tax bill. Briefly, the excess of the gross receipts over the exemption limit is treated as the taxable rental income, instead of the actual profit. But you cannot then claim any of the expenses of the letting.

For the purposes of the Rent a Room scheme, gross receipts include not only rents but also payments made to you for the provision of any other goods or services (such as meals, cleaning, laundry etc.) in connection with the letting. The £4,250 limit may be halved if someone else gets rents from letting in your home.

The Rent a Room scheme applies to ordinary lettings of living accommodation in your own home. It does not apply to rooms let as an office or for other business purposes. But the scheme applies to genuine lodgers who study in your home or who do some of their business work in your home in the evenings or at weekends.

Rent a Room applies to people who let a room in a home they rent as well as to people who own their homes. It is not relevant for tax but you may want to check whether:

- your lease allows you to take in a lodger (where you rent your home)
- your lender has any objection to your taking in a lodger (where you have a mortgage on your home);
- your insurance company is content; your cover may not be adequate if circumstances have changed.

Details of the Rent a Room exemption limits

The exemption limit of £4,250 is reduced to £2,125 if during the tax year to 5 April, someone else received income from letting accommodation in the same property. This might happen where you own your home jointly with another person.

If the period of letting is less than 12 months, the limit of £4,250 is reduced to £2,125 if some other person lets accommodation in the same residence at any time in any period of 12 months that includes your less-than-12-month period.

— You move home during the year

The Rent a Room rules apply to the total gross furnished letting receipts for the tax year from your own home. If you move home, and lettings in both your old and new home qualify for Rent a Room relief during the same year, you must add together the rents from both to find the total receipts.

— You move abroad

If you let your home in the United Kingdom while you live abroad, you will not normally be within Rent a Room. This is because the let property will not usually be a residence of yours at any time during the basis period for the letting. Ask your Tax Office or your tax adviser for advice.

— You are below the exemption limit

Where you are below the exemption limit you are automatically exempt from tax. But you can ask to be taxed in the normal way - that is, on your receipts less expenses. This may be to your advantage where, for example, you have a loss and you would like to use that loss. A similar point may arise where you are taxed on the excess of your receipts over the exemption limit but you actually made a loss.

Lodger provided with services that amount to a trade - basis period

Some lettings may amount to a trade. This is likely to happen where you run a guest house or bed and breakfast business, or if you provide material services, for example, meals and cleaning. If your lettings amount to a trade, Rent a Room relief may still be claimed, but you should exclude any assessable profits from your rental business and return them as trading profits.

The basis period for a property business must be the tax year itself (the year to 5 April) or the actual period of letting in the tax year if this is shorter. But if your letting activity amounts to a trade, you can choose a different annual period (generally a period of one year ending on a date in the tax year). You will usually find your tax calculations easier if you stick to a 5 April year end.

Two Rent a Room methods for receipts above exemption limit

The Rent a Room scheme provides two ways to work out your tax when your receipts are above the exemption limit of £4,250 (or £2,125 if someone else also had income from the same property in the same period). You can choose which of the following two methods is best for you:

- A paying tax on the profit you make from letting, worked out in the normal way for a rental business (that is, rents received minus expenses), or
- B paying tax on the gross amount of your receipts (including receipts for any related services you provide) minus the £4,250 (or £2,125) exemption limit.

Method A applies automatically unless you tell your Tax Office within the time limit (see page 4) that you want method B.

Once you have elected for method B it continues to apply in the future until you tell your Tax Office you want method A. You must tell your Tax Office within the time limit if you decide you no longer want method B to apply. You may want to do this where the taxable profit is less under method A or where expenses are more than the rents (so there is a loss).

For example, your gross receipts may be £5,000 but your expenses are £6,000 so you have a loss of £1,000. Unless you opt out of method B, you will still be taxable on the excess of the gross receipts of £5,000 over the exemption limit of £4,250; that is, the taxable profit from letting in your own home will be £750.

Example where method B is better - Florence

Florence lets out a room in her own home for £150 a week. Nobody else lets a room in the house. Her gross receipts for the year are £7,800. She is not exempt from tax because her gross receipts exceed the exemption limit of £4,250. She has expenses of £1,000 so her profit is £6,800. The excess of her receipts over £4,250 is £3,550 (£7,800 minus £4,250).

- Using method A, she pays tax on her actual profit of £6,800.
- Using method B, she pays tax on a profit of £3,550.

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

Example where method A is better - John

John lets out a room in his own home for a rent of £150 a week plus contributions to the heating and light. His total letting receipts for the year from letting the room are £7,800 rent plus £200 for light and heating = £8,000. He has expenses of £4,500 so his profit is £3,500. The excess of his gross receipts over £4,250 is £3,750 (£8,000 minus £4,250).

- John pays tax on his actual profit of £3,500 if he uses method A.
- John pays tax on a profit of £3,750 if he uses method B.

In John's case, method A is better. Therefore he either does not elect for method B or, if he has already done so, he tells his Tax Office that he no longer wants it to apply.

— Changing from method A to method B and vice versa

You can change from method A to method B (or vice versa) from year to year. But each time you want to change you must tell your Tax Office within the time limit.

Method B will automatically cease if the rent you get drops below the exemption limit of £4,250 (or £2,125). You will then be automatically exempt from tax on this rental income unless you ask within the time limit for your actual profit or loss to be taken into account. If, in the following year, your gross receipts go up and you want to use method B again, you must tell your Tax Office within the time limit. Otherwise you are automatically taxable on the normal rental business basis (receipts less expenses).

Rent a Room and losses

Losses cannot be created under the Rent a Room scheme. So, if you are under the exemption limit or you are taxable under method B, any actual loss you make cannot be relieved unless you tell your Tax Office within the time limit that you do not want Rent a Room to apply.

Any losses outstanding from earlier years when your rents were not within the Rent a Room scheme are not wasted. They are dealt with as follows:

- suppose your gross receipts from letting in your own home in the current year are no more than £4,250 (or £2,125) and you therefore have no tax to pay on that income. Here the full amount of any losses from an earlier year can be brought forward and set against any other business profits of the current year. If there are no other business profits in the current year, the losses can go forward to be set against the first business profits of a later year. The losses are not reduced because Rent a Room exempts or reduces your tax bill for the year.
- suppose your gross receipts from letting in your own home are more than £4,250 (or £2,125). Here the earlier losses can be set against your net profits in the normal way (however the taxable profits are calculated). That is, whether the income from letting in your own home is calculated under method A or B, and whether or not there is any other letting. For example, suppose you have no other lettings and you chose method B. Here your business profits will be the excess over £4,250 (or £2,125) and it is this excess amount that will absorb any losses. Any remaining losses will then be allowable against the taxable business profit of the following or later year, however calculated.

Interest and Rent a Room

Interest paid on a loan used to buy a property cannot be claimed as a deduction in your rental business if Rent a Room applies during a year. That is, if:

- your receipts from letting a room in your own home are below the exemption limit and you have not opted out of Rent a Room, or
- you elect for method B, where the tax is simply based on the excess of receipts over the exemption limit.

This is the same treatment as applies to any other expenses.

Relief under the MIRAS arrangements will not normally be affected unless you let more than one third of your home.

Rent a Room time limits

There are time limits within which you must tell your Tax Office if:

- you do not want to be exempt when your gross receipts are below the exemption limit of £4,250 (or £2,125), **or**
- you want method B to apply, or want it to stop applying.

The time limits are:

- just under 22 months from the end of the tax year for 1996-97 and later years, **and**
- 12 months from the end of the tax year for 1995-96 and earlier years.

— Extension of time limits for Rent a Room

The time limits for letting your Tax Office know what you want done are strictly applied. But we may extend the time limits in certain exceptional circumstances, for example, where you have been seriously ill for some time and it was impossible for you to deal with your tax affairs. The limits are unlikely to be extended if you leave everything to the last minute and then have a minor illness. If you have, for some good reason, missed a time limit, please explain the circumstances to your Tax Office.

These notes are for guidance only, and reflect the position at the time of writing. They do not affect any rights of appeal.