



RESIDENTIAL INVESTORS & LANDLORDS TAX INFORMATION

The following notes are intended to provide a useful background for investors buying and letting UK residential properties. Independent advice, tailored to your specific needs and circumstances is essential and these notes should be used as general guidance only.

General Considerations Before Buying

Investment or Trade

The tax treatment of a residential property purchase is determined by your future intentions. If the property is bought for letting, generally it will be regarded by HM Revenue and Customs (HMRC) as an investment property. If the intention is development and sale, it will usually be regarded as a trading activity. It is important to determine which of these applies, as each has different tax consequences. If the purchase is treated as an investment property, any profits on disposal are taxed under Capital Gains Tax (CGT) regime.

How to Hold Property

This depends on your circumstances and your plans for the future. The newly introduced interest rate restrictions described below will have an impact on your decision. Many landlords buy in their own name but Partnerships, Limited Liability Partnerships, Limited Liability Companies and trusts are all useful vehicles in certain circumstances. How the property is held will determine whether any profits are taxed under Income Tax or Corporation Tax legislation.

Proper planning is essential before you buy your property as this will have a significant impact on your total taxes both in terms of the tax payable on the annual rental profit and the capital gains tax on an eventual disposal. Even if you are an existing landlord, you should consider whether your current business is structured in the most efficient way. It is often possible to implement changes to reduce tax exposure.

Restrictions of loan interest relief from April 2017

Historically, gearing up a property has been a common feature to make the structure more tax efficient as the related loan and finance costs were previously fully tax deductible. However from April 2017 mortgage interest relief (and finance costs) for individual landlords is being restricted to the basic rate of tax. This is a fundamental change for landlords and to ease the full impact, the measure is being phased in starting from April 2017 (2017/18 tax year) with full implementation in the 2020/21 tax year. In light of this significant change, investors need to review their strategy as they will potentially be exposed to higher taxes. This change affects all individual landlords (including basic rate tax payers) as relief from now on will be given as a tax deduction and not as an allowable expense.

Depending on your circumstances the loss of higher rate tax relief may be prohibitively expensive for existing landlords. There are possible alternative ways to hold your property such as through a limited company where the tax rates are set to reduce to 17% by 2020 or as a furnished holiday let. However for both of these, there are other important tax issues which need to be taken fully into consideration.

Capital Expenditure

Expenditure on repairs to bring a newly purchased un-lettable property up to a rentable condition is regarded by HMRC as capital expenditure; so if you are planning to buy and refurbish, do not assume that the expenditure will make your rental business free of tax for a few years: it may not!

Tax Issues at the Time of Purchase

Stamp Duty Land Tax (SDLT) - 3% Increased Rates

SDLT is payable on the purchase or transfer of property or land in the UK, at rates ranging from 0% to 15% for residential property and from 0% to 5% for commercial property.

Since 1 April the higher rates charged on purchase of additional residential property (second homes or buy to let properties) is 3% above the current SDLT rates on purchases over £40,000. Relief from the 3% surcharge is usually available when a main residence is being replaced.

For companies, the default rate of SDLT for purchases of UK residential property is 15% but relief is available from the default rate in a number of circumstances such as where the property is used for the purposes of a property rental business or for redevelopment and sale.



For full details of SDLT bands and other tax rates download our free WSM Tax App for iPhone, iPad, Android and Blackberry

Value Added Tax (VAT) on Professional Fees

VAT is charged on all professional fees at the standard rate (currently 20%) and this will include fees for your surveyor, valuer, estate agent, lawyer and accountant. VAT incurred on these costs can not be claimed back from HMRC for purchases of residential property.

Tax Issues During the Period of Ownership

Advising HM Revenue and Customs (HMRC)

If you do not already submit a self assessment tax return, you have to notify HMRC if you receive rent in excess of £10,000 or your rent after expenses exceeds £2,500 in a tax year. Even if your rental income is below these limits you should notify HMRC if you owe tax on your rental income or you wish to claim a tax loss. You should take professional advice if you are unsure about your obligations to HMRC. If you already submit an annual tax return you should include your property income and expenses on the return each year.

Record Keeping

Proper record keeping is essential. HMRC requires property letting to be treated like a business, and income and expenditure should be recorded appropriately and details kept for six years.

Records of the purchase and any capital expenditure should always be kept for at least three years after the property is sold.

Making Tax Digital for Business (MTD)

Under HMRC's plans to introduce MTD, the majority of the self employed, property landlords and company tax payers will be required to use software in order to report quarterly to HMRC followed by an annual update. This change represents a big challenge for everyone in the accounting, bookkeeping and tax professionals. The time table for implementation is being phased in and has already been delayed due to the complexity and practical problems. Self employed Vat registered individuals are to start reporting from April 2019 and as it currently stands, from 2020 (no date confirmed) it will be applicable for Self employed individuals and landlords whose turnover /gross income exceeds £10,000 and companies.

Income Tax/Corporation Tax on Profits

Tax is charged each year on the rental profit generated from the property. The profits are calculated at the end of each year and the accounts showing the rental income less expenses. From April 2017 the 'cash basis' is the default basis for small unincorporated property businesses and taxpayers can elect to use the conventional accruals basis. Detailed accounting rules are applicable for the cash basis.

Cash basis is not available under certain circumstances some of which include where cash receipts are over £150k in a tax year; you operate via a company, an LLP, a trustee or a partnership with at least one non-individual member. Rental profits are added to other income during the tax year and are taxed at the individual or corporate marginal rate of tax applicable.

Allowable expenses

All expenses incurred (other than capital items) wholly and exclusively on the rental business are allowed against the rental income when calculating the taxable profits. The wholly and exclusively requirement can cause difficulty and professional advice may be required; indeed there is a variety of case law surrounding the definition. The expenses that can be claimed are typically, but not exclusively letting and management fees; maintenance and repairs; building service charges; ground rents; insurance and mortgage interest.

Replacement Furniture Relief (“RFR”)

The generous wear and tear 10% allowance for fully furnished properties has been abolished and replaced by RFR in April 2016. Under the new system, tax relief is given for the actual replacement cost of furnishings. These will include moveable furniture, furnishings such as carpets, curtains, household appliances such as fridges and freezers, televisions etc. Items must be provided solely for the use of the tenant within the residential property. This is bad news for many landlords as the change will result in higher profits and higher tax liabilities as the previous wear and tear allowance was usually more favorable.

Council Tax

This tax is usually only paid by the landlord if the property is empty; otherwise it is normally the responsibility of the tenant occupying the property.



Rent a Room Relief

An individual may rent a room in their own residence and provided the rental income does not exceed £7,500 (previously £4,250) all rental income is tax free each year. Various conditions are applicable. A regular review is advisable because sometimes such a claim is not advantageous as no deductions for allowable expenses can be made where this relief is claimed.

Tax Losses

Where the computation of rental income and expenditure for the property portfolio produces a tax loss, the loss can be carried forward and set off against profits from the property portfolio in subsequent years.

Tax Issues on Disposal

Capital Gains Tax (CGT)

Tax is charged on the increase in the capital value of your investment property. In calculating the gain, the rules allow the deduction of the original purchase price, SDLT and other purchase costs, capital improvements during the period of ownership and selling expenses from the sales proceeds. The resulting gain is the chargeable gain.

Lower capital gains tax rates of 10% and 20% were introduced from April 2016. Unfortunately these lower rates do not apply to the disposal of residential property interests which continue to be taxed at 18% and or 28%.

Currently, CGT is payable on 31 January following the end of tax year, which may be up to 22 months after the date of disposal, giving landlords the cash flow advantage of funds. It was announced from 2019, taxpayers will be required to make a payment on account of any CGT due on disposal within 30 days of completion. Draft legislation has not been published and it remains to be seen if this will happen.

Annual CGT Allowance

Each individual owner of the building is entitled to deduct, from their portion of the chargeable gain, an annual exempt amount which is £11,300 for the 2017/18 tax year.

Indexation Allowance – Frozen

A corporate owner of an investment property is liable to pay corporation tax on the chargeable gain. Companies do not get an annual exempt allowance. However, companies are entitled to deduct an indexation allowance from the chargeable gain to remove the eroding effects of inflation from the gain. The indexation allowance is based on published monthly RPI movements. This deduction is not available to non-corporate owners. In the Autumn 2017 Budget, it was announced that this allowance will be frozen at 31 December rates for disposals on, or after 1 January 2018

Principal Private Residence Relief

When you sell your own home, you usually do not have to pay tax on any gain you make. This is known as Principle Private Residence (PPR) relief. If a rental property has at some time been occupied by you as your main residence, you may be able to take advantage of PPR to reduce, or even eliminate the taxable gain arising on disposal. The gain arising is time apportioned between the period of owner occupation (exempt) and the letting period (taxable).

18 Months Rule and Letting Exemption

Where a property has qualified as your main residence, the last 18 months of ownership are usually also entitled to exemption from CGT, even if the property is let out during this period. In addition, lettings relief of up to £40,000 per owner may be available; so where the property is jointly owned by two persons, the lettings relief can exempt a further £80,000 (£40k x 2) of gain - so long as various other criteria are met. Again, professional advice is recommended to assist in calculating the chargeable gain, and this should be reported to HMRC on the individual's tax return for the tax year of sale.

Tax Issues: Special Circumstances

Furnished Holiday Lettings

Special legislation exists for properties in the UK and the European Economic Area (EEA) that are used to provide commercial furnished holiday lettings. This provides certain tax advantages including some CGT reliefs (i.e. business asset roll-over relief and entrepreneur's relief).

To qualify for this tax treatment, various conditions must be met. These conditions are very detailed and getting professional advice is recommended. They include strict rules on the commerciality of the letting and availability of accommodation during the year.

Non-UK Resident Investors/Landlords

Non resident investors who own an investment property in the UK will be treated as carrying on a UK property business. Income tax is applicable on the rental profits and specific rules are applicable.

Letting agents and/or tenants are required to withhold tax at the basic rate and account this to HMRC, unless successful registration has been made to formally register as a non resident landlord and to receive rent without any tax deduction.

Removal of CGT Exemption for Foreign Investors

The major change in this area came into effect for disposals after 5 April 2015. Generally, an individual who is resident in the UK for tax purposes is chargeable on his or her worldwide income and capital gains.

Prior to 5 April 2015, non residents could dispose of UK residential property and were not subject CGT. It is important to note that only gains arising after 5 April 2015 are liable for CGT. Taxpayers can choose between using the property's 6 April 2015 value as a base cost and applying a time apportionment of the entire gain. The most favorable method will not be apparent until the property is sold, which may be years away and it would be advisable for non residents to obtain a 6 April 2015 valuation for future use while evidence is easily available.

The rate of tax for non resident individuals will be the same as the CGT rates for UK resident individuals: currently 18% or 28% depending on the total UK income and chargeable gains in the tax year.

Annual Tax on Enveloped Dwellings (ATED)

ATED is an annual charge on UK dwellings held by a non-natural person (e.g a company). The tax is payable based on a scale charge starting with a property value exceeding £500,000. Fortunately for landlords and property developers a number of reliefs are available under certain specific circumstances. An annual return must be filed to claim the relief and filing deadlines are applicable. The result is that ATED is most commonly payable when the residential property is let 'uncommercially' or to a connected party.

WSM PRIVATE CLIENT

U K T A X S P E C I A L I S T S

Here at WSM, we have in depth knowledge and experience in dealing with this complex area and are able to provide practical tax planning solutions.

We have many “landlord/investor” clients. Many of them are non UK residents and we have enormous practical experience in dealing with the additional complications caused by this, such as registering under the non resident landlord scheme. Indeed our experience covers the widest range of property tax issues to minimize tax, from initial buying strategies right through to disposal.

This guide is for general information only. No responsibility is taken for any action or refrained from in consequence of its contents. Always seek professional advice before acting.



Shakeel Butt

Corporate and Private Client Director
Residential Property Specialist

Shakeel.Butt@wsm.co.uk
020 8545 7624

Shakeel trained and qualified with a Central London firm and is a fellow of the Association of Chartered Certified Accountants. Shakeel has over 25 years of hands-on experience and is able to advise on a wide range of accountancy, taxation and business related issues.

Specialties

Tax planning advice for resident and non-resident property investors
Personal, corporate and capital gains tax compliance and planning
Personal, business advisory and consultancy services
Tax mitigation strategies

“My approach is to understand fully my client’s needs and requirements. I help to organize their affairs accordingly and build a good working relationship to achieve their goals. Successful clients become profitable and need tax planning to mitigate their liabilities. With over 25 years experience, I am able to offer effective tax strategies to achieve these ends.”