



**F S P G**  
CHARTERED ACCOUNTANTS



**KEY GUIDE**

# Taxation of property



## Becoming a landlord

You may have been lucky enough to inherit rental property or be in the position to purchase property outright. However, buying-to-let is the usual way of becoming a landlord, and it is an attractive proposition for anyone who can raise a deposit. Given a prolonged period of low borrowing costs and generally rising property values, this is not surprising. There has also been a perceived lack of good alternatives, with low savings rates and restrictions on the amount that can be saved into a pension.

However, recent tax changes, tighter lending rules and last November's bank base rate increase have had a negative impact on the buy-to-let market. This means that anyone thinking of becoming a landlord in future will need to carefully consider the pros and cons, especially when it comes to tax.

## Buying a property

While finding the right property in the right area at the right price will be at the forefront of your mind, you should not forget the tax implications.

### Stamp duties

Although you will incur various lending, legal and survey costs, stamp duty land tax (SDLT) is usually the biggest expense when purchasing a property. SDLT rates are increased by 3% when it comes to buy-to-lets, regardless of whether you buy the property personally or through a limited company. If purchasing a buy-to-let in Scotland, you will pay land and buildings transaction tax (LBTT) instead of SDLT, but again a 3% surcharge will apply. In both instances, tax is paid on the slice of the purchase price falling within each tax band. Wales will replace SDLT with a land transaction tax from April 2018. Current rates, including the 3% surcharge, are shown in the table below:

UK – SDLT (excluding Scotland)	Scotland – LBTT	Rates
Under £40,000	Under £40,000	0%
Above £40,000 and up to £125,000	Above £40,000 and up to £145,000	3%
Above £125,000 and up to £250,000	Above £145,000 and up to £250,000	5%
Above £250,000 and up to £925,000	Above £250,000 and up to £325,000	8%
Above £925,000 and up to £1,500,000	Above £325,000 and up to £750,000	13%
Above £1,500,000	Above £750,000	15%

As a general rule, living in a property before letting it out will not get around the 3% surcharge. The only situation where the surcharge will not apply is when your buy-to-let purchase is your only property, such as where you are personally living in rented accommodation.

### Example – SDLT calculation

Emma, who already owns a main residence, purchases a buy-to-let property in England for £280,000. The amount of SDLT payable is £12,400, calculated as:

First £125,000 at 3%	£3,750
Next £125,000 (£125,000 to £250,000) at 5%	£6,250
Final £30,000 (£250,000 to £280,000) at 8%	<u>£2,400</u>
	<b>£12,400</b>



### Planning point

*SDLT is not payable on any part of the purchase price that is attributable to such things as carpets, curtains and any other furniture and domestic appliances that the vendor leaves in the property, so a modest reduction in the amount of SDLT payable may be possible.*

## Personal or corporate purchase?

An important decision that you will have to make at the outset is whether to purchase your buy-to-let property personally or through a limited company. The recently introduced restriction to the tax deductibility of finance costs has increased the relative attractiveness of the company route. The low rate of company tax (currently 19%, falling to 17% from April 2020) also means that this option makes sense if you are aiming to retain profits for reinvestment in additional property or to repay some of your financing.

A company structure makes it relatively easy to include family members in your property business, and control can gradually be passed to children or grandchildren which makes for good inheritance tax (IHT) planning.

However, the overall tax charge might well be higher if profits are withdrawn from a company. If taken as remuneration, national insurance contributions could be payable. If extracted as dividends, there could be a double charge to tax if the dividends are more than the tax-free dividend allowance (currently £5,000, but reducing to £2,000 from 6 April 2018). Capital gains may also suffer a double tax charge.

### Example – Tax charge on company dividends

Winston, a higher rate taxpayer, has £20,000 of property income within his property company which he wishes to withdraw as a dividend during 2017/18.

If Winston had received £20,000 of property income as an individual, then he would have paid income tax of £8,000 (£20,000 at 40%), leaving him with £12,000.

The company will pay corporation tax of £3,800 (£20,000 at 19%), leaving £16,200 to pay out as a dividend. If the dividend allowance is not available, Winston will pay income tax of £5,265 (£16,200 at 32.5%) on the dividend, leaving him with net income of £10,935.



### Planning point

*If buying a leasehold property, check that the ground rent is not excessive. The recent use of high, escalating, ground rents, can seriously impact on the future value of the property and, in some cases, make it unsaleable. Although leasehold reforms have been proposed, these are mainly focused on new properties.*

## Impact of the finance costs restriction on the level of borrowing

The restriction to the tax deductibility of finance costs also affects the amount that you can borrow. The affordability tests applied by lenders take account of the tax that you will have to pay on property income, which could be higher given the restriction if you pay tax at more than the basic rate. Lenders will probably require rental income to be 145% of your finance costs if you are a higher rate taxpayer, compared to the previous level of 125%. Borrowing at the 125% level should still be possible, if using a limited company or if you just pay tax at the basic rate.

## Renting a property

The basis for taxing property income used to be straightforward, but this is no longer the case following recent tax changes.

For individuals, property income is calculated on a tax year basis, with accounts being prepared to 5 April (31 March is permitted). Income and expenses for all your buy-to-let properties are pooled together, with figures normally calculated on a cash basis. Rent and expenses are therefore included when received or paid. For companies, property income is calculated according to the company's accounting period and must be done on an accruals basis.

## Allowable deductions and reliefs

To be allowable, expenses must be incurred wholly and exclusively for your buy-to-let business, and will typically include:

- Letting agent's fees.
- Cost of maintenance, repairs and gardening.
- Council tax, water rates, gas and electricity.
- Property insurance.
- Advertising.

You can also deduct any amounts spent on replacing furniture and furnishings. This includes such items as beds, televisions, fridges and freezers, carpets and floor coverings, curtains, and crockery and cutlery. However, there is no relief for the initial cost of furniture and furnishings. The amount of relief is reduced by any proceeds from selling the old asset which has been replaced. Also, relief is not given for any cost which represents an improvement, for example: if a washing machine is replaced with a washer-dryer, only the cost of an equivalent washing machine qualifies for relief. However, this rule is relaxed if the improvement element is incidental, such as replacing single-glazed windows with the modern equivalent of double-glazed windows.

## Finance costs

Tax relief for an individual's finance costs, such as interest on mortgages and loans to furnish a property, is to be replaced with a basic rate relief tax reduction. This change is being phased in over four years, with just 75% of finance costs allowable against rental income for 2017/18. The percentage will drop to 50% for 2018/19 and 25% for 2019/20. Thereafter, no finance costs will be deductible.



### Planning point

*Unless you are using a letting agent, make sure that you check the right to rent of all new tenants aged 18 or over, even if they are not named on the tenancy agreement. You will need to ask for, and keep copies of, original documents proving that tenants are permitted to live in the UK.*

### Example – Finance costs restriction

For 2017/18, Alice, a higher rate taxpayer, has buy-to-let rental income of £20,000, allowable deductions of £2,000 and finance costs of £14,000.

Alice can deduct £10,500 (£14,000 x 75%) of her finance costs, so her property income for 2017/18 is £7,500 (£20,000 – £2,000 – £10,500), on which she will pay higher rate tax of £3,000. She can then deduct tax relief at the basic rate for the other 25% of her finance costs (£3,500 at 20% = £700), resulting in a tax liability on her property income of £2,300 (£3,000 – £700).

Assuming the figures stay the same, over the next three years, Alice's tax liability will increase as follows because of the increasing finance costs restriction:

2018/19:	£3,000
2019/20:	£3,700
2020/21:	£4,400

Therefore, from 2020/21 onwards, Alice's tax liability of £4,400 will exceed her buy-to-let profit of £4,000 (£20,000 – £2,000 – £14,000).

If Alice had used a limited company structure to purchase her property, then the company would have paid tax of just £760 (£4,000 at 19%) – 100% of the finance costs being deductible. However, Alice would then face more tax when extracting the property income from the company.

## Proposed allowance

From 6 April 2017, an annual property allowance of £1,000 can be claimed as a deduction by individuals if this is more than your actual allowable deductions and reliefs.

## Common errors

Many landlords are unaware of their tax responsibilities. HM Revenue & Customs has been running a let property campaign for several years and has published examples of errors made by landlords. You might not even think of yourself as a landlord. This could be because you've inherited a property, just rented out a property to cover your mortgage payments, or moved in with someone and have therefore had to rent out your house. None of these are a reason for not correctly calculating and declaring property income.

## Non-tax issues

There are many non-tax issues, but two are worth mentioning:

- **Agent or not?** The first is whether to use a letting agent or run things yourself. A good agent will be invaluable when it comes to finding tenants (and filtering out bad ones) and ensuring that tenancy agreements are watertight. They will be up to date with property legislation (especially fire safety), take much of the stress out of maintenance and provide an impartial buffer should the tenancy go sour. However, lettings agents are not cheap, so one popular option is to just use an agent to find and vet tenants, and to set up the tenancy.
- **Multiple occupancy** The second is the need to be aware of the additional requirements if you rent out your property as a house with multiple occupancy (an HMO). This is a complex area, but essentially multiple occupancy means at least three tenants, forming more than one household, but who share facilities like a bathroom. Student lets will normally be classed as HMOs.



### Planning point

*It can make sense to try and retain an existing tenant by foregoing rent increases. Apart from the costs associated with finding a new tenant, there is generally no discount from council tax when your property is empty.*

## The tax implications of sale or disposal

Although there is no certainty, your buy-to-let property portfolio may increase in both size and value, and at some point you may want to cash in some properties, possibly to pay down the finance on those to be retained. Another option as you get older might be to gift some properties to your children or grandchildren. Capital gains tax (CGT) will come into play whether you sell or gift property, although this tax can be avoided by simply retaining property until your death. Your children or grandchildren can then inherit properties with an uplifted base cost for CGT purposes, although IHT then becomes an issue.

- **CGT:** The gain will be based on what you sell a property for, or its market value if gifted. You can deduct the original purchase cost, incidental costs of purchase and sale (such as legal fees and stamp duty) and any expenditure which has enhanced the value of the property (and will therefore not have been deducted as repair expenditure when calculating property income). After deducting any available annual exempt amount (currently £11,300), gains will sit on top of your income for the tax year of sale or disposal. Any part of the gain that falls within your basic rate band will be taxed at 18%, with the remainder taxed at 28%.
- **IHT:** Outright gifts of property will have IHT implications if you die within seven years of making the gift. If your property portfolio is retained until death, then it will be included as part of your estate at its value at the time of death. Basically, IHT is payable at the rate of 40% once a nil rate band of £325,000 (up to £650,000

if you can benefit from the nil rate band of a deceased spouse or civil partner) is exceeded.



### Planning point

*If the 105 day test for a furnished holiday letting cannot be met for a particular property, then see if you can meet this test by applying an average over two or more holiday lets.*

## Corporate disposals

If you have used a company structure for your buy-to-lets, then any gains will be made within the company and taxed at the 19% company tax rate. But note that companies do not benefit from the annual exempt amount. The base cost of any property disposals is uplifted by an indexation allowance, which allows for the impact of inflation, as measured by the retail prices index (RPI).

However, indexation has been frozen at December 2017, so no relief will be given for inflationary gains from January 2018 onwards. Properties acquired on or after 1 January 2018 will not benefit from indexation. Should you wish to subsequently extract the proceeds of a company property disposal, then you will face a potential double tax charge – the corporation tax payable on the gain and then your personal tax on the withdrawn proceeds – which is inefficient when compared to the tax cost of disposing of a personally owned property.

For gifts during lifetime or on death, the relevant asset will be the company's shares rather than the underlying property assets. The value of the company's shares will be included in your estate on death, with no uplift to the base cost of the property held within the company. IHT business relief does not generally apply to property company shares.

## Other types of property letting

The introduction of the finance costs restriction for buy-to-lets has spurred interest in other types of property letting which do not suffer the same restriction.

### Furnished holiday letting

Furnished holiday lettings are treated as a trade and therefore qualify for various tax advantages, although they will obviously require considerably more work given the short-term nature of the lettings. Apart from not suffering from the finance costs restriction when calculating property income, any gain on the disposal of a furnished holiday letting can benefit from a 10% capital gains tax rate.

However, the qualifying conditions are quite difficult. Essentially, a property must be available for letting at least 210 days a year and let for at least 105 days.

### Commercial property

You might not like the idea of commercial property, but semi-commercial property, such as where there is a flat above a shop, might be an attractive proposition, being halfway between commercial and residential investment. The purchase of such a mixed-use property will not suffer the 3% stamp duty surcharge, and the finance costs restriction will not apply to those finance costs associated with the purchase of the commercial element of the property.

#### Example – SDLT saving on a mixed-use commercial property

Referring back to Emma, who purchased a buy-to-let property for £280,000, paying SDLT of £12,400, if she had instead purchased a mixed-use commercial property, the amount of SDLT payable would have been just £3,500 based on the non-residential rates – a saving of £8,900.

Also, the rental yield from mixed-use commercial property is often significantly higher than that from a traditional buy-to-let.



### Planning point

*Consider renting out a furnished room (or rooms) in your own home. Rents of up to £7,500 each tax year are exempt from tax.*

## Renting a room

Although on a much smaller scale, do not overlook the tax advantage of renting out a furnished room or rooms in your own home. Rents of up to £7,500 each tax year are exempt from tax, which will be quite beneficial for a higher rate taxpayer. The relief does not apply, however, if you have converted part of your home into a separate flat.

You can either rent to a long-term lodger or make use of an online site such as Airbnb to offer holiday lets. But don't forget to inform your mortgage lender, review insurance cover and check whether there are any local authority restrictions.

## How we can help

We can advise you of the tax implications prior to you purchasing a property and help you decide whether a corporate structure is going to be appropriate for you.

Once your property business is up and running, we will manage your tax affairs each year, doing our best to minimise your tax liability.

And when it comes time to sell, we can advise you of what it's going to cost in tax terms. We can also undertake estate planning so that future IHT liabilities are kept to a minimum.

There have recently been several important changes to the way in which property income is taxed. We can keep you up to date with any further changes that will affect you.

*This publication is for general information and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. This publication represents our understanding of law and HM Revenue & Customs practice as at 10 January 2018.*



**FSPG Chartered Accountants**

21 Bedford Square London WC1B 3HH  
Telephone: 020-7637 4444 Fax: 020-7323 2857  
E-Mail: [admin@fspg.co.uk](mailto:admin@fspg.co.uk) Web: [www.fspg.co.uk](http://www.fspg.co.uk)

**Contacts**

Jon Glasner FCA, BSc Howard Presky FCA Ian Fenton FCA Jayendra K. Shah FCCA, CTA  
David Tropp FCA Anthony Cohen FCA Khalid Q Rana FCCA Jason Samuels ACA  
Paul Maurice FCA, CTA Ian A. Sussman FCA

Registered to carry on audit work in the UK and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales.

