Your buy-to-let tax guide

Award-winning mortgage advice

Mortgage Advice Bureau

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Introduction

With relatively low interest rates and strong demand amongst tenants (due to the lack of new house builds and the fact that lenders are retaining a very cautious approach to first time buyers by demanding significant high levels of deposit) we believe that demand for the rental sector is likely to remain and potentially grow in the future.

When making a buy-to-let investment decision, landlords need to be aware of the tax issues and obligations facing them, not only as property investors, but also as individuals with other businesses, careers and investments. Many factors can affect the returns in both capital and income and it is important to start with the right purchasing structure and to make use of all the available tax reliefs at the appropriate times.

Tax is a very complex area and the rules can change rapidly. A business structure setup in 2021 may not receive the same tax treatment in 2026.

It is essential that landlords seek advice from a specialist taxation and accountancy adviser. This will ensure a strategy is devised which best suits your individual needs over the long term.

This booklet does not cover every tax aspect of a buy-to-let business. It sets down the basics and provides pointers for tax saving ideas. To minimise your own tax liabilities it is essential to take tax advice that is tailored to your individual situation.

1. What is a property investment business?

There are slightly different tax rules that apply to property investment businesses – when property is held for the medium to long term in order to let out, and a property trading businesses – when property is acquired for development and a quick sale. In the case of a property trading business, the property is treated as a stock item rather than as an investment, and the profits are taxed as a trade (see chapter 6).

You do not have a choice as to whether your property business is taxed as property investment business or a trade. The facts of how you make your money determine the tax treatment.

Most individuals who buy property to let will hold and let that property for some years, and they will be taxed as a property investment business. The landlord is taxed on the annual profits made from letting their property under the tax rules for UK property income.

If the property is located in another country the profits or losses from that business must also be kept separate from your UK property letting (see chapter 10). You may also have to comply with tax reporting rules in the country where the property is situated.

As a landlord you may hold the property in your own name, in which case you are subject to the income tax rules for property income. From 6 April 2017 there are restrictions on the level of finance and interest costs which can be deducted from residential letting income for tax purposes (see chapter 4).

When you hold your let property through a company, that company is currently subject to corporation tax at 19% on the profits. However, the profit or loss from letting through a company is calculated without the restriction for interest and finance charges which apply to individual landlords (see chapters 4 and 13).

There are a number of differences between a property investment business and a normal trade, which can be advantageous.

With a property investment business:

- Your annual profits are not subject to national insurance;
- Any profit made on disposal of a property is taxed as a capital gain so your personal annual exemption can be deducted (see chapter 8);
- A residential letting business does not have to be VAT registered, although there are exceptions (see chapter 11).

There are also disadvantages of the property income tax rules:

- Losses cannot generally be set against your income from other sources;
- Expenditure connected with aborted sales or purchases of property is not deductible;
- Gains made on sales of residential property are taxed at 18% or 28%;
- The value of the properties will be subject to inheritance tax on your death;
- It may be difficult to transfer the business without incurring capital gains tax (CGT) charges.

Special tax rules apply when you let property as furnished holiday accommodation. The profits or losses from those holiday lettings must be kept separate from your other property income (see chapter 7).

What is property income?

In income tax terms 'property income' is the rents you are due to receive less the expenses that can be set against those rents for tax purposes (see chapter 4). It does not include the profit you make when selling the property, and it does not take into account the costs of buying, selling or improving the property.

All of the income you receive from your property in the UK, both residential and commercial, is combined and taxed as one property investment business. This means a loss on one property can be relieved against profits made from another in the same tax year. Overseas property, and furnished holiday lets are treated as separate businesses (see chapters 7 and 10).

Deposits collected from tenants are not part of your property income unless they become non-returnable under the tenancy agreement.

You should only include the retained deposit in your property business accounts when the funds are used to cover the costs the deposit was designed to pay for, such as renewal of furniture, repairs or legal fees.

TOP TIP

Don't forget to exclude the deposits you receive from new tenants when you tot up your property income for your tax return.

When does the property letting business start or finish?

It is important to determine when your property letting business starts or finishes, as the costs you incur outside this period may not be tax deductible, (but see pre-letting expenditure below).

Start date

Your property letting business starts as soon as you have acquired your first property and it is available for letting. This means it is in a condition where it can be let, subject to cleaning, furnishing and drawing up tenancy agreements and inventories. If the property is in such a poor state that it can't be let, it must not be treated as part of your property letting business. However, once your property letting business has started, any later expenditure leading up to the letting of the second and subsequent properties is part of the property letting business and can be deducted, as long as it qualifies as tax deductible (see chapter 4).

Pre-letting expenditure

Pre-letting expenses, such as advertising or repairs, can be deducted from the rents you receive in the first tax year if two conditions are met:

- The expenses are classified as revenue costs rather than capital expenditure; and
- the costs are incurred within seven years of the date on which you first let the property.

The expenses connected with renovating a property to bring it into a habitable condition are capital costs so are not deductible.

HMRC may query any hefty repair or maintenance costs incurred before letting began. To get a deduction for these costs you need to show that the property was in a fit state to be let before the sprucing-up began.

Whether you could let it at a rent acceptable to you is another matter.

TOP TIP

Keep all documentation connected with repairs or renovations, including any builders' quotes which specify the state of the property before the work began.

Example

You buy a run-down property that has been let as student accommodation, but you would like to let it as family accommodation for a higher rent. Before you attempt to let the property you have it deep-cleaned, decorated, and get minor repair jobs done such as replacing locks. This work should all qualify as revenue expenses as the property was in a fit state to let before the work was done, as it had been let immediately before you purchased it. If you undertook more extensive works before letting, such as removing internal walls and refitting bathrooms and kitchens, those costs would be classified as improvement expenditure which must not be deducted from the rents.

Finish date

Your property letting business finishes when you no longer have any properties available for rent, and you are not looking for tenants. This may be because you have decided to occupy the last property yourself, or you are keeping the property empty prior to sale.

2. Who is taxed and when is the tax payable?

Jointly held property

The owners of the property are generally taxed on the property income in relation to the proportion of the property they each own. However, the tax law assumes that a married couple (or civil partners) share the income from a jointly held property equally, i.e. 50:50 whatever their actual ownership. This split of income applies for tax purpose unless an election on HMRC's form 17 has been made by the couple, that they should be taxed on the profits in a different ratio (see chapter 5). If you own a property jointly with your spouse, and have not made this election, you should each report half of the income and expenses from the property on your individual tax returns.

Warning

A couple can only divide the property income from a property between them if they both actually own a share in the let property, see chapter 5.

TOP TIP

A married couple (or civil partners) who are living together can transfer a property from the sole ownership of the higher earner to the sole ownership of the lower earner, or into joint ownership, so all or part of the property income is taxed at a lower tax rate. There is no capital gains tax to pay on such a transfer, but Stamp Duty Land Tax (SDLT), or the equivalent tax in Scotland or Wales may be due if the property is mortgaged, see chapter 11.

Property allowance

If the gross rental income from your property business is less than £1,000 per year, it is covered by your annual property allowance of £1,000. In this case you have no tax to pay on that property income and you don't have to declare the income on your tax return.

If you receive more than £1,000 per year from letting, you can set the property allowance against that income but you can't also deduct other expenses. You also have to declare the property income on your tax return.
In most cases it is not worth claiming the property allowance as you will want to deduct all allowable expenses from your property income.

Tax return

If you hold UK properties in your own name, all of the income and expenses from those let properties should be shown on the UK property section of your personal self-assessment tax return. These amounts must be reported even if you don't make a profit in the year from the letting.

Warning

If you have not declared the income or gains from your let properties on your personal tax returns, you should use HMRC's Let Property Campaign to bring your tax affairs up to date **(letproperty.campaign.gov.uk)**. If you make a full disclosure before HMRC find you, the penalties imposed will be much lower than they would be otherwise and you should avoid a formal tax investigation.

If your let property is located overseas, the total rents and expenses must be shown in the foreign income section of your personal tax return. You may also be required report the income and gains from your property to the tax authority of the country where the property is located.

Where your let properties are owned through a company, the profits or losses from that letting business must be reported on the company's annual corporation tax return. There are also extra taxes to consider with corporate ownership (see chapter 13).

Making tax digital

Landlords who hold their properties in their own name, or in a partnership, will have to comply with the new rules for Making Tax Digital for Income Tax Self Assessment (MTD ITSA) from 6 April 2023.

These rules will apply to you if your total income from property and self employment is in excess of £10,000 per year. You will have to submit quarterly reports of your income and expenses to HMRC using MTD-compliant software. You will also have to submit an End of Period Statement and a finalisation statement (which will replace the self-assessment tax return) using API-enabled software.

When is the tax payable?

Self-assessment

Under the self-assessment system, the tax you are due to pay on all your different sources of income is added together, so there is no separate payment date just for your property income. Any tax already deducted, say under PAYE, is set against the total tax due and the balance is paid in up to three instalments:

A. 31 January within the tax year;

B. 31 July after the end of the tax year; and

C. 31 January after the end of the tax year.

The instalments A and B are known as "payments on account". They are estimated amounts, based on the total tax you paid under self-assessment for the previous tax year.
If most of the tax you paid was deducted under PAYE, and less than £1,000 was due under self-assessment, you are not asked to make payments on account. Where your tax bill for the current year is higher than the previous year's total, you must pay the extra tax due at instalment C.

Instalment C is due by 31 January and coincides with the first instalment A, for the next tax year. This means that when you start your property letting business, you may have to pay 150% of the annual tax due on 31 January following the tax year in which your letting business started. This is because you won't have made any payments on account (tax instalments A and B) within and after the end of the tax year, as in the previous tax year you had no self-employed or property income.

PAYE

The tax due on your property income can be collected through your PAYE code. After you submit your tax return showing taxable property income, HMRC may automatically adjust your PAYE code so the tax due on your property income is collected directly from your salary. By using your PAYE code to collect the tax due HMRC receives your money in monthly deductions from your pay, and you lose the cash flow advantage of paying the tax due in three instalments.

TOP TIP

Put aside about 20% of the profit from your properties in a savings account each month, so when the income tax bill arrives you have the funds to hand. If you already have over £50,270 (£43,662 for Scottish residents) of earnings from other sources you may need to put aside at least 40% of your profits to pay the tax due.

You can ask HMRC not to tax your property income through your PAYE code. If you would rather pay the tax in three instalments under self-assessment, contact HMRC (you can do this online: **www.gov.uk/personal-tax-account**) and ask for the property income to be removed from your PAYE code. HMRC must then alter your PAYE code back to its original form.

Where the gross rents from your let property amounts to less than £10,000 per year AND you pay the tax on your property income through PAYE, you may not be asked to complete a self-assessment tax return form. This can save you time and money.

You will pay the same total amount of tax whether or not you pay the tax due on your property income directly out of your earned income under PAYE, or over three instalments under self-assessment.

When you let more than one property, or you have variable costs or income, you should complete a tax return every year to ensure you receive full tax relief for all the eligible expenses.

TOP TIP

Always check your PAYE code if you are an employee. Many PAYE codes are incorrect as they can include expenses or benefits received in respect of earlier tax years which no longer apply, and may include an inflated estimate of the level of your other income. Get your PAYE code changed by accessing your personal tax account or call HMRC on: 0300 200 3300.

Student loan repayments

If you have an outstanding student loan you need to budget to pay an additional 9% as student loan repayments on your rental profits, where your total income for the year exceeds the loan repayment thresholds of: £19,895 for plan 1 loans, £27,295 for plan 2 loans, or £25,000 for plan 4 loans.

Those with a postgraduate loan also need to repay that loan at 6% of income above £21,000, in addition to any undergraduate loan repayments due.

Income Loss

When your letting income received in the tax year is less than the expenses you are permitted to deduct (see chapter 4) you have made a loss, and no income tax will be payable on your property income for that year. The loss should be reported on your tax return, so it can be set against profits from your property business made in later years. The loss will reduce the tax payable for later periods until it has been fully utilised. The loss generally can't be used to reduce the tax you pay on your non-property income for the same year.

Warning

The loss generated by your property letting can only be used to reduce profits from the same property business in a future tax year if you have declared that loss on your tax return for the tax year in which it arose.

If the loss shown in your property accounts is created by capital allowances on equipment used for the property letting business, that loss may be set against your other income for the year.

Capital Gain

When you sell your let property you would expect to make a profit after deducting the purchase cost and selling expenses. You must declare this profit on the capital gains section of your tax return, and pay capital gains tax on the amount of the gain which exceeds your annual capital gains exemption, (£12,300 for 2021/22). When you dispose of a UK residential property, you must report the gain and pay the tax within 30 days of the sale (see chapter 8). There are different rules for commercial property, and when the owner does not live in the UK.

Capital Loss

You may be forced to sell your let property for less than you bought it for, which means you make a capital loss. This loss cannot be set against your property income or against your other income. It can only be set against a capital gain which arises in the same tax year or in a future tax year.

Corporation Tax

If you hold your let properties through a company, that company will generally have to pay corporation tax on its profits nine months and one day after the end of its accounting year end.

A company can pick any date for its year end, although changing the date frequently is not permitted. Large companies with profits over £1.5 million generally have to pay tax in four instalments starting part way through the accounting period.

Companies currently pay corporation tax at 19%, which is lower than most income tax rates payable by individuals. However, the rate of corporation tax will increase on 1 April 2023 where the annual profits of the company exceed £50,000.

Where profits do not exceed £50,000 the tax rate will remain at 19%, for profits above £250,000 the tax rate will be set at 25%. Profits between those two thresholds will be taxed at 25% with some marginal relief.

Companies are eligible for different tax reliefs to individuals (see chapter 4).

Companies may also have to pay the annual tax for enveloped dwellings (ATED) in respect of residential property valued at over £500,000 (see chapter 13).

3. What records do you need to keep?

As a landlord you are required to maintain complete and accurate records of all expenses incurred, and the income you receive from your let properties. This means you need to record every relevant expense and keep either the original invoice, or a copy of it. You should also record the use of any personal assets for your letting business, such as your own vehicle, home/ office or computer (see chapter 4).

HMRC ask you to record the dates of each individual letting or lease. You also have a responsibility, as a landlord, to check that your tenants have the right to live in the UK, so keep copies of the documents you viewed for that purpose, and note the date when you checked them.

Deposits should be recorded separately, with precise dates of when they were received and returned. Only non-returnable deposits should be included as income in your property business accounts.

TOP TIPS

Keep a separate bank account for your property letting business. Pay all the rents into this account and all the property related expenditure out of it. If HMRC ask you to provide evidence to back up the figures in your accounts, the separate bank account makes it easier to provide those details, as the property related costs are not mixed up with your personal expenditure.

Remember to download and retain your bank statements on a regular basis. Those statements may contain the only record of the rents paid into that account, but the bank may only provide access to online statements for a limited period.

Cash basis

As a landlord, with annual rents of no more than £150,000, you are expected to keep accounting records for your property business using the cash basis of accounting. This means you only record the transactions which are completed within the tax year. Rent isn't counted as income until you receive the funds. Similarly, expenses incurred aren't taken into account until the bills are paid.

You can opt out of using the cash basis and use the accruals basis of accounting instead by making an election on your tax return. Companies, limited liability partnerships (LLPs) and partnerships which include a company as a member, are not permitted to use the cash basis of accounting for trading or property income.

Once your rental income exceeds £150,000 per year you must use the accruals basis of accounting, taking account of debtors and creditors at the year end.

Retaining records

All the records relating to your property business should be retained for five years after the tax return filing date. Documents relating to the tax year to 5 April 2021 should be retained until 31 January 2027. Sale and purchase contracts, and receipts relating to property improvements should ideally be kept for four years after the end of the tax year in which the property is sold, just in case HMRC enquire into the capital gain shown on your tax return.

Warning

If you fail to retain tax-related paperwork and this leads to an incorrect statement in your tax return, you could be charged a penalty of up to 100% of the tax lost. In addition, if your records are examined before you submit your tax return, and HMRC judge them to be inadequate, you could be fined up to £3,000.

4. Tax allowable expenditure

Capital and revenue

You need to sort your expenses into those connected with buying, selling or improving your properties; known as capital costs, and other expenses that are likely to be repeated as tenants change; known as revenue costs. The capital costs can't be deducted from the rents received but the revenue costs can.

Types of revenue costs

The categories of expenses which can be deducted from rents received includes:

- Legal fees for drawing up tenancy agreements or collecting debts, but not those connected with acquiring or disposing of properties;
- Letting or managing agents' fees;
- Accountancy fees for drawing up the property business accounts;
- Advertising for tenants;
- Gardening, cleaning, and security services where relevant;
- Motor expenses for travelling to the property (see page 23);
- Ground rent and service charges for leased property;
- Replacement of contents (see page 19);
- Maintenance and repairs (see page 17);
- Buildings and contents insurance;
- Stationery, telephone calls and use of your office or home;
- Water rates and council tax;
- Heating and lighting costs.

You can only deduct the last two items from the rents received if the letting agreement doesn't make the tenant responsible for paying those charges. The liability to pay council tax normally falls on the individual residing in the property, but if the property is empty or it is a property in multiple occupation (see page 23), the landlord may be required to pay the council tax. If the tenant pays the council tax or the utility bills, you can't also claim a tax deduction for the same costs.

Timing

Revenue costs should be deducted from the rents received for the year in which the expense was incurred. Rents should be recorded for the tax year in which the income was received.

If you use the accruals basis of accounting rather than the cash basis (see chapter 3), you can take account of certain expenses due before they are incurred. This only applies where you have an obligation to pay an expense in the future and it is certain that you will have to pay it.

Example

Martin buys a leasehold flat in a block of flats in January 2021 and lets it immediately. The flat management company asks all the leaseholders to contribute to the cost of repairing the fire-escape on the outside of the building. Martin's share of the fire-escape refurbishment is £2,000 but it's not payable until the work is completed in September 2021.

If Martin opts out of the cash basis by making an election on his tax return for 2020/21, he can use the accruals basis of accounting for the year to 5 April 2021. This allows him to include his share of the fire-escape repair costs in his property letting accounts for the year to 5 April 2021, as it is certain at that date that he will have to pay this cost. If Martin does not opt out of the cash basis he can only account for the cost of the fire-escape in 2021/22, when the bill is paid.

TOP TIP

Check you haven't overlooked anything which HMRC expect you to report when letting property, by working through the checklist in HMRC's property rental toolkit: **tinyurl.com/HMRCPRTK**. Make sure you use the version of the toolkit that relates to the tax year you are reporting income for (e.g. 2020/21), as the tax law changes each year.

Repairs or improvement

All properties require some maintenance, and it's important to distinguish between expenditure which relates to repairs, as opposed to the cost of improvements to the property. The cost of repairs can be set against the rental income, but an improvement adds to the value of the property so it can only be deducted from the amount received when you sell it.

It is not the quantum of the cost that determines whether the item is a repair or an improvement, but the nature of the items fitted or work done. A repair restores what was originally there without adding new functionality, any other expenditure on the building will be classified as an improvement.

Example 1

Replacing an old conservatory with a new one of the same size will qualify as a repair. However, if the conservatory is a completely new addition to the property it should be treated as an improvement, and the cost can't be deducted from the rents. In that case the cost of the new addition to the building is deducted from the value received when the property is sold.

Example 2

Refurbishing a kitchen can qualify as a repair if the new kitchen is of a similar standard as the one it replaces. HMRC are clear that the whole cost of the kitchen refurbishment; including rewiring, plastering and tiling, will be treated as a repair. Where the kitchen is substantially upgraded, by say increasing the size or by using higher quality materials, the whole cost of the project should be treated as a capital improvement. You can not apportion costs between repairs and improvements on a single piece of work.

TOP TIP

Keep all the architect's drawings, plans and builder's invoices for any work done on the property in order to demonstrate which side of the repair/ improvement line the work falls on, should HMRC challenge the deduction of those costs in the future.

The boundary between a repair and an improvement can move over time. The windows in a house built over 60 years ago are likely to be single glazed with wooden frames, but if you need to replace a window the standard modern equivalent will be a double glazed PVC unit. HMRC accept that landlords can deduct the cost of double glazed windows where those windows replace single glazed ones.

TOP TIP

If you have not claimed some repair costs in the past as you thought HMRC would argue about them, you can amend the tax return for the period in which the costs were incurred to include that expense, up to one year after the deadline for submitting that tax return.

Property contents

This covers the replacement of loose domestic items included in a let residential property such as carpets, curtains, furnishings and crockery, but not the initial cost of purchasing those made available to your tenants. The cost of replacing those domestic items can be set against the rental income you receive from all your let properties.

The replacement or repair of any items fixed to the property such as: central heating boiler, sink, toilet, shower or built-in hob, should be claimed as a repair cost.

TOP TIP

You can claim for the cost of replacing domestic items in the property and for disposing of the old items, but not for the initial cost of furnishing and equipping the house.

Where the property qualifies as commercially let furnished holiday accommodation (FHL), capital allowances can be claimed for items used in the property (see chapter 7). Capital allowances are not available for items used **inside** other let residential properties, but they may be available for items used on the outside of the property, such as ladders, or a van to move furniture.

Interest and loans

From 6 April 2020 none of the interest and finance charges you pay in connection with letting your residential properties can be deducted from the rental income (see below). This restriction on the deduction of finance costs does not apply to companies, or to landlords who only let non-residential property or furnished holiday accommodation.

Restriction on interest deductions

When you borrow to finance your property business, the interest and arrangement fees related to that loan cannot be deducted for periods from 6 April 2020 onwards. In place of the blocked interest and finance charges you are permitted to deduct a tax credit from the income tax payable on your rental income. The tax credit is calculated as 20% of the lower of:

- blocked finance costs
- rental income for the year before interest
- total taxable income exceeding allowances

Any unused amount of this tax credit is carried forward to be relieved against tax payable on rents in a future tax year.

Example

Harry receives rent of £40,000 per year from his let properties and pays interest charges of £32,000. He receives a salary of £36,570 from his main job, on which he pays income tax at 20%. We have assumed that Harry has no other expenses relating to his let properties, and he is resident in England (taxpayers who live in Scotland pay income tax at different rates).

Harry's tax position for 2021/22 is calculated as follows:

Salary	36,570
Letting income	40,000
Interest deduction	Nil
Net income	76,570
Less: personal allowance	(12,570)
Taxable income	64,000
Basic rate band limit	37,700
Tax charged @20%	7,540
Tax charged @40%	10,520
Tax credit – see below	(6,400)
Total tax payable:	**11,660**

In 2021/22 Harry receives a tax credit calculated as **20% of the lower of:**

- finance costs not deducted from income (£32,000)
- income from the property business before interest (£40,000)
- total income exceeding allowances (£64,000)

Harry's tax credit is 20% x 32,000 = £6,400

Harry is actually making an annual profit of £8,000 (£40,000-£32,000) from his let properties, but as the interest deduction is restricted, he pays tax on £40,000 of property income.

This increases the amount of income which is subject to the higher tax rate of 40%, although he benefits from a tax credit to reduce his tax bill.

Warning

The blocking of finance charges as a deduction from rental income has the greatest effect on landlords who pay high interest charges.

You may need to restructure your property portfolio and loans to avoid your lettings business from becoming uneconomic.

Your options for restructuring include:

- Let the residential property as furnished holiday lettings – for which the interest restrictions do not apply;
- Sell some residential property and reinvest in commercial buildings;
- Transfer your residential properties into a company which you control.

Any sale and repurchase of properties, or a transfer of the properties into a company may create capital gains which will be subject to CGT, and are likely to incur land tax charges (see chapter 11). Also, your mortgage provider must agree to transfer any loans into your company.

Capital Allowances

You can't claim capital allowances for furniture and fittings used inside a let residential property. Such items are covered by the deduction for replacing domestic items (see above). However, you can claim capital allowances for equipment you use to run your lettings business and to maintain the properties on the outside. There are special rules for furnished holiday lettings (see chapter 7).

What allowances can you claim? It depends on whether you are responsible for the maintenance of the building or if you outsource that task to a letting agent. Office equipment used predominately for your letting business can qualify, as can a vehicle used wholly or mainly for travelling between the properties, moving furniture etc., but see page 23 regarding travel expenses. If the properties have gardens, tools such as lawnmowers and hedge trimmers will qualify. External maintenance such as painting and gutter cleaning will inevitably require the use of extendable ladders, which also count as equipment for capital allowance claims.

The annual investment allowance (AIA) allows you to claim 100% capital allowances on up of £1 million of equipment purchased in the three years to 31 December 2021, or £200,000 from 1 January 2022. The AIA cap can cover the cost of commercial vehicles such as vans but not cars. Capital allowances for cars are restricted according to their CO_2 emissions. You can get a 100% deduction in the year of purchase if you buy a new electric car before 6 April 2025.

Your own time

You can't deduct the cost of your own time from the rental income, even if you manage the property yourself, and do all the maintenance, collect the rents, and vet the tenants. If you let the property through a company, that company can employ you, and pay you for the time you spend on property matters.

Other wages

You can deduct wages paid to a member of your family who doesn't own a share in the property but who undertakes property related tasks for your property business. This can be a useful way of distributing some of the rental profits around the family without transferring a share in the properties to your spouse or partner.

If your spouse has no other income in 2021/22, a property managing fee of up to £8,840 per year (£737 per month) will be covered by their annual personal allowance, and will be free of tax and national insurance. There is also a tax saving if your spouse pays tax at a lower rate than you do. However, there is an obligation to operate PAYE and report the pay figures online to HMRC under the real time information system (RTI), once the pay of any employee exceeds £520 per month.

Warning

The amount paid to your spouse or family member must be reasonable, and the wage must actually be paid, not just accrued in your property business accounts.

So how much is a reasonable wage? Start with a typical fee for a commercial managing agent and discount it by say 50% as you are not paying an expert, unless your relative happens to be an experienced property agent. Keep records of the time spent by your assistant on the property business, so if HMRC ask, you can justify the hourly rate amount paid.

If you let properties through a company, that company must pay at least the national living wage rate of £8.91 per hour for those aged 23 and over, other national minimum hourly rates apply for younger workers.

Travelling costs

You may have to make a number of journeys connected with your property business after you have purchased the property. If you manage the property yourself you may make regular journeys to deal with the turnover of tenants and to check repair work. The cost of those journeys can be set against your rental income, if each journey is wholly connected with the letting and anything else you did on the same trip, such as personal shopping, was merely incidental.

The deductible cost of journeys made by public transport is the price of the ticket. If you use your own vehicle you need to keep accurate mileage records. An easy way to calculate the amount of motor expenses to deduct in your property accounts is to use the fixed rate of 45p per mile for each property related journey. This rate applies for the first 10,000 miles each tax year, use 25p per mile for any excess miles.

A more elaborate, but fairer method is to keep track of all the costs you incur to keep your car running in the tax year (TC); repairs, servicing and fuel, and record the total mileage (M) as well as the property related journeys (P), then apply this formula:

$$\textbf{Cost of property motoring} = \frac{TC \times P}{M}$$

Houses in Multiple Occupation (HMO)

An HMO is a residential property let out to at least three people who are not from one household, (as a family) but do share facilities such as a bathroom and kitchen. You must obtain a licence from the local authority if your property is an HMO which is occupied by five or more persons who form two or more households, (i.e. unrelated tenants) in England or Wales. The fee charged for an HMO licence varies significantly across the country, but the cost of the licence is deductible from your rental income. Additional requirements for HMO licences vary from area to area, so check with your local council as to the licence requirements.

5. How should you own your property?

Jointly held property

Where a let property is held in joint names it can generate a useful income stream for a spouse/civil partner who has little or no other income to soak up their annual tax-free income tax allowance (£12,570 for 2021/22). The personal allowance will be frozen at this level until 6 April 2026.

In England and Wales you can own property as joint tenants, which means both owners hold an equal interest in the whole property. The alternative is to hold the property as tenants in common where each owner holds a separate and identifiable share, say 10% and 90% of the property. There are different rules for properties located in other countries, including Scotland.

Married or civil partners

When a legally joined couple (married or civil partners), own property as joint-tenants any income from that property should be split equally between them for tax purposes (50: 50).

However, the couple can opt to be taxed in proportion to their actual beneficial ownership in the property if they make a declaration on HMRC's form 17. HMRC will want to see evidence submitted with the form 17 that supports the beneficial interest, such as a declaration of trust, or a copy of the ownership deeds for the property.

Once the form 17 declaration has been made it can only be overturned if the underlying beneficial ownership in the property changes.

A gift of a share in a property between husband and wife (or civil partners), who are living together, is not subject to capital gains tax at the time of the gift. The recipient takes on their share of the property at the acquisition value paid by the other partner. Such a transfer between spouses is also generally exempt from inheritance tax.

When the property is sold any gain arising on the sale must be split according to the proportional ownership, so think ahead.

TOP TIP

Where a let property is owned by one spouse, a transfer into joint ownership can save income tax on the annual profits, and capital gains tax on the eventual sale, as both spouses will be able to set their annual capital gains exemption (£12,300) against the capital profit made.

Unconnected owners

The joint owners may be siblings or other relatives who have inherited a property, or friends who have pooled resources to purchase a property together. Where the owners are not married they can agree to share the income from the property in whatever ratio they choose, although this profit sharing ratio would normally reflect the underlying ownership of the property (see HMRC's Property Income Manual para PIM1030).

Partnership or LLP

The joint owners can form a partnership or Limited Liability Partnership (LLP) to collect the rents from the jointly held property and allocate the net income between them. Merely holding a property in joint names does not constitute a partnership for income tax purposes, although it will do for VAT purposes. To prove you operate the property business as a genuine business partnership you should sign a partnership agreement which covers the income and gains to be made from the business.

TOP TIP

Where a genuine business partnership exists, the partners can share the annual profits and losses from that business in any ratio the partners agree on. This ratio may be varied from year to year, which can be very handy for tax planning.

Company

Where let properties are held through a limited company the restriction on the deduction of interest and finance charges does not apply. However, the company needs to hold any loans required to finance the lettings business in its own name.

Lenders are aware of the tax advantages of holding property within a company and there are several mortgage products on the market specifically designed for property letting companies.

But don't rush into anything, running a limited company is a long term commitment and it benefits from careful planning.

Warning

Where a residential property is acquired by a company there are a number of additional or increased tax charges which may apply (see chapter 13).

Before you make the decision to hold your let properties through a company, some serious number crunching is required to work out the potential tax savings and costs.

First compare the tax rates and allowances available to you and the company (all rates apply for 2021/22 tax year unless otherwise stated):

- the company pays corporation tax (currently at 19%) on its income and gains with no tax-free allowances;
- the first £12,570 of your total personal income is generally tax free;
- you pay income tax on the profits from your lettings business at 20%, 40% or 45%;
- a Scottish taxpayer will pay income tax on profits at 19%, 20%, 21%, 41% or 46%;
- you have an annual exemption of £12,300 to set against your capital gains (this allowance is frozen until 6 April 2026);
- on gains in excess of your annual exemption you pay CGT at 18% or 28% on the disposal of residential properties, 10% or 20% on disposal of non-residential properties.

If your home country was not the UK, and you have lived in the UK for less than 15 years, you may enjoy the 'non-domiciled' tax status. In this case you may not benefit from a personal allowance or annual exemption to set against your UK income or gains.

Extracting profits from the company in the short term can generate additional corporate tax and personal tax charges, see chapter 13. For more information regarding the VAT implications of letting property, see chapter 11.

6. Trading or investment?

The property income discussed in previous chapters is generated by holding and letting your properties for the medium to long term, as a passive investor. If you intend to turn over your properties more frequently, or manage other people's properties for reward, HMRC can treat your business as a trade rather than as a property investment (predominately letting) business.

This may apply when you undertake activities such as:

- managing properties owned by others, collecting rent, etc;
- buying and selling properties within short periods; or
- buying and renovating, then selling on those properties.

> **Example**
>
> Say you buy a dilapidated house for £200,000 and spend £160,000 over four months on repairs and renovations, with the intention of selling the property as soon as possible for a profit. In this situation, you are acting as a property developer and the profits you make will be taxed as trading profits, rather than as property income.

If you are considered to be trading, rather than passively investing in a property to let, this will have the following tax consequences:

- the gains you make from selling residential properties will be subject to income tax at rates of 20% to 45% (up to 46% if you are resident in Scotland) rather than CGT at 18% or 28% (10% or 20% for non-residential properties);
- you can't set your annual capital gains exemption against the gains made from selling properties (see chapter 8);
- the main residence exemption and letting exemption for capital gains isn't available (see chapter 8);
- national insurance contributions are due on the profits if the business is run in your own name or through a partnership;
- you may need to register for VAT; and
- any rents you receive may be taxed as incidental trading income.

The tax advantages of having your property business taxed as a trade are:

- the value of your business can attract a 100% exemption from inheritance tax if it qualifies as ‘business property’ (see chapter 9);
- you get tax relief for indirect or abortive expenses connected with buying and selling properties;
- any losses you make by trading in your own name can be set against your other income;
- if you trade through a company the shares of that company may qualify for business asset disposal relief (formerly entrepreneurs’ relief) when you sell them, which can reduce the tax on gains to 10%.

7. Furnished holiday lettings

Letting property on a commercial basis as furnished holiday lettings (FHL) attracts some favourable tax treatments, see the advantages of FHL listed on page 30.

To qualify as a FHL property the accommodation may be situated in any part of the UK. The location doesn't have to be in a recognised holiday centre. However, the pattern of lettings must satisfy these conditions for each year:

1) **the property must be available for commercial letting as holiday accommodation for at least 210 days; and**

2) **it must be actually let as short-term holiday accommodation for at least 105 days.**

'Holiday accommodation' means letting to any tenants at a commercial rent for periods which do not normally exceed 30 days. The periods for which the property is let as holiday accommodation don't have to be in a continuous block, but lettings for continuous periods of 31 days or more to the same tenant don't count as holiday letting.

The property may be let to one tenant for longer periods if the 210-day availability period is met for the same tax year.

If you let more than one property as FHL, you can average the days let across all your holiday properties to determine whether condition 2 is met across your entire FHL business. This averaging exercise can allow all your properties to qualify as FHL where some properties easily meet condition 2 and others do not. The letting periods for properties in the UK cannot be averaged with periods of letting for properties outside of the UK.

The threshold of 105 days of actual letting may not be achieved in some years, in which case you can use the 'grace period' election. This allows a property to qualify as FHL, if it qualified in the previous year or the year before that. In each case the property must be available for letting for the full 210 days in the year. You can make the grace period election for up to two consecutive years.

Example

Your apartment is let as holiday accommodation for the following days per year:

Tax year	Let days required	Actual days let	Grace period needed?	Qualifies as FHL?
2017/18	105	120	No - qualifies	Yes
2018/19	105	100	Yes	Yes on election
2019/20	105	107	No	Yes
2020/21	105	20	Yes	Yes on election
2021/22	105	95	Yes	Yes on election

Advantages of FHL

FHL businesses attract the following tax reliefs:

- profits from the FHL business are treated as earnings for pension contributions;
- capital allowances can be claimed for the cost of fittings and equipment used within the property as well as for the cost of equipment used for running the FHL business;
- a capital gain made on the disposal of properties that have been used for FHL may attract:
    - o business asset disposal relief where the FHL business is disposed of (and other conditions for the relief are met);
    - o rolled-over relief when another business asset is purchased (within certain categories), so no tax is paid until the replacement asset is sold; or
    - o hold-over relief when a FHL property is given away, so no capital gains tax is paid until the recipient disposes of the property.

Where business asset disposal relief applies, the rate of capital gains tax charged on the gain is 10% rather than at 18% or 28%. However, the disposal must amount to the whole of the FHL business, or a large part of the business which is sufficient to form the basis of a new business when operated by the new owner. HMRC are unlikely to agree to a claim for business asset disposal relief on the disposal of a single FHL property out of a business that includes several FHL properties.

Warning

The above tax reliefs all have complex conditions attached. Ask a specialist tax adviser to confirm whether a particular tax relief may be available before you finalise any significant transaction.

Disadvantages of FHL

The disadvantages of letting as FHL as opposed to standard six month residential lets are:

- the turnover of tenants is much higher;
- advertising and cleaning costs are higher;
- losses can only be set against future profits of the same FHL business, but not against an FHL business that contains overseas properties;
- you may have to register for VAT;
- business rates may be charged on the property in place of council tax (see page 32).

Overseas properties

Properties let as holiday accommodation in EEA countries can also qualify as FHL businesses if the property is let for short term lets for at least 105 days a year, and it is available for short term letting for at least 210 days a year. The EEA countries comprise all of the 27 member states of the European Union plus, Liechtenstein, Norway and Iceland.

Your FHL business using UK properties must be kept completely separate from the FHL business using properties located in other EEA countries. The profits and losses from those two businesses must be reported separately on your tax return, and the losses from the overseas property business cannot be set-off against profits from another FHL business.

Local taxation

Occupants of residential property are normally required to pay council tax. However, in England properties that are available for short term letting for more than 140 days per year are subject to business rates rather than council tax. This applies to all properties that qualify as FHL properties. The rules are slightly different for properties in Wales and Scotland. Business rates are not charged on properties in Northern Ireland, where the old rates system applies to both domestic and business properties.

If the rateable value of your only FHL property in England is less than £15,000 you may qualify for small business rates relief. Different thresholds for small business rate relief apply in Wales and Scotland. Where the property has a rateable value below a certain level (which varies between England, Wales and Greater London) you pay business rates at the small business rate of 49.9p rather than the large business rate of 51.2p.

8. Capital gains

What is a gain?

When you dispose of a property the capital gain is the difference between the net amount you receive from the sale and the total amount you paid out to acquire the property, including any acquisition costs and the costs of any improvements you have made while you owned the property. The taxable gain can be reduced by exemptions or reliefs due in respect of your occupation of the property, or in the case of furnished holiday lettings or commercial property, the business use.

If you give away a property, or sell it at a discount, to someone connected with you (such as a family member), the sale proceeds will be deemed to be the market value of that property at the date of the transfer.

Capital gains on residential properties are taxed in your hands at either 18% or 28%, depending on the level of your net taxable income for the tax year. If business asset disposal relief applies to the gain it is taxed at 10%, subject to a lifetime limit of £1 million of gains.

When is the tax payable?

The gain from a residential property must be reported online to HMRC within 30 days of the completion date, and any capital gains tax must be paid as an "on account" payment within that 30 day period.

This acceleration of reporting of the gain and payment of the tax due does not apply to gains arising from non-residential properties where the seller is a UK resident.

Where a non-resident taxpayer sells any type of property in the UK, the gain or loss must be reported to HMRC within 30 days of the completion date even if there is no tax to pay (see page 34). Where capital gains tax is due it must be paid within 30 days of the completion of the sale.

Penalties and interest can be imposed if the 30-day timetable is not met. However, HMRC will not impose a late filing penalty for transactions completed before 1 July 2020.

Companies pay corporation tax on capital gains at the rate that applies to their other trading profits. Corporation tax for all companies is set at 19% until 1 April 2023. The corporation tax payable by most companies is due nine months and one day after the end of the accounting period in which the gain arose.

Allowable expenses and exemptions

The following expenses and exemptions may reduce the taxable gain on the disposal of a property:

- solicitors' and estate agents' fees on the sale and purchase;
- Stamp Duty Land Tax (SDLT), Land and Buildings Transaction Tax (LBTT) (in Scotland) or Land Transaction Tax (LTT) (in Wales) paid on the purchase;
- cost of improvements;
- annual capital gains exemption (£12,300 frozen until 6 April 2026);
- capital losses;
- main residence exemption (see below);
- lettings relief (if the main residence exemption has also applied – see below)
- business asset disposal relief, if the property qualified as FHL (see chapter 7) or was sold as part of a trading business.

Main residence election

The dilemma with let properties is that you invest in them partly to realise a profit on sale, but that gain is subject to capital gains tax. The value of your own home may also increase but that gain is protected from capital gains tax for the period that you lived in the property as your main home, under the main residence exemption.

If the let property has been your main residence for part of your ownership, the gain on disposal is apportioned according to the periods when the property was your main home, and those when it wasn't. The gains relating to the main home period, plus the last nine months of ownership, are exempt from capital gains tax.

If you occupy more than one property as a home concurrently, perhaps a town flat and a country house, you can nominate one to be treated as your main residence for capital gains tax purposes.

You can only have one main residence at any one time and you must actually spend some of the year living in the property in order to nominate it as main residence.

Married couples and civil partners can only have one tax-free main residence between them at one time.

You need to make the main residence nomination within two years of starting to use the second or subsequent property as a home, but once the nomination is made you can change it at any time. Slightly different conditions apply for this nomination process if the property is located in a country where you are not tax resident (see chapter 10).

Living in a property for some time before or after it is let can help reduce your capital gains tax liability on the sale of that property, but the gain on your other home will be exposed to tax while it is not your main residence. You can't nominate a property as your main residence to cover a period while it is let.

Example

You bought a flat in Dorset on 1 September 2011 and use it as a holiday home but continued to live in your house in London. Before 1 September 2013 you nominate your London house as your main residence. The flat is let from 31 May 2014 until 31 May 2019 when you decide to spend the summer in the country so move into the Dorset flat on 1 June 2019. From the same date you change your nomination of your main residence for capital gains tax purposes in favour of the Dorset flat.

You return to live in your London house from 1 October 2019, and nominate your London home as your main residence. You sell the Dorset flat on 1 September 2021 making a capital gain of £120,000, which is an average gain of £12,000 per year of ownership.

As the Dorset flat was your main residence for four months in 2019; one third of the annual gain (£4,000) is exempt from capital gains tax. Also, the last 9 months of gain (£9,000) is tax free. The remaining £107,000 of the gain is taxable subject to deduction of your annual exemption.

If you had not nominated the London property as your main residence election within two years of buying the flat in September 2011 you would not have been able to alter that nomination in favour of the flat in June 2019 and alter it back again in October 2019. The full gain of £120,000 made on selling the flat would then have been subject to capital gains tax, after deduction of your annual exemption.

Lettings relief

For sales made on and after 6 April 2020 lettings relief is restricted to periods where the landlord and tenant occupy the property at the same time.

The tax relief is restricted to the lower of three amounts:

- the part of the gain exempt because it was used as your main home;
- the gain attributed to the let period; and
- £40,000 per owner.

Business asset disposal relief

When this relief applies, capital gains tax is charged at 10% on the net gain, after deducting losses and the annual exemption. Business asset disposal relief can only be claimed by individuals, and by trustees in restricted circumstances, it is not available for companies.

Business asset disposal relief for gains made on let property will generally be restricted to the following circumstances:

- where the property has been let as furnished holiday accommodation (see chapter 7);
- where the property is sold as part of a trading business and other conditions are met;
- where the property was used by the trading business at the time that business ceased and the property is disposed of within three years of the business ceasing.

Questions to ask to check you have included all reliefs

When you sell a residential let property ask yourself these questions to ensure you have deducted all the available reliefs and taken advantage of all exemptions due to you:

1. On what dates were contracts exchanged and completed for the sale of the property? Both dates are important.
2. The exchange date, when the agreement to sell the property became unconditional, is the "sale date" for capital gains tax and determines the tax year in which the gain is taxed. Your personal rate of capital gains tax may vary in different tax years, according to the level of your total income, so it is crucial to correctly identify the date of disposal for capital gains tax.

3. The completion date, the date on which the final payment is normally made and the keys are handed over to the buyer, determines the start of the 30 day period in which you must report the gain arising on a residential property, and pay the tax due (see page 33).

4. What were the costs of the sale and purchase, including land transaction taxes (SDLT, LBTT in Scotland, LTT in Wales), estate agent's and solicitor's fees? All of these costs should be included in the capital gains computation.

5. Who owned the property at the date of sale? Splitting the gain over two or more owners can mean each person's share of the gain is covered by their annual exemption and less capital gains tax is payable overall. Remember to report only your own share of any taxable gain on your tax return.

6. How was the property owned; as tenants in common or joint tenants? If it was held as joint tenants then the property was certainly held in equal shares. If it was held as tenants in common check exactly what share you owned. Remember to split the gain along the actual ownership ratio for the property.

7. Do you own other let properties? A property letting business brings together all the rental income and expenses from UK properties into one pool. This means repair costs on a temporarily empty property can be set against the income from other properties in the same year, while the property business continues.

8. Have there been any improvements made to the property, which you have not claimed as deductions from rental income? The cost of improvements should be deducted from the sale proceeds to calculate the gain.

9. Did you ever live in the property as your main home so it qualified as your main residence? If you did occupy it and nominated the property to be your main residence, when exactly did you move out and change that main residence nomination?

10. Was the property let as furnished holiday lettings? If it was, business asset disposal relief may reduce rate of tax charged on the taxable gain.

9. Inheritance Tax

Inheritance tax (IHT) is charged on the net value of everything you own when you die, plus the value of certain gifts made during the last seven years of your life, although the amount that falls within the nil rate band (£325,000) is exempt. This nil rate band can be increased to £650,000 for those who inherited most or all of their deceased spouse's or civil partner's estate. Where the value of a family home is left to a direct descendent an additional nil rate band of £175,000 may be due.

Any value you leave to your UK domiciled spouse or civil partner, charities, political parties, or for the national benefit is exempt from IHT. That leaves the value of all your other possessions, including the home you live in and your buy-to-let properties; all potentially subject to IHT.

The rate of IHT is generally 40%, but where at least 10% of your net estate is left to charity the rate of IHT is reduced to 36%. The net estate is calculated after deducting debts, exemptions and the nil rate band.

TOP TIP

Your Will needs to be carefully drafted to ensure that a sufficient proportion of your estate is left to charities to achieve the reduced rate of IHT of 36%. Have your Will reviewed regularly as your personal circumstances change.

Example

Charles never married, has no children, and owned the following assets when he died on 1 May 2021. He made no Will and so died intestate. As a result no tax exempt gifts were made on his death. The inheritance tax due is calculated as:

Own home:	£300,000
Let property (net of mortgage):	£160,000
Cash:	£8,000
Premium bonds:	£2,000
Quoted shares:	£20,000
Total value of estate:	**£490,000**
Less nil rate band:	£325,000
Taxable estate:	£165,000
Inheritance tax due at 40%:	**£66,000**

All the beneficiaries of Charles' estate agreed that his estate should be divided in a different manner so they signed a Deed of Variation to alter the arrangement set by the intestate law to allow his quoted shares to pass directly to a charity. The inheritance tax payable on his death is charged at the reduced rate of 36% due to the charitable donation. This cuts the IHT bill to £52,200, saving tax of £13,800. The charitable gift of £20,000 has cost the beneficiaries of Charles' estate just £6,200:

Total estate:	£490,000
Less tax exempt gift to charity:	£20,000
Net estate:	**£470,000**
Less nil rate band:	£325,000
Taxable estate:	£145,000
Inheritance tax payable at 36%:	**£52,200**

One way to reduce the potential IHT charged on your let properties is to ensure your property business is treated as a trade (see chapter 6). In this case the value of your property business may attract 100% business relief, which will wipe-out the value for inheritance tax purposes.

HMRC will challenge IHT business relief claims for properties let as furnished holiday accommodation, and very rarely agree to the relief being given.

TOP TIP

On death all the assets, including any let properties should be valued on an "as is basis", taking into account the tenancies in place. A property with a sitting tenant will normally sell for less than a property sold with vacant possession. The lower the value at the date of death, the lower the amount of inheritance tax which will be payable.

10. Overseas issues

Overseas property owned by UK residents

Letting overseas property

When you invest in property located abroad you need to declare and pay tax on any income from that overseas property in the country where you belong. If you normally live in the UK, you are taxed in the UK on your foreign property income and on any profit you make on sale of that overseas property.

There are exceptions to this general rule if you do not normally live in the UK: in tax terms you are "non-resident". If the country you regard as your permanent home is not the UK: in tax terms you are "non- domiciled". The tax rules for UK residents who may be non-domiciled are very complex and are outside the scope of this guide.

The rental income from your overseas property may be liable to tax in the country where the property is situated, as well as in the UK. You should inform the tax authorities where the property is located about your rental income.

You may be asked to complete a local tax return for that country, in which case you should take local tax advice. If you use a property letting agent, that agent may be required to withhold tax from the rents, as a down-payment against the local income tax due.

If you have paid foreign tax on your rental income, and there is a double taxation agreement in place between the UK and the country where your property is situated, which covers rental income, you can treat the foreign tax paid as a part-payment of your UK tax liability. Unfortunately, you can't reclaim any foreign tax if your UK tax liability on the profits from your overseas property is lower than the foreign tax paid.

The income and expenses from your foreign property need to be reported on the foreign income section of your UK tax return. Be aware that other countries have different rules for determining which expenses can be deducted for tax purposes. Each type of foreign tax can only be set-off against its equivalent UK tax.

For example, foreign land taxes similar to the UK local authority business rates will not be available to set-off against UK income tax although you may get a deduction against the rental income received.

You need to calculate the rental profits from your overseas property for the local fiscal year, which is likely to be the calendar year, rather than the year to 5 April as applies in the UK. This means you may need to draw up two sets of property accounts for different periods.

Losses made on letting overseas property can't be carried back, or off-set against your other UK income. However, those losses can be used against overseas profits in the same year or carried forward to set against other foreign letting profits.

Gains on overseas property

When you sell your overseas property you will be liable to pay UK capital gains tax on the profit you make. You may also be liable to pay tax on that profit in the country where the property is situated. If there is a double taxation agreement in place you may be able to set the foreign capital gains tax against any UK capital gains tax due.

TOP TIP

If you actually live in your overseas property for at least 90 days a year you can nominate it as your main residence for tax purposes. This can protect a proportion of the gain from UK capital gains tax that arises on the sale (see chapter 8). Unlike for UK properties, the nomination of an overseas property to be your main residence is made at the time you sell the property.

Holding the overseas property inside a foreign registered company will not necessarily remove the capital gain from UK tax. There is a special tax rule that looks through a non-resident company to tax any gains the foreign company makes on the shareholders of the company, where a shareholder holds at least 10% of the company.

Warning

Take UK and local tax advice before setting up any special structure, such as a company, to hold an overseas property. Such a property-holding company could affect the tax payable by your UK trading company.

UK Property owned by landlords who live overseas

Non-resident landlord scheme

"Non-resident" means not resident in the UK for tax purposes. Whether an individual is non-resident is determined by the statutory residence test which is outside the scope of this guide.

Any managing agent or tenant, who pays more than £100 per week in rent to a non-resident landlord must withhold income tax at 20% and pay that tax to HMRC on a quarterly basis. However, if the landlord has approval from HMRC under the non-resident landlord scheme (NRL), HMRC will authorise the agent or tenant to pay the rent gross, without deduction of tax.

Landlords

To receive approval for gross payment under the NRL the landlord must show that:

- their UK tax affairs are up to date; or
- they have not had any UK tax obligations before they applied; and
- they do not expect to be liable to UK income tax for the year in which they apply.

Agents

A property agent acting for a non-resident landlord must register with HMRC within 30 days of taking rent for the UK property. The agent must submit an annual information return (form NRLY) to HMRC by 5 July each year. Some letting agents are not aware of their obligations under the NRL, which are set out in detail here: **www.gov.uk/personal-tax/non-resident-landlord-scheme**

Capital gains

Where a UK property, or a property-rich company is sold by a non-resident individual or non-resident company they must pay capital gains tax (CGT) on the gains arising. The disposal of the property must be reported online to HMRC using the UK Property Account within 30 days of the completion of the property deal.

This UK Property Account return must be submitted whether or not there is any tax to pay, unless the disposal is a gift between connected persons. Penalties apply if this **30-day** reporting deadline is not met.

Where NRCGT is payable, that tax is also due within 30 days of the conveyance.

TOP TIP

When selling a property located in the UK, while resident in another country, take specialist tax advice both for the UK tax system and for the country in which you are tax resident.

Temporary non-residence

If you make gain by selling property in the UK while you live overseas, that gain can be taxed in the UK when you return to the UK, if you lived overseas for less than five years. These tax rules are very complex so you should take specialist tax advice if you plan to be resident for tax purposes outside of the UK for a relatively short period.

11. Transactional taxes

VAT

Letting of residential property is exempt from VAT, unless the property is let as holiday accommodation. You should not charge VAT on the normal long term letting of a residential property, but if the property is let as holiday accommodation, you may be obliged to charge VAT (see below).

VAT can apply at various rates to property transactions, for example:

- standard rate (20%) on repairs carried out by VAT registered trader (see page 45) or where the option to tax has been made for a commercial building;
- reduced rate (5%) on the renovation of an empty property, or on hotel or holiday accommodation under COVID recovery measures (see page 46);
- zero rate (0%) where the first interest in a residential property is sold;
- exempt from VAT when a second hand residential property is sold;
- special 12.5% rate on hotel or holiday accommodation and food;
- outside the scope of VAT when the building is sold as part of a trade.

TOP TIP

If you are dealing with a property transaction which is in anyway unusual, get expert VAT advice. That does not mean ringing the HMRC VAT helpline: ask a VAT specialist.

Holiday accommodation

VAT at the standard rate of 20% generally applies to income from letting holiday accommodation if the owner is, or should be, VAT registered. This covers all holiday and hotel accommodation, not just furnished holiday lettings.

However, to help the tourist industry recovery from the Covid-19 pandemic, the VAT rate was reduced to 5% for holiday accommodation including furnished holiday lets from 15 July 2020 to 30 September 2021. From 1 October 2021 to 31 March 2022 the rate of VAT on holiday accommodation will be 12.5%.

You need to register for VAT if the rental income from your holiday lets plus any other VATable sales you make exceeds £85,000 in any 12-month period. This is the compulsory VAT registration threshold which has been frozen at that level until at least 31 March 2024. If you are already VAT registered, the amount charged for letting out holiday accommodation must have VAT at 5% or 12.5% must added to the basic price.

Repairs

The costs of repairing and improving the let property will normally carry VAT, but you can't reclaim this VAT when the rent you charge for the property is exempt from VAT.

However, if you hold your let properties through a trading company that is VAT registered, and normally charges VAT on its other sales, it may be possible to reclaim VAT on the property maintenance costs. **This is the case if the total VAT on the residential property costs does not exceed the following limits for the whole business:**

- £625 per month on average, which is £7,500 a year; and
- 50% of the total VAT the business has to pay on all its purchases.

Dwellings to be combined or split

Your builder may be able to charge you VAT at 5% rather than 20% if you are converting a building to one with a different number of dwellings or converting a commercial building into a residential one.

For instance, the conversion of a large house into three flats should qualify for the reduced 5% rate of VAT as there was one dwelling before the conversion and three afterwards. However, the transformation of a pub with a flat above it into one large house must be charged at the full standard VAT rate as there is one dwelling before conversion (the flat) and one afterwards (the larger house).

Warning

VAT law is very complex so ask your builder to request a written ruling from HMRC on the correct rate of VAT to charge, before the work starts.

Homes to be renovated

The 5% rate of VAT can also apply where the number of dwellings in the building does not alter but the property has been unoccupied for at least two years before the work begins.

This reduced rate of VAT applies to building materials used in the renovation, but not to the labour costs.

TOP TIP

Collect evidence that the building was unoccupied for at least two years. A letter from the local council Empty Properties Officer may suffice.

If the building becomes occupied before the renovations are completed the occupier must be the person who acquired the property either solely or jointly, and the person who is the customer for the renovation services. Also the renovations must be completed within one year of acquisition of the property.

Land transaction taxes

There are now three separate land transaction taxes which can apply to properties purchased in the UK:

- Stamp Duty Land Tax (SDLT) for properties located in England or Northern Ireland.
- Land and Buildings Transaction Tax (LBTT) for properties in Scotland purchased on and after 1 April 2015.
- Land Transaction Tax (LTT) for properties in Wales purchased on and after 1 April 2018.

When you buy a residential property for £40,000 or more, which is not your first property or a replacement for your main home, you must pay a 3% SDLT supplement on the entire purchase price, or 4% LTT or LBTT supplement for properties in Wales or Scotland.

A company must pay the relevant supplement on the value of any residential properties it purchases which cost over £40,000, as a company can't have a main home.

If you are transferring properties from your own name into a company you control, SDLT, LBTT or LTT will normally be due on the full market value, as the transfer is between two connected parties.

There are a number of reliefs from SLDT where multiple dwellings are acquired in one transaction, or the transaction consists of mixed residential and commercial property. A relief can also apply where the transaction involves a partnership of connected individuals.

TOP TIP

The detailed rules for SDLT, LBTT and LTT charges are very complex, so take relevant tax advice in advance of every purchase.

The LLT and LBTT charges must be paid by the purchaser within 30 days of the effective date of the purchase, but SDLT is due within 14 calendar days of the effective date. This is normally the completion date, the day on which the funds are handed over. But beware of taking possession of a property before the completion date, as this will bring forward the due date of payment of the tax.

The land transaction taxes paid on the purchase of the property can be deducted from the sale proceeds when it is sold (see chapter 8).

The purchaser must self-assess how much tax is due on the purchase, but your solicitor will help you complete the land transaction forms that report the purchase to the relevant revenue authority. Penalties are imposed if the form is late, and interest is due on any tax paid late. You cannot register a property with the Land Registry, or Scottish Registrar until the land transaction tax is paid.

How much?

The starting threshold for SDLT was increased on 8 July 2020 to £500,000 and it will reduce to £250,000 on 1 July 2021 then revert to £125,000 on 1 October 2021 – see table.

SDLT applies to purchases of residential properties at the following rates:

Property value	Rates for main home: 8 July 2020 to 30 June 2021	Rates for investment property or 2nd home: 8 July 2020 to 30 June 2021	Rates for main home: 1 July to 30 Sept 2021	Rates for investment property or 2nd home: 1 July to 30 Sept 2021
Up to £125,000	0%	3%	0%	3%
£125,001 to £250,000	0%	3%	0%	3%
£250,001 to £500,000	0%	3%	5%	8%
£500,001 to £925,000	5%	8%	5%	8%
£925,001 to £1,500,000	10%	13%	10%	13%
Above £1,500,000	12%	15%	12%	15%

SDLT is calculated on a progressive fashion such that the rate of SDLT applies only to the amount of the purchase price that falls within the SDLT band – see example.

Example

A residential property acquired in May 2021 for £300,000 to let out, will create a SDLT liability for the purchaser of £9,000 (300,000 x 3%)

For the rates of SDLT applicable to commercial properties see chapter 12. If a residential property is purchased by company for over £500,000, the rate of SDLT may be 15% on the entire purchase price (see chapter 13).

Gifts

If you make a gift of a property there is no SDLT payable on the value of that property. However, if the property has a mortgage attached that is also transferred to the new owner, the transfer value of that debt is subject to SDLT.

Example

Lionel gives a let property worth £283,000 to his civil partner Kevin. The property is subject to a mortgage of £100,000. Kevin assumes liability for the mortgage. SDLT of £3,000 is payable being 3% of the debt transferred.

SDLT avoidance schemes

All SDLT avoidance schemes have been shut down with effect from 21 March 2012. If a new SDLT avoidance scheme is discovered by HMRC it also will be shut down with retrospective effect back to March 2012.

Land and Buildings Transaction Tax (LBTT)

LBTT applies to purchases of land and buildings located in Scotland. The starting threshold for LBTT was also increased to £250,000 for the period from 15 July 2020 to 31 March 2021, but that LBTT "holiday" has not been extended. The rates of LBTT charged on purchases of residential property are as follows:

Property value	Rate of LBTT for the band from 25 January 2019	
	Rates for main home	Rates for investment properties and 2nd homes
Up to £145,000	0%	4%
£145,001 to £250,000	2%	6%
£250,001 to £325,000	5%	9%
£325,001 to £750,000	10%	14%
Above £750,000	12%	16%

LBTT is calculated in a progressive fashion, such that each slice of the consideration is subject to the tax rate for the band it covers, in the same manner as SDLT. The LBTT is payable when the land return is submitted, which must be no later than 30 days of the transaction's effective date.

Land Transaction Tax (LTT)

LTT applies to purchases of land and buildings located in Wales. The starting threshold for LTT was increased to £250,000 from 27 July 2020 to 30 June 2021, but this only applied for purchases of a main home. The rates of LTT charged on purchases of residential property are as follows:

Property value	Rate of LTT for the band from 22 December 2021	
Wholly residential property	1st property or replacement for main home	Rates for investment properties and 2nd homes
Up to £180,000	0%	4%
£180,001 to £250,000	3.5%	7.5%
£250,001 to £400,000	5%	9%
£400,001 to £750,000	7.5%	11.5%
£750,001 to £1,500,000	10%	14%
Over £1,500,000	12%	16%

12. Commercial property

Letting commercial properties can involve less management time than residential property lettings for the following reasons:

- the leases tend to be drawn up for longer periods, so there is less turnover of tenants; and
- the tenant is normally responsible for repairs and insurance.

Pension schemes

Pension schemes can invest directly in commercial property, or in trusts or funds that hold a range of properties, such as Real Estate Investment Trusts (REITs). You can use your own self-invested pension plan (SIPP) to purchase a commercial property, which may be let to your business. The SIPP can borrow up to 50% of its net assets to make the purchase, but expert advice will be required for such a transaction. Residential property cannot be placed in a SIPP.

VAT

The VAT issues concerning commercial property can be quite complicated, for example:

- The purchase price of a building may or may not have VAT attached, depending on the age of the building and whether the previous owner has made what is called "an option to tax" election.
- Where the building costs over £250,000 the capital goods scheme may restrict the VAT that can be reclaimed if the building is sold within 10 years.

TOP TIP

Take expert advice on VAT matters whenever you consider a lease or purchase of commercial property.

SDLT applies at the following rates for commercial properties:

Freehold property value:	**Rate of SDLT on band:**
Up to £150,000	0%
£150,001 to £250,000	2%
Over £250,000	5%

LBTT applies at the following rates for commercial properties from 25 January 2019:

Freehold property value:	**Rate of LBTT on band:**
Up to £150,000	0%
£150,001 to £250,000	1%
Over £250,000	5%

LTT applies at the following rates for commercial properties:

Freehold property value:	**Rate of LTT on band:**
Up to £225,000	0%
£225,001 to £250,000	1%
£250,001 to £1m	5%
Over £1m	6%

The thresholds at which SDLT, LBTT or LTT apply for commercial property are higher than for residential property but commercial property tends to be more expensive.

SDLT, LBTT and LTT also apply to rents paid for commercial leaseholds, where those rents are substantial or the lease is long term.

TOP TIP

The formula for calculating the land transaction taxes due on rents payable under leases is complicated, but there are a number of online interactive tools to help you:

www.tax.service. gov.uk/ calculate-stamp-duty-land-tax

www.revenue.scot/ land-buildings-transaction-tax/ tax-calculators

gov.wales/ land-transaction-tax-calculator

13. Holding your property in a company

Extracting your funds

When you let property through your own company the profits that company generates are currently subject to corporation tax at 19%. When you pay funds out of the company to yourself as a salary or as a dividend there will be further tax, and possibly national insurance, to pay. The first £2,000 of dividends you receive in the tax year is taxed at 0%. This allowance applies in addition to your personal allowance of £12,570.

If you have an outstanding student loan, you will have to pay 9% of your total income over the loan repayment threshold relevant to your loan plan (Plan 1: £19,895, Plan 2: £27,295 Plan 4: £25,000 all in 2021/22). There is an exemption from student loan repayments for up to £2,000 of investment income. Those with postgraduate loans have to pay an additional 6% on total income above £21,000.

The exact amount of tax payable on the sums you extract from your company will depend on the level of your other income in the same tax year.

Tax avoidance

Higher tax charges apply where the purchaser of residential property is a "non-natural person" defined as: a company, or a partnership containing a company, or a collective investment scheme.

The process of acquiring a property through a non-natural person is referred to as "enveloping" the property.

The following tax charges can apply to the value of residential properties acquired or held by such non-natural persons:

- SDLT at 15%; and
- Annual Tax on Enveloped Dwellings (ATED).

SDLT at 15%

SDLT is due at 15% on the entire purchase price of residential property valued at over £500,000, where the purchaser is a non-natural person.

There are exclusions from the 15% rate where the property is acquired for exclusive use of a commercial business for purposes including:

- property rental;
- property development;
- property trading;
- housing employees; or
- open to the public.

These exclusions don't apply if the property is occupied by a person connected with the owner of the property, such as the company directors, shareholders, or their associates. If the conditions for the exclusion cease to apply within three years of the purchase date, the 15% rate of SDLT will be re-applied. Where the 15% rate does not apply, the SDLT is levied at the normal rates (see chapter 11). This flat rate does not apply to LBTT for properties in Scotland or to LTT for properties in Wales.

TOP TIP

Before purchasing a residential property through your company take tax advice to ensure the company falls within the strict exemptions such that the 15% rate of SDLT does not apply.

ATED

The annual tax on enveloped dwellings (ATED) applies in similar circumstances as the SDLT rate of 15%, to the value of UK "dwellings" which are held by non-natural persons. However, ATED can apply to residential properties located anywhere in the UK. Hotels, guest houses, boarding school accommodation, hospitals, student halls of residence, military accommodation, care homes and prisons are not classified as dwellings, so are not subject to ATED.

TOP TIP

The exemptions that apply for the 15% rate of SDLT generally apply for ATED, but this should not be assumed, so always obtain expert advice before purchasing.

The ATED charge must be paid by 30 April within each year, for the year that runs from 1 April to 31 March, or within 30 days of acquiring of the property, 90 days where the property is a new build. The current rates are:

Property value:	2021/22 £	2020/21 £
£500,001 to £1,000,000	3,700	3,700
£1,000,001 to £2,000,000	7,500	7,500
£2,000,001 to £5,000,000	25,300	25,200
£5,000,0001 to £10,000,000	59,100	58,850
£10,000,001 to £20,000,000	118,600	118,050
Over £20,000,000	237,400	236,250

The base value of the property to calculate the ATED charge due in the periods: 2018/19 to 2023/24 is the open market value on 1 April 2017, or the purchase date, whichever is the later date.

Where the ATED is payable, the property owner (or their agent) must submit an ATED return for each property by 30 April in each year. Where relief from the ATED is due, such as when the property is commercially let to an unconnected third party, the owner should claim relief by submitting an ATED relief declaration return by 30 April each year.

14. Summary

We appreciate that finding the best buy-to-let mortgage to suit you has become more complex. That means the role of a mortgage adviser is becoming more important than ever, and with today's lower interest rates, you'll want to make sure you are on the best mortgage deal possible.

Buy-to-let deals to suit you

Whether you are looking for ways to save money by remortgaging your existing loans or looking to purchase additional property, contact your adviser who will have access to a range of buy-to-let mortgages by searching the whole market. This means we can get you the right deal so ultimately you receive the best returns from your investment. It certainly makes sense to go direct to a mortgage broker, rather than direct to a specific lender, as you'll get much more choice.

Simple and straightforward

Advisers will help you plan your portfolio by understanding your strategy both now and in the future. They'll look at both your aspirations and exit strategy – then they'll work out a mortgage payment plan designed for individual needs. They'll also take care of all the paperwork for you.

To get plans moving, contact your local adviser today.

Contact details are on the attached business card.

Disclaimer

1. Please note that this guide is intended as general guidance only for individual readers and does NOT constitute accountancy, tax, investment or other professional advice. Mortgage Advice Bureau accepts no responsibility or liability for loss that may arise from reliance on information contained in this guide.
2. Please note that tax legislation, the law and practices by the UK Government and tax authorities are constantly changing and the information contained in this guide is only correct as at the date of publication.
3. This guide only covers UK taxation, foreign tax implications are beyond the scope of this guide.
4. Please note that Mortgage Advice Bureau has relied wholly on the expertise of the author in the preparation of the content of this guide. The author is not an employee of Mortgage Advice Bureau but has been selected by Mortgage Advice Bureau using reasonable care and skill to write the content of this guide.

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