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Buy to Let Guide

Introduction

In this short guide, for the tax year beginning 6 April 2021, we look at the taxes on Buy to Let residential property in the UK. For letting out commercial property we are happy to advice on an individual basis.

Tax on purchasing the property

Stamp duty and land tax (SDLT) nil rate threshold in England, which is normally £125,000 has been temporarily increased to £500,000 until 30 June 2021, after which it is due to drop to £250,000 until 30 September 2021, when it will revert back to its normal level. When you buy a second home for £40,000 or more, which is not a replacement for your main home, you pay an extra 3% on the entire purchase price. For example, if in July 2021 you buy your main home in England for £400,000, you will pay SDLT of £7,500 but if you buy the property as second home or to let, the total SDLT charge will be £19,500.

If you buy your residential properties through a company, that company must pay the 3% land tax supplement on all purchases of over £40,000. From 1 April 2021, any non-resident buying UK residential property in England or Northern Ireland will normally have to pay a further 2% SDLT supplement. There are different definitions of non-residence for SDLT purposes compared to normal statutory rules, so it is possible for an individual or company that is otherwise UK resident to be subject to the supplement.

Taxes as Landlord

Landlord must pay income tax on your 'property income'. This is the sum of the rents you receive less the tax-deductible costs (see 'Tax allowable expenditure'). Property income does not include the profit you make when you sell the property and it does not take into account any costs of buying, selling or improving the property.

All of the income from letting property in the UK, both residential and commercial, is combined and taxed as one property investment business. A loss on one property can be relieved against profits made from another in the same tax year or in later years. Overseas property and furnished holiday lets are treated as separate businesses.

Ownership by an individual

If you hold the let properties in your own name, you will be taxed on the income and gains arising from those properties. You can't transfer the income before tax to another person without first transferring an interest in the property to that person.

You should declare all the income and expenses from your let properties in the property income section of your self-assessment tax return. If you make a loss from the letting, you need to declare that loss on your tax return so that it can be deducted from the profits you make from letting in a later period. If you let properties which are situated overseas, the income and expenses from those properties must be shown on the foreign income section of your tax return.

Joint owners

Where a let property is held in the joint names of a married couple or civil partners, it can provide a useful income stream if one of the couples has little or no other income. In England and Wales, you can own a property as 'joint tenants' (where both owners hold an equal interest in the whole property) or as 'tenants in common' (where each owner holds a separate and identifiable share, say 30% and 70% of the property). There are different rules for properties located in other countries, including Scotland.

When a legally joined couple (married or civil partners) own property as joint tenants, any income from that property must be split equally between them for tax purposes and declared as such on each person's tax return.

If the same couple hold the property as tenants in common in unequal shares, they can make a declaration on HMRC's form to have the property income taxed in the proportion that reflects each partner's beneficial interest in the property. Without the declaration, the couple will each be taxed on an equal share of the income from the property. When the property is sold any capital gain arising must be split according to the beneficial ownership of each owner.

Buying under limited company

A limited company pays tax at 19% on its income and capital gains, although from April 2023 this rate is due to increase to 26.5% or 25%, when profits exceed £50,000 and £250,000, respectively. In contrast, most individuals pay tax on rental income at rates between 20% and 45% (19% and 46% in Scotland). Individuals also pay Capital Gains Tax (CGT) on residential property gains at 18% or 28%. Also, unlike individuals, companies do not suffer a restriction on the deduction of interest and finance charges.

A company which holds surplus funds, investing in Buy to Let property can make commercial sense, provided the company can secure a mortgage for the balance of the purchase price.

Before letting

When a property is available for letting, you need to start identifying the costs that are deductible from the rental income (see 'Tax-allowable expenditure').

"Available for letting" means the property is in a condition where it can be let, subject to cleaning, furnishing and drawing up letting agreements. If the property is in such a poor state that it cannot be let, it cannot be treated as part of your property letting business. The expenses connected with renovating a property to bring it up to the standard to meet that "available for letting" condition are not deductible from your rental income but may be deductible when you sell the property (see 'Capital costs' below).

Expenses incurred before the first tenant moves in, such as advertising or minor repairs, can be deducted from the rents you receive in the first tax year.

Tax allowable expenditure

Property related expenses falls into categories of ‘Capital costs’, connected with buying and selling or improving your properties and ‘Revenue expenses’ that re-occur as the tenants change or general upkeeping of the house. If your tenant is responsible for paying in costs, such as energy and council tax bills, you can't claim a deduction for those items.

Allowable revenue expanse can include:

- accountancy fees for preparing the property business accounts
- letting or managing agents' fees
- advertising for tenants
- ground rent and service charges for leased property
- stationery, telephone calls and use of your office or home
- heating and lighting costs
- insurance for the buildings and contents
- legal fees for drawing up tenancy agreements or collecting debts, but not those connected with acquiring properties
- water charges and council tax
- maintenance and repairs
- motor expenses for travelling to the property
- replacement of furnishings

Interest paid

From current tax year 2020/21, none of the finance charges (such as loan interest and arrangement fees) you pay in respect of your let property are deductible from rental income. This applies if you let residential property as an individual or jointly with other individuals, but companies can deduct all finance costs.

Where you have disallowed finance costs, you can claim a tax credit to set against your Income Tax bill. The tax credit is equal to 20% of the finance charges you paid in the year, even if you pay a higher rate of tax on your rental income.

If you have significant loans connected to your let property business, your taxable profits will be much higher than your actual accounting profits. This could have knock-on effects for other taxes and charges you have to pay.

Example 1

Mr John lets a property in England for £20,000 per year and pays £10,000 in interest per year. He has no other property expenses, but he is employed on a salary of £32,000. John's tax position for 2021 /22 is calculated as follows:

Year			2021/22
Salary			£32,000
Letting income			£20,000
Total Income received			**£52,000**
Less: personal allowance			- £12,570
Taxable income			**£39,430**
Basic Rate Band	£37,700 Tax charged @20%		£7,540
Higher Rate Tax charged	£1,730 @40%		£692
Total income on which tax due		**£39,430**	
Income tax charged after allowances and reliefs			£8,232
Tax credit (20% of £10,000)			-£2,000
Total tax payable			**£6,232**

Note: Mr John is making an annual profit of £10,000 (£20,000 - £10,000) from his property but interest deduction is restricted and she pays tax on £20,000 of property income.

Capital costs

Capital costs, such as improvements, can only be deducted from the sale proceeds of the property. You need to keep record of which capital expenses relate to which let property and retain all the relevant receipts and contracts.

Repairs

The cost of repairs is deductible from rental income, but the cost of improving a property is a capital cost that is not immediately deductible. The difference between a repair and an improvement is that a repair restores what was originally there without adding new functionality; everything else is a capital improvement.

Furnishings

You can deduct the actual cost of replacing furnishings used in your let property. This covers the cost of replacing items such as carpets, curtains and free-standing white goods, but not the initial cost of those items. The cost of replacing items that are fixed to the property should be claimed as well.

Example 2

Mrs Tom has a new bathroom fitted where one didn't exist before and at the same time redecorates the adjoining bedroom. The redecoration is a repair. She asks her builder to give her separate bills for the new bathroom and the decoration of the bedroom. The new bathroom is an improvement, as it is a new feature added to the house.

She claims the decorating cost against rental income and treats the new bathroom as a capital improvement.

Holiday lettings

When furnished property is let for a large number of short periods, it could qualify as a Furnished Holiday Letting (FHL). The property doesn't have to be in a holiday centre; it can be situated in any part of the UK or even in another European Economic Area (EEA) country. Qualifying as a FHL allows you to deduct interest and finance charges fully from the rental income and claim capital allowances for many items used inside and outside the property.

Also, when you sell the property, it may be possible to defer CGT due on gains by buying another business asset. If other conditions apply, business asset disposal relief can reduce the rate of CGT to 10% when you close your FHL business.

The profits and losses for an FHL business are calculated in a similar way to those for an ordinary lettings business, but losses can only be set against other FHL profits. If annual turnover is over £85,000, you will have to register for VAT as holiday lettings are subject to the standard rate of VAT (20%), whereas normal residential letting is exempt from VAT. As a VAT registered business, you will have to submit VAT returns using accounting software and keep all your VAT records in a digital format.

Selling the property

Your property letting business ends when you no longer have any properties available for rent and 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.

You can't deduct any revenue expenses which are incurred after the last property has been withdrawn from the lettings market. Thus, the costs of maintaining the property post-letting but pre-sale are not tax-deductible.

Capital gains

When you sell your let property, you would expect to make a profit, after deducting allowable costs . Gains made from selling residential property, which are not covered by an exemption or other relief, are subject to CGT at 28%, except to the extent that the seller has basic rate band available, when the rate is 18%. The gain must be reported to HMRC online within 30 days of the completion of the sale. Penalties will apply if this 30-day deadline is missed.

If all the capital gains you make in the tax year (not just from property disposals) exceed your annual capital gains exemption (£12,300 for 2021 /22), you must declare those gains on the CGT section of your self-assessment tax return. This applies even where you have already reported the gain online to HMRC within 30 days of the completion date.

If you give away the property to someone other than your spouse or civil partner or sell it to someone connected to you at a discount, that disposal is treated as a sale at market value for tax purposes.

Allowable costs

- solicitor and estate agent fees paid on the sale and purchase
- land tax (e.g. SDLT)
- cost of improvements

Former Home

When you live in a property, the gains made relevant to your period of occupation are exempt from CGT. The gain relating to the last nine months of ownership is also exempt from CGT if you previously lived in the property. If you live in more than one home concurrently, you can nominate which property is to be treated as your 'main home' and thus exempt from CGT. You must make the first nomination within two years of the date on which you started to use the second property as your home. A husband and wife or civil partners can only have one CGT-free main home between them.

Non-resident landlords

If you live outside the UK and let property located in the UK. your letting agent (or tenant where there is no agent) should deduct 20% tax from the rents before paying you. However, where HMRC agrees that you qualify under the non-resident landlord scheme, you can receive the rental income without tax deducted. You have to promise to declare the income from your let properties on a UK tax return and pay any tax due on the profits.

Gains arising from the disposal of UK property are subject to CGT in the UK, even where the landlord lives in another country. The gain must be reported to HMRC and the tax paid, within 30 days of the completion date, as described above. However, non-resident landlords must also report disposals where there is no tax to pay or a loss is incurred.

Inheritance Tax

The value of all your possessions, including the home you live in and your Buy to Let properties, are all potentially subject to Inheritance Tax (IHT) on your death. However, the first £325,000 ("nil rate band") is effectively exempt from IHT and any unused nil rate band may be inherited by your spouse or civil partner. There is an additional residential nil rate band of £175,000 per person that can be deducted if you leave the value of a home to one or more of your direct descendants, but this is not available if the property has always been rented out. Any unused amount is also transferrable to a spouse or civil partner.

There are exemptions for gifts made more than seven years before you die and amounts left to your spouse or civil partner or to charities. It is essential to have a well-drafted and up-to-date Will to take full advantage of IHT exemptions and reliefs. At MSR we can help to plan your Property taxes, CGT or IHT and other reporting needs to HMRC.

Disclaimer: This guide is written for the benefit of our clients and is based on information available in May 2021. Further advice should be obtained before any action is taken.

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