Taxation of property

Key guides

WREN STERLING

Taxation of property

Introduction

Property outlook

For anyone looking to enter the buy-to let market as a new landlord, the decision is currently far from straightforward. On the plus side:

- Average rents increased by 8.6% over the year to June 2024, with the average monthly rental now standing at £1,310;
- Although house prices remain subdued, recent cuts in mortgage rates may lead to an improvement. The extension of the mortgage guarantee scheme until 30 June 2025 will help support property prices at the lower end of the market; and
- Mortgage costs should continue to fall following the reduction in the rate of inflation to 2% (June 2024).

On the negative side, the new Labour government is going to introduce a Renters' Rights Bill. This will overhaul the private rental sector in England, and, in particular, abolish no-fault evictions and give tenants the power to challenge rent increases.

There are reports of a number of landlords leaving the market because of relatively high mortgage costs together with increased costs generally. The licencing fees being charged by some councils also do not help.

In Scotland, the Scottish government is introducing legislation which will include a system of rent controls. The Welsh government has also consulted on possible rent controls, although it looks as if such a move will not go ahead.

Please note that all examples included in this guide are fictitious.

Becoming a landlord

Anyone thinking of becoming a landlord should be in a fairly strong position if they are either a cash buyer or are able to put down a substantial deposit. Although rents in London have fallen in recent months, rents remain high across the rest of the UK. The relatively high cost of servicing a mortgage, however, means a landlord must be more careful than ever to avoid periods when a property is unlet. Although property prices remain subdued, there can be regional differences. For example, prices in Northern Ireland have seen a 4% annual increase. So, buying the right property in the right place can make all the difference. Many tenants will be looking for a property where they can easily work from home, and a garden or outdoor space may also add a premium to the rent that can be charged.

One particularly difficult decision is whether to opt for a fixed rate or a variable rate mortgage, and, if fixed, for how many years. It all depends on your view of where interest rates are going to go; an especially difficult decision given the bank base rate has remained unchanged since August 2023. A variable deal will mean an immediate saving if interest rates fall, but a longer fixed-rate deal provides certainty; and a saving if interest rates were to increase again and then remain high for a few years. However, with inflation now down to 2%, it looks as if interest rates have reached their peak.

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Finance costs

For those looking to invest in property, an individual's finance costs, such as interest on mortgages and loans to furnish a property, are not tax deductible. A basic rate relief tax reduction is given instead.

Example – Finance costs restriction

For 2024/25, Alice, a higher rate taxpayer living in Suffolk, has buy-to-let rental income of £20,000, allowable deductions of £2,000 and finance costs of £8,000.

None of Alice's finance costs are deductible, so her property income for 2024/25 is £18,000 (£20,000 − £2,000), on which she will pay higher rate tax of £7,200. She can then deduct tax relief at the basic rate for the finance costs (£8,000 at 20% = £1,600), resulting in a tax liability on her property income of £5,600 (£7,200 − £1,600).

One way to avoid the finance costs restriction is to use a limited company structure to purchase property. In Alice's case, a company would have paid tax of just £1,900 ((£18,000 – £8,000) at 19% (assuming the company's profits do not exceed £50,000)) with 100% of the finance costs being deductible. However, as explained below, Alice would then face more tax when extracting the property income from the company.

Joint Ownership

Income from a rental property owned jointly with a spouse or civil partner is normally shared equally for income tax purposes, even if the actual ownership is different. This can be quite advantageous if your spouse or civil partner pays tax at a lower rate than you. They can be given, say, a 10% share of the rental property, but 50% of the property income will be taxed at the lower rate.

If you wish to be taxed on your actual share of ownership rather than the deemed 50:50 split, this can be achieved by making a declaration of beneficial interests to HMRC.

For capital gains tax (CGT) and inheritance tax (IHT) purposes, the actual share of ownership is always used.

The question of joint tenancy or tenancy in common also needs to be considered. On death, a share of a property owned under joint tenancy automatically passes to the surviving joint tenant. With tenancy in common, the deceased's share of the property is distributed in accordance with their will or the rules of intestacy.

Renting out a property

Using a letting agent

A good agent will be invaluable when it comes to finding tenants (and filtering out bad ones) and ensuring that tenancy agreements are watertight. They will be up to date with property legislation, such as the 2022 amendments to the smoke and carbon monoxide regulations. They can take much of the stress out of maintenance and provide an impartial buffer should the tenancy go sour. However, lettings agents are not cheap, so one popular option is to use an agent just to find and vet tenants, and to set up the tenancy.

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Basis of taxation

The basis for taxing property is not quite as simple as you might think.

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

Allowable deductions and reliefs

Allowable expenses must be incurred wholly and exclusively for your buy-to-let business, and could include:

- letting agent's fees;
- cost of maintenance, repairs and gardening;
- council tax, water rates, gas and electricity;
- property insurance;
- advertising; and
- business mileage calculated using HMRC's mileage rates (45p per mile up to 10,000 miles, and 25p thereafter) or based on the actual cost.

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

Planning point
Unless you are using a letting agent, make sure that you check the right to rent of all new tenants aged 18 or over, even if they are not named on the tenancy agreement. You will need to ask for, and keep copies of, original documents proving that tenants are permitted to live in the UK. Fines for non-compliance have increased substantially from February 2024.

Property allowance

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

Multiple occupancy

You need to be aware of the additional requirements if you rent out your property as a house with multiple occupancy (an HMO). This is a complex area, but essentially multiple occupancy means at least three tenants, forming more than one household, but who share facilities like a bathroom.

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Student lets are normally classed as HMOs. Fines can be punitive for renting out an HMO without having the required licence.

Future changes

It is not just the current rules and regulations that you need to be aware of, but also possible future changes.

The recently announced Renters' Rights Bill will introduce various changes for English landlords, including:

- Abolishing no-fault evictions (so, in future, landlords will probably want a guarantor to be provided);
- Tenants will be given the power to challenge rent increases;
- Landlords will not be able to unreasonably refuse a tenant having a pet (landlords will, however, be able to request pet insurance to cover any potential damage);
- Landlords will have to fix damp and mould issues within strict time limits ('Awaab's Law'); and
- Landlords will not be able to discriminate against tenants who receive benefits or have children.

A somewhat similar tenancy regime has been in place in Scotland since 2017, where there are no longer no-fault evictions. Scotland is also looking at introducing a minimum standard of energy efficiency for rented properties. This could be a major issue for Scottish landlords with just a few older properties. Although the previous Conservative government backtracked over changes to the minimum standard of energy efficiency for property situated in England and Wales, the new government may well look at reintroducing a minimum standard. Currently, the minimum required rating for England and Wales is 'E'.

Planning point
It can make sense to retain existing tenants by foregoing rent increases. Apart from having an unlet period and the costs associated with finding a new tenant, there is generally no discount from council tax for empty properties.

Tax implications of buying a property

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

Stamp duties

Although you will incur various lending, legal and survey costs, stamp duty land tax (SDLT) is usually the biggest expense when purchasing a property in England or Northern Ireland. SDLT rates are increased by 3% when it comes to buy-to-lets, regardless of whether you buy the property personally or through a limited company.

If you are purchasing a buy-to-let in Scotland, you will pay land and buildings transaction tax (LBTT) instead of SDLT. For buy-to-let purchases in Wales, land transaction tax (LTT) applies. The buy-to-let surcharge is 6% for Scottish property and 4% for Welsh property (although there is an anomaly for

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Wales in that the surcharge is effectively 7.5% from £180,001 to £225,000, 1.5% from £225,001 to £250,000 and 3% from £250,001 to £400,000).

In each case, tax is paid on the slice of the purchase price falling within each tax band.

Stamp duties on second residential properties					
England and NI – Stamp Duty Land Tax	Rates	Scotland – Land and Buildings Transaction Tax	Rates	Wales – Land Transaction Tax	Rates
£0 to £250,000	3%	£0 to £145,000	6%	£0 to £180,000	4%
£250,001 to £925,000	8%	£145,001 to £250,000	8%	£180,001 to £250,000	7.5%
£925,001 to £1,500,000	13%	£250,001 to £325,000	11%	£250,001 to £400,000	9%
Above £1,500,000	15%	£325,001 to £750,000	16%	£400,001 to £750,000	11.5%
		Above £750,000	18%	£750,001 to £1,500,000	14%
				Above £1,500,000	16%

The 3%, 4% and 6% surcharge rates are not charged on a property costing £40,000 or less, meaning no SDLT, LBTT or LTT will be charged for such a purchase.

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

Example – SDLT calculation

Emma, who already owns a main residence, purchases a buy-to-let property in England for £380,000. The amount of SDLT payable is £17,900, calculated as:

First £250,000 at 3%	£7,500
Remaining £130,000 (£250,001 to £380,000) at 8%	£10,400
	£17,900

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

Personal or corporate purchase?

An important decision that you will have to make at the outset is whether to purchase your buy-to-let property personally or through a limited company. The restriction to the tax deductibility of finance costs (explained above) has made the company route more attractive. The relatively low 19% small profits rate of corporation tax also means that this option makes sense if you are aiming to retain profits for reinvestment in additional property or to repay some of your financing. However, higher rates of corporation tax apply if a company's profits exceed £50,000. Where a company's profits fall between £50,000 and £250,000, the small profits rate of 19% only applies on the first £50,000 of profits, with an effective rate of 26.5% applied on profits falling between

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£50,000 and £250,000. If profits exceed £250,000, a main rate of 25% applies to all of the company's profits.

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

The overall tax charge might well be higher if profits are withdrawn from a company. If taken as remuneration, national insurance contributions could be payable. If extracted as dividends, there will be a double charge to tax for dividends in excess of the £500 tax-free dividend allowance. Capital gains may also suffer a double tax charge.

Example – Tax charge on company dividends

Winston, a higher rate taxpayer, has £20,000 of property income within his property company, which he wishes to withdraw as a dividend during 2024/25.

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

Assuming the small profits rate is applicable, the company will pay corporation tax of £3,800 (£20,000 at 19%), leaving £16,200 to pay out as a dividend. If the dividend allowance is not available, Winston will pay income tax of £5,468 (£16,200 at 33.75%) on the dividend, leaving him with net income of £10,732.

Planning point
Ground rents are now effectively set at zero for new leases, but check for excessive ground rent if buying a second-hand leasehold property. The elimination of ground rents for new leases could create a two-tier market, making older leasehold property less attractive and more difficult to sell (the new Leasehold and Freehold Reform Act does, however, allow leaseholders to obtain a 990-year lease extension and, at the same time, effectively eliminate future ground rent; but this comes with what could be a significant cost). The new government has announced plans to tackle existing ground rents.

Tax implications of sale or disposal

Your buy-to-let property portfolio may increase in both size and value, and at some point, you may want to cash in some properties, possibly to pay down the finance on those to be retained. Another option as you get older might be to gift some properties to your children or grandchildren. CGT will come into play whether you sell or gift property, although this tax can currently be avoided by simply retaining property until your death. Your children or grandchildren inherit properties with an uplifted base cost for CGT purposes, although IHT then becomes an issue.

- **CGT** The gain will be based on what you sell a property for, or its market value if gifted. You can deduct the original purchase cost, incidental costs of purchase and sale (such as legal fees and stamp duties) and any expenditure which has enhanced the value of the property (and will therefore not have been deducted as repair expenditure when calculating property income). If a property has not been occupied as a main residence, the only exemption, if available, will be the annual exempt amount (£3,000 from 2024/25 onwards). Gains will then sit on top of your income for the tax year of sale or disposal. Any part of the gain that falls within your basic rate band will be taxed at 18%, with the remainder taxed at 24% (be warned that the new Labour government may well increase rates of CGT, although

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any changes are unlikely until the 2025/26 tax year). A payment on account of the CGT due is required 60 days after completion.

- **IHT** Outright gifts of property have IHT implications if you die within seven years of making the gift. If your property portfolio is retained until death, it will be included as part of your estate at its value at the time of death. Basically, IHT is payable at 40% once a nil rate band of £325,000 (up to £650,000 if you benefit from the nil rate band of a deceased spouse or civil partner) is exceeded.

One issue that landlords wishing to sell might face is that having a sitting tenant in the property can make a sale difficult. One way round this is to sell to the tenant, with the tenant taking out a concessionary mortgage. For a concessionary mortgage to be available, the landlord has to sell for at least 10% below market value, but this might be worth it for a quick sale with no estate agent fees incurred.

Property retained after moving homes

Many landlords have built up property portfolios by retaining property when they move homes, with the retained properties then rented out. One attraction of this approach is that rental properties, having previously been occupied as a main residence, can often be sold in the future at little or no CGT cost.

A proportion of the gain arising on sale is exempt, based on the period of occupation. In addition to actual periods of occupation, the final period of ownership is also exempt. However, this final period exemption is limited to nine months.

Corporate disposals

If you have used a company structure for your buy-to-lets, then any gains will be made within the company and taxed at the company tax rate of 19% or 25% (or even 26.5%). But note that companies do not benefit from the annual exempt amount.

Should you wish to extract the proceeds of a company property disposal, you will face a potential double tax charge – the corporation tax payable on the gain, then personal tax on the withdrawn proceeds – which is inefficient compared to the tax cost of disposing of a personally owned property.

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

Other types of property letting

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

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Furnished holiday letting

Furnished holiday lettings are treated as a trade and therefore qualify for various tax advantages, although they will obviously require considerably more work given the short-term nature of the lettings. Apart from3 not suffering from the finance costs restriction when calculating property income, any gain on the disposal of a furnished holiday letting can benefit from a 10% capital gains tax rate. Returns can also be higher when compared to a regular property rental.

The qualifying conditions can, however, be difficult to meet. Essentially, a property must be available for letting at least 210 days a year and let for at least 105 days.

One further advantage is that a furnished holiday letting in England can normally be registered for business rates rather than council tax, with nothing then payable if small business rates relief is available. The business rates qualifying conditions are generally less onerous than the furnished holiday letting conditions. Scottish rules are similar, but Welsh rules are actually stricter than those for furnished holiday lettings.

From 6 April 2025, however, the furnished holiday lettings tax regime is set to be abolished. Furnished holiday lettings will then be treated exactly the same as a buy-to-let for tax purposes, with the finance costs restriction being applied.

Planning point
Although a furnished holiday letting should still be more profitable than a buy-to-let even after the tax advantages are lost from 6 April 2025, some owners may decide to sell before then to take advantage of the 10% rate of CGT currently applicable if business asset disposal relief is available. After 5 April 2025, the rate of CGT might be as high as 24% (or even higher if the rates of CGT are increased).

Commercial property

You might not like the idea of commercial property, but semi-commercial property, such as where there is a flat above a shop, could be an attractive proposition, being halfway between commercial and residential investment. The purchase of such a mixed-use property will not suffer the relevant stamp duty surcharge, and the finance costs restriction will not apply to those finance costs associated with the purchase of the commercial element of the property. There is an annual 3% write-off if you buy commercial property where the construction contract was signed on or after 29 October 2018. The cost of converting or renovating an existing property also attracts the 3% relief, but the value of land and any dwelling element are excluded.

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

Example – SDLT on mixed-use commercial property

If Emma – who purchased a buy-to-let property for £380,000, paying SDLT of £17,900 – had instead purchased a mixed-use commercial property, the SDLT payable would have been £8,500 based on the non-residential rates – a saving of £9,400.

Renting a room

Do not overlook the tax advantage of renting out a furnished room or rooms in your own home, especially to a long-term lodger. Rents of up to £7,500 each tax year are exempt from tax, which

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will be quite beneficial for a higher rate taxpayer. The relief does not apply, however, if you have converted part of your home into a separate flat.

You can either rent to a long-term lodger or make use of an online site such as Airbnb to offer holiday lets. Don't forget to inform your mortgage lender, review insurance cover and check whether there are any local authority restrictions. Leaseholders may find, however, that short-term renting is not permitted under the terms of their lease.

Planning point
There are several steps you can take to protect your property from being fraudulently sold or mortgaged. For property situated in England or Wales, one of the easiest steps is to sign up to HM Land Registry's property alert service. This doesn't prevent a change, but you will receive an immediate alert.

How we can help

We can help you to understand the tax implications prior to you purchasing a property, and the effects of using corporate structures.

We can help you understand what a sale will cost in tax terms. We can also discuss estate planning options that can help keep IHT liabilities to a minimum.

Important changes have been announced on how furnished holiday lettings are to be taxed in the future. We can advise on the impact of these changes and keep you up to date with any further changes.
Investing in property should be regarded as a long-term investment and should fit in with your overall attitude to risk, and financial circumstances.
Past performance is not a reliable indicator of future performance, and you may not get back the original amount invested.
The value of investments and income from them can go down as well as up.
Tax planning including estate planning, inheritance tax planning, trusts, commercial mortgages and some buy to let mortgage advice is not regulated by the Financial Conduct Authority.
Commercial mortgages are on a referral basis.
Tax treatment varies according to individual circumstances and is subject to change.
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