Buy To Let – dealing with tax

What are your duties?
How can Base52 help you?

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BASE52
Chartered Management Accountants

Personal or company Buy to Let – which structure is best?

In recent years many people have invested in buy to let and the number of private landlords has increased significantly. This eBook outlines the main tax rules relating to buy to let including recent changes.

You can own a buy to let property personally or via a company.

Usually personal ownership is considered to be more beneficial if you are a basic rate taxpayer. This is because your net rental income is then taxable at your marginal rate of 20%.

You may wish to consider owning a buy to let property via a company if you are a higher/additional rate taxpayer and are also thinking of purchasing more than one buy to let property. This is because companies pay Corporation tax at 19% (from April 2017). This makes the tax rate very attractive compared to 40%/45%.

However, tax planning is essential when extracting the profits from the company as further tax may be payable personally.

You can invest in various types of let; residential, commercial such as office and Furnished Holiday Lets.

Furnished Holiday Lets are treated slightly differently for tax purposes. They are a short term let as opposed to longer term letting. Certain conditions need to be met for a property to qualify as a Furnished Holiday Let.

Tax implications for personal ownership

Income tax
You may have to pay income tax on any profit that you make (dependant on your other income), at your marginal rate.

You can claim a deduction for allowable expenses, from your gross rental income. Allowable expenses include (but are not restricted to) letting agent fees, maintenance and repairs to the property, ground rent, service charges and accountancy fees.

You cannot deduct 'capital expenses' from your rental income. These are costs which usually relate to improvements or enhancements made to the property. Replacement of domestic items relief – this can be claimed from April 2016 if you replace an item such as beds, sofas, fridges and carpets.

Rental losses can be carried forward and offset against future profits. If an individual makes a rental loss this cannot be offset against other income.

Capital Gains Tax
Capital gains tax will need to be considered if an individual sells a buy to let property. The gain is the disposal proceeds less any costs (including acquisition cost) and improvements.

Individuals have an Annual Exemption for Capital Gains (2017/18 £11,300). This can be offset against the gain before tax is calculated. Gains on residential property are taxed at either 18% (basic rate) or 28% (higher rate).

Dependant on your other income you may pay a proportion of the gain at 18% and the remainder at 28%. *The new CGT rates introduced from April 2016 do not apply to residential property.* You may be able to claim certain tax reliefs if the property has ever been your main residence. If the property is a Furnished Holiday Let, you may be able to claim Entrepreneurs' Relief, providing certain conditions have been met.

Non UK residents are subject to CGT when disposing of a UK residential property.

Stamp Duty Land Tax
You will pay higher SDLT rates for additional properties purchased which is an increase of 3% to the standard rates. *Properties in Scotland are subject to Land and Building Transaction Tax.*

If you are considering transferring a buy to let property from personal ownership to company ownership you will need to consider SDLT on the transfer. This is also relevant if transferring a property which has an outstanding mortgage. There are certain rules depending on the circumstances.

Tax implications for company ownership

Corporation tax
The rental profit is calculated in the same way as for properties owned personally; rental income less allowable expenses.

You cannot deduct 'capital expenses' from your rental income. These are costs which usually relate to improvements or enhancements made to the property.

Losses can be offset against other profits in the same accounting period. The losses can also be carried forward and used in the next accounting period if not fully utilised in the year the loss arose.

Chargeable gains
When a company sells a property, the gain is liable to Corporation Tax (19% 2017/18). There is no Annual Exemption.

Indexation Allowance can be claimed by the company which effectively allows for inflation and uplifts the cost of the property.

Non UK resident companies are subject to CGT when disposing of a UK residential property.

Stamp Duty Land Tax
The 3% increase also applies to companies which purchase residential property.

You could consider selling shares in the company as opposed to the property. Stamp Duty on shares for the buyer is much lower (0.5%) than the rates in respect of purchasing property.

Properties in Scotland are subject to Land and Building Transaction Tax.

Annual Tax on Enveloped Dwellings
This is an annual tax payable mainly by companies that own UK residential property which is valued at more than £500,000. To calculate the amount payable the property will need to be valued.

What changes are coming in or are already implemented?

1. The Wear and Tear Allowance was abolished in 2015/16. Landlords can claim a ‘Replacement of domestic items’ relief; tax relief on the cost of replacing a domestic item such as beds, sofas and fridges.

2. HMRC have introduced new rules from April 2017 (2017/18), to restrict the amount of relief available to landlords in respect of finance costs and mortgage interest on residential properties.

Companies, commercial lets and Furnished Holiday Lets are not affected.

Landlords will no longer be able to deduct the finance costs/mortgage interest from the rental income. Instead, a basic rate tax reduction will be deducted from their income tax liability.

This restriction is going to be phased in over a few years as follows;

2017/18; 75% of finance costs can be deducted from rental income. 25% of the finance costs will be given as a basic rate reduction.

2018/19; 50% of finance costs can be deducted from rental income. 50% of the finance costs will be given as a basic rate reduction.

2019/20; 25% of finance costs can be deducted from rental income. 75% of the finance costs will be given as a basic rate reduction.

2020/21; No finance costs can be deducted from rental income. All finance costs will be given as a basic rate reduction.

The basic rate reduction available will be up to 20% of the finance costs not included within the rental accounts. The basic rate reduction may be restricted in some cases, for example; if the rental profit is less than the finance costs, then the basic rate reduction is restricted to 20% of the rental profit.

There could potentially be a restriction if you have property losses brought forward or if your total income is low. If there is a restriction, finance costs which have not been used in the calculation can be carried forward.

When do these changes come in and how will this affect me?

1. The ‘Replacement of domestic items’ relief was introduced from April 2016.

2. Restriction to finance costs including mortgage interest will be introduced from the 2017/18 tax year and will be in full force by 2020/21.

The changes will mean that landlords will see an increase in their rental profit as the finance costs / mortgage interest is no longer deducted within the rental accounts.

If you remain a basic rate taxpayer, even with these changes, then you will not see a difference in the amount of tax payable.

If you are a higher or an additional rate taxpayer or, if the removal of the finance costs within your rental accounts means you will fall into the higher rate or additional rate tax band, you will have a greater tax liability.

What steps do I need to take if I am letting property?

- You will need to report your rental income and expenditure to HMRC. A Self-Assessment Tax Return will be needed if net rental profit is between £2,500 and £9,999 and if your gross profit is £10,000 or more.

- An individual will need to register for Self-Assessment by 5th October following the tax year end in which rental income was received.

- Rental profit made on a company owned property needs to be reported on the Corporation Tax Return.

- Ensure that you maintain accurate records for rental income and expenditure together with property acquisition and enhancement costs.

How can Base52 help you?

There are many factors to consider when investing in a buy to let property.

At Base52, we can:

- help you plan and make your investment in a tax efficient manner;
- assist with preparation of any necessary tax work such as rental accounts and capital gains tax calculations
- plan ahead so you are aware of your future tax liabilities and potential reductions.

If you would like Base52's advice and assistance with any aspect of compliance with Buy to Let property, contact Carly:

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