Buy-to-let **Tax Guide** for landlords

Hello and welcome to our buy-to-let tax guide

Hello and welcome to our buy-to-let tax guide. As you'll be well aware, the private rented sector (PRS) has changed considerably in recent years.

It now accounts for almost 20% of households nationwide and nearly 30% of households in London.

With significant growth comes great opportunities for landlords - tenant demand in the capital is at an all-time high and average rents have been rising steadily over the last decade.

However, the growth of the PRS has also attracted the attention of the government. The result of this has been a cooling of the buy-to-let market with the aim of helping first-time buyers onto the property ladder.

One area that the government has targeted is landlord taxes and it's undeniable that a series of measures and regulations have made letting a property more challenging.

As the tax landscape for landlords continues to change and becomes increasingly complex, it's vital that you're aware of the latest rules and any future changes which could affect your property portfolio.

That's why we've created this timely guide to help you navigate your way around the landlord tax system in 2022.

With the right procedures and strategies in place, London landlords can still make a fantastic return on investment.

Giles Atkinson
Director

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A changing tax landscape

What do you need to know?

An overview of the key updates:

The additional stamp duty surcharge

What?
An additional 3% stamp duty charge levied on the purchase of buy-to-let properties and second homes.

See further details here.

When?
April 2016.

Why?
To cool the buy-to-let market with the aim of 'levelling the playing field' between investors and first-time buyers.

The Wear and Tear Allowance abolished

What?
The formal Wear and Tear Allowance - which allowed landlords to claim tax relief against 10% of rental profits each year - was scrapped.

See further details here.

When?
April 2016.

Why?
The Wear and Tear Allowance was replaced with a relief system which only allows landlords to deduct the costs they actually incur on replacing furnishings in the property. The idea of this initiative was to 'improve consistency and fairness' in the taxation of property.

Additional stamp duty for overseas investors

What?
An additional 2% stamp duty charge (on top of the existing 3% stamp duty surcharge) for overseas buyers of buy-to-let properties and second homes.

Find out more here.

When?
April 2021.

Why?
To make it harder for overseas investors to purchase property in the UK. Proposed with the aim of further supporting domestic buyers.

Capital Gains Tax changes

What?
'Lettings relief will only be available to landlords who share their property with tenants. And, for landlords selling a property they have let and lived in, the CGT exemption is being reduced.

Find out more here.

When?
April 2020.

Why?
To increase the tax income from accidental landlords, part of the government's plans to make the tax system 'fairer' across the board.

The phasing out of buy-to-let mortgage interest tax relief

What?
The buy-to-let mortgage interest tax relief landlords can claim is being reduced until it reaches the basic income tax rate of 20%.

More information can be viewed here.

When?
April 2017
- April 2020.

Why?
A policy proposed at the same time as the stamp duty surcharge with a similar aim of cooling the buy-to-let market in favour of first-time buyers.

Making Tax Digital

What?
Allowing landlords to keep digital records of their tax payments and provide live updates to HMRC.

More information can be viewed here.

When?
April 2020

Why?
Part of HMRC's ambition to become one of 'the most advanced tax administrations in the world', aiming to make paying tax more efficient, effective and easier to get right.

The stamp duty surcharge explained

One of the most controversial pieces of new legislation for landlords was introduced in April 2016, when the government brought in an extra 3% stamp duty surcharge on buy-to-let and second homes.

The measure was designed to make buy-to-let investment less attractive and improve the chances of first-time buyers getting on the ladder.

It's faced a fierce backlash ever since, with regular calls for the surcharge to be altered or scrapped.

How does it work?

Announced in the 2015 Autumn Statement and taking effect from April 1 2016, the extra stamp duty surcharge means paying added tax on top of the stamp duty that buyers already have to pay when purchasing a home.

It applies to anyone buying an additional residential property for £40,000 or more.

- For those that only own a share in another home, the extra stamp duty rates still apply if that share is worth over £40,000.
- Overseas buyers purchasing their first home in the UK can be hit by the tax, too, if their share of a home in another country is higher than £40,000.
- The higher rates of stamp duty apply to homes in England and Northern Ireland, with very similar legislation in Scotland and Wales.

Before, buy-to-let investors only had to pay the stamp duty rates that regular buyers face when purchasing a property. But the change means buy-to-let landlords effectively have to pay stamp duty twice over. And, in many cases, buy-to-let investors will be paying more than 3% extra.

That's because while normal levels of stamp duty work via a tiered approach, the extra surcharge operates as a slab tax, with the added tax applying to the entire price of the home.

Tax band changes

Band	Existing residential SDLT rates	New additional property SDLT rates
£0 - £125k	0%	3%
£125,001 - £250k	2%	5%
£250,001 - £925k	5%	8%
£925k - £1.5m	10%	13%
£1.5m+	12%	15%

How much does it cost?

If you were purchasing an additional residential home for £350,000, you would pay the regular 5% stamp duty for a home of this value (equating to £7,500), plus the extra stamp duty surcharge on the entire price of the home (which in this case would be a further £10,500).

Overall, then, a landlord's stamp duty bill for a home of this value would be £18,000 rather than £7,500.

To find out how much you could owe, you can use this handy online stamp duty calculator.

A further tax on overseas investors

Since April 1 2021, non-UK residents have had to pay a further 2% stamp duty surcharge when purchasing homes in the UK. The extra 2% surcharge is on top of the 3% surcharge outlined above. It is designed to make house prices more affordable, helping people to get onto and move up the housing ladder in line with the government's wider objectives on homeownership. The revenue raised will be used to tackle rough sleeping.

You can find out more details here.

How are purchase costs affected?

The reduction of buy-to-let mortgage interest tax relief

It was announced in 2015 that the government was going to reduce the ability of landlords to deduct mortgage interest costs from taxable profits. Despite a fierce backlash, and even a legal challenge taken to the High Court, attempts to get the government to change course ultimately failed.

How does it work?

The changes, also known as Section 24, came into force on April 6 2017 and dramatically altered the rules on how landlords could declare their rental income.

Before, buy-to-let landlords had a tax advantage in that they only needed to declare their rental income after they'd paid their mortgage.

They could deduct mortgage interest and all other costs before paying income tax on their profits.

With most landlords holding interest-only mortgages, they could in theory claim back all their mortgage repayments.

Under the old system, a landlord with rental income of £12,000, mortgage interest costs of £6,000 and £1,000 in other costs would have a profit of £5,000.

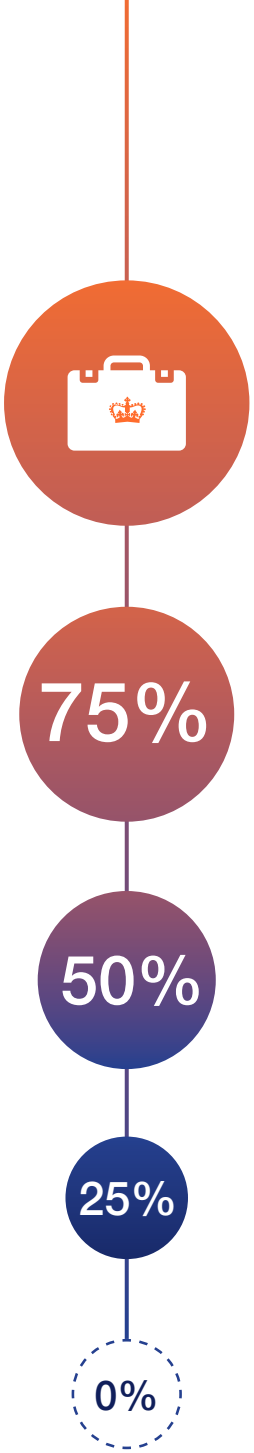
This profit was then charged at their marginal rate - for basic rate taxpayers this is currently 20%, for higher rate taxpayers it's 40%.

However, the tax relief has been gradually phased out, replaced with a new tax credit which means landlords can cut their final tax bill by 20% of their interest. This is set to have a dramatic effect on profits.

This is set to have a dramatic effect on profits. For a higher rate landlord of a home with £600 in mortgage costs per month, and charging £950 rent a month, their final tax bill since April 2020 has been £3,120 as opposed to £1,680 before.

As a result, profit after tax and mortgage costs have been factored in would be £1,080 rather than £2,520 – a significant fall.

A Timeline of the Changes



July 2015

George Osborne announces in his Summer Budget the proposals for the phasing out of mortgage interest tax relief over four tax years.

April 2017

The phasing out begins, with the allowable deduction of mortgage interest from property income reduced to 75% for the 2017/18 tax year.

April 2018

The next stage comes into force, reducing the allowable deduction to 50%.

April 2019

The allowable reduction is slashed to 25%.

April 2020

By the end of the 2020/21 tax year, mortgage interest relief falls to 0%, replaced by a 20% tax credit, allowing landlords to cut their final tax bill by 20% of their interest.

How can landlords reduce the impact of Section 24?

One way in which landlords have sought to protect their profits is by incorporating. This is when they transfer their property portfolios into a limited company structure to avoid paying more tax.

Unlike individual private landlords, businesses are not affected by the changes to mortgage interest tax relief. There are, however, pros and cons to this approach (see pages 10-11), with extra stamp duty and capital gains tax two potential downsides.

Alternative solutions:

- Switching to a shorter-term fixed-rate mortgage deal to secure a lower interest rate.
- Transferring ownership of properties to a partner or spouse, if they pay less tax and will be less affected by the tax relief changes.

The pros and cons of incorporation

With the steady phasing out of mortgage interest tax relief, incorporation has been something more landlords have been considering to offset any major hits to their profits.

But what exactly is incorporation? And how popular has it become since the new rules on tax relief were introduced?

This is the process by which landlords convert their property portfolios into limited companies in order to pay lower levels of corporation tax and lower taxes on profits.

The restrictions on tax relief to only the basic rate of tax (currently 20%) do not apply to companies, who must only pay corporation tax on their profits (19% currently).

Limited companies, in other words, aren't affected by the mortgage interest tax relief changes, so turning a property business into a company is a way for landlords to protect their profits and reduce their tax outgoings.

What are the pros?

Once a landlord has incorporated, their tax return changes from an income tax return to a corporation tax return, with a landlord's rental income no longer appearing on this form.

While income tax is paid twice, in January and July, and is based on estimated profits, corporation tax is paid just once annually and is based on calculated profits.

Capital gains (see page 14) made on a rental property, too, are charged at the corporation tax rate for those who own properties through limited companies.

It's also important to remember that you don't need to have a property portfolio to incorporate - individual or one-property landlords are not barred from taking this step. But a landlord must be able to highlight that they are treating the letting out of homes as a business and that their activities meet what is labelled as the 'business threshold'.

What are the cons?

While limited companies aren't impacted by the changes to mortgage interest tax relief, landlords still have to pay corporation tax on their profits. Although this rate has been steadily falling in recent years, it could just as easily go back up with a change of government, with corporation tax becoming less attractive to businesses if the political landscape alters.

Labour, for example, has pledged to put the corporation tax rate back up to 26% (21% for small businesses) if elected.

Landlords should also bear in mind that they are likely to face capital gains and stamp duty charges when transferring properties from personal ownership to a limited company structure.

When transferring, you are effectively selling your properties to a new business (the limited company you've set up) and face the costs this incurs, which could be significant.

Landlords will be subject to another stamp duty bill, including the extra 3% stamp duty surcharge on buy-to-let homes (see page 6).

Furthermore, setting up a limited company takes quite a lot of work, with formal statutory accounts needing to be produced and submitted to Companies House, while tax returns could be more complex and take longer to complete.

Finally, it's likely to be more difficult to source a business buy-to-let mortgage deal (although the number of these on offer is increasing), and they are likely to be more expensive and include higher flat fees than those available to individuals.

Incorporation advantages summarised:

- Limited companies are not affected by the tax relief changes.
- Corporation tax is lower than income tax.
- You can offset tax on your mortgage interest as a business expense.

Incorporation disadvantages summarised:

- Corporation tax could go up with a change in government.
- You may have to pay significant capital gains and stamp duty costs when transferring.
- Mortgage deals can be expensive, which could offset the benefits of incorporating.

How popular is incorporation?

There has been a surge in the number of landlords using limited companies in recent years as a result of the phasing out of mortgage interest tax relief, and a desire to make rental portfolios more tax efficient.

According to a recent report, over the last four years the number of landlords operating their buy-to-let business through a limited company has doubled.

In 2021, right across the UK, there were some 47,400 new buy-to-let companies – the highest number since the tax changes introduced by former chancellor George Osborne led to landlords paying more income tax.

Despite this, the growth in the number of incorporations is now slowing, with 2021 probably close to its peak. The trend is expected to decline throughout this year.

Previous research from Precise Mortgages revealed that nearly two out of three landlords with more than four properties were planning to add to their portfolio using limited company status. The study found that 64% of landlords with more than four properties were planning purchase using limited company status in 2021, compared with just 21% who intend to buy as individuals.

Across the market as a whole, the research suggested that some 44% of landlords would buy using limited company status, dropping to 17% among landlords with one to three properties.

The Wear and Tear Allowance: Your FAQs answered

Back in April 2016, the Wear and Tear Allowance was scrapped and replaced with the Replacement Relief system.

The Wear & Tear Allowance provided landlords with the opportunity to claim tax relief against 10% of their rental profits each year. They could claim this allowance regardless of whether they had spent any money on replacing items or property improvements.

The Replacement Relief system which has taken its place allows landlords to claim tax relief only for wear and tear costs they have actually incurred.

What can you claim for?

You're able to claim Replacement Relief for the following 'moveable assets': furniture, soft furnishings, appliances, crockery and flooring. It's also important to remember that any items you claim for must be for the sole use of the tenant.

Can I only claim the cost of a replacement item?

No, you can claim for the cost of a replacement (capped at the typical cost of a modern replacement) and any costs incurred when disposing of the old item.

Does it matter if my property is furnished or unfurnished?

Not anymore. Previously, under the Wear and Tear Allowance, landlords letting unfurnished properties could only claim the 10% allowance against the replacement of integrated appliances.

The new system is open to all landlords. However, if you are providing furnishings for the first time, then you are unable to claim Replacement Relief.

Does Replacement Relief apply to all lets?

No, there are several categories of lets to which it doesn't apply. These include holiday lets, lets which are subject to Rent-a-Room Relief and lets which are charged at below the market rate for 'uncommercial' purposes.

What constitutes fair wear and tear?

This can sometimes be a grey area, but usually it just requires application of common sense. Acceptable wear and tear is gradual damage or deterioration you'd expect to see over time.

In rental properties, the most common wear and tear issues for which landlords can use Replacement Relief include: worn carpets, faded curtains, chipped or cracked paintwork, scuffed floors or loose hinges.

Here you can see a handy guide which outlines the difference between fair wear and tear and damage (which you can charge tenants for).

Why was the new system introduced?

The new system was introduced to create a more level playing field for all landlords as the tax relief no longer varies on rental income or location of property. What's more, the system no longer favours landlords offering fully-furnished properties.

By only allowing landlords to claim tax relief against the costs they actually incur, the Replacement Relief system also incentivises owners to maintain the furnishings in their property each year, rather than claim for relief without making any improvements.

The ins and outs of Capital Gains Tax

Capital Gains Tax, often referred to as CGT, is the tax paid on the profit made when selling an asset such as a property.

Understanding the basics

As a landlord, it's highly likely that you'll be required to pay Capital Gains Tax when you come to sell a rental property.

CGT is calculated by deducting the amount you originally paid for the property from the eventual sales price, and then making any additional deductions for costs and improvements.

You'll then need to set your gain against the annual exemption allowance (currently £11,700) and then pay tax at the required rate on any gain over this allowance.

Then depending on your annual income, you'll need to pay CGT on your final calculated gain, which is charged at a basic rate of 18% and a higher rate of 28%.

If you're thinking of selling a property, you can get an idea of how much your CGT bill could be by using this handy calculator.

At the most recent Budget, chancellor Rishi Sunak didn't raise CGT in line with income tax as many expected, and instead relaxed the deadline by which landlords must pay the tax after selling an investment property or second home.

Before, the bill must have been paid within 30 days – a change that was only introduced in 2020 – but that timeframe has now been doubled to 60 days, giving landlords more time to report and pay CGT on the properties they sell.

Key things to remember

- If you're selling a rental property within three years of purchase, you'll be exempt from paying CGT.
- Every year, there is an amount your asset can gain which is exempt from CGT. This is known as the 'annual exemption allowance'.
- The annual exemption allowance is larger if the property has multiple owners and it also increases the longer you've owned the asset.
- The costs of home improvements, such as an extension, can be deducted from your gain.
- You're also eligible to deduct the stamp duty you paid when purchasing the property, as well as the solicitor and estate agent fees you pay when selling it, from your gain.

2018 CGT changes explained

As part of 2018's Autumn Budget, Chancellor Philip Hammond proposed two significant changes to the CGT system which could impact landlords if introduced.

If you have lived in the rental property you are selling at any time during ownership, you are not required to pay CGT for the period you lived there plus the last 18 months of ownership (regardless of whether you have been living there). This is known as the Private Residence Relief.

However, the final 18 months ownership exemption has been reduced to nine months since April 2020.

The other proposed change centres on Letting Relief, a further exemption complementing the Private Residence Relief, which the government is intending to reduce unless landlords have lived in a shared occupancy with their tenant.

You can read about the 2018 Budget's proposed CGT changes in more detail here.

HMRC is on the lookout for unpaid tax

Launched in 2013, HMRC's Let Property campaign aims to recoup unpaid tax from landlords.

It provides landlords who believe they may have underpaid tax with an opportunity to come forward and pay what they owe on favourable terms.

Participating landlords will re-pay tax based on why they've failed to properly disclose their income. There are harsher penalties for those who admit to deliberately withholding information as opposed to making a simple mistake.

HMRC says that not all landlords will have to pay a penalty and for those that do, penalties will be lower if they disclose their situation rather than HMRC finding out independently.

Has the campaign worked?

At the time of launch, the government estimated that up to 1.5 million landlords had underpaid or failed to pay up to £500 million in tax between 2009 and 2010.

A recent Freedom of Information request by accountancy firm Saffery Champness revealed that between 2013 and 2018, 35,099 people made voluntary disclosures through the Let Property Campaign, representing just over 2% of the individuals originally identified.

During this period, the campaign recovered approximately £85 million (17%) of the £500 million it intended to recoup.

As we can see, the campaign's results have been underwhelming when compared to HMRC's estimates. However, the tax authority says it is still 'targeting compliance activity across all landlord types' and will identify and write to those they consider may not have declared all their rental income. For those who do not come forward voluntarily, HMRC is entitled to go back up to 20 years and open a criminal investigation.

What should you do?

The official estimates show that there are likely to be many landlords still out there who owe HMRC money but are yet to come forward.

If you believe you could fall into this category, you should seek advice from a tax expert and contact HMRC as soon as possible.

Making Tax Digital

Alongside tax measures designed specifically for the property sector, the government is also making significant changes to the entire tax system. These changes, known as Making Tax Digital (MTD), will also affect landlords.

What is MTD?

Making Tax Digital is an initiative which intends to digitalise the entire tax system in the UK. The principal aim of this is to improve efficiency and make it easier for individuals to see how much tax they owe.

How will it affect landlords?

The key change to consider is that the traditional self-assessment tax return will be replaced by a system whereby taxpayers keep digital records and update HMRC quarterly.

Have you incorporated your portfolio?

If you're currently letting properties through a limited company and your annual income is over £85,000, you may already be required to keep digital tax records for VAT purposes.

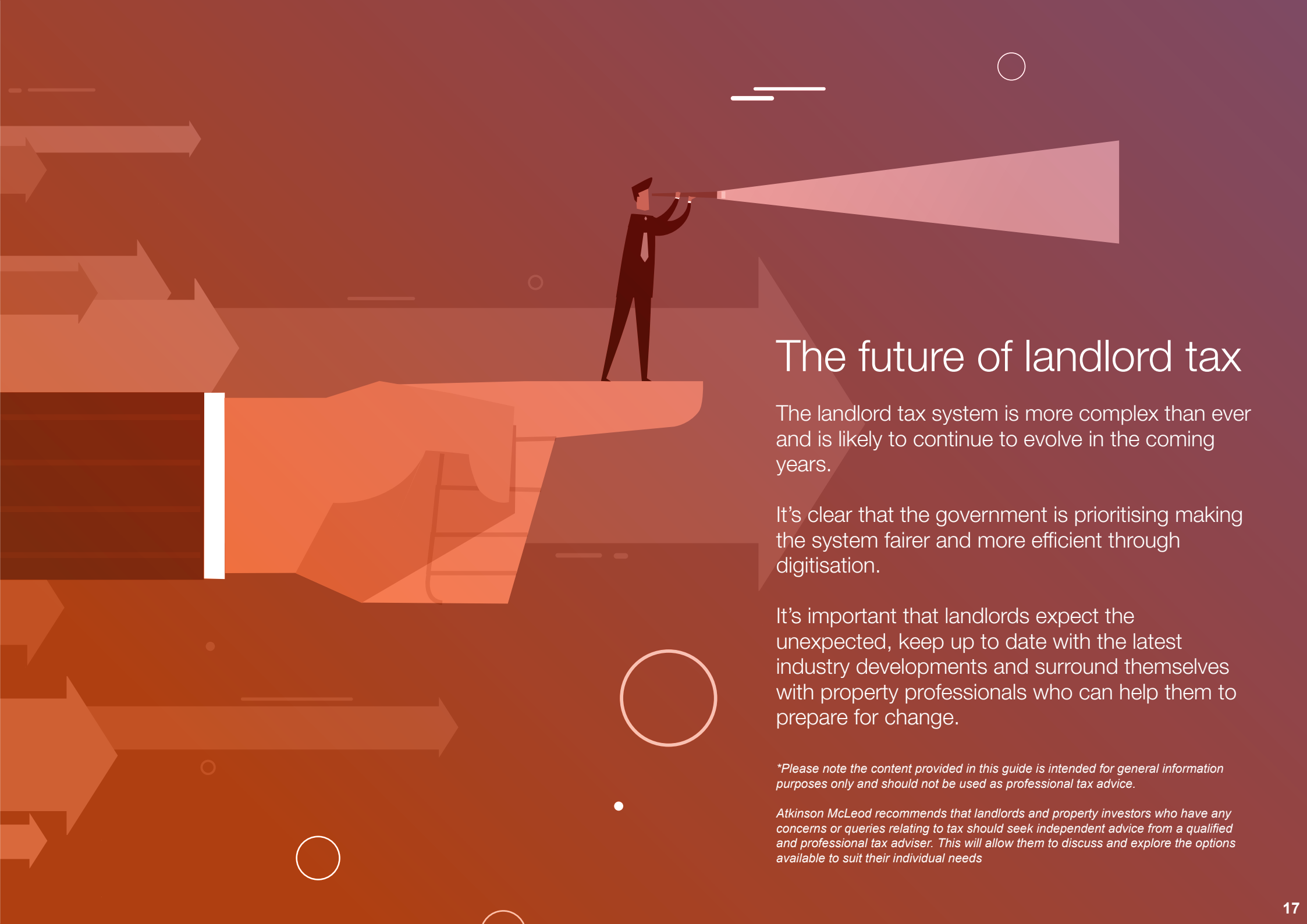
If this is the case, you'll also have to submit your VAT return digitally through software which is compatible with MTD.

Landlords will need to:

- Keep digital records of income, expenses, rental payment information and key dates.
- Send a quarterly update to HMRC which summarises outgoings, income and profit.
- Make an end of year tax declaration.

As a landlord, you have been required to adopt this system since April 2020.

You can find out more about a landlord's obligations when it comes to Making Tax Digital by clicking here.



The future of landlord tax

The landlord tax system is more complex than ever and is likely to continue to evolve in the coming years.

It's clear that the government is prioritising making the system fairer and more efficient through digitisation.

It's important that landlords expect the unexpected, keep up to date with the latest industry developments and surround themselves with property professionals who can help them to prepare for change.

**Please note the content provided in this guide is intended for general information purposes only and should not be used as professional tax advice.*

Atkinson McLeod recommends that landlords and property investors who have any concerns or queries relating to tax should seek independent advice from a qualified and professional tax adviser. This will allow them to discuss and explore the options available to suit their individual needs

We hope this guide has been useful but if you need assistance on anything to do with landlord tax, please don't hesitate to get in touch with us.

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