

# MISC

## Buy-to-let property

A guide for individual landlords on the recent tax changes.

Whether you own one or 50 let properties, you need to be aware of the tax changes that have already started to take effect – and which will accelerate over the coming years.

### Restricted interest

For periods before 6 April 2017, all the interest and finance charges relating to funding for a residential property business could be deducted in full from the rental income.

From 2017/18, the financial costs which may be deducted from residential property income by individual landlords are restricted as follows:

Tax year	Finance costs permitted
2017/18	75%
2018/19	50%
2019/20	25%
2020/21	nil

The landlord receives a tax credit equivalent to 20% of the lower of:

- finance costs not deducted from income
- income from the property business before interest
- total income exceeding allowances.

This tax credit is set against the income tax liability for the year (see example).

Any unused tax credit is carried forward to be relieved against the tax payable on the property income in a future tax year. This restriction on finance charges will have the greatest impact on landlords who pay significant amounts of interest or other finance charges, and who may be pushed into the higher tax rates due to their increased taxable income.

### Example

Pete lets two properties in Kent, for which he receives rent of £40,000 after deducting agents' fees and other costs. He pays £32,000 per year in interest on loans relating to his property business. Pete also receives a salary of £35,000 from a separate job.

Pete's tax position is shown for 2016/17 when all the interest is deductible, for 2017/18 when 75% of the interest is deductible, and for 2020/21 when no interest is deductible.

The tax rates and allowances for 2020/21 have been assumed to be maintained at the 2017/18 levels **purely for the purpose of this example**. They are likely to change.

Tax year	2016/17	2017/18	2020/21
Salary	£35,000	£35,000	£35,000
Letting income	£40,000	£40,000	£40,000
Interest permitted as deduction	(£32,000)	(£24,000)	nil
Net income	£43,000	£51,000	£75,000
Less personal allowance	(£11,000)	(£11,500)	(£11,500)
Taxable income	£32,000	£39,500	£63,500
Basic-rate band limit	£32,000	£33,500	£33,500
Basic-rate tax @20%	£6,400	£6,700	£6,700
Higher-rate tax @40%	-	£2,400	£12,000
Tax credit: non-deductible interest @20%	-	(£1,600)	(£6,400)
Total tax payable:	£6,400	£7,500	£12,300



# Buy-to-let property

Pete was a basic-rate taxpayer in 2016/17, and made a profit of £8,000 from his let properties, on which he paid tax of £1,600 (£8,000 × 20%). He also pays tax of £4,800 on his salary in that year.

From 2017/18 onwards he is a higher-rate taxpayer due to the reduction in the deduction for interest.

Although the net income from his properties remains at £8,000, in 2017/18 he pays tax of £2,800 on that income, and £4,700 on his salary. In 2020/21 he will pay tax of £7,600 on his rental income, leaving him with net income after tax from his properties of £400.

## Restructure

The restriction for deduction of finance charges only applies to landlords who let residential property and pay income tax on those profits. It does not apply if the property is commercially let as furnished holiday accommodation (FHL), or the landlord is a company.

To avoid this restriction, the property business could be restructured to:

- let the residential property so it qualifies as FHL
- sell the residential property and reinvest in commercial buildings
- transfer the residential property into a company the taxpayer controls.

A sale and repurchase of properties, or a transfer into a company, is likely to generate a capital gain as the transfer is deemed to occur at market value. The gain will be taxed at 18% or 28% depending on the level of the landlord's other income.

Where an actively-managed property business is incorporated, the gain can be rolled into the value of the company's shares – but this incorporation relief doesn't apply in all circumstances.

Any loans attached to the property business must be transferred into the company as leaving the borrowing in the individual's name would defeat the purpose of the restructuring.

When the company acquires the properties, stamp duty land tax (SDLT) or for Scottish properties land and buildings transaction tax will be due, including the 3% supplement.

There are several reliefs from SDLT where multiple dwellings are acquired in one transaction, or the transaction consists of a mix of residential and commercial property.

Full relief from SDLT can apply where the transaction involves a partnership of connected individuals transferring the properties to a company they control, but this is rarely found in practice.

## Letting through a company

When you let property through your own company, the profits that company generates will be 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 contributions (NICs) to pay.

The first £5,000 of dividends you receive in the tax year is taxed at 0%. This allowance applies in addition to your personal allowance of £11,500. The exact amount of tax payable on funds you extract from your company will depend on the level of other income you receive in the same tax year.

## Property trading

Most landlords hold and let out their properties for the medium to long term as a passive investor.

If you intend to turn over your properties more frequently, HMRC can treat your property business as a trade, rather than as a property investment business. This can apply when you:

- manage properties owned by others
- buy and sell properties within short periods
- buy and renovate properties in order to sell at a profit.

When your property business is treated as a trade, the gains you make from selling residential properties will be subject to income tax at rates varying from 20% to 45%, rather than capital gains tax at 18% or 28%, (10% or 20% for non-residential buildings). You may also be required to register for VAT and pay NICs on your business profits.

## Keeping records

Landlords are required to keep records of income and expenses relating to their property business which complies with the same standards and accounting conventions as other businesses, known as generally accepted accounting practice (GAAP).

Trading businesses with an annual turnover of up to £300,000 are permitted to record their accounting records using the cash basis, as an alternative to GAAP.

Under the cash basis, only transactions completed within the tax year or accounting period are recognised in the accounts. Debts owed by customers are ignored until the amount is paid. Similarly, expenses aren't taken into account until the bill is paid.

Currently landlords are not permitted to use the cash basis, but the government has proposed that a form of cash basis should be available to landlords with turnover of up to £150,000. This change is being backdated after coming into force from 6 April 2017.

Individual landlords will be able to opt out of using the cash basis. Companies, limited liability partnerships and partnerships which include a company as a member, won't be permitted to use the cash basis.

Contact us to discuss your property tax issues.