Nicklin
Chartered Accountants &
Business Advisers

TAX GUIDE
PROPERTY INVESTORS

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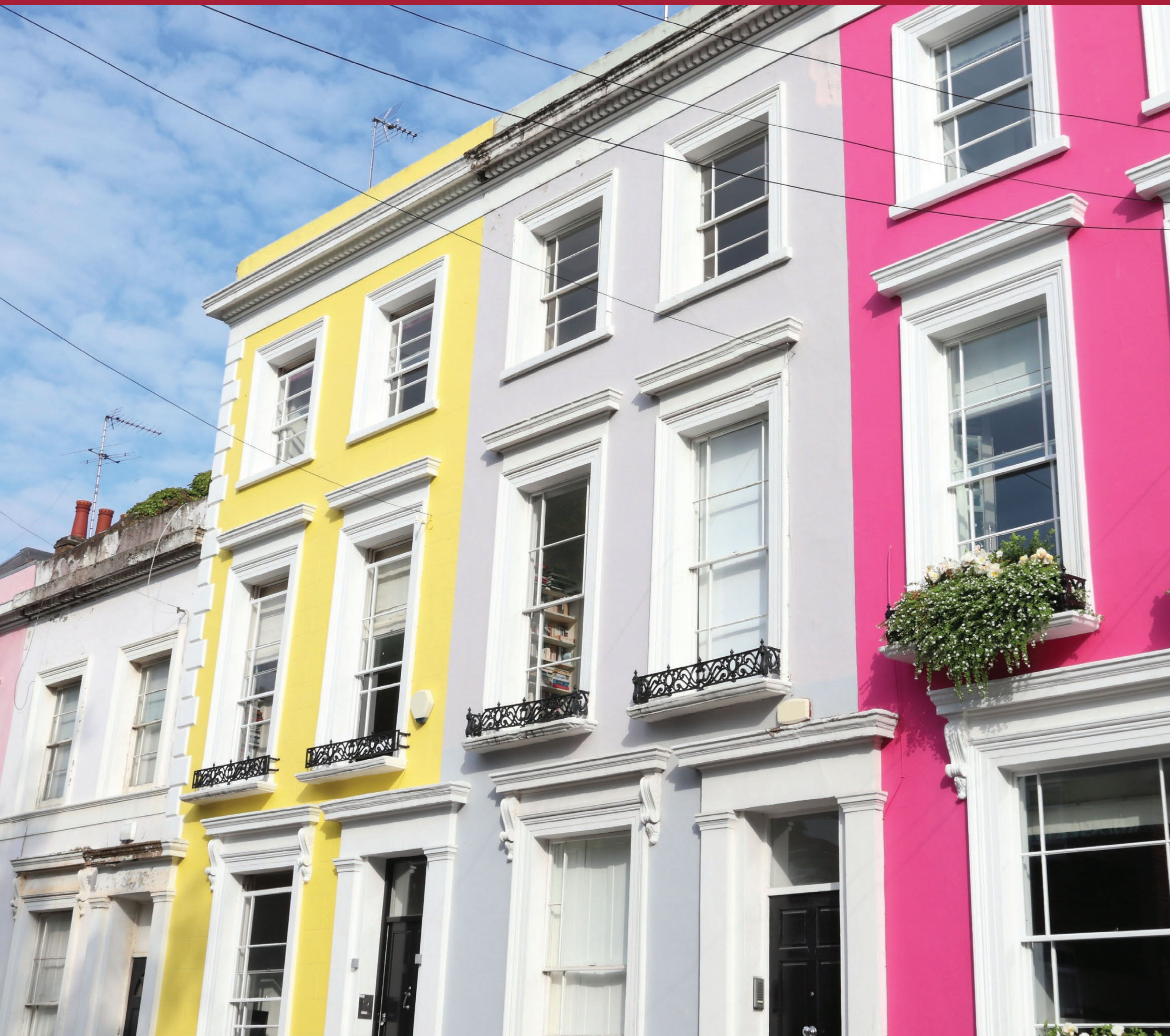
INTRODUCTION

Investing in property appeals to many people. The attraction goes beyond the rental yield, the prospect of capital appreciation over the long term and the ability to secure borrowings to fund part of the cost. No investment is without risk. But in an uncertain world, where banks can fail and whole countries become bankrupt, an investment in bricks and mortar has a reassuring feel about it.

Property investors come in all shapes and sizes. At Nicklin, we have many property clients including both investors and owner-occupiers, who range from a single shop owner to those with a property portfolio, from individuals to groups of companies, owning both residential and commercial property.

This guide is a brief summary of some of the tax issues which affect property owners. Of course, it cannot be a substitute for proper professional advice, but we hope it will provide some useful pointers for both existing and prospective investors.



STRUCTURE

A property investor, like anyone going into business, needs to consider the most appropriate structure through which to operate.

This may be by way of:

- Personal ownership, either alone or jointly.
- Trust.
- Limited Company.
- Limited Liability Partnership (LLP).
- Pension scheme (commercial property only).

Usually, personal or joint ownership will be the most suitable structure for smaller investors. For example, claims to rent a room relief, Capital Gains Tax private residence exemption and furnished holiday let status will generally only be available for personal owners.

Trusts may be appropriate in some cases, usually as part of an Inheritance Tax planning strategy linked to family asset protection, but they can be complex and relatively expensive to run.

Limited companies may suit some investors as profits are subject to corporation tax at a rate of 19 per cent at the moment, but this has changed from April 2023. From this date, Corporation Tax will only be levied at the 19 per cent rate for companies with profits of below £50,000. Companies with profits of more than £250,000 will have to pay Corporation Tax at 25 per cent, while there will be a sliding scale of relief for companies between these two thresholds.

However, if a property is sold and the profits are extracted, there can be a double tax charge – firstly corporation tax on the company's profit on the sale and then income tax or capital gains tax at a personal level on the extraction of the remaining funds by the shareholders. A company will probably only be the right choice for larger investors who are planning to hold property ownership long-term for the benefit of future generations of families.

A Limited Liability Partnership is a corporate entity, very much like a limited company for legal purposes. However, it is taxed like a normal partnership as its profits are allocated to the partners and charged to income tax or Capital Gains Tax, at the individual's marginal rate of tax.

Investors in high-value residential properties must bear in mind the additional stamp duty, Annual Tax Levy, and Capital Gains Tax payable both by companies and other 'non-natural persons'.

Pension schemes can be a very tax-efficient way to invest in commercial property, including premises used by the members' business.

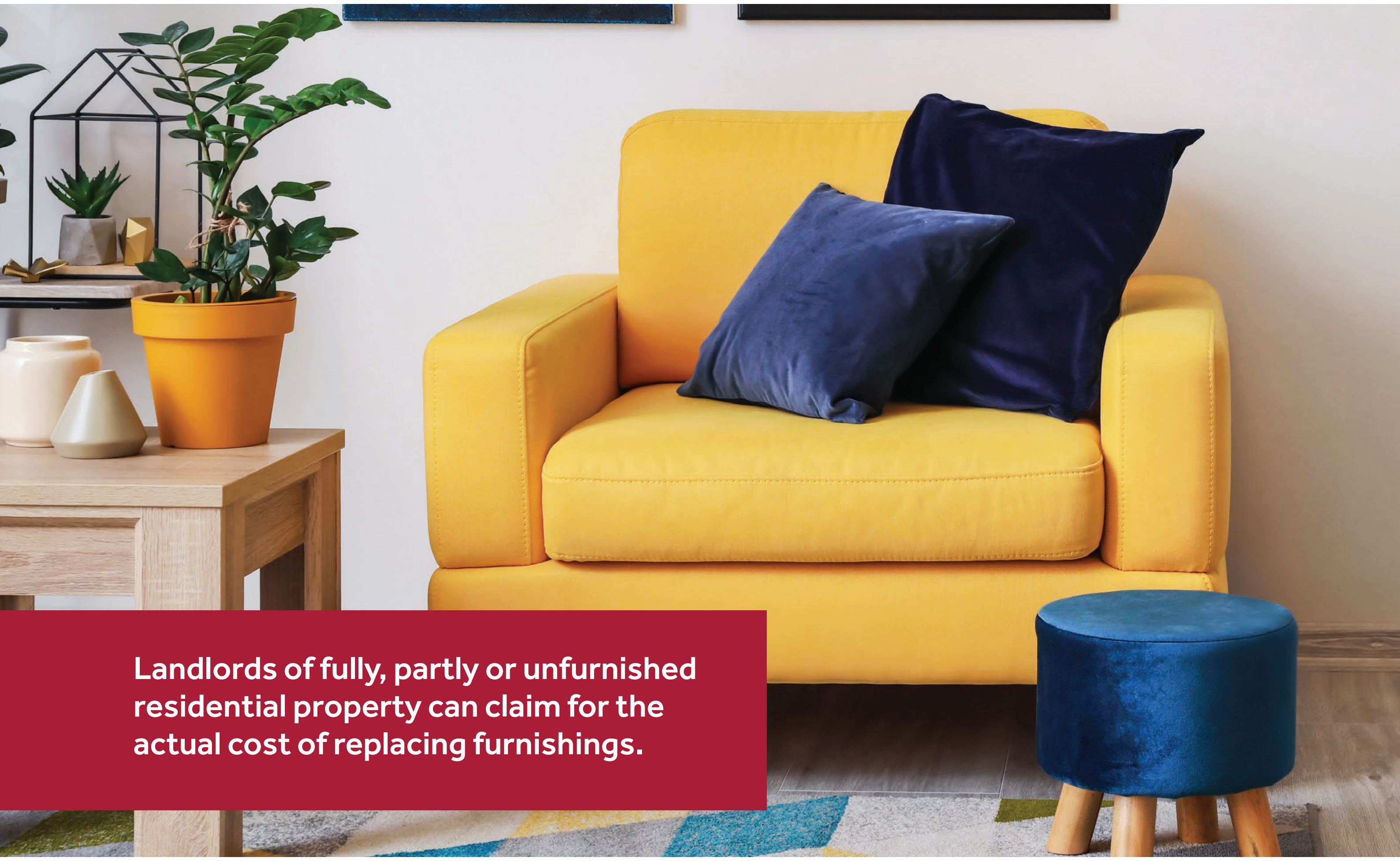
As well as providing a source of funding, the pension scheme's tax exempt status allows the rent paid to it by the business to accumulate tax-free and any profits on the eventual sale of the property can be tax-free too. In choosing a structure, it is important to consider the commercial picture as well as the tax implications, for example the cost of running a company or trust, and the cost of borrowing.

TRADING IN A PROPERTY

Some property investors buy property and retain it as a long-term investment. In these circumstances, when a property is sold, the gain arising will usually be subject to Capital Gains Tax (CGT) of 28 per cent unless you are a lower rate taxpayer in which case you will pay the lower rate 18 per cent.

An annual CGT exemption £12,300 and various other reliefs may be available for offset. All CGT from a residential property sale must be reported to HMRC and paid within 60 days of completion.

REPLACEMENT OF DOMESTIC ITEMS RELIEF (RDIR)



Landlords of fully, partly or unfurnished residential property can claim for the actual cost of replacing furnishings.

The RDIR is not available to furnished holiday let businesses.

Replacement items that are available for RDIR include:

- Moveable furniture of furnishings (e.g. beds or suites).
- Televisions.
- Fridges and freezers.
- Carpets.
- Floor coverings.
- Curtains.
- Linen.
- Crockery or cutlery.

Fixtures that are part of the building and would not normally be removed if the owner sold the building would not qualify for the RDIR.

These fixtures would include:

- Baths and washbasins.
- Toilets.
- Boilers.
- Fitted kitchen units.

These may all be allowed as repairs.

Additional considerations:

- The relief only applies to replacement costs. The initial cost of furnishing a property is not included.
- The RDIR is based on the replacement cost less any proceeds from the sale of the replaced item.
- Any improvement cost would be excluded from RDIR. For example, if a washing machine is replaced by a washer/dryer that cost £600, only the cost of a similar washing machine, say £400, is allowed.

INCOME TAX ON RENTAL INCOME

Individuals with rental income must calculate their taxable profits based on them operating a rental income business.

This means that all their rental activities form a single business, and income and expenditure must be dealt with under proper accounting principles. A statement of income and expenditure will need to be drawn up to 5 April each year.

REPAIRS

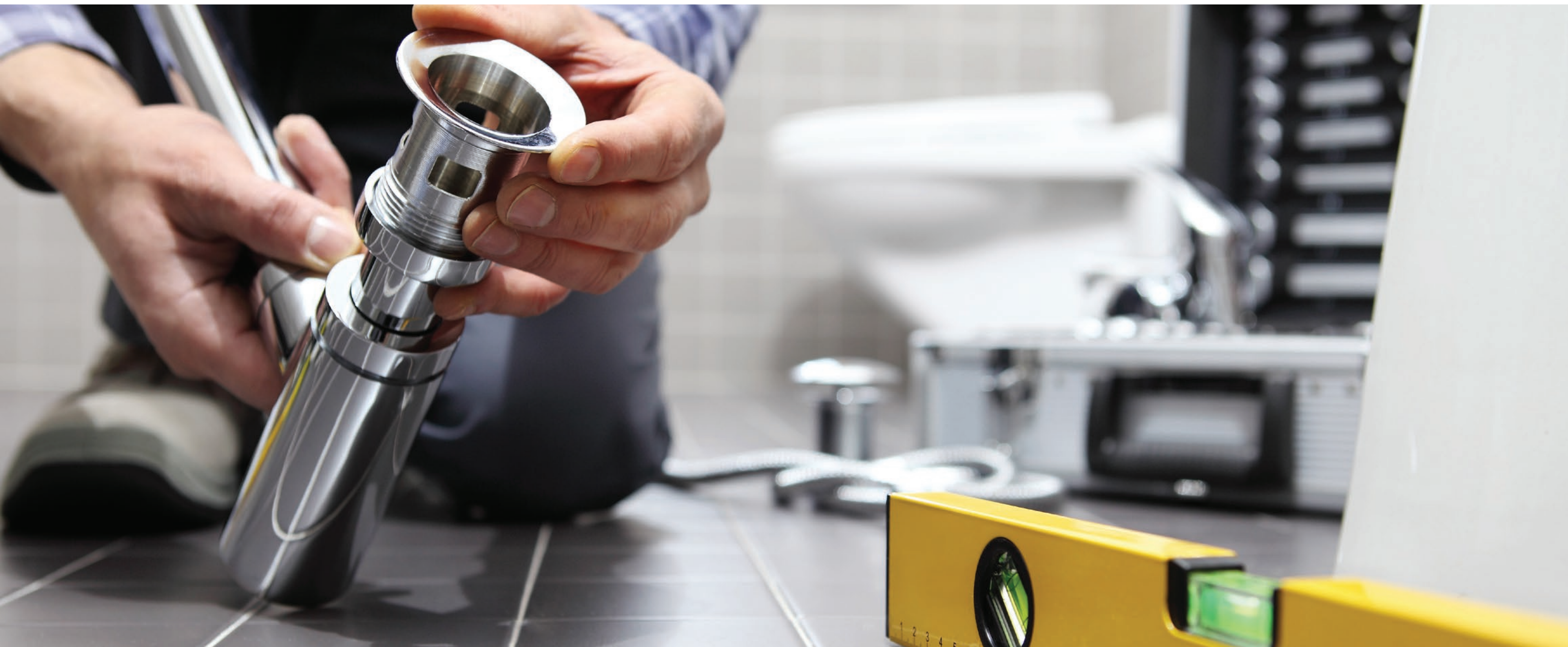
Expenditure on repairs is allowable as a revenue expense for Income Tax purposes, provided that the work carried out does not represent an improvement.

> **HMRC will normally accept that repairs do not constitute an improvement merely because more modern materials are used, such as when a single-glazed window is replaced by a double-glazed window.**

An example of an improvement would be work carried out on a roof, where instead of simply restoring the roof to its original condition, new windows were installed as part of a loft conversion. Expenditure in relation to improvement, additions or extensions to a property is capital, and is added to the cost of the property for Capital Gains Tax purposes.

As a general rule, the replacement of part of an asset is a repair, but the replacement of an entire asset is likely to be capital.

Sometimes a builder's invoice will cover a mixture of items, some of which are allowable and others which are not. It will be necessary to obtain a breakdown or calculate a realistic analysis and disclose the workings as part of your submitted tax return.



FINANCE COSTS

Many investment properties are financed partly by loans; these may be secured on the property itself, on other investment property or on the investor's own home.

Generally it is the purpose for which the funds were used, not the security given, which matters when considering whether the related interest is tax deductible. So, if a loan is taken out, secured on your private residence, and the money is used to buy a property to let, the interest charged will be allowable.

If a property which has been a private residence is subsequently let, borrowings secured on it, up to its value at the time it is introduced to the letting business, will qualify. It may be possible to refinance an existing rental property, use the funds for other purposes, and still obtain tax relief on the interest. This will depend on the circumstances, and you should seek further advice if considering this option.

The amount of Income Tax relief landlords can claim on residential property finance costs is restricted to the basic rate of tax.

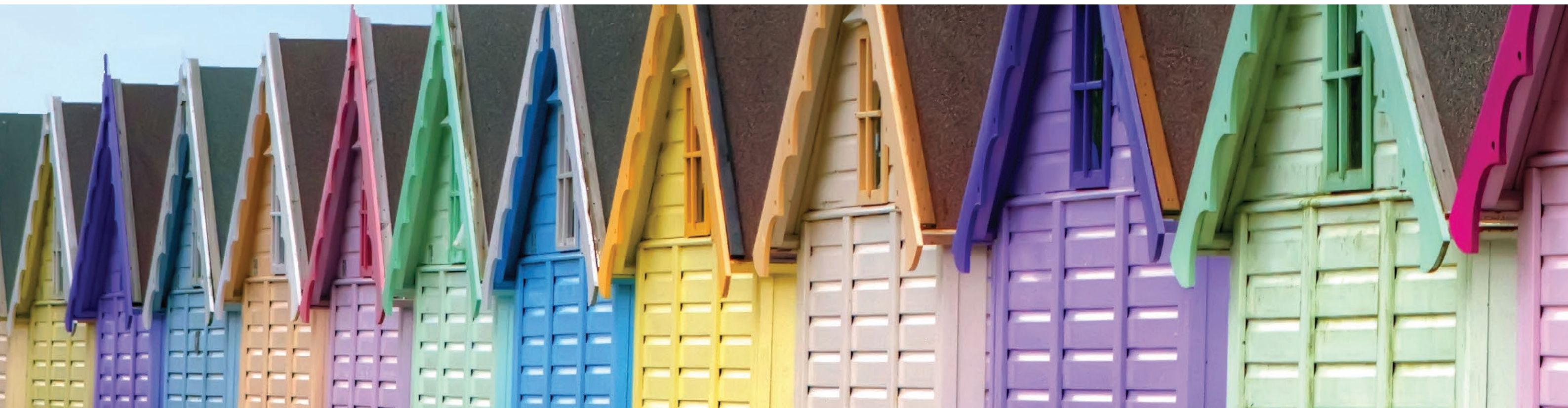
Applicable finance costs include interest on mortgages, loans - including loans to buy furnishings, overdrafts, alternative finance returns, fees and any other incidental costs relating to repaying mortgages and loans.

> **Remember that it is only the interest which qualifies for tax relief. HMRC has commented in the past that a common error found in enquiries into 'buy to let' taxpayers is the claiming of tax relief on capital repayments. Also, life insurance premiums, even if a condition of obtaining a loan, are not deductible, although arrangement and valuation fees and other 'incidental costs of loan finance' are.**

TRAVEL

Provided that the 'rental income business' can be shown to have a base – which may be your home – travel costs incurred in visiting property to inspect it, carry out maintenance, collect rents etc. are allowable. You should keep records, and also avoid combining the journey with non-business related travel, as this would disqualify the whole journey from tax relief.

Generally, reasonable claims will not be challenged, however, if there is a single property, some distance away, demonstrating where the business is based will be more difficult.



FURNISHED HOLIDAY LETTINGS (FHL)

Furnished Holiday Lettings – see below for how this is defined – are treated as if they were a trade for certain tax purposes, which means they qualify for some tax concessions.

The conditions

To qualify for FHL status the property must be:

- Situated within the European Economic Area;
- Furnished;
- Let to the public commercially as holiday accommodation;
- Available for letting for at least 210 days in the tax year;
- Actually let commercially for at least 105 days; and
- Not let for periods longer than 31 days at a time to any one tenant.

The tax advantages

The concessions available are:

- Capital Allowances are available on furnishings and appliances (not generally the case for other types of residential property).
- Capital Gains Tax roll over relief (so that a gain on a property sale may be deferred from tax assessment if a replacement property is bought).
- Capital Gains Tax entrepreneurs' relief may be due so that CGT on sale is potentially reduced from 28 per cent to 10 per cent.
- Profits count as trading income for pension contribution purposes. Full relief of mortgage interest.

HOLIDAY LETTINGS

The general rule that rental income is VAT exempt does not apply to holiday accommodation, which is standard rated.

Many investors will not need to worry about this rule, as their annual rental turnover will be under the threshold of £85,000. However, where a number of properties are owned, this may not be the case.

Particular care should be taken by those who are already VAT registered, as the registration applies to all the business activities of the person or entity so registered. For example, a farmer letting out a cottage as holiday accommodation may need to account for VAT on the income because overall, the farmer's total business income exceeds £85,000 per annum.

CAPITAL ALLOWANCES ON COMMERCIAL PROPERTY

Capital Allowances is the system under which businesses obtain tax relief for their capital expenditure. The legislation categorises capital assets and regulates whether, and at what rate, allowances are given. Generally, in considering property investors, we are concerned with allowances for 'machinery and plant'.

There are numerous rules which relate specifically to items contained within buildings, so the area can be a complex one. The rules generally apply equally to property investors and those using the property as trading premises. In essence, expenditure on plant and machinery will give rise to an annual writing down allowance, the rate of which will depend on the nature of the asset. An annual investment allowance may also be due, which will provide a 100 per cent allowance in the year of expenditure, up to a maximum. The current allowance is £1 million. The definition of 'machinery and plant' is complex, but will generally include items such as kitchens, WCs, heating systems, fire alarms, air conditioning, lifts, conveyors, racking and some electrical works.

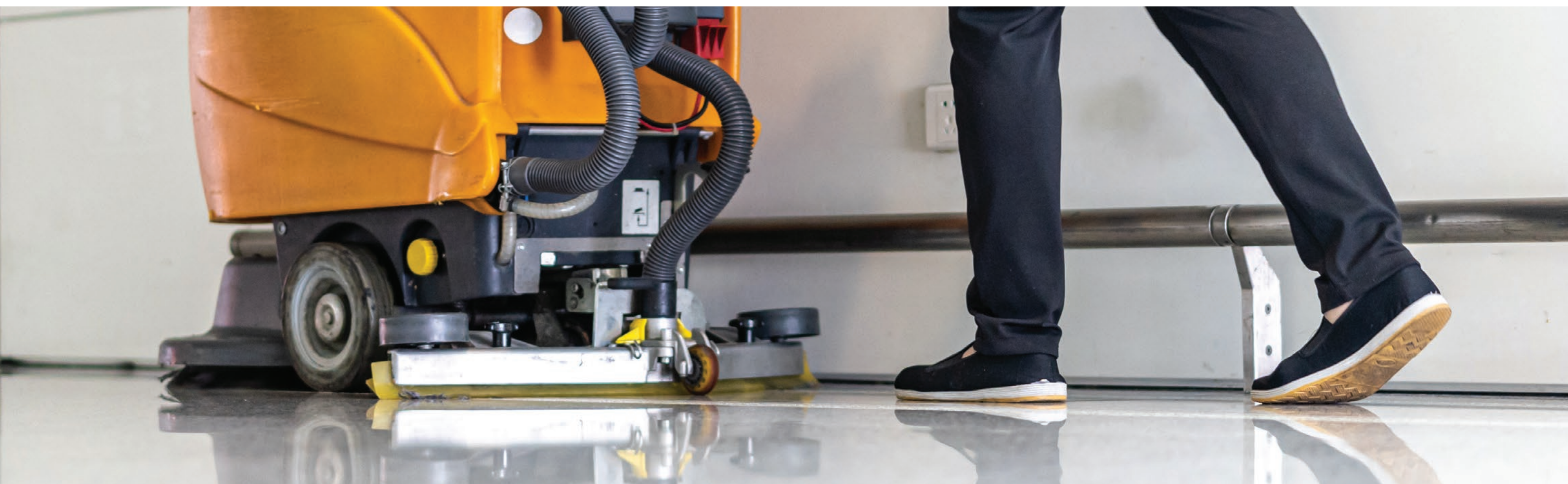
When buying a commercial property, the fact that the purchaser may attribute a value to the machinery and plant element of the cost, and claim Capital Allowances on it is often overlooked. The amounts involved can be substantial.

ENHANCED CAPITAL ALLOWANCES

The Enhanced Capital Allowances scheme is designed to encourage investment in low emission cars, energy saving and water efficient technology by giving a 100 per cent first year allowance for expenditure on equipment on an approved list.

The allowances include items such as boiler equipment, heat pumps, ventilation equipment, lighting, hand driers, refrigeration equipment, uninterruptible power supplies, showers, taps, toilets, washing machines and industrial cleaning equipment, as well as more recent additions including active chilled beams and desiccant air dryers with energy saving controls.

It is only possible to claim Capital Allowances where the seller has pooled the expenditure for Capital Allowances purposes by notifying HMRC. Thus buyers will need to ensure that the seller (who may not have had any need to claim Capital Allowances) has cooperated in making such an election notice in order that the buyer may make a claim for Capital Allowances.



CAPITAL GAINS TAX (CGT)

Private residence exemption

Generally speaking, a gain arising on the sale of your home will be exempt from CGT. Often, some exemption will be available if the property has been let but has also been your home, and the amount of exemption available will depend on the circumstances. However, see the section on trading for cases where a charge to income tax may arise. It would be quite possible to write a book on this area alone. What follows is an outline of the main areas where difficulties arise.

Has it really been your residence?

To qualify for the exemption, the house must really be your residence. There is no set period for this, but it has to be more than just living there for a short while, or nominating it as your address when you actually live somewhere else.

HMRC are prepared to challenge borderline cases, and it really is important to be able to prove the truth. As well as the length of occupation, factors such as correspondence address, electoral register, children's schooling and involvement in the local community may be taken into account.

Is it your main residence?

If you have more than one private residence, you may make an election as to which one will be exempt. This is to eliminate uncertainty in cases where there are genuinely two homes in which you actually reside. But it may only be used to nominate which actual residence is to be the main residence. You cannot elect for a property to be treated as your residence if, based on the facts, it is not.

If you sell a building plot

The exemption covers gardens up to 0.5 hectare, so if your garden is within this and you sell off a part of it for development, you can claim the exemption provided that you actually do occupy the property claimed. However, if you sell the house first, the plot will cease to be your residence and will no longer be exempt from tax.

Can married couples claim separately?

No. A married couple that are not separated may only have one exempt property between them.

Property was let for part of the time

The gain will be time apportioned to calculate the exempt portion, and the balance will be subject to CGT. However, you may qualify for a further exemption of up to £40,000 per individual if jointly-owned.

If part of the property was let

The exemption will not apply to the proportion of the property which was let. However, as stated above, a further exemption of up to £40,000 may be available. This extra relief was introduced specifically to encourage people to let surplus accommodation in their homes.

If you have been absent for any time

If a property is now your private residence, some additional periods could be treated as exempt if you were not living in the property at the time, or have let it during your absence. Most importantly, the last 18 months is always treated as a period of deemed residence. Other 'permitted periods of absence' are only exempt if you resume residence when they come to an end.

TAX ADVICE FOR NON-RESIDENT LANDLORDS

For people who are not domiciled in the UK (non-doms), there are a number of tax planning opportunities available which can bring a number of financial benefits when investing in UK property.

Careful planning can produce substantial tax savings – however, certain things must be taken into consideration including a person's length of residence in the UK, and calculating this can be especially complicated. This is why it is recommended that you seek professional advice as early as possible.

Individuals not domiciled in the UK need to check whether tax planning opportunities are still available before becoming resident in the UK, when recording details of their overseas income, gains and the original costs of their assets in order to avoid any unexpected tax liabilities which could otherwise be avoided.

We can advise on a range of areas including:

- Income Tax and Capital Gains Tax.
- Services for non-residential landlords.
- Inheritance Tax.
- National Insurance contributions.
- Tax relief for both foreign and UK pension contributions.
- Setting up and managing offshore trusts and companies.
- Immigration matters.
- International and national VAT reclaims and registrations.
- UK tax filing compliance requests.

STAMP DUTY LAND TAX (SDLT)

SDLT is a levy on transactions in land in the UK. It applies to 'chargeable transactions', which generally means a purchase or the grant of a lease.

The tax as it affects most transactions, is relatively straightforward. There are inevitably more detailed provisions to deal with complex transactions and tax avoidance schemes, but these are beyond the scope of this briefing note.

Residential properties

You pay SDLT on increasing portions of the property price above £250,000 when you buy residential property, e.g. a house or flat.

Property or lease premium or transfer value	SDLT rate
Up to £250,000	Zero
The next £675,000 (the portion from £250,001 to £925,000)	5%
The next £575,000 (the portion from £925,001 to £1.5 million)	10%
The remaining amount (the portion above £1.5 million)	12%

STAMP DUTY FOR BUY TO LET PROPERTY

The majority of buy to let purchases attract an additional three per cent Stamp Duty surcharge. There is a starting threshold of £40,000 which will capture nearly all buy to let transactions.

The surcharge applies to all buy to let purchases unless total individual ownership is limited to a single dwelling, i.e. the purchaser does not already own other residential property.

ANNUAL TAX ON ENVELOPED DWELLINGS (ATED)

Some people choose to use trusts and company structures to hold UK residential property. Specific tax rules apply, both to domiciled and non-domiciled individuals who own UK residential properties using a special purpose company vehicle. One of these rules is the Annual Tax on Enveloped Dwellings. ATED is a tax payable by companies that own high value residential property or 'dwellings' sited in the UK.

ATED is charged annually on residential property valued at over £500,000 held by a 'non-natural person' such as a company or a collective investment vehicle. The amount due depends on the value of the property.

Property value	Annual charge in 2023/24
More than £500,000 up to £1 million	£4,150
More than £1 million up to £2 million	£8,450
More than £2 million up to £5 million	£28,650
More than £5 million up to £10 million	£67,050
More than £10 million up to £20 million	£134,550
More than £20 million £269,450	£269,450

Holding UK property through a trust or company can avoid Inheritance Tax for non-domiciled individuals. If the trustees and/or the company are non-UK resident, they do not have to pay Capital Gains Tax when they sell the property.

CGT may however be payable by the UK tax resident beneficiaries of the foreign trust and company property-owning structures. Restructuring may be required so that property is no longer held by a non-natural person i.e. a company. However, please note that moving a property out of a company can bring it within the Inheritance Tax net – so careful consideration is required before deciding what course of action to take.

RENT A ROOM

Income from the letting of furnished accommodation which is part of an individual's main residence is tax-free provided that, before deducting any expenses, it does not exceed £7,500 in a tax year.

The property must be used as the main residence at some point in the tax year. If the gross rent exceeds £7,500 per year you have a choice either to pay tax on the excess or to claim property expenses in the normal way.

You can also ignore the exemption, and base your return on the actual income and expenditure, if a loss arises.

NON-RESIDENTS OWNING UK RESIDENTIAL PROPERTY

Capital Gains Tax (CGT)

The UK tax loophole which allowed overseas investors and British Expats to avoid CGT on the sale of residential property is now closed. Gains arising on the sale of all UK residential properties is subject to CGT, even if owned by non-UK resident persons.

VALUE ADDED TAX (VAT)

VAT on property transactions is a complex area and, as with other taxes, it is essential to take timely expert advice.

VAT exempt status

Income received from the sale or rent of land and buildings will normally be exempt from VAT (20 per cent output VAT on the income is not charged). Neither is the recipient of such income entitled to reclaim the input VAT paid.

Where a person carrying on a business has only exempt supplies, there is no need to register for VAT. However, there are some very important exceptions to the general VAT exemption.

New residential property

The sale of a new residential property is zero-rated rather than exempt. This means whilst the builder will generally not be required to charge VAT on its sale, the builder will be able to recover the input tax on the costs of building the property.

DIY house builders

There is also a scheme to enable 'do it yourself' builders to recover the input tax they pay on constructing a new dwelling.

However, there are strict rules governing when claims must be submitted, what may be reclaimed, and what supporting documents are required.

The 'option to tax'

The option to tax – or, technically, the making of an election to waive VAT exemption – as the name suggests, makes supplies subject to VAT which would otherwise have been exempt.

The election will generally be made to enable the recovery of input tax in connection with a sale which would otherwise have been exempt (for example, on the development of a commercial building for sale or rent).

Once an election is made, there is a cooling off period of six months during which it may be withdrawn, but after that it may not be revoked until 20 years after the date it was made.

With substantial amounts of tax often at stake, the decision as to whether to make an option to tax should only be made after careful advice and consideration prior to completing any property transaction.

If you buy a 'taxable' building, you will need to consider the implications carefully, and may need to register for VAT if not already registered.

INHERITANCE TAX (IHT) PLANNING

Investment properties generally

Property portfolios which have been built up over a period of time can give rise to substantial potential IHT liabilities on either the death of or gifting of such assets by their owners.

Owners are unlikely to qualify for IHT Business Property Relief (BPR), so, if their land assets remain in the owner's estate until death, they will be subject to IHT. However, if they have appreciated in value, a lifetime transfer may create a Capital Gains Tax (CGT) bill if gifted prior to death. A gift is treated as a disposal at market value for CGT – so giving the property away is not a simple solution either. Similar problems can apply to shares in property investment companies.

There may be some possible solutions if IHT planning is structured by way of making lifetime gifts is desired:

- Transfers into some trusts allow gains to be held over so that, instead of an immediate CGT charge arising, the trustees inherit the CGT base cost of the person creating the trust. However, the value which is transferred may be restricted to the IHT nil rate band as trust transfers are generally chargeable to IHT at the lifetime rate of 20 per cent.
- Capital losses on property may be realised and set against gains on those being gifted.
- Trusts owning properties where there is a history of personal occupation may qualify for the private residence exemption to reduce the CGT arising.
- Shares in property companies may be carefully transferred over a period of time to use the CGT annual exemptions available.

For substantial property companies, where the measures listed above would not really make much impact on the problem, it may at least be possible to freeze the value of the existing shares and enable future capital growth to pass to the desired beneficiaries in a tax-efficient manner.

Investment properties generally

Care should be taken where a property is used in a business to ensure that BPR is not wasted. For example, property owned personally, but used by a family company or partnership may possibly qualify for BPR at 50 per cent rate. Property owned in a standalone company, but let to a trade under the same control, may not qualify for BPR.

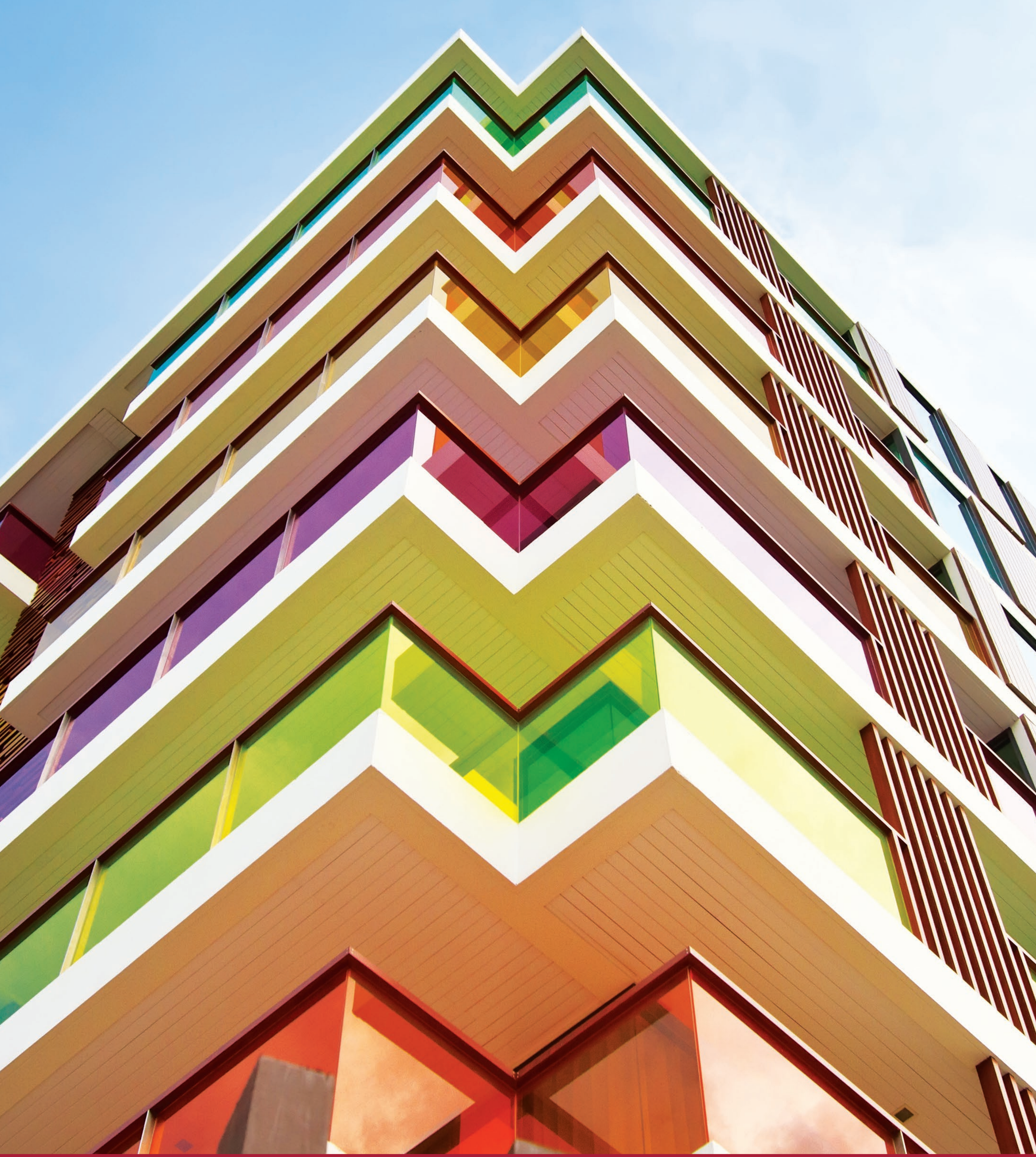
In either of these scenarios, the tax position can generally be improved. There is often a significant amount of tax at stake, so planning steps should always be considered.

Furnished Holiday Lets (FHL)

The tax concessions extended to FHLs do not include an automatic right to IHT BPR. FHL properties will normally be fully subject to IHT.

To qualify for the relief, the owners (either personally or through employees) would be expected to play an active part, beyond the usual activities such as dealing with bookings, cleaning and changeovers. In short, active business participation is required to be performed by the owner(s).

To make it a qualifying business for BPR would require either something more akin to a hotel, with the provision of meals and other services, or an involvement in the holiday activity itself, such as providing guided tours, or other sport and leisure activities.



Halesowen Office:

Church Court, Stourbridge Road,
Halesowen, West Midlands B63 3TT

Tel: 0121 550 9916

Email: info@nicklins.co.uk