Technical factsheet

FAQs on residential buy to let (BTL) property

What is the definition of a residential property?

The term has been defined at more than one time within the legislation. Section 116 of Finance Act 2003 defines residential property for SDLT purposes as below.

A residential property means:

a) a building that is used or suitable for use as a dwelling, or is in the process of being constructed or adapted for such use,
b) land that is or forms part of the garden or grounds of a building within paragraph a) (including any building or structure on such land) or
c) an interest in or right over land that subsists for the benefit of a building within paragraph a) or of land within paragraph b).

Non-residential property means any property that is not residential property.

Section 112 of Finance Act 2013 expresses a 'dwelling' for the purpose of annual tax on dwelling (ATED) purposes as:

a building or part of a building counts as a dwelling at any time when:

a) it is used or suitable for use as a single dwelling, or
b) it is in the process of being constructed or adapted for such use.

The key terms to remember when checking whether a property is a residential property or not is that the building **is used or suitable for use** as a dwelling even if nobody lived there before. It includes the garden or grounds attached to that building.

The first-tier tribunal decision P N Bewley Ltd Vs. HMRC analyses the above definition.

What is the difference between a 'legal owner' and 'beneficial owner'?

A legal owner is the 'official' or 'formal' owner of the property or land who owns the legal title and whose name appears on the land registry. They may or may not be the beneficial owner. Beneficial interest is an equitable interest in the economic benefit of the property. The beneficial owner is entitled to the benefits of the property, ie who has the **right to the income and sale proceeds** of the property. The legal owner holds the beneficial interest in the property on *trust* for the beneficial owner.

Normally, a joint legal owner of a property has a default right of equal beneficial ownership, unless or otherwise it is declared differently. The legal and beneficial ownership of property can be separated using a declaration of trust: see CG70230.

A declaration of trust confirms the beneficial ownership of a property and sets out the respective beneficial interest of each tenant in common, regardless of the title entries at the Land Registry.

What are the taxation rules for rental income?

Whether the income from a residential property is taxable or not depends on how you own the property and what are you using it for.

Main residence and rent-a-room relief

If you own a property in your individual name and you are using it to live in, there are no tax implications. However, if you are renting a part of it – say, a room – you should be able to claim 'rent-a-room' relief (ITTOIA 2005, S786), subject to all of the following conditions:

- The gross rent from the rent-a-room is not more than £7,500 (2019/20).
- The accommodation must be a UK residence, furnished and the individual's only or main residence for all or part of the income period.

The threshold is the limit per individual, not per lodger. This is not pro-rated if the income period is less than a full year. It is very unlikely that the income from a lodger would be considered to be a trade.

Renting the property

If you own and let UK residential property, you are subject to income tax at your marginal tax rates, ie up to 45% on the rental profit, regardless of your UK residence status. There are deductions available for revenue expenses, eg repairs and letting agent fees.

Properties let as furnished holiday lets are subject to different rules.

Non-UK resident landlords are subject to 20% withholding tax on rents received unless an application is made to HMRC under the non-resident landlord scheme for rents to be paid gross. The 20% withholding tax can be utilised as a credit against their actual tax liability.

Can the rental receipts be treated as trade receipts?

Normally the answer is no. But sometimes it depends how you are carrying out your rental business. You have to meet all the following to count as running a business:

- Being a landlord is your main job.
- You rent out more than one property.
- You buy new properties to rent out.

If all apply, then the partners/sole traders are treated as self-employed property investment business income. There is no class 1 or class 4 national insurance (NI) payable by any of the partners unless the business engages in trade as well as property investment. But you may have to pay class 2 NI (£3 per week) if your profits are over £8,632 a year (2019/20) for each partner.

HMRC manual guidance for 'badges of trade' could be used to support the nature of the business activity.

In 2013 the upper tribunal in Ramsay vs HMRC concluded for the purpose of capital gains taxes (CGTs) that the property business is a trade on the basis of numbers of hours spent in managing the property portfolio.

What are the eligible expenses that you can claim when computing your rental income?

In calculating rental business profits, you can deduct business expenses so long as they are:

- incurred wholly and exclusively for business purposes
- not of a capital nature.

Most of the trading expenses rules are applied to property income. In recent years, there have been many changes for landlords for claiming expenses; one of them is s24 Finance Act 2015 restricting finance cost. ACCA has produced a summary and examples of some of the expenses that a landlord can claim.

Detailed guidance can be accessed in HMRC's *Property Income Manual*.

Can you use cash accounting to prepare your rental accounts?

Yes, it is possible. The Finance Act 2017 inserted sections 271A- 271E in Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005) to cover these provisions in the legislation.

Cash basis is not available for:

- incorporated property businesses that must continue to use GAAP to prepare accounts on an accrual basis
- unincorporated property businesses whose annual rental income exceeds £150,000.

The cash basis applies by default to unincorporated property businesses that meet all the eligible criteria. Section 271A stipulates five conditions in which property business is *not* able to use cash basis:

a) The property business is carried on by a corporate body, eg a company, a limited liability partnership, a corporate firm, the trustees, or personal representatives.

b) The receipts for the property business are more than £150,000.

c) For a jointly owned property with a spouse or a civil partner, one has made an election to account for the income on an accruals basis.

d) A business premises renovation allowance is made in calculating the profits of the property business, and there is a balancing event that would give rise to a balancing adjustment.

e) The property business has opted out of the cash basis and made an election to use the accrual basis within one year of the filing date for that tax year, ie by 31 January 2019 for 2017/18.

Key features of the cash basis are summarised here.

What is form 17?

The form 17 procedure is used to formally notify HMRC that there is, in fact, a different underlying beneficial ownership in the asset in question, other than 50:50 TSEM9848. ITA 2007, s 836 sets out the legal assumption that income derived from any property that is held jointly by a married couple (or civil partnership), and where they are living together as a couple, is to be split 50:50, *unless:*

- The income is from furnished holiday lettings.
- There is actually a partnership in which case the income is divided according to the terms of the partnership agreement.
- both spouses or civil partners have signed a declaration stating their beneficial interests in both the property and the income arising from it.

The declaration on form 17 must reach HMRC within 60 days from the date of signature of the last spouse to sign; otherwise, it is invalid. HMRC generally enforces this time limit strictly. The form 17 rule applies only to income arising from the date of the declaration (s 837(4)). Thus, a declaration made very late in the tax year may have little or no effect on the couple's overall tax position for that year.

Should you be charging a commercial rent on your rental property?

Not necessarily. Sometimes when you let out a property to your friend or a relative, you may decide to charge them nominal rent instead of full commercial rent. If this is the case, then HMRC restricts the level of expenses you are able to claim up to the amount of the rent received for that property. HMRC argues that the expenses of the property are not incurred wholly and exclusively for business purposes. Similar restriction is placed on capital expenses on a 'just and reasonable basis': see PIM2130.

What are the ways to handle 'undeclared rental income'?

The only way is to 'declare' it before HMRC finds out. You can declare unpaid tax by telling HMRC about rental income from previous years via the Let Property Campaign (LPC). If you have to pay a penalty, it will be lower than if HMRC finds out about the income itself.

You'll be given a disclosure reference number. You then have three months to work out what you owe and pay it. Full guidance on making a disclosure is here.

Do you have to pay CGT when you sell/transfer your property?

The answer depends on the use of the property.

If you are selling the house you live in, then there is no CGT to pay as you are able to claim private residence relief (TCGA92 S.222). If there are periods of non-occupation, part of the gain may become chargeable. This will depend on the reason for the non-occupation. Similarly, if any part of the property has been set aside exclusively for business purposes, the relief must be apportioned between business

and private use. If a person works from home, it is a good idea for the part used for business not to be used exclusively for that purpose.

Any transfer between spouses or civil partners who are living together, whether by sale or by gift, does not give rise to any CGT.

There is no CGT payable if you give your land and property to charity. But if you sell your property for more than the cost but less than its market value, then you may have to pay CGT. You need to work out your gain using the amount that the charity actually pays you, rather than the value of the asset.

The gain on the disposal of buy to let residential property is subject to normal CGT rules, irrespective of your residential status. You need to work out your gain by deducting your cost of the property (including enhancement expenditures) from the sale proceeds. However, you need to use the market value of the property as disposal if:

- It was a gift (there are different rules if it was to your spouse, civil partner or a charity).
- You sold it for less than it was worth to help the buyer.
- You inherited it (and do not know the inheritance tax value).
- You owned it before April 1982.

What are the CGT rates when you sell a residential property?

Individuals
You pay a different rate of tax on gains from residential property than you do on other assets.

Tax band	Residential property	Other gains
Higher rate income tax	28%	20%
Basic rate income tax	18%	10%

Limited companies

Limited companies are subject to corporation tax rate of 19% (2019/20) and 17% from 2020/21. An indexation allowance is available to companies, with the tax due charged at the corporation tax rates we’ve already mentioned. However, no indexation allowance is available from 1 January 2018.

What are the reliefs available when you sell a buy-to-let property or property business?

Incorporation relief

TCGA92/S162 relief is available where a person who is not a company transfers a property business to a company in exchange for shares. This relief is automatic and you need to make an election to disapply it. Whether the property-letting business is a business for this purpose is a matter of fact; one can refer to Ramsay case as highlighted above.

The following conditions must be met before you are eligible to claim the relief:

- The business is transferred as a going concern.
- The whole of the assets of the business (or the whole of the assets other than cash) are transferred to the company.
- The consideration for the transfer is satisfied wholly or partly by an issue of shares in the company to the person transferring the business.

Further details can be found in HMRC guidance HS276.

Furnished holiday lets (FHLs)

TCGA92/S241 (3)

For the purposes of the reliefs listed below:

- Any UK property business that consists of, or so far as it consists of, commercial letting of furnished holiday accommodation shall be treated as a trade.
- All such furnished holiday lettings undertaken by a particular person or partnership are treated as a single trade.

The reliefs to which the above treatment applies are as follows:

1. roll-over relief under TCGA92/S152-TCGA92/S157
2. entrepreneurs' relief under TCGA92/S169H
3. gifts hold-over relief under TCGA92/S165
4. relief for loans to traders under TCGA92/S253

Further details can be found in HMRC guidance HS253.

Can you roll over the CGT when you buy another residential property?

Normally when you have a capital gain on the sale of a rental property, you are not able to roll over the gain, even if you have used the sales proceeds to purchase another property. However, there is an exception under TCGA92/S247.

Roll over relief on compulsory acquisition of land

TCGA92/S247 relief may be claimed when you dispose of your rental property to an authority exercising or having compulsory powers. You must not have taken any step to make known your willingness to dispose of the property to the authority or others by advertising or otherwise. The landowner must apply the whole or part of the consideration for the disposal of the old property in acquiring other property in the period beginning 12 months before and ending three years after the disposal of, or of the interest in, the old assets, or at such earlier or later time as the board may by notice allow.

Roll-over relief is not automatic. It must be claimed. If the tax return needs to be submitted prior to the reinvestment of the proceeds, a provisional claim can be made under TCGA 1992, s 153A. Once the proceeds have been reinvested, another claim must be submitted under TCGA 1992, s 152 or TCGA 1992 or s 153 (depending on whether full relief is claimed), which supersedes the provisional claim.

The time limit for the roll-over relief claim is four years from the end of the tax year in which the old asset was sold. Therefore, for a sale in the 2018/19 tax year, a roll-over relief claim is only valid if it is made on or before 5 April 2023 (TMA 1970, s 43).

Can you claim the letting relief on the disposal of a rental property?

Letting relief may also be available to buy-to-let landlords, in addition to principal private residence (PPR) relief, on the condition that the property has, at some time, been let as residential accommodation, and a chargeable gain arises by virtue of the letting period.

Letting relief allows you to claim the *lower* of the amount of:

- PPR relief available in respect of the letting
- the amount of the gain arising by reason of the letting
- £40,000.

Letting relief is thus a valuable additional relief that may reduce the CGT payable on the sale of a rental property, where it was, at some point, the taxpayer's only or main residence: TCGA92/S223 (4)

The government has announced that from April 2020 the relief will change and only be available to those who are in shared occupancy with a tenant. This change will not affect owner-occupiers or landlords who have never lived in the property they are renting out.

What are the rates of stamp duty land tax (SDLT) when you buy a residential property?

SDLT rates in England

Property or lease premium or transfer value	Residential property	Residential property (additional property rates)
Up to £125,000 (note 2)	Nil	3%
More than £125,000 but not more than £250,000	2%	5%
More than £250,000 but not more than £925,000	5%	8%
More than £925,000 but not more than £1,500,000	10%	13%
More than £1,500,000	12%	15%

Further rates for residential properties in Scotland and Wales can be found within this guide.

When should you be registered for self-assessment for your rental income?

The first £1,000 of your income from property rental is tax-free. This is your 'property allowance', introduced in Finance Act 2, 2017.

Contact HMRC if your income from property rental is between £1,000 and £2,500 a year.

You must report it on a self-assessment tax return if your rental income is:

- £2,500 to £9,999 after allowable expenses
- £10,000 or more before allowable expenses.

If you do not usually send a tax return, you need to register by 5 October following the tax year you had rental income.

What is the property allowance?

From 6 April 2017 you can get up to £1,000 a year in tax-free allowances for property income. If your annual *gross* property income is £1,000 or less from one or more property businesses, you won't have to tell HMRC or declare this income on a tax return. Gross income means the total amount you would put on your tax return before any allowances or expenses are taken off. You must keep records of this income. This is known as 'full relief'.

If your annual gross property income from one or more properties is more than £1,000, you can use the tax-free allowances instead of deducting any expenses or other allowances. If your expenses are more than your income, it may be beneficial to claim expenses instead of the allowances.

If you use the allowances, you can deduct up to £1,000 but not more than the amount of your income. This is known as 'partial relief'. If you own a property jointly with others, you're each eligible for the £1,000 allowance against your share of the gross rental income.

Is it worth incorporating the rental business on a long term?

S 24 Finance Act 2015, which restricts finance cost, has encouraged many landlords to incorporate the rental business as the companies are able to claim the full interest on its corporate tax return. Remember that these changes do not necessarily affect every landlord, eg a landlord with one property who is well within the basic tax rate band. Higher rate tax payers should take a specialist property advice before taking any decisions.

Questions that may help you to decide include:

- What is your current income level?
- Do you need to sell properties in future to support your retirement or do you want to pass them to the next generation?
- Is your property portfolio big enough to justify the additional cost of maintaining the company books and records?
- Do you need the rental income to survive?
- What is your inheritance tax position and how would you like it to be distributed on your death?
- Do you have a high gearing on your properties?
- Are your properties of high value, which may trigger annual tax on enveloped dwellings (ATED) within the corporate structure?

What is annual tax on enveloped dwellings (ATED)?

ATED is an annual tax payable mainly by 'non-natural persons' who own UK residential property valued at more than £500,000. An ATED return is required if the property:

- is a dwelling, and
- is in the UK, and
- was valued at more than:
  - £2m on 1 April 2012, or at acquisition if later, for returns from 2013 to 2014 onwards
  - £1m on 1 April 2012, or at acquisition if later, for returns from 2015 to 2016 onwards
  - £500,000 on 1 April 2012, or at acquisition if later, for returns from 2016 to 2017 onwards
- is owned completely or partly by a:
  - company
  - partnership (including LLP) where one of the partners is a company
  - collective investment scheme – for example, a unit trust or an open-ended investment vehicle.

HMRC full guidance can be accessed here.

Can you avoid SDLT or CGT when you incorporate the rental business?

Normally, SDLT (including the 3% surcharge) is chargeable on the incorporation of a property business, based on the market value of the portfolio being transferred into the new company. However, this could be avoided if a registered property partnership business (or LLP) is incorporated. The partnership exists if it is registered with HMRC, has a separate bank account and has written partnership agreement. The SDLT relief is given as long as ownership of the new company matches the original partnership shares.

If you can satisfy all the conditions of TCGA92/S162 while incorporating your property business, then incorporation relief can postpone tax on any increase in property values prior to the date of incorporation until the shares in the incorporated business are sold.

Useful links

ACCA free webinar on the practical implications of incorporating a property portfolio

ACCA online course: Property tax for accountants

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