Tax Guide for Property Investors

2016-17 Edition

An eBook by The Friendly Accountants

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Disclaimer

This guide is designed to alert you to some of the major issues you should be considering. It is not a replacement for professional advice tailored to your precise needs and circumstances.

You should always seek the advice of a suitably qualified professional before acting on any of the advice.

And if you would like to speak to us about any of the issues covered in this guide, please feel free to give us a call or drop us an email.

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The information can only provide an overview of the regulations in force at the date of publication and no action should be taken without consulting the detailed legislation or seeking professional advice.

This e-book is intended as a general tax planning guide for UK based property investors, in relation to the 2016/17 tax year.

The book has been written by The Friendly Accountants, a small accounting practice that specialises in working with freelancers, contractors and small businesses. For more information please visit: www.thefriendlyaccountants.co.uk.

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1 Introduction

Whilst there are potentially big financial rewards for investing in UK property (despite Brexit, the UK market still appears to be buoyant as we write this), in tax terms there are much greater risks because of the wide range of taxes that you are potentially exposed to as a UK property investor.

This long list includes:

- Council Tax
- Business Rates
- Stamp Duty Land Tax (for property purchases in England, Wales & Northern Ireland)
- Land & Buildings Transactions Tax (for property purchases in Scotland)
- Corporation Tax
- Capital Gains Tax
- VAT
- National Insurance
- Income Tax
- The Annual Tax on Enveloped Dwellings,

In the overwhelming majority of cases, the most important taxes you'll face as a property investor are capital gains tax and income tax.

This guide will therefore focus on these two particular taxes and highlight areas where it may be possible to limit your exposure to them.

However, we also discuss Stamp Duty Land Tax, VAT and the Annual Tax on Enveloped Dwellings and the instances where you are likely to attract liabilities, though this guide stops short of offering any detailed tax planning in these areas.

We believe this guide will provide you with sufficient awareness as to how these taxes affect you as a property investor and give you some insight into some of the pitfalls you'll face and how you can avoid them.

We hope you enjoy reading this guide and find it useful, though if do you have any questions, please let us know – we are always happy to help.

2 Is it property investment or property trading?

2.1 Introduction

How you are taxed on the profit (or loss) you realise when you sell your property will be determined by your intentions from the onset and whether or not HMRC consider you have owned your property as an investment or held it as part of your stock in trade.

The subject of property trading is worthy of a whole book in itself so this chapter should be regarded as an overview - particularly if you are contemplating acquiring a new property as an investment for the first time or adding to your existing property portfolio.

2.2 What is the difference in tax treatment?

Broadly speaking, if HMRC accepts that you are investing in property, the following tax treatment applies to your circumstances:

- Any profit you realise on the sale will be subject to capital gains tax (CGT)
- You will be able to take advantage of annual CGT exemption (currently £11,100)
- Any losses you make can only be offset against other capital gains
- You may be able to take advantage of principal private residence relief (PPR) – please refer to section 4
- There will be no National Insurance to pay on any profit you make
- You won't be able to claim tax relief for any expenditure relating to an aborted sale (surveys, finance applications etc.)

However, if HMRC consider that you're a property dealer/developer, then the position is likely to be as set out below:

- You will have better scope for claiming abortive expenditure if a sale doesn't go through
- You won't be able to claim the CGT annual exemption against any gains you make
- You'll have much greater scope for claiming tax relief for interest costs
- You have flexibility in choosing which year-end the profits are taxed in
- Any losses made can be used against your other income
- The profit will be taxed at your marginal rates (up to 54%) and attract National Insurance if you are treated as self employed
- Alternatively profits will be charged to corporation tax at 20% if you trade as a limited company.

2.3 Factors that indicate you are trading

HMRC recognise that property transactions can be either a trading or investment activity, they do not adopt any hard and fast rules.

HMRC will view the position 'in the round' weighing up a number of factors known as 'The badges of trade' to determine whether they think you are trading in property or purchasing it as an investment. Essentially, the more 'badges' you have, the more likely HMRC will argue you are a property trader as opposed to a property investor. These 'badges of trade' and how they could apply to property transactions are discussed below:-

2.3.1 Subject matter

Some assets are commonly held as an investment for their intrinsic value – for example you might purchase a painting to enjoy the work of art, rather than with an intention to make a profit quickly from any subsequent sale.

So put in the context of a property purchase, if the character of the property is such that it is completely dilapidated and ripe for development, as opposed to suitable for immediate long-term rental or living in as your home, then HMRC are likely to lean towards the opinion that any profit on sale could arise from a trading activity rather than an investment.

2.3.2 The way in which an asset is acquired and held

Where you acquire a property from an inheritance or a genuine gift, it's difficult for HMRC to argue that this has been acquired as part of a trading activity with the intention of selling it quickly to realise a profit. However if you bought a run-down property from a property auction, HMRC may take a different view.

2.3.3 Frequency of transactions

Where HMRC are looking at an isolated property sale they are less likely to view this as a trading activity. However, where there have been previous property sales at regular intervals that happen repeatedly, then this could indicate to HMRC that you are trading in property.

2.3.4 Length of ownership

If you purchase a property, hold it in the short-term, never actually letting it and then sell it at a profit then this may point towards a trading activity in HMRC's eyes.

2.3.5 Supplementary work

When significant improvement work is carried out on a property prior to a sale, rather than purely cosmetic re-decoration, then HMRC may regard any profit realised on sale as arising from a trading activity, rather than an investment.

2.3.6 Profit motive and circumstances surrounding the sale

Where no short-term profit motive can be established from the onset, for example where you purchase a property for your children in order to provide them with an income or place to live whilst at university, it will be difficult for HMRC to argue that the sale proceeds should be taxed as a trading activity.

2.4 How to avoid being taxed as a property trader

We would stress that none of the above tests in isolation are likely to determine whether you are treated as a property trader, however, when you do sell a property, HMRC may apply the various badges of trade to establish the tax treatment of a property transaction. This is probably best illustrated by the two examples below.

2.4.1 Example 1

Tony is a marketing consultant who buys a three bedroom property. His intention is to keep it as a long-term investment. He updates the property with the intention of letting it out to young professionals. However, due to his impending divorce, he is forced to sell the property after 18 months, having completed the renovations, realising a profit of £25,000.

Tony's intention was to hold the property long-term as an investment. Although he sold it after a relatively short period, the original motivating factor has not changed. The `profit' he makes on the property is therefore treated as a chargeable gain. Tony is liable to pay CGT on the gain, after deduction of the CGT annual exemption to the extent that this is available.

2.4.2 Example 2

Bill is a builder who buys a dilapidated property at an auction and intends to renovate it as quickly as possible and sell it on at a profit. He plans to reinvest any proceeds from sale into further properties to renovate and sell.

Unlike Tony, Bill's main motivation in buying the property is to make a profit by renovating and selling it quickly. Looking at the intention behind the purchase it suggests that Bill is trading when he buys and sells the property with a view to making a profit. Therefore any profit made by Bill on the sale would be liable to Income Tax rather than CGT.

Tips

If you want to reduce the risk of being taxed as a property trader by HMRC you should give due consideration to the following:

1. Start with making a note as to why you bought your property. A business plan will demonstrate what your plans are from the start. If your plans change you should document them as well. There may be a perfectly good reason why a long term investment was sold in the short term and any documentary evidence will support your case if this is challenged by HMRC.

2. Beware of the frequency of transactions. If a property is bought and sold every now and then, that would suggest an investor, but if you are buying frequently and selling on, that would suggest a trader.

3. HMRC tend to get agitated if there are a number of property transactions in a relatively short period of a time. Arguably you can purchase a property, improve it, move and claim the Principal Private Residence exemption (refer to Section 4). However if you do this every six months, HMRC may get upset and suggest property trading. Given that moving home is one of the most stressful things you can do in life, why would you choose to do it every six months?

4. How have you financed the property purchase? Mortgages and long term finance are usually more indicative of a property investment, rather than a trade.

5. If you actually let out a property, this is indicative of an investment not a trade.

6. How long a property is held for may also influence HMRC, though again there is no hard and fast rule on this one.

3 How is property income taxed?

3.1 Property income or trading income?

We discussed previously the difference in tax treatment between someone who invests in property as opposed to someone who is regarded as a property trader. In this chapter we discuss how property income is actually taxed.

3.1.1 When is property income taxed as trading income?

Generally speaking if you receive income from any form of interest in land and property, it's taxed as property income, rather than trading income. However there are a few exceptions:

- Rents received by hotels, guest houses, boarding houses, holiday parks and furnished holiday lettings are treated as trading turnover because these businesses are taxed as trades, not as property businesses. **The detailed rules for furnished holiday lettings are covered in a later section of this guide.**

- Rent received by the owner (or lessor if we're using the legal terminology) of tied premises is also treated as a trading receipt - this arrangement is common in the brewery trade.

- Where rent factoring is involved. In other words a landlord selling his rights to collect rent over a short period of time, in exchange for a lump sum from a financial institution. This is not treated as normal business loan finance. In these circumstances any lump sum payment received is taxed as property income.

Additionally, if you let part of your business premises you might be allowed to include the rent as a trading receipt and have it taxed with your business profits, though only in the following circumstances:

- The let accommodation is currently surplus to your business requirements on a temporary basis. It must have been used previously or is intended to be used, in your business. It won't apply where it is obvious that the premises have become surplus to the requirements of your business in the long term.

- There is mixed use of your premises - partly for your business and partly for letting.

- The rental income is comparatively small in relation to your business turnover.

- The rents relate to surplus business accommodation only.

3.1.2 What's the effect of taxing rental income as trading income?

If rental income is treated as trading income (for example where you let surplus business premises) then it is included in your trading business computation and it becomes ***earned*** income for Income Tax purposes and ***trading*** income for Corporation Tax purposes.

3.2 How is property income assessed to tax?

You calculate your profits and losses from your property business in exactly the same way as you would from your trade or profession.

So if you're an individual, profits and losses will be calculated on a tax year basis (i.e. 6 April to 5 April), or an accounting period (e.g. 1 April to 31 March) if you run your property business via a company.

In the case of a partnership the rules are a bit more complicated:

- If it's a property letting partnership it's taxed on a tax year basis (i.e. 6 April to 5 April).

- If it's a trading partnership with ancillary letting income, the property income element is taxed on the same basis as the partnership's trading accounting period.

  So for example, if a trading partnership's accounting period is the year ended 31 December 2016 then the partners will be taxed on their share of rental profits for this period as opposed to the tax year basis (see above).

  Matters can become even more complex if the partnership changes its accounting date or ceases to trade.

3.3 Tax treatment of losses

3.3.1 Losses for property business run by an individual or partnership

The tax position if you run your property business as an individual or partnership is as follows:

a) Losses incurred in a year of assessment are either offset against property profits of the same tax year, or carried forward and utilised against any profits of the property business for subsequent tax years until fully utilised.

b) A loss on a property that is not let on a commercial basis will **not** be allowable. For example, if you let a property at less than market rent to a relative or a person connected to you. Where there is personal use HMRC will also expect to see an adjustment to disallow expenses pro-rata in such circumstances.

3.3.2 Sideways loss relief

In a property income context the ability to offset property losses against non-property income is known as sideways loss relief. The situation where this is most likely to arise is where a loss arises as a result of a capital allowances claim on a property. The subject of capital expenditure on your property and what capital allowances you can claim as a property investor is discussed in the following chapter.

Losses from capital allowances

The most common situation where a loss is created by capital allowances, a claim may be made to offset all or part of the loss against total income of the year in which the loss is incurred.

Note that you can’t claim capital allowances on plant and machinery used in a property letting business which consists of the letting of residential property. Therefore this situation is likely to apply to the letting of commercial properties (e.g. offices) or furnished holiday lettings (see section 5).

Tip

Capital allowances ***might*** be available to create a loss where you are claiming them on plant and machinery used by you as the landlord, for example a lawnmower or van - though not in the property itself.

Losses for a property business run as a limited company

The tax position if you run your property business as a company is as follows:-

A property loss must first be set against the company's total profits for that accounting period.

Any unrelieved loss may then be:

- Surrendered as group relief (if group relief is available).
- Carried forward to the next accounting period, providing the property business is continuing.
- A company that is **not** an investment company cannot carry forward unrelieved property losses beyond the end of the accounting period in which the property business ceases.
- Where an investment company with a property business ceases to carry on such a business, any unrelieved losses are treated as management expenses of the next accounting period. They can be set against the profits of that or a subsequent period as long as the company continues to qualify as an investment company.

3.4 What expenses can I claim?

When you receive rental income from a property, HMRC treat you as running what they term a 'property business' What this means is that your ability to deduct expenditure follows the same principles as that of an ordinary non-property business. So in other words, you should be able to deduct expenses from any rental income you receive as long as they are:

1. Incurred wholly and necessarily for the purpose of the property business and
2. Not of a capital nature (this point is covered later on in section 3 of this guide).

Here are some typical examples of some of the expenditure you can claim when running your property business:

3.4.1 Advertising

Whilst you can claim the cost of advertising for new tenants in the local paper, or more and more these days the internet, you would not be able to deduct any advertising fees for selling the property.

3.4.2 Unpaid rent

Provided you have taken all reasonable steps to collect the rent then any outstanding monies can be written off and claimed as a bad debt. Additionally any solicitors costs which you have incurred in order to enforce collection of the rent can also be claimed as a deduction.

3.4.3 Maintenance

The full cost of any maintenance work (e.g. cleaning) can be claimed where a property is let wholly for business. However, where you occupy a property privately, for example as a landlord in a purpose built block of flats, then any expenditure must be adjusted to reflect private usage accordingly.

3.4.4 Buildings and contents insurance

The same principles apply as for maintenance costs (see above).

3.4.5 Interest paid - hire purchase, loans and overdrafts

Currently any interest paid on a loan used to purchase a property is allowable as a deduction in full, provided it passes the 'wholly and exclusively' test referred to above. In most circumstances overdraft interest should be an allowable deduction, however HMRC have indicated in their internal guidance here that this may be disallowed if your drawings exceed you capital account in your property business. If the lender happens to be based overseas then relief can usually still be claimed, provided the lender and borrower are not connected and the interest is charged at a commercial rate.

Note that from 2017/18 higher rate income tax relief for loan interest relief on buy to let property will be restricted (see section 3.5).

3.4.6 Fees associated with securing the loan

Any fees associated with the loan such as commissions paid, guarantee fees can be claimed as an allowable deduction provided the property is let out on a commercial basis – in other words the rent charged is at market rate. If there is any personal aspect to the loan secured then any expenses should be restricted to reflect the private element. **Again be aware of the impact of the new rules for buy to let landlords (see above).**

3.4.7 Landlord's office costs

You can claim expenditure on the costs associated with running a dedicated office for your property business. Where you run the office from your home then any costs should be restricted to reflect any private element.

3.4.8 Travelling expenses

You should be able to claim a deduction for travelling expenses incurred between home and your rental property, or between rental properties if more than one is owned. However, if your properties are wholly managed by a letting agent or outside office, then any claim for travel expenses incurred between home and your rental properties may be challenged by HMRC.

3.4.9 Salary costs

Any salary costs for employees of your rental business should be allowable, subject to the wholly and exclusively rule referred to above. Care should also be taken where family members are involved in running your property business as HMRC will disallow any wages they consider to be excessive.

3.4.10 Repairs and renewals

There is always a risk that you might claim an item of expenditure as a repair or a renewal item (and therefore deductible from rental income) when it is in fact capital expenditure (and **not** deductible). Any expenditure which represents an improvement or enhancement made to a property is likely to be considered to be capital expenditure – although see below:

- Tax treatment will generally follow the accounting treatment.
- Expenditure designed to enhance, improve or change the nature of a property tends to be a capital cost.
- Expenditure in renewing or repairing a property, even if it means substantially replacing it with modern materials and using modern techniques, tends to be a revenue expense - for example double glazing.
- Leases: dilapidations are capital, but repairs resulting from general wear and tear are revenue.

Where a property has been newly acquired, particular care needs to be taken when it comes to expenditure on repairs. Where it is questionable that a property is capable of being rented to an unconnected third party before the work is carried out, then HMRC will seek to disallow the expenditure and argue that it is a capital improvement, particularly where the purchase price reflects the dilapidated state of the property

Tip

- Where repairs are likely to be substantial, discuss the tax implications of what is being done **prior** to carrying out the work.
- Evidence of what repair work was done will be important: maintain full documentation from the original quote to the final billing of the contract and any extras.

3.5 The new rules for loan interest relief

In his Summer Budget 2015 the Chancellor introduced changes to restrict tax relief for mortgage interest on buy-to-let property. Going forward, higher rate tax relief on mortgage interest will be restricted for buy-to-let landlords.

However if you're a basic rate taxpaying landlord you're not immune from the new measures: mortgage interest will no longer be an allowable deduction from property income and a new adjustment will be required in order to claim basic rate tax relief.

3.5.1 Who is affected?

The new rules apply to individuals, trustees, partnerships and limited liability partnerships, although UK and overseas companies will **not** be affected.

The new legislation also applies to all non-corporate partners of mixed partnerships.

The main impact will of course be in connection with loans taken out to buy property for letting - however other loans taken out by residential property businesses also fall within the scope of the legislation, such as loans taken out to finance the purchase of a vehicle or an office.

You should also be aware that loans taken out to purchase an interest in a property letting partnership are also caught by the legislation.

3.5.2 Who is not affected?

Because the new legislation applies to residential property businesses, property trading businesses are **not** affected (refer to section 1 for the definition of property trading).

Letting of commercial premises (e.g. managed offices) and furnished holiday lets are also **not** affected. Where mixed residential and commercial property is let, the restriction will only apply to the residential part.

3.5.3 What property finance costs are caught by the new rules?

As well as loan interest, 'finance costs' also include any amount paid that is economically equivalent to interest for the person entitled to receive it.

So for example, incidental costs of obtaining finance, such as fees and commissions, legal expenses for negotiating drafting loan agreements, or valuation fees in providing security for a loan, are all potentially caught by the new rules.

3.5.4 How does the restriction work?

The new rules work in two stages.

Firstly, they deny tax relief for finance costs so they're no longer allowed as a straight forward deduction from rental income. This measure is gradually being phased in from April 2017 onwards.

Secondly, a 'tax-reduction for non-deductible costs' is calculated instead. The tax reduction effectively allows relief for the costs at basic rate only and includes the capacity to carry forward any unused relief.

3.5.5 Withdrawal of tax relief for finance costs

The withdrawal will take effect gradually with effect from the 2017/18 tax year with a restriction of 25% each year, until 6 April 2020 at which stage they will only count as a basic rate tax reducer against rental income as opposed to a deduction. This can be illustrated by the table below:

Year	% of costs deducted from profits	% of costs as a basic rate tax reducer
2017/18	75%	25%
2018/19	50%	50%
2019/20	25%	75%
2020/21	-	100%

There's an example below of how we envisage the rules working in practice:

Example:

Nigel incurs £4,000 per year on his fixed rate loan interest on his buy to let property. For the next few years he will be able to claim the following amounts as a straight forward deduction against the rental income in his rental accounts:

Year	2016/17	2017/18	2018/19	2019/20	2020/21
Paid	4,000	4,000	4,000	4,000	4,000
Allowed	4,000	3,000	2,000	1,000	0

Next we work out how the tax reduction is calculated.

Stage One:

In the most straight-forward position, the tax reduction equates to the disallowed finance costs multiplied by the basic rate of tax (currently 20%). So, continuing the example above, Nigel's tax reduction is calculated as follows:

Year	2016/17	2017/18	2018/19	2019/20	2020/21
Paid	4,000	4,000	4,000	4,000	4,000
Allowed	4,000	3,000	2,000	1,000	0
Disallowed	0	1,000	2,000	3,000	4,000
Tax reduction	0	200	400	600	800

Stage Two:

Just to confuse matters the basic rate of tax multiplier is actually **not** applied to the amount of the disallowed finance costs (in this case £1,000 rising to £4,000) but to the lower of:

- the amount of the finance costs plus any unrelieved costs brought forward

OR

- the amount of the rental profits less any rental losses brought forward

So, continuing the example above, Nigel's tax reduction and the unrelieved costs are calculated as below:

Year	2017/18	2018/19	2019/20	2020/21
Rental profits before finance costs	6,000	3.000	2,000	5,000
Interest allowed	3,000	2,000	1,000	0
Rental profits after finance costs (A)	**3,000**	**1,000**	**1,000**	**5,000**
Unrelieved loan interest current year (B)	1,000	2,000	3,000	4,000
Unrelieved loan interest b/forward (C)	0	0	1,000	3,000
Total unrelieved interest (B + C = D)	1,000	2,000	4,000	7,000
Reduction based on interest (if D lower than A)	200	-	-	-
Reduction based on rental profits (if A lower than D)	-	200	200	1,000
Unrelieved loan interest to c/forward (D - A if result is positive)	**0**	**1,000**	**3,000**	**2,000**

- The effect of the above is that a tax reduction of £1,400 has been given on the unrelieved loan interest.
- The total unrelieved loan interest (B) over the four years is £7,000 and so overall relief has been given at 20%.

Stage Three:

However, that's not the end of it, because the tax reduction is subject to yet another restriction in the event that the lower of:

- the amount of the finance costs plus any unrelieved costs brought forward

OR

- the amount of the rental profits less any rental losses brought forward

is actually greater than the taxpayer's 'adjusted total income' (ATI).

What is the ATI? Well this is your total income for the year, less savings income, less dividend income, less personal allowances.

So, considering Nigel's example above, let's assume that ATI for the four years is as shown in the table below, and compare this to the finance costs and rental profits in step two above:

Year	ATI	Finance costs (step 2)	Rental profits (step 2)
2017/18	10,000	1,000	3,000
2018/19	0	2,000	1,000
2019/20	2,000	4,000	1,000
2020/21	1,000	7,000	5,000

In 2020/21 ATI is the lowest figure and so an adjustment to the tax reduction for this year which was calculated in Step 2 is required.

In 2020/21 the tax reduction was calculated as £7,000 @ 20%, £1,000.

However, we must further restrict the tax reduction using the formula ATI / GFCR x (BR x L).

In this formula:

- ATI is defined as total income, less savings income, less dividend income, less personal allowances (£1,000)

- BR is the basic rate of tax, currently 20%

- L is the lower of finance costs and rental profits, as already calculated (£7,000)

- GFCR, which stands for 'gross finance costs relief', is not clearly defined in the draft proposals. However for now we'll assume it is the amount multiplied by the basic rate of tax to provide the tax deduction. Effectively, this is the same as L (£7,000)

So, applying this formula, for 2020/21 the tax deduction is restricted to £200.

The effect of this third step is therefore to reduce the tax deduction to the amount of tax actually payable on the individual's ATI: £1,000 @ 20%.

Finally, this last restriction now means that there are unrelieved finance costs to carry forward to 2021/22. Of the finance costs of £7,000, relief has only been given for £1,000. The unrelieved amount of £6,000 can therefore be carried forward.

Tip

The new legislation does not to apply to residential property businesses carried out by limited companies, furnished holiday lettings or commercial property rental. **Maybe now is the time to consider re-structuring your property portfolio to take account of these new rules.**

It is also worth mentioning that mortgage arrangement fees, early repayment fees and interest charged on a loan to purchase furniture (see section 3.3.2) should be wholly allowable.

4 Capital Expenditure on your property

4.1 Introduction

If you own a property rental business you may be able to claim quite a wide range of tax allowances in respect of any capital expenditure you incur in making improvements to your commercial or residential rental properties.

4.2 Commercial property

Given the choice of different allowances it can often be easier to claim the Annual Investment Allowance as an alternative to the allowances set out below. The new owner of a commercial property may also be able to claim allowances on capital expenditure incurred by the previous owner.

4.2.1 Business premises renovation allowance

The Business Premises Renovation Allowance (BPRA) is a 100% capital allowance given on certain expenditure incurred on the conversion or renovation of redundant commercial property, where the intention is to bring it back into commercial use, and the person making that expenditure owns the building concerned.

General conditions

- Expenditure must be incurred before 1 April 2017 for corporation tax purposes and 6 April 2017 for income tax purposes.
- BPRA only applies to property located in designated disadvantaged areas, which include, for example, parts of Birmingham, Newcastle, Glasgow, Liverpool, Luton, Sheffield, Wales, Cornwall and the entire area of Northern Ireland.
- The person incurring the expenditure must hold, broadly speaking, a freehold or leasehold interest) in the building.
- Qualifying expenditure is limited to €20 million per project.
- A reduced allowance can be claimed, rather than the 100% initial allowance, with the balance of the expenditure being claimed as a writing down allowance.
- A balancing allowance or charge can arise if certain events occur within a set time period from the first use of the building.

What costs are covered?

The relief is intentionally generous and can be claimed on the cost of converting, renovating and repairing a Qualifying Building into Qualifying Business Premises. Expenditure isn't just restricted to plant and machinery – structural work to buildings qualifies as well – this wouldn't ordinarily qualify for tax relief.

You can even claim BPRA where the conversion or renovation relates to part of a building. For example, the conversion of an unused floor or room can qualify, even if the remaining part of the building is in full use.

The cost of acquiring land, making extensions to the building (other than creating a means of access to the Qualifying Business Premises) or acquiring moveable plant and machinery, does **not** qualify for relief..

There are also restrictions to what can be claimed where the expenditure on the conversion or renovation of the building is funded by a grant which is classified as 'notified state aid'.

The Finance Act 2014 included restrictions to the nature of the costs which qualify for the relief, these being limited to:

- building work;
- professional fees in respect of architects, designers, surveyors or engineers;
- fees in connection with planning applications and other statutory provisions;
- other associated costs (e.g. project management fees) where they do not exceed 5% of the cost of the building work.

It also includes provisions to restrict the availability of the relief where the expenditure is paid in advance of the work being undertaken and where the expenditure is in excess of the normal market value of those works.

Which types of buildings qualify for BPRA?

In order to qualify for the relief, **before** the renovation or conversion commences, the building must be a Qualifying Building, that is:

- it must be situated in a designated disadvantaged area on the date that the conversion or renovation work commences;
- it must have been empty for at least one year before the conversion or renovation work commences;
- it must have been used last for the purposes of a trade, profession or vocation, or as an office; and
- the last use of the building must not have been as a dwelling.

Following the renovation or conversion work, the building must be Qualifying Business Premises. In order to meet this condition, it must be used in, or available and suitable for, letting for the purpose of a trade, profession or vocation, or as an office and **not** as a dwelling.

The use of the building in certain trades (including fisheries, shipbuilding, coal or steel industry, synthetic fibres or certain agriculture or dairy production) prevents the building being Qualifying Business Premises, and therefore prevents a claim for BPRA being made.

Restrictions to the relief

Where certain events occur within a set period commencing at the point that the renovation or conversion is complete, and the Qualifying Business Premises are first used or available for use, a balancing event will occur, which could lead to a balancing allowance or charge. These events include:

- the disposal of the relevant interest in the building by the person who incurred the expenditure (including the granting of a long lease);
- where the relevant interest is a lease, the ending of that lease (unless the lessee acquired the reversionary interest);
- where the person making a claim is an individual, the death of the person;
- the demolition or destruction of the building; or
- where the building ceases to be Qualifying business Premises, i.e. not used in, or available and suitable for, letting for the purpose of a trade, profession or vocation or as an office or if it is used as a dwelling.

The set period referred to above was seven years, however, the Finance Act 2014 introduces a reduction to five years for expenditure on or after 1 or 6 April 2014.

Tip

Ideal buildings ripe for conversion would be a former bank, office, pub or even a church (!), which could be converted into a hotel, restaurant, care home or serviced offices.

You should be aware that demand for new commercial property can quickly become saturated in a disadvantaged area. Also without stating the obvious you should ensure that the area is actually a designated disadvantaged area before committing to any project

4.2.2 Enhanced capital allowances – energy saving plant:

A property business (UK or overseas) and a furnished holiday lettings business (UK or within the European Economic Area) are able to claim a 100% Enhanced Capital Allowance (ECA) on expenditure incurred on energy saving plant and machinery.

What are the conditions for claiming tax relief?

- The plant and machinery must be new and not second hand.
- A person can claim the ECA as well as the Annual Investment Allowance (AIA**), but** it is not possible to claim both allowances on the same assets.
- As claims can be complicated, where possible it will save time and effort to claim the AIA if this is available instead.
- The landlord of an ordinary residential property business is not able to claim ECAs,

There are three categories of schemes for ECAs:

- Low carbon dioxide emission cars, zero emission goods vehicles, and natural gas and hydrogen refuelling infrastructure
- Energy-saving plant and machinery
- Water conservation plant and machinery

Cars and vans with low CO2 emissions

Whilst not directly relevant, ECA's available for expenditure on the following vehicles in the context that they may be used by a landlord in a property business:

- New cars with low carbon dioxide emissions driven for use in their business
- Electric cars
- Zero emissions goods vehicles (e.g. vans)
- Natural gas and hydrogen refuelling equipment at refuelling stations.

This measure was due to end in 2015, but it was announced in December 2014 that it would be extended until 2018.

Energy-saving plant and machinery

This includes expenditure on:

- Active chilled beams
- Air to air energy recovery
- Automatic Monitoring and Targeting
- Boilers
- Combined Heat and Power
- Compact heat exchangers
- Compressed air equipment
- Desiccant air dryers with energy saving controls
- Heat pumps for space heating
- HVAC zone controls
- Lighting
- Motors
- Pipework insulation
- Refrigeration Equipment
- Solar thermal systems
- Thermal screens
- Variable Speed Drives
- Warm air and radiant heaters

From 1 April 2012:

- The ECA will not be available on equipment that generates or produces electricity or heat and attracts payment under the feed-in tariff (FIT) or renewable heat incentive (RTI) scheme. Taxpayers will have the option of claiming ECAs or the tarriff. Where an ECA is claimed and a tarriff also received the ECA will be clawed back.

- Solar panels are treated as special rate expenditure and so subject to the special (reduced) rate writing down allowance.

- The AIA is unaffected (so may still be claimed on solar/PV equipment).

From 1 April 2014:

The ECA is no longer available for combined heat and power (CHP) equipment installations.

Water conservation plant and machinery

This covers expenditure on:

- Flow Controllers
- Meters
- Leakage detection
- Efficient toilets
- Efficient taps
- Rainwater harvesting equipment

How to claim ECAs

- Go to **www.eca.gov.uk/etl/claim/** for the list of qualifying plant and machinery which is updated from time to time.

- As with other capital allowances, a claim for ECAs is made on the corporation tax or income tax return of the business or individual.

- The main difference between a claim for ECAs and other plant and machinery is the requirement to submit detailed evidence of the qualifying expenditure.

Claiming for listed products

For products on the Energy Technology Product List, a claim may include the cost of the equipment itself, and other costs directly involved in installing it. These include

- Direct Transportation — the cost of getting equipment to the site.

- Direct Installation — crainage (to lift heavy equipment into place), project management costs and labour, plus any necessary modifications to the site or existing equipment.

- Professional Fees — if they are directly related to the acquisition and installation of the equipment.

Claiming for non-listed products

When plant and machinery meets the Energy Technology Criteria, but does not appear on the Energy Technology Product List (ETPL), a claim is more complex, and the process changes depending on which technology group the product is in - see **www.eca.gov.uk/etl/claim/**.

4.3 Residential property

A residential landlord can't claim capital allowances on the cost of plant and machinery (including fixtures, furniture and equipment) that is used by the tenant. However these rules do not apply to Furnished Holiday Lettings.

Residential landlords used to be able to claim the Wear and Tear allowance; however this has now been ditched in favour of the new replacement furniture relief below.

4.3.1 Wear and tear allowance – the old rules

Whilst residential property landlords could not claim capital allowances on their expenditure on assets such as plant and machinery and fixed fixtures used by their tenants (see above), until 5th April 2016 they could claim:

- The costs of repairs and renewals to the property including to fixed fixtures.
- Either their costs in connection with the provision of furniture and replacement of trade tools and other articles employed in the trade, or, if they are providing fully furnished accommodation, a 10% wear and tear allowance.

The concessionary replacement cost basis for new plant and equipment ended on 5 April 2013, as this was redundant following the enactment of the wear and tear allowance. The wear and tear allowance has itself now been replaced (if you'll pardon the pun) by the new replacement furniture relief (see below).

4.3.2 New replacement furniture relief

From 6 April 2016, the ‘wear and tear allowance’, which previously allowed landlords to deduct 10% of adjusted gross rent as a type of furnishings depreciation, has now been superseded by a new system that only allows them to get tax relief when they replace furnishings.

Scope of the relief

The relief will apply to all let property, regardless of the extent of the furniture provided. It will only apply to replacement cost, less the cost of any improvement element (beyond the nearest modern equivalent). The sale proceeds of the old item(s) will also be deducted from the replacement cost, however you will be able to claim a tax deduction for the cost of disposing of the old item(s).

The cost of replacing the following ‘domestic items’ will qualify for the relief:

- movable furniture or furnishings, such as beds or suites
- televisions
- fridges and freezers
- carpets and floor-coverings
- curtains
- linen
- crockery or cutlery
- beds and other furniture

The scope is restricted to items provided for the tenant’s use. So you can’t claim capital expenditure on a car for example. This relief is also not available if rent a room relief is claimed – please refer to section 10.4 in this guide.

Integral features

Integral features (e.g. a boiler) will not be included; however replacements of these items will continue to be tax deductible as a repair in any case.

Example – before and after

Bill lets a property for £9,000 per annum. In 2016/17 he replaces the worn-out fitted kitchen on a like-for-like basis at a cost of £2,500. He also buys a replacement sofa, dining table, chairs, a fridge freezer and two beds at a cost of £3,000. The tax position under the old rules and the new rules is shown below.

	Old rules	New rules
Gross rent	£9,000	£9,000
Less:		
Repairs	(£2,500)	(£2,500)
W&T allowance	(£900)	-
Replacement furniture relief	-	(£3,000)
TAXABLE INCOME	**£5,600**	**£3,500**

Tip

Where you are letting an existing furnished property for the first time, ensure that expenditure on new replacement furniture is incurred **after** a period of letting.

5 Your private residence and tax relief

5.1 What is a residence?

With full marks for mentioning the obvious, HMRC’s internal guidance helpfully states "A residence is a place where somebody lives".

There’s no minimum period of time that is required in order to establish a residence – this was confirmed by a leading tax case.

In fact, for many years, HMRC’s own internal guidance has suggested that you could occupy a property for a very short period of time and it be treated as your main residence.

However every case must be decided upon its own particular facts.

A residence could include your holiday home, although the definition of a residence is unlikely to include a buy to let property if you have never made it your home.

In view of the above, it’s probably easier to ask "what is not a residence" and there have been a number of tax cases which concluded that a building is unlikely to be considered as a residence if:

- It has never been lived in by the owner
- It is uninhabitable (especially if there’s no electricity supply or running water!)
- It has been occupied, possibly even overnight, but the owner shows no signs of living there. There is no use of utilities or signs of "home making" which are necessary to confirm sufficient quality of occupation.
- It was put on the market to re-sell or to let out before the owner occupied it – we’ve heard of a case where an individual told HMRC he was actually planning to put a property on the market within days of supposedly moving in!

5.1.1 Permitted buildings, garden and grounds

A residence doesn't only include the main building and other buildings within its grounds - it can also include the following buildings (the argument being that together they are occupied as part of the main residence as a whole):

a) Outbuildings, staff accommodation, stables and gatehouses.

b) Properties that are not physically connected to the main buildings – these are considered on their merits. However, if outbuildings are separated from the main house by a public road it is unlikely that they will be accepted as part of the main residence.

The sale of land attached to your residence is also exempt providing that the total grounds (inclusive of the site of the house) are less than 0.5 of a hectare (approximately 1.25 acres). It is possible in some circumstances for HMRC to accept that a larger area is covered by the main residence exemption.

5.1.2 Building on your grounds

Generally speaking, if your garden and grounds are within the permitted area (see above) any gain on the disposal of land within the area will be covered by the exemption while the property remains your main residence.

Tip

Please bear in mind that if your property is divided up, relief may be denied on a later disposal of land. This will particularly be the case where you have negotiated to receive a slice of any future development profit. In fact, there is danger that HMRC may treat any future sums you receive as chargeable to income, rather than capital gains tax.

5.2 When am I treated as occupying a main residence?

As well as not actually having to spend a great deal of time in a property to establish it's your residence, HMRC may also accept you occupy a property as your main residence even when you're not physically present there!

5.2.1 Permitted periods of absence

Provided your property qualifies as your main residence or is subject to an election (see below), HMRC will treat you as living in your property for the last 18 months of ownership (it used to be 3 years before 6 April 2014) even if you weren't actually living in the property as your main residence at the time.

Additionally, provided that your property was occupied as your main residence both before and after your absence, you are treated as occupying your property as a main residence during the following periods of absence:

- Any period of absence of up to three years
- Any period in which you're required to live in job-related accommodation – although not where you have any interest in the company or partnership which provides the accommodation
- Any period in which you're required to work full-time overseas
- A period of up to four years in which you're required to work away from home in the UK
- Where you're prevented from resuming residence as a result of the location of your place of work or due to a condition imposed by your employment contract requiring you to reside elsewhere or to secure the effective performance of your duties, or
- Where you live with your spouse or civil partner and the same circumstances above apply.

Tip

The work periods referred to in points 3 and 4 above, will also apply if you are self-employed.

5.3 Election for more than one residence

If you own two or more properties and each is occupied as your only or main private residence we'd recommend you submit an election to HMRC to nominate which property is your main residence. So you are effectively lodging a claim principal private residence relief (or 'PPR' for short) on a property.

The reasons for this are as follows:

- Submitting an election significantly reduces the risks of any questions from HMRC as to which of one or more residences is your main residence.
- Once an election is accepted by HMRC they cannot challenge the claim unless they can prove that the property was never in fact occupied as a residence.
- If you fail to submit the election nominating which property is your main residence, it is decided on the facts – you will need to submit evidence to HMRC in order to support any claim. **This is why it is so important to ensure you submit an election within the necessary time limit.**

5.3.1 What is the time limit for submitting the election?

HMRC must be given notice within two years of the second property being used as a 'residence' (this does not necessarily mean the date of purchase) and you can also vary the election by notifying HMRC within two years of the change.

As long as the initial election for PPR has been made, it can then be varied or 'flipped' as many times as you like by submitting a further election. There is no specific wording for the election, though it must be made within two years of a change in 'combination of residences'. Should the two year time limit be missed, there needs to be a 'trigger' event to reset the election date.

Examples of trigger events that could be used to change the 'combination of residences' are:

- Marriage/civil partnership – both parties owning property used as their respective residence, or where there is joint ownership. Married couples/civil partners can only have one main residence qualifying for PPR such that any election must be made jointly.
- Renting out one of the properties – where the tenancy comes to an end the owner can then take up residence.

- Transferring ownership of a main residence into a trust under which the owner has a beneficial interest.

- Selling half of one residence where the seller is no longer in full ownership though still lives there.

Example

Jim's main residence is in Poole, his mother lives in Dorchester. Jim's mother dies and leaves her house to Jim, who lives there at weekends. Jim is unaware that an election is required and misses the election date. Three and a half years after his mother's death the election still hasn't been made. Jim marries Angela and the Dorchester property is transferred into joint ownership. On marriage the election can be made.

Tip

Given this is a complex area (particularly where an election has been missed) the default position where more than one property is involved is to ensure you submit an election to HMRC within the two year window.

5.3.2 Are there any circumstances when HMRC can challenge an election?

Usually, once you've made the election it is conclusive. However HMRC can challenge this if they can show that the property was never a residence.

An example of this would be where there is no actual physical occupation of a nominated property, or where the property was a development property and therefore never capable of occupation as a residence.

Tip

Unless there are exceptional circumstances, a property has to be habitable to be capable of being a residence.

5.3.3 Where there are two properties and no election has been made

If you have two properties and fail to make a main residence election (see above) and you can't rely on a trigger event (see above) the matter will have to be decided by looking at the facts. In this event **evidence is crucial.**

Therefore, when there is no election you will need to show that you have actually occupied a property as your main residence.

The type of evidence HMRC would expect to see is as follows (please be aware this list is not exhaustive!):-

- Evidence that your main source of income is not from property development.
- Proof you are paying the full rate of council tax on the property concerned.
- The property's postal address is the address for banks, utilities, HMRC (!) etc.
- All mains services are connected.
- Your spouse or partner resides with you at the same address.
- You have moved personal effects and belongings into the property concerned.

5.3.4 How are Non-UK residents with UK property and UK-residents with non-UK property taxed?

From 6 April 2015 all Non-UK residents are subject to Capital Gains Tax (CGT) on gains on the disposal of UK situated residential property.

The charge applies to non-resident individuals, non-resident trustees, personal representatives of a non-resident deceased person and some non-resident companies disposing of UK residential property.

It only applies to residential property that is used as the individual's home or maintained as an investment asset and also includes land that is or forms part of the garden or grounds of a residential building.

There are some forms of residential property which are exempt from the non-residents CGT charge. Broadly speaking these are as follows:

- All disposals of UK residential property made by diversely held institutional investors, such as collective investment funds.

- Purpose built student accommodation, residential accommodation for school pupils, care homes and nursing homes.

- Smaller establishments used as student accommodation, for example family houses that may have been converted or have rooms let out.

- Hospitals and hospices, military accommodation and prisons.

- Building land - although "off plan" development land sales are within the charge.

There are special rules which apply when a building is demolished.

The rate of tax for non-resident individuals is the same as the CGT rates for UK individuals. Therefore it is either 18% or 28% depending on your total UK income and chargeable gains for the tax year.

The more generous CGT rates of 10% and 20% which were introduced in the Budget this year, do **not** apply to the disposal of residential property.

However if you are a Non-resident individual you will be able to claim the CGT annual exempt amount of £11,100 which is in line with that available to UK residents.

Private residence relief – Non-UK residents

If you are a Non-resident individual who is potentially within the scope of charge to UK tax you might be eligible for private residence relief (PRR). However you need to bear the following points in mind.

- PRR isn't available on the disposal of properties located in a jurisdiction where you are deemed non-tax resident.
- This rule applies equally if you are a non-resident disposing of UK residential property or you are a UK resident disposing of residential property which is located outside the UK.
- The rule requires that in either of those circumstances, your residence will not be capable of being treated as your only or main residence for a tax year, unless you have spent at least 90 days in that property in the tax year (the "90-day rule").
- A day counts as spent in the property if you are in the house at midnight, or if you were in the house at some point during the day, and then the next day have stayed overnight at the house. This is to prevent individuals from manipulating the day count cater by going out in the evening and returning home late after midnight.)

Once these factors are taken into account, the ability to access PRR will then follow the usual rules discussed above.

If you're Non-resident you may nominate that a UK property meeting the 90-day rule is your only or main residence for a tax year at the time of disposal.

Additionally, the ability to claim PRR is available for trusts, if the beneficiary is non-UK resident on the same basis.

As husband/wife and civil partners are treated as one and the same person for PRR purposes, occupation of a residence by either spouse or civil partner will count as occupation by the other spouse or civil partner. For example, in the event that one spouse is UK-resident in a UK private residence and the other spouse is non-UK resident, then in order to access PRR both will need to be deemed UK resident.

To summarise, if you are non-UK resident, you will only be able to claim main residence relief for a UK property if you can demonstrate that you were present in your UK home for 90 midnights, or that you were UK resident in the tax year concerned.

Conversely if you are UK-resident, you are unable to elect to claim main residence relief on an overseas property unless you can show that you were present in the foreign property for 90 midnights in the tax year.

The above should of course be considered in conjunction with the Statutory Residence Test which can have far reaching ramifications especially where non-UK income and capital gains are significant.

5.4 Property developers

Capital gains treatment on the disposal of a property will be challenged if the main reason for purchasing a dwelling is to let out the property or make a development profit. Profits will be assessed as the profits of a trade (refer to section 1).

If HMRC suspect that main residence relief is not due, they will:

- raise an income tax assessment on developers on the basis that the land or property were purchased to make a development gain, or

- Challenge a claim by landlords on the basis that the property neither qualified as a dwelling house, nor was it an only or main residence, nor was any land used for the taxpayer's occupation and enjoyment.

If you are a builder or developer and undertake work on your own house, you may need to prove that the quality and quantity of occupation were sufficient to establish it as your main private residence, as well as showing that the property was not acquired for the purposes of your development business. This is generally of concern to HMRC where there is only short-term occupation of property.

5.5 Other situations

5.5.1 Rental and lettings

If a property which at any time has qualified for main residence relief is later let, letting relief may be claimed to offset the capital gain attributable to the letting period.

Relief is given on the lower of:

- the gain that relates to the period of letting,
- the gain subject to PRR and
- £40,000.

Where a couple marry or form a civil partnership they may be able to juggle main residence elections and then obtain letting relief on a property which is subsequently let,

Tip

The fact that rent-a-room relief has been claimed has no effect for main residence purposes - the property is treated as being a main residence throughout.

5.5.2 Business use

There is no main residence relief for a part of a house which has been used exclusively for business purposes. Any gain in a house with mixed use must be apportioned on a reasonable basis.

Tip

If a room is being used for business purposes and rented under a licence agreement, you should **always** ensure that the letting is for non-exclusive use.

5.5.3 Dependent Relative Relief

A gain made on the disposal of a property used by a Dependent Relative prior to 5 April 1988, is CGT exempt.

5.5.4 Trusts and trustees

A trustee may claim main residence relief when trust property is occupied by a beneficiary as a main residence. Transitional rules apply to periods before 2004.

5.5.5 Delay in occupation

There is a limited concession to extend PPR relief should you not be able to move into your only or main residence on purchase. Typically this covers the following situations where you:

- Buy land on which your home is to be built
- Have your home altered or decorated before you move in
- Remain in the first property whilst it was still on the market, provided when it is sold your second property becomes your only or main residence

In such circumstances the period before you actually occupy your property qualifies for PPR, provided the period between acquisition and occupation is a year or less. This can be extended to two years, though only where HMRC are satisfied that factors outside of your control prevented you from taking up occupation.

5.5.6 Conversion of a property

If a property that was initially your main residence is converted into flats and sold. PPR will be denied in respect of the gain attributable to the period of ownership whilst the conversion is taking place. This is because the expenditure has been incurred ‘wholly or partly’ (in HMRC’s view) for the purposes of realising a gain.

When computing the gain, a valuation of the property in its unconverted state is required and this is compared with the sale price, post conversion in order to determine the additional gain arising as a result of the conversion.

Example

Terry lived in a property as his main residence from the date he purchased it in August 1996 (cost £125,000) to August 2015 when work commenced on converting it into four flats. Work was completed in December 2015. The flats were finally all sold in July 2016 for £275,000 each.

The conversion cost £125,000. If the property had remained one house the sale proceeds would have been £775,000.

The additional expenditure of £125,000 generated an additional gain of £200,000 calculated as follows:

	Total Gain	Exempt PPR Gain	Taxable Gain
Proceeds/valuation	£1,100,000	£ 775,000	£325,000
Original cost	£ (125,000)	£ (125,000)	
Conversion costs	£ (125,000)		£ (125,000)
Gain	£ 850,000	£ 650,000	£ 200,000

5.6 Married couples and main residence relief

The rules dictate that a married couple or civil partnership may only have one residence or main residence between them.

It therefore follows that any election to nominate a property as a main residence must be made by both husband and wife, or civil partners.

5.6.1 Transfers of property between couple (in life or on death)

A transfer by one spouse of their interest in a property (whether this is a transfer of legal title or beneficial ownership, or both), takes place at nil gain/nil loss for CGT purposes.

Where a property qualified as a main residence and it is transferred from one to the other, the transferee acquires the transferor's period of ownership provided that:

- The couple are living together and the residence is their main residence or has been nominated as their main residence at the date of the transfer (or just before death).

Where a property did not qualify as a main residence and it is transferred from one to the other, the transferee's period of ownership for CGT is the date of transfer.

Tip

You could use this to 'flush out' gains on a previously let property - see examples below.

Example: Property which has not qualified as a residence

Penny purchased Rose Cottage as a buy to let investment in 1995 for £100,000. By 2016 it is worth £520,000. On 1 May 2016 she transfers full beneficial interest in the property to her husband Leonard. He acquires the property at a base cost of £100,000 (no gain/no loss for CGT purposes because they are married). Just afterwards, the couple then nominate Rose Cottage as their main residence. Leonard sells the property one year later for £530,000. The entire gain on the disposal is tax-free because throughout Leonard's CGT period of ownership the property has been his main residence.

Example: As above but with letting

After living in Rose Cottage the couple then move out, they may then let the property - obtaining letting relief on that part of the gain, and the last 18 months of ownership will be a period of deemed occupation.

Example: Property which did qualify as a residence

Penny purchased Rose Cottage as her only residence on 1 July 1995 for £100,000. She married Leonard on 1 July 2005 and they let out Rose Cottage and lived in his house Big Bang Towers. On 1 July 2016 the couple nominate Rose Cottage as their main residence and Penny then transfers full beneficial interest in the property to her husband Leonard. He acquires the property at a base cost of £100,000 (no gain/no loss for CGT purposes). Leonard sells the property one year later for £530,000.

When calculating his capital gain Leonard's actual and deemed periods of occupation as his main residence are:

1.7.1995 to 1.7.2005 (taking over Penny's period of occupation)

1.7.2016 to sale date (covered by the couple's PRR election)

He may also claim letting relief for the period in which the property was let.

Example: Property which has not qualified as a residence - transfer on death

Penny purchased Rose Cottage as a buy to let investment in 1995 for £100,000. On 1 May 2016 she dies, leaving the property to her husband Leonard. He acquires the property at probate value, say £475,000. As the property was not their joint property at Leonard's death, Leonard's acquisition date for CGT is 1 May 2016. Leonard may well elect at this stage for it to be his main residence (although he may choose not to as he has benefited from the market value uplift on Penny’s death).

5.6.2 Divorce and PRR

- A married couple (or civil partners) can only have one main residence between them whilst they are living together as husband and wife (or in a civil partnership).

- This rule changes upon separation, and each will be treated individually for Private Residence Relief (PRR) purposes and can therefore make an election in respect of which property is their main residence.

It is important to consider the implications this might have on a future sale of the former family home, or any other property.

Ownership

The courts can determine that a beneficial ownership exists, even if the property is registered legally in the sole name of one of the parties, if the other party has contributed directly or indirectly to the cost of the property in proportion of those contributions.

The spouse with no legal ownership can therefore be granted an equitable interest by court order. When this happens, the PRR period will be treated as starting at purchase, **not** the date the order was made.

Sometimes a court will simply order a percentage of the sales proceeds be paid to the spouse or partner with no legal interest. In this case no transfer takes place, and the owning spouse is fully liable to the tax on any gain upon disposal.

Moving out

In most cases, a separation will mean one party to the marriage or partnership moving out. The other party may also move out, or they could remain in the property indefinitely. They could decide to sell the property. Alternatively the court can order that the property is sold, with a proportion of the proceeds transferred as part of a divorce settlement, or can order that an interest in the property be transferred.

The disposal by the departing spouse of their interest in their former main residence will attract relief for a period of 18 months following their departure.

If the property is still not sold within this time frame, then additional relief on the transfer of the property by the departing spouse to the spouse remaining in the property, is as follows:

An election allows the ex-couple's residence to be treated as the only or main residence of the transferring spouse or civil partner from the date his or her occupation ceased until the earlier of:

- the date of transfer, and
- the date on which the property ceases to be the only or main residence of the spouse or civil partner to whom the property is transferred.

There are three conditions which must be met:

- The transfer must be made as part of their separation or divorce arrangements, either by court order or by agreement between themselves

- The election must be made whilst the transferee spouse still occupies the property as their main residence

- The departing spouse must not elect for any other residence to be his main residence prior to making this election

If the transferring spouse or civil partner has acquired another residence they will need to consider whether to claim main residence relief on their new home or whether it is more advantageous for a claim to be made on the grounds above. Main residence relief can only apply to one residence at a time.

It is important to note that this election does not provide relief for the departing spouse in the event that the jointly owned property is sold to a third party; only on the transfer of their interest to their (former) spouse.

Mesher orders

A Mesher order is one which postpones any sale of the property until a specific event occurs, often the 18th birthday of the youngest child, or the remarriage of the remaining spouse. The order will also grant one spouse the right to remain in the property until this event takes place. A trust is created at the date of the order for tax purposes.

Exchange of interests

Normally the CGT rules for gifts between spouses and civil partners are treated as being made at 'no gain/no loss' for tax purposes. However in the case of divorce or when a civil partnership is dissolved, these rules only apply to the tax year of separation. Therefore ideally the transfer of any jointly held assets should be made some time before the end of the tax year of separation in order to be fully exempt. The property (which could include the main PPR) will then have an 'uplifted' value if the property is subsequently sold without the benefit of PPR.

If a transfer of property takes place after the tax year of separation, CGT is charged on the donor as if market value had actually been received. Although in a situation where ex-spouses or civil partners are joint owners and wish to become sole owners then provided no money actually changes hands, a form of 're-investment relief' can be applied and no CGT is payable.

It is important to note that if the properties are not of equal value, or if one of the parties pays extra for a higher percentage share, CGT will be charged on the person receiving payment equivalent to the actual amount paid (see example overleaf).

Example:

Tom and Margaret jointly own two investment properties, Broadchurch worth £325,000 and The Gables worth £375,000. Both of these properties were acquired for £125,000 each. Tom and Margaret separated in the 2016/17 tax year. Under the terms of the divorce settlement it was agreed that Tom would give up his 50% interest in The Gables in exchange for exclusive title to Broadchurch. The CGT position is as follows:-

Cost for future CGT purposes = Cost of original ½ share + deemed cost of ½ share in exchange

Tom's calculation:

	£
Market value consideration	**162,500**
Less cost	**(62,500)**
Less 'reinvestment'	**(100,000)**
Gain	**NIL**

Margaret's calculation

	£
Market value consideration	**187,500**
Less cost	**(62,500)**
Less 'reinvestment'	**(100,000)**
Gain	**25,000**

6 Furnished Holiday Lettings

6.1 Introduction

Furnished holiday letting (FHL) is an activity which has for many years benefited from a very favourable set of tax rules. It's treated, by default, as trading, for Income Tax purposes.

6.2 How does a property qualify?

There are a number of conditions that need to be fulfilled before a property can be treated as 'furnished holiday letting business' (or FHL for short):

- The letting must involve an arrangement for a person to use the accommodation.
- The accommodation must be let on a commercial basis, which means that it must be capable of realising profits. Where it appears that rental income is simply funding maintenance costs, HMRC have been known to deny the relief.
- The accommodation is furnished (somewhat obviously!)
- The property must be available for let and actually let for a minimum qualifying period.
- The property must be located in the UK or European Economic Area (EEA) (this includes Iceland, Liechtenstein and Norway). So it can be situated in or near a city as opposed to a traditional holiday resort.
- The property must not be let to the same person for more than 31 days at a time.
- The maximum period in which the property can be let on long lets cannot exceed 155 days.

The following conditions also apply

- The minimum period in which a qualifying property must be available for letting to the public in the relevant period is 210 days in a year.
- The minimum period over which a qualifying property is actually let to the public in the relevant period is 105 days in a year

6.3 When to apply the test

Once it's determined that a property qualifies as FHL, it's necessary to determine which period the 'day count' tests mentioned in 4.2 are applied and this is done as follows:-

- For a continuing let, apply the tests to the tax year itself.
- For a new let, if the let was not a FHL in the previous year, apply the tests to the first 12 months from when letting of the property began.
- When the property stops being let as a FHL, apply the tests to the 12 months ending on the date letting finished.

How does this work in practice:

- Leonard has let an FHL property since 2014. For 2016–17 the days of that tax year are counted.
- Penny buys a property on 1 January 2016 and lets it as a FHL from 1 March 2016. To work out whether the letting qualifies for 2015–16, the tests are applied to the 12 months from 1 March 2016. For 2016–17 the tests are applied to the tax year itself. This means that some availability and occupancy days can count twice – those from April 2016 to February 2017.
- Sheldon has let a FHL property for many years, but letting stops on 30 September 2016 and the property is sold on 1 December 2016. To see if 2016–17 qualifies, the tests are applied to the 12 months ended on 30 September 2016. Again some days can count twice.

6.3.1 Occupancy elections

Averaging and Period of Grace elections allow property owners to deem that the occupancy conditions have been met. Each election must be made by 31 January following the end of the tax year.

Averaging

Where a person has multiple properties and some meet the qualifying letting periods and others do not, it is possible to make an election in order to average out the letting periods.

- The election is made with the tax return for the year.
- UK FHL properties may not be averaged with EEA FHL properties. They must be treated as separate businesses.

Example:

In 2016/17 Rose Cottage and Box Cottage are both available as UK FHL lets for the whole year.

- Both are available for 210 days during the year.
- Rose Cottage is actually let for 125 days but Box cottage is only let for 85 days.
- The owner can elect under section 327 to average the two letting periods so that the two properties are treated as being let for 105 days each: (125 + 85) / 2 = 105 days each
- If no election were made, only Rose Cottage would qualify for FHL tax treatment.

'Period of grace' provisions

Where the availability test is met and there is a genuine intention to let the property for 105 (2012/13 and after) or 70 (up to 2011/12) days in a year (as demonstrated by marketing or other evidence to HMRC's satisfaction) a FHL business is permitted to elect to be treated as having met the occupancy threshold in each of the following two years, even though it does not in fact meet the threshold in those years.

A FHL must have qualified in the year before in order to make the election, it may be made for two years following:

Example:

The Old Cottage is available for letting all year. In 2013/14 it was actually let for 110 days, in 2014/15 it is only let for 95 days and in 2015/16 for 100 days. Its owner may elect for both 2014/15 and 2015/16 for a Period of Grace, so that the property is deemed as meeting the occupancy condition in both years. If it fails to be actually let for at least 105 days in 2016/17 no further Period of Grace election is possible.

Combining elections

The Averaging and Period of Grace elections may be combined according to HMRC.

For example, The Old Mill and Seaton cottages, both located in the UK

	The Old Mill days let	Seaton days let	Averaging election	Period of Grace election
2013/14	110	100	Yes, deems each property is let for 105 days	
2014/15	65	95	n/a	Yes, because both qualified as FHL in 2013/14
2015/16	95	105	n/a	Yes, though only necessary for The Old Mill
2016/17	80	80	Not eligible	Not eligible for The Old Mill because it no longer qualifies as a FHL. Yes for Seaton as it qualified as a FHL in 2015/16

If the property 'fails' as a FHL, the letting income is simply treated as a 'property rental business' instead. This means that:

- For capital allowances purposes there will be a disposal at market value of the assets of the old FHL, which may create a balancing charge or allowance.
- No losses can be carried forward.
- The business will no longer qualify for CGT Entrepreneurs' Relief: however, relief may apply if there is a disposal of the property within three years of loss of FHL status.

If the let only fails to qualify for some years and not for others, any losses brought forward are not lost.

6.4 Income & Corporation tax treatment

When FHL is treated as a trade for Income and Corporation Tax the following treatment applies:-

- Income is accounted for on an accruals basis; it is recognised when due, **not** on the date of physical payment.

- FHL businesses which exceed the current VAT registration threshold must register for VAT.

- The business should draw up accounts, and expenses are allowable for tax in the normal way, and if necessary adjustments should be made to add back part or a proportion of any expenses which relate to private use.

  What are the tax advantages?

- Unlike residential buy to let’s, FHLs may claim capital allowances on expenditure on plant, furniture, fixtures and fittings.

- FHL income is also relevant earnings for an individual’s pension purposes – so you may be able to match your pension contributions with your FHL profits.

6.4.1 Private use

- Where a FHL is run by a sole trader, as joint property or as a partnership, and is used partly privately, capital allowances and expenditure should be restricted as necessary.

- Where a FHL is being run by a company there will be a benefits' charge where the accommodation is made available to the director and his family. However, with careful planning this issue can be avoided.

6.4.2 Losses

- Losses made in a qualifying UK or EEA furnished holiday lettings business may only be set against income from the same UK or EEA furnished holiday lettings business.

- Losses may not be offset from a UK business against the profits of an EEA business and vice versa.

6.5 Capital Gains and Inheritance Tax issues

The special reliefs that are available for business assets and business property are unlikely to apply if FHL status is lost. If a gain has been rolled over on one property into a FHL, and the property is later disqualified from FHL status, there is no claw back of tax relief provided that the initial conditions for roll-over were met.

6.5.1 Inheritance Tax and Business Property Relief (BPR)

In order for an FHL to qualify as relevant business property for BPR and thus 100% relief from inheritance tax:

- There must be a business carried on
- It must be carried on for a gain

It must also not be a business consisting wholly or mainly of 'holding investments'. Holding a property for ordinary rental is regarded by default as holding an investment. To qualify for business property relief you have to demonstrate that there are significant business activities undertaken which are integral to the holiday letting.

An FHL business therefore has to be very actively managed and include many more services than just a regular holiday letting business in order to secure BPR.

An FHL will be more likely to be viewed as active and not as an investment business (and will therefore qualify for IHT business property relief) if:

- The lettings are for short periods and are very frequent. For example, the property is mainly let for days, or weekends and/or weekly throughout the year.

- The owner, either himself or through an agent, housekeeper or relative, is substantially involved with the holidaymaker(s) in terms of their activities on and from the premises.

- There is an active website and bookings service promoting the business and selling additional services offered to holiday makers.

- There is a full weekly cleaning and laundry service, which includes all linen.

- There are other services provided/offered over and above the letting.

To claim to be 'substantially involved with the holiday maker' you'll be required to demonstrate that the business is actively run and other services or activities are provided over and above just letting furniture and accommodation.

6.5.2 Additional services

The following is a list of some of the services that might be offered by a furnished holiday business:

- Meet and greet guests on arrival
- Complimentary groceries, such as bread, milk and eggs on arrival
- Delivery of daily papers, milk, bread, and a veg box
- Guided walks, provision of maps and local information
- Book exchange, video and DVD rental
- Babysitting
- Ordering service for gourmet meals, picnic hampers and chef services
- Hire service for bicycles and boats
- Sale or provision of fire wood
- Organised activities: trekking/art/cookery/writing/cycling etc

6.5.3 Property maintenance and repairs

Property maintenance is an essential cost for all property owners. The level of expenditure or amount of maintenance undertaken is unlikely to affect any claim for IHT purposes because whether a property is used actively, or as an investment, it will still require maintenance. Expenditure will attract Income Tax relief or, if it is capital in nature, CGT relief.

6.5.4 Rates

Council tax, water rates and light and heat will all be paid for by the owner, although the FHL guest may pay for light and heat from a meter. The fact that these are paid by the owner may indicate that there is a holiday trade on-going rather than a rental investment business (where it is likely that the tenant would pay council tax and rates).

Most FHL properties will be subject to business rates, but whether these are charged to the holidaymakers or not, will not normally have a bearing for IHT purposes.

HMRC have suggested that claims for IHT business property relief will be queried where:

- The lettings are longer term (including Assured Shorthold Tenancies).
- Where the owner had little or no involvement with the holidaymakers, as will often be the case with villas or apartments abroad.
- Where the lettings were to the owners' friends and relatives only.
- Where it is clear that no services were provided to the holidaymakers.

The same treatment will apply likewise for CGT purposes, but bear in mind that if the property remains empty for long periods (due to substantial renovation or other reasons) or is let un-commercially, **it may fail** the basic criteria for furnished holiday letting. It may though, still qualify as a trade for tax purposes in general.

6.5.5 Capital Gains Tax

CGT relief is available on the disposal of a FHL property, as it qualifies as a business asset.

For individuals this includes:

- Entrepreneurs' Relief
- Roll-over Relief
- Gift Relief

Entrepreneurs’ Relief (ER) applies to:

1. A disposal of a sole trade business, or partnership or part of a business, or a partnership interest
2. A disposal of the assets of a business following its cessation.
3. A disposal of the shares or securities of an individual's personal company.
4. A disposal of trust business assets.
5. A disposal of business assets associated with disposal of an interest in a partnership or shares in a company.

Tip

Some careful planning is required when FHL is in joint ownership and there is mixed use, for example if a second home becomes a FHL with the aim of obtaining ER on the eventual sale. This also has to be balanced against IHT planning.

6.5.6 Running a FHL via a company

When a FHL business is run via a company, it will qualify for:

- Roll-over relief
- The trade is treated as qualifying trade in connection with a disposal of shares under the Substantial shareholding exemption

6.6 What happens on loss of FHL status?

The effect of losing FHL status means that the owner may be restricted in how he can use any losses arising in the business. It may change the type and the amount of expenses he can claim and affect his entitlement to capital allowances (there will be a deemed disposal at market value, which may also create a balancing charge).

It also means that most CGT and IHT business property reliefs may no longer apply.

The fact that the nature of the business has changed may affect what is allowable in the eyes of HMRC.

Tip

Review the type of expenses you are claiming, especially if you have been claiming round sums or estimates according to the same formula year on year.

- Is this basis of claim still applicable?
- Do you explain the use of estimates on your tax return?
- Do you have receipts to match expenses?

6.6.1 Capital allowances

Capital allowances cannot be claimed on the plant and machinery (including fixtures and integral features) used in the letting of a dwelling house. A furnished property business that is no longer a qualifying FHL can claim the replacement furniture relief.

A residential property letting business may claim capital allowances on assets which are included in the garden or grounds, such as swimming pools, tennis courts, barbeques etc.

6.6.2 Losses

A change of status will also affect the availability of loss relief, however losses can be carried forward against future rental profits on the same property.

6.6.3 CGT main residence and letting relief

Where FHL status is lost the owner might consider the practicality of their own use of the property, if only for a very short time, as a holiday home, in order to make a qualifying election for private residence relief.

A successful election of PRR will mean that if the property is let out as a normal let, then letting relief applies.

Example:

Bill acquires Woodmans Cottage in May 2006. He lets it exclusively as a FHL until April 2013 when he decides that FHL is too much trouble! He then decides to use the property as his own holiday home making it for the first time his 'residence'. As a result he may now make an election for the property to be his main private residence. He flips the election back to his own home shortly afterwards. He lets the property from August 2013 on a series of six month lets, before in 2016 selling the property. His PRR election has given him letting relief and also he is now deemed to have occupied the cottage for the last 18 months of ownership.

Tip

A business may still qualify as trade, despite losing FHL status. It depends on the nature of the business and the activities. To qualify you need to be able to demonstrate that substantial trading activities are undertaken in conjunction with letting

6.7 Joint property, partnership profit sharing ratios and FHL

A jointly owned FHL may be run (and reported for tax) as a jointly held property or as a commercial partnership.

If a partnership is running a FHL, the split of profits is decided according to the profit sharing ratios which have been agreed by the partners.

Husband and wife FHL owners might decide to run their FHL as a commercial partnership or simply report the income as joint income. The joint property rules and the presumption of a 50:50 split between husband and wife do not apply to either FHL or partnership interests, so you have the option to split the profits between yourselves differently.

There is a potential problem if FHL status is lost. The FHL will automatically switch to being taxed as a property business (see section 2). As a result the split of profits is based on the beneficial interest of each owner in the property concerned.

If the property is jointly owned by a husband and wife, then they are taxed on a normal property (ie 50:50) though it is possible to change this ratio to a more tax effective split.

6.8 VAT issues

As a general rule non-FHL residential rental income is exempt from VAT. Rental income received from a commercial property is also exempt from VAT unless the owner has opted to tax the building. (please refer to section 8 below for more details).

However, accommodation supplied by a FHL, hotel, guest house, boarding house or similar establishment is standard rated. This also applies to the supply of any rooms that are hired out, if also supplying accommodation or catering for the functions held there. Typically this would be for a wedding or party.

VAT Flat Rate Scheme or VAT cash accounting could be adopted providing that taxable turnover does not exceed £230,000 pa.

When hotel type accommodation is let out on a long lease or normal residential terms, it is possible to exempt some of the rental income from VAT and not impact on your ability to reclaim input VAT.

Holiday accommodation is standard rated. The owner of a FHL or a group of FHLs will be liable for VAT once turnover exceeds the VAT registration threshold. However, if a FHL is let out of season as residential accommodation for more than 28 days the supply is treated as exempt.

Holiday accommodation is generally standard rated for construction purposes if construction is by a developer and planning permission states that the building is to be used solely for holiday accommodation. The VAT rules apply as for commercial property, so that after three years the building itself will be exempt from VAT.

6.8.1 Mixed rate supplies and furnished holiday lettings

The supply of furnished holiday lettings, including power, is standard rated for VAT purposes and this was confirmed in a recent tax case.

6.8.2 FHL overseas landlords

Only a business established in the UK can benefit from the UK's VAT threshold. This means that if overseas residents have FHL property located in the UK, they are required to charge VAT on their rental income. They may avoid VAT by creating a fixed establishment in the UK.

If a UK based agent manages the property, the business is treated as being established at the agent's address.

7 Holding property personally or via a limited company?

7.1 Introduction

With the new restrictions on loan interest relief for buy to let properties coming into effect in the next year or so, you may be thinking about transferring your property portfolio into a limited company structure. Alternatively you may be starting a new property business. This section therefore covers the issues you need to consider.

7.1.1 New business

If you have not yet started letting a property, you could consider funding and using a company structure from the start. A significant advantage of doing this is that it will avoid a second stamp duty charge on a transfer later on. The initial stamp duty will still be payable of course – by the company in this case.

7.1.2 Incorporating an existing business?

If you are an existing landlord, you may be wondering whether it will be worth transferring your existing let property to a company. Generally this will probably **not** be beneficial when considering a single property, unless the rental yield is particularly high; however, when you come to purchase your second or third property it may be far more relevant. In fact, if you are looking to acquire more properties and build a portfolio up, a company is a very efficient way of retaining as much rental income as possible toward future purchases.

7.1.3 Advantages of holding property in a company

You could view a property investment company as a tax efficient structure which you can use as your personal ‘money box’ or as an alternative to investing in a private pension.

There are a number of advantages, namely:

- The money received from rental income can be kept in the company until it is needed, without triggering further tax charges.
- The retained rental profits can be invested in the company’s own name.
- The rate of corporation tax is significantly lower than the top rates of income tax, meaning the size of the pot will grow more quickly compared to holding and being taxed in your own name (see example below).
- When you do need to access the funds from your company, you may be a non-taxpayer or basic rate taxpayer, meaning a double charge does not arise. Currently basic rate tax payers do not pay any income tax on dividends.

  However, from 2016/17 the reforms to the tax on dividends affect profit extraction by company owners. These may be an advantage in some family investment companies.
- The amounts taken can be planned and controlled to ensure maximum efficiency.

Example:

An additional rate taxpayer (45%) holds a property personally making £15,000 profit each year. They will pay £6,750 (£15,000 x 45%) in tax each year. However if the same property is held in a company, the tax liability amounts to £3,000 a year (corporation tax at 20% x £15,000). The tax saving of £3,750 can therefore be used to help finance additional property purchases.

7.1.4 Including the family in a property investment company

You can also use a property investment company to provide an income to other family members and also as an Inheritance Tax planning structure. Some key advantages of this are:

- You can use the company to maximise efficiency by using multiple personal allowances and basic rate bands.
- You could provide for expenditure in a tax efficient way – for example school or university fees.
- Family members could be encouraged to take an active part in the running of the company.
- Control of the company can gradually be passed down to the next generation.
- Gifts of shares to family members will be Potentially Exempt Transfers (assuming they are bona fide) and therefore could reduce your taxable estate for IHT purposes.

A bespoke solution for your family

A property investment company structure can also be structured very specifically to meet your needs. If, for example, you were looking for a tax efficient way of paying for your grandchildren's school fees, you could make them shareholders and pay them dividends – though be aware of the new rules for dividend taxation from 2016/17.

A company can also be a very effective method of sheltering your assets from Inheritance Tax for the following reasons:

- You could structure the shareholding up in a way that takes the bulk of the value out of your estate after seven years.
- The assets that do not form part of your estate are not subject to probate – this can help to simplify matters for your executors.
- You can retain decision making power and direct the investment strategy.
- You can consider using the profits to make other investments, which are tax efficient in a company structure.

You should be aware that some family investment company structures can become complex and special attention is required in order to draft the company's Articles and to fully document and register any changes in ownership.

7.1.5 Tax considerations on transfer to a limited company

When transferring any existing property to a company, you will need to consider the tax implications:

- A transfer will be a chargeable transfer for capital gains tax.

  It will be deemed to take place at the market value even if the company does not actually pay you anything for it. Therefore capital gains tax will be due if the market value at date of transfer is more than the price you originally paid for the property.

  In certain circumstances it may be possible to hold over any capital gain, thereby preventing any capital gains tax liability arising on transfer.

- Stamp duty land tax will also be payable by the company if the market value exceeds the residential property threshold.

  Any stamp duty payable will be calculated using the market value not the consideration paid for the property.

  However if the buy-to-let the business is run by a partnership it may be possible to transfer property to a company without incurring a stamp duty charge. However be warned, HMRC will require evidence that the property letting business was run via a partnership - so procced with caution.

- The transfer is normally VAT free.

7.1.6 Are there any advantages in selling the property to a company?

You could sell the property to the company, leaving the monies outstanding on the Director's Loan Account. You can then draw this out of the company with no further personal tax to pay.

However there may be a capital gains tax charge when selling the property and you would need to ensure you had enough to pay any liability which arises.

Whilst selling the property to the company has its advantages, this course of action could prevent you from holding over any capital gain.

8 ATED CGT: UK residential property & non- natural persons

8.1 Introduction

This section covers the Annual Tax on Enveloped Dwellings (ATED), once called the Annual Residential Property Tax.

It is an annual charge on UK residential property held by a non-natural person – for example a company.

It is similar to stamp duty land tax (see section 9), except that it is payable in advance, annually and in the year of purchase. There are also in-year filing requirements.

8.2 Compliance

The filing deadlines for ATED returns are detailed below:-

- An annual ATED return must be filed by 30 April each year.
- An ATED return must be filed within 30 days of the acquisition of a high value property, e.g. if you purchase a property on 1 June you must file a return by 1 July.
- An ATED return or a Relief Declaration return must be filed if you wish to claim any relief from the ATED charge.

All ATED returns can be submitted online via HMRC website, or on paper.

8.2.1 Current year

- An annual ATED return and payment of tax for the year ending 31 March 2017 was due by 30 April 2016.

- Relief declaration forms are also due for submission by 30 April 2016.

8.2.2 Earlier years

- For property falling into the £1 million band in 2015/16, the Return was due on 1 October 2015 and the payment due on 31 October 2015.

- In all other circumstances, the return and tax payment for 2015/16 were both due on 30 April 2015.

- Relief declaration forms for 2015/16 were due on 1 October 2015.

- The return and tax payment for 2014/15 were both due on 30 April 2014.

- The first ever ATED return, for the 2013/14 tax year, was due on 1 October 2013 and tax was due by 31 October.

8.3 What is the value of property that is subject to ATED

The ATED applies to a residential property if it is valued at £500,000 with effect from 1April 2016.

So you will need to bear this in mind if you are contemplating transferring your residential property portfolio to avoid the tax relief being restricted on your loan interest payments (see section 1.6 above).

8.4 Who is regarded as a Non-Natural Person?

A Non-Natural Person is defined as a company, a partnership with a corporate partner, or a collective investment scheme

A trust is **not** regarded as a Non-Natural Person.

8.5 How much is the ATED charge?

The annual charge, payable in advance, is currently as set out below (though don't be surprised if this is increased by stealth next year).

Property value	ATED charge for the year commencing: 1 April 2016
£500k	£3,500
£1m	£7,000
£2m - £5m	£23,350
£5m - £10m	£54,450
£10m-£20m	£109,050
£20m+	£218,200

Where a property is purchased mid-year the charge is time apportioned (submit a return within 30 days of purchase).

8.6 How is property valued?

The value of the property is determined as either the value of the property on 1 April 2012, or its actual cost if acquired later. There is no deduction for debt secured or otherwise on the property.

Joint owners of a property are jointly and severally liable for ATED.

The value will be reassessed every five years.

8.6.1 ATED when moving house or for a new build

A return and payment is due within 30 days of moving house, or within 90 days in the case of a new build (though see below).

8.6.2 New and improved properties

If a property is purchased during a tax year, an ATED return is due 30 days after purchase.

When a property's improvements take it into an ATED charge, then an ATED return will be due within 90 days.

An ATED return is required even if relief is being claimed (see below for reliefs).

8.6.3 Pre-return banding checks (PRBC)

If a property value is within 10% of any band, HMRC will provide a PRBC to confirm whether your valuation is acceptable. HMRC should usually respond to a PRBC request within 30 days.

You can also file a PRBC request online.

HMRC will accept valuations prepared by a professional property valuer but they reserve the right to:

- enquire into any subsequent ARPT returns
- challenge valuations included in those returns where they consider there is a risk that the return or valuation is wrong

8.7 De-enveloping

A company might decide to de-envelope a property – in other words return it to shareholders. If so, then they should consider the tax consequences. Liquidation may be the most desirable way to achieve this, but the property may also be distributed in specie – for example, as a dividend.

8.8 Reliefs and Relief Declaration Return

A Non-Natural person must make a nil-charge return in order to claim relief from ATED.

HMRC have published Relief Declaration Returns which are to be used instead of the ATED return when a relief is available which would reduce the charge to nil.

Relief will apply and there will be no tax charge for:

- Dwellings being redeveloped or held as stock for resale by a property developer.
- Dwellings held by property rental businesses where the building is let out to a third party on a commercial basis.
- Dwellings that are open to the public for at least 28 days a year or used to provide accommodation or other services to the general public on a commercial basis.
- Farmhouses occupied by working farmers.
- Dwellings held by trading companies for the use of employees in the trade.
- Dwellings owned by providers of social housing.
- Dwellings acquired by financial institutions in the course of lending.

8.9 Exemptions

The following are exempt from ATED and do not have to submit a return or claim a relief:

- Charitable companies holding a property for charitable purposes.
- Public bodies.
- Bodies established for National Purposes (e.g. the trustees of the British Museum)
- Dwellings conditionally exempt from IHT (usually properties designated of national interest)

8.10 ATED penalties

The penalties are calculated on a similar basis to the Self Assessment regime, in the sense that they are levied for late filing and late payment and there are also penalties for error or mistake (leading to a loss of tax).

Late payment penalties are due when ATED is unpaid. The key payment deadlines are:

- Within 30 days of purchase of a new property
- Within 90 days of a new build property
- By 31 October 2016, for existing properties worth £1 million
- By 30 April (following the end of the tax year) the annual charge for all other properties falling into the charge.

Interest is charged on both unpaid tax and unpaid penalties.

Late filing	Late payment	Penalty
Miss filing deadline		£100
	30 days late	5% of tax due
3 months late		Daily penalty £10 per day for up to 90 days (max £900)
6 months late		5% of tax due or £300, if greater
	6 months late	5% of tax outstanding at that date
12 months late		5% or £300 if greater, unless the taxpayer is held to be deliberately withholding information that would enable HMRC to assess the tax due.
	12 months late	5% of tax outstanding at that date
12 months & taxpayer deliberately withholds information		Based on behaviour: • deliberate and concealed withholding, 100% of tax due, or £300 if greater. • deliberate, but not concealed 70% of tax due, or £300 if greater. Reductions apply for prompted and unprompted disclosures and telling, giving and helping.

9 VAT on land and property

9.1 Introduction

A taxable person, for VAT purposes could be you as an individual, in partnership with someone else or a limited company.

VAT then becomes payable in the course of any business carried on by you for certain supplies of goods and services in the UK, the acquisition in the UK of goods from the other EU member states and goods imported from outside the EU.

We would stress that The VAT rules for land and property can be complex and it is therefore vital to establish the specific nature of **any** land or property transaction **before** applying them.

This is important because not all supplies of land and property attract VAT, and therefore will affect your ability to recover any VAT suffered on your costs. For example, certain sales of residential property are an exempt supply for VAT purposes.

9.2 What is a supply of property?

A supply of land or property for VAT purposes means the disposal of part or the whole of a property. A supply which is subject to VAT can usually arise in the following circumstances:

1) By selling the freehold of a property.
2) By granting a lease for 21 years or more (20 in Scotland).
3) By selling an existing lease of 21 years or more (20 in Scotland).
4) Any payment to vary rights over land, the grant or disposal of a short lease, sub-lease, a rental, licence, or reverse lease premiums.

The transactions in 2 and 3 are commonly referred to for VAT purposes as a ‘major interest’ in land. The types of land and property usually involved are Land, commercial property (e.g. a warehouse) or a dwelling house (e.g. a domestic new build).

9.3 Is property rental subject to VAT?

Letting or renting a property is generally considered an exempt activity. Therefore no VAT is chargeable – though see below.

9.3.1 Residential property

The letting of residential property is always exempt. It is not possible to opt to tax residential property. Although note that income from Furnished Holiday Lettings is potentially standard rated for VAT.

9.3.2 Commercial land and buildings

The letting of commercial property is an exempt activity unless an option to tax has been made. In this case, the letting of commercial property will be standard rated when an option to tax has been exercised – see point 7.3.5 below.

Commercial land and buildings: exempt supplies

The following supplies are exempt for VAT, unless the owner has exercised an option to tax:

- The sale of commercial land or buildings which are more than three years old
- The sale of civil engineering works which are more than three years old
- The letting of a commercial building
- The supply of undeveloped land

Commercial land and buildings: standard-rated

The following supplies are standard-rated for VAT purposes:

- The sale of a new or uncompleted commercial building which is less than three years old
- The sale of civil engineering works which are ongoing or less than three years old
- The sale or letting of a building, civil engineering works or undeveloped land where the owner has exercised an option to tax
- The provision of holiday, hotel and bed & breakfast accommodation, caravans and camping facilities
- Parking facilities
- Storage facilities, including self-storage facilities
- Sporting or fishing rights
- Rights to fell trees and remove timber

All supplies of construction goods and services supplied during the construction, renovation and refurbishment of commercial property are standard-rated.

9.3.3 Non-commercial land and buildings

Transactions involving non-commercial land and buildings usually fall into either, exempt, zero-rated or standard rated VAT categories.

Non-commercial land and buildings: exempt

Supplies of existing residential or charitable land or buildings or non-commercial civil engineering works are normally exempt from VAT.

Non-commercial land and buildings: zero-rated

Zero-rating applies when the supply consists of the sale or grant of a long lease of property developed by its landowner as:

- A new building
- Conversion of a commercial building into a residential or charitable building
- Renovation of a residential building that has been empty for at least ten years
- Conversion of the non-residential part of a dwelling into flats (note that a sealed off part of a building, such as a roof space may qualify as a non-residential part but something like a garage, or loft with access will not).

The advantage for the seller when a transaction is a zero-rated supply, means that they can recover the input tax which it has incurred and which is attributable to the sale.

A DIY self-builder is entitled to reclaim any VAT charged on construction materials on completion by making a claim to HMRC; the self-builder is not required to be a taxable person.

Where a supply is the grant or assignment of a lease of more than 21 years, zero rating only applies to the premium. If there is no premium, it only applies to the first payment of rent due under the lease.

Non-commercial land and buildings: standard-rated

The following supplies are standard-rated:

- The right to take game or fish
- The provision of holiday accommodation
- The provision of parking facilities
- The right to fell trees and take timber

Non-commercial buildings: supplies of construction goods and services

These are all standard-rated with the exception that they are zero-rated where the goods or services are supplied:

- In constructing a new building.
- To a relevant housing authority in the course of conversion of the whole or part of a non-residential building,

and they are supplied:

- To a person who intends to use the building for a relevant residential or charitable purpose and has provided the supplier with a certificate of zero-rating, or
- In relation to a dwelling.

Services incidental to the construction such as landscaping and tree planting, architects and other professional fees, site investigations and scaffolding are standard-rated.

Reduced rate supplies

Goods and services are taxable at a reduced rate of 5% where they are

- Supplied during the renovation of empty residential premises where there has been no occupation for two years
- Supplied during the conversion of premises to a different residential use

Non-commercial land and buildings: partial exemption

Where a house builder lets out dwellings temporarily before sale, VAT partial exemption rules are applied.

Self-supply on change of use of non-commercial buildings

Where a non-commercial building (other than a dwelling) was a zero-rated supply and ceases to be used for a non-commercial purpose within ten years of its completion, VAT becomes chargeable on the supply made by the recipient of the zero-rated supply. If the change of use is other than by way of a disposal by the recipient of the zero-rated supply, the recipient is deemed to make a self-supply.

9.3.4 Miscellaneous land transactions

Reverse premium

A reverse premium is a payment made by a landlord to a tenant which, depending on its nature will be either exempt as a supply of an interest in land, or standard rated as a supply of services.

Licences to occupy land

Licences to occupy land are exempt supplies unless the licensor has elected to waive the exemption.

Barter transactions

The consideration of say, the use of facilities in return for the grant of a lease, amounts to a barter transaction which may have VAT implications when one supply is taxable.

Land Registry fees

Land Registry scale fees are assessed on the VAT inclusive value of the monetary consideration paid.

Miscellaneous property transactions

Room and premises hire

- Basic room hire is an exempt supply.
- Premises hire, where catering or entertainment is provided, is standard rated.
- The supply of boxes or seats at entertainment venues is standard rated.

Long stay accommodation

- The provision of accommodation, such as a hotel room is standard rated.
- If it continues for more than 28 days only 20% of the charge remains standard rated, with 80% being outside the scope of VAT.

Covenants concerning land

- A payment to remove a restrictive covenant will be exempt or, if the grantor has exercised an option to tax, standard-rated.

Rights of light

- A right of light is a right over land and its grant will therefore be exempt, or if the grantor has exercised an option to tax, standard-rated.

Fixtures and fittings

- Supplies of articles that are attached to the land are generally treated in the same way for VAT purposes as supplies, in relation to the land itself, unless specially excluded from zero-rating.
- Standard-rated items include fitted furniture (other than kitchen furniture), carpets, certain landscaping and many electrical appliances.

Sports facilities

- Providing sports facilities to the public is generally standard rated. Where the supply is for a continuous period of over 24 hours, and the customer has exclusive control over them for that period, the supply is exempt unless an option to tax has been exercised.
- Where the customer is a school, club or association, the supply is exempt where it involves at least ten sessions at intervals of between 1 and 14 days.

Leased equipment

- A separate lease of permanently installed equipment and machinery will be standard rated.
- A single lease of land and installed equipment is likely to be treated as a single supply of land, which will be VAT exempt unless the landlord has opted to tax.

9.3.5 What is the option to tax?

If you're the owner of an interest in a commercial building, you may decide to waive exemption from VAT by making a formal election to HM Revenue and Customs (HMRC) to opt to tax the property.

You would usually opt to tax a property in order to recover the VAT costs which you incurred during ownership, or on a subsequent sale of the property. This is because letting of a commercial building is ordinarily an exempt activity for VAT purposes and so you can't recover VAT on your costs.

However you should also be aware that it will be necessary to charge VAT at the standard rate in respect of any supply relating to your property, for example when you rent or sell it.

The option usually applies for 20 years and you must notify HMRC of an option to tax within 30 days. Although in some cases late notification of an option to tax may be accepted, provided direct documentary evidence can be produced which indicates that the decision was made at the relevant time

Alternatively there should be evidence that output tax has been charged and accounted for and input tax claimed in accordance with the option.

9.3.6 Can this option lapse within 20 years?

The option can lapse if a building becomes a residential property. You can also have the problem that if a building becomes split into a combination of residential and commercial property, any VAT suffered must be apportioned because of partially exempt supplies (the residential rents being exempt supplies).

The other situation where an option to tax may lapse is where a commercial property is treated as a part of a transfer of a going concern (or TOGC for short).

A commercial property that is subject to an option to tax may be transferred as TOGC and so will be outside the scope of VAT **only** if the purchaser has registered for VAT and also notified an option to tax that property.

Timing is crucial in such situations, as in a worst case scenario the seller has to apply VAT to the sale proceeds and the purchaser will be unable to recover the VAT charged.

9.3.7 Other situations where VAT has an impact

Where VAT can't be recovered on the purchase of an asset it will be treated as part of:

- Your capital cost for any capital allowances claim.
- The base cost of the asset for capital gains purposes.

Any VAT will be considered as chargeable consideration for the purposes of Stamp Duty Land Tax (see section 8) unless the VAT arises as a result of an option to tax exercised after the effective date of the relevant transaction.

If you are not taxable for VAT and so not registered for VAT purposes you cannot charge VAT on your supplies.

You therefore cannot normally reclaim any input VAT incurred, however there is an exception which applies for DIY house builders.

Rental income is generally exempt from VAT, however, the owner of a commercial building may elect to tax a building (this is under option to tax arrangements).

The following rules apply:

- Rental income, where a building is being used for storage is standard rated from 1st October 2012.

- Rental income is included in turnover for calculating VAT under the VAT flat rate scheme. It is not included in calculations for leaving the scheme.

- VAT will need to be charged when services are included in a rental agreement or licence,

- Furnished Holiday lettings are subject to VAT, if the landlord is VAT registered.

10 Stamp Duty Land Tax & residential property - the higher rate

10.1 Overview

From 1 April 2016 there was an increase in the rates charged on the purchase of an additional residential property (though not on commercial property). The rates are now 3% above the usual residential Stamp Duty Land Tax (SDLT) rates.

If you're an individual, the higher rate will apply to a property transaction if at the end of the day of the transaction, all of the following conditions A to D are met:

- Condition A: The chargeable consideration is £40,000 or more
- Condition B: The interest acquired in the dwelling is not subject to a lease with more than 21 years left to run
- Condition C: The buyer owns an interest in another dwelling with a market value of £40,000 or more which is not subject to a lease with more than 21 years left to run
- Condition D: The buyer is not replacing their existing own or main residence

For companies, each purchase of a dwelling is subject to higher rates.

10.1.1 Determining what is the main residence

Unlike for CGT purposes (see section 3) there is no main residence election for SDLT.

Therefore HMRC will determine which is the main residence based on fact, so you could have a situation where the main residence for SDLT may be different from the main residence for CGT.

HMRC have indicated what factors they would consider when determining whether a property is considered a main residence for SDLT purposes, these include:

- Where you and your family spend their time
- If you have children, where they go to school
- At which residence you are registered to vote
- Where you work
- The location and degree of furnishing and location of moveable possessions
- The correspondence and registration addresses given to various organisations
- Where your car is registered and insured
- Which address is your main residence for council tax

10.1.2 Replacing the main residence

When the replacement residence is purchased on the same day as the previous residence is sold, the higher rates of SDLT will **not** apply.

However when the replacement residence is purchased **after** your previous residence is sold, the higher rates will not apply provided your last residence was sold within the previous 3 years.

When the replacement residence is purchased **before** you sell your previous residence, the higher rates will apply. However, provided the previous residence is sold within the next 3 years a refund of any excess SDLT will be available.

The above 3 year time limit will only be applied to property purchases which take place on or after 26 November 2018.

If you purchase a property before this date, the rules stipulate that you must have previously disposed of a property that was your main residence in order to avoid the higher SDLT charge, though this can be more than 3 years previously.

10.1.3 Special situations

Married couples

Married couples and civil partners may own one main residence between them at any one time for the purposes of the higher rates. Additionally, property which is owned by either partner (and any minor children) are taken into account when determining if an additional property is being purchased or not.

You may also be liable for the higher rates of SDLT on a property purchase if you, your spouse or civil partner, has an existing residential property.

If the existing and additional properties are your main residence, then the higher rate will be refunded when your existing property is sold. However this would not apply if you were separated in circumstances which are, or are likely to be, permanent.

Joint ownership

If two or more people own or purchase property jointly, then if **any** of the joint purchasers has two or more properties at the end of the day of the transaction and is not replacing a main residence, then the **whole** of the property purchase is subject to the higher rates of SDLT.

Special rules for partners

When a partnership, in which an individual is a partner, owns a dwelling which is used for the partnership's trade then the ownership can be ignored when the individual partner acquires a dwelling other than for partnership purposes, for example as his own private residence.

However, this ownership can't be ignored when the second dwelling is being purchased for the purposes of the partnership.

Companies and large scale investors

There is no exemption from the higher rates for investors who own or purchase more than 15 residential properties, as has been put forward previously in HMRC's consultation document.

The exemption, which would normally be applicable if you were buying your first property does not apply, if this is a purchase by your company. Therefore the first purchase of any residential property by your company (or a collective investment vehicle) would be liable to the higher rates of SDLT.

Multiple dwellings relief (MDR): purchase of more than one dwelling

Where you are looking to purchase two or more dwellings in a single transaction, you may be able to claim what is known as multiple dwelling relief (or MDR for short). The higher rate of SDLT applies to claims for multiple dwellings relief.

- There are special rules for determining whether the higher rates apply to transactions involving the purchase of more than one property, if MDR is not claimed.
- Where six or more dwellings are purchased in a single transaction, the purchaser can choose whether to apply MDR, using the higher residential rates, or to apply the non-residential rates without MDR.
- MDR is not available if the interest acquired is subject to a long lease (more than 21 years).

SDLT: a note on linked transactions

- Properties can also be 'linked' for SDLT if the seller sells two or more properties to a buyer who is connected to other buyers.
- For example, Chloe and Kim are sisters and they buy two flats from the same seller.
- When transactions are linked, SDLT is calculated on the combined cost, as if one large property had been purchased.

10.1.4 So what are the additional SDLT rates?

The bands and rates are as follows:

Band: market price £	Additional residential properties from 1 April 2016.
0- 40,000	0%
0 -125,000	3%
125,001 – 250,000	5%
250,001 – 925,000	8%
925,001 – 1,500,000	13%
1,500,001 and over	15%

10.1.5 What is exempt from the higher SDLT charge?

The following are exempt from the higher rate of SDLT:

- Properties purchased for under £40,000,
- Caravans,
- Mobile homes
- Houseboats

These do not count as properties owned.

Land is not considered a dwelling, though some off-plan purchases are considered dwellings, as is the case for multiple dwellings relief.

10.1.6 When the higher SDLT charge may not apply

If your new property is intended to replace your old home which hasn't yet been sold, the higher rates will apply, though any excess SDLT will be refunded should the sale take place within the next 3 years. Please refer to section 7.1.2 above for more details on this point.

Properties located outside England, Wales and Northern Ireland are not subject to SDLT, though they will need to be taken into account when considering whether the higher rates apply to transactions of property within England, Wales and Northern Ireland.

Certain properties with a self-contained annexe will be exempted from being treated as two dwellings.

Mixed-use properties are considered to be non-residential properties for higher rate purposes.

10.1.7 Other situations where the higher rate of SDLT may apply

Higher rate SDLT charges can apply to furnished holiday lettings and the purchases of residential property by companies. It may be possible to avoid the higher SDLT charge when transferring residential property to a company (see section 5.4 above).

The purchase and ownership of property by trustees where beneficiaries have an interest in possession over the property, are treated as if the property was actually purchased or owned by the beneficiary themselves. The higher rates also apply to purchases of residential property by trustees where beneficiaries have no interest in possession over the property.

10.1.8 Examples:

Penny sells a property which was her main residence and purchases a new residential property. At the end of the day of the transaction she has one property, so she will not pay the higher rates of SDLT.

Jim lives in a rented flat and owns a buy-to-let property. He sells the buy-to-let, and purchases another buy-to-let. At the end of the day of the transaction, he still only owns one property, so he will not pay the higher rates of SDLT.

Fiona owns both a main residence and a buy-to-let property. She sells her main residence and purchases a new one. At the end of the day of the transaction she has two properties, however, as she has replaced her main residence she will not pay the higher rates of SDLT.

Bill purchases his first property, which he decides to use as a buy-to-let. At the end of the day of the transaction he owns one property, so he will not pay the higher rates of SDLT. Two years later, he purchases a second property to use as his main residence. At the end of the day of this transaction Matthew owns two properties and has not replaced a main residence. He will pay the higher rates of SDLT.

Leonard lives in a rented house and owns a property in Scotland which he uses as a buy-to-let. He purchases a property in England which he will use as his main residence. At the end of the day of the transaction he owns two properties and has not replaced a main residence. He will pay the higher rates of SDLT.

Olivia owns her main residence and she purchases the freehold interest in a property that is subject to a 99 year lease. She is not buying the lease. The higher rate of SDLT does not apply, condition B is not met.

11 Property and letting – other tax issues

11.1 Introduction

This final section is an overview of some of the tax issues not covered elsewhere in this guide.

11.2 Income tax

Letting is not a trading activity, nor is it a business activity for NICs, so Class 2 or 4 NICs do not apply to lettings income.

11.2.1 EIS, SEIS and EMI

Property letting and qualifying Furnished Holiday letting are both activities which are excluded for the purpose of the Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Enterprise Management Investment (EMI) share option scheme.

11.3 Capital Gains Tax

Where there are mixed property activities (eg mixed letting and trading activities), the scale of activities undertaken are weighed up to determine the tax treatment and what rate of CGT applies.

For CGT purposes the measure is whether investment activities are substantial or not.

HMRC will examine the various activities in the round and apply a percentage test in order to determine the tax treatment

11.4 Rent-a-room relief

You may rent a room in your own home, and provided that rental income does not exceed the specified limit, all rental income is tax-free.

The old exemption was £4,250 per household, though from April 2016, this has increased to £7,500 per household.

11.4.1 What are the conditions?

- Accommodation is furnished, and
- Is part of your only or main residence in the UK, and
- No other taxable income, other than rent a room receipts, is obtained from the relevant trade or letting agreement, or that source of income.

Rental receipts can include income for goods and services if supplied in connection with the rent a room (e.g. meals, cleaning, laundry etc).

'Residence' includes a building, or part thereof, designed as a single residence. The relief cannot be claimed for letting a permanently separated part of a building such as a flat or annex. A residence also includes a caravan or a houseboat.

No deduction is permitted for expenses.

If the rental income is shared or otherwise split between two or more persons, rent a room relief is halved.

Rent a room relief is **not** applicable when a property is let to a business.

11.4.2 Rent a room - alternative treatments

An election can be made to dis-apply the rent a room treatment (for instance if after deduction expenses a loss was incurred, that could be used against other income). In this case the rental profit or loss is calculated as property income, after deduction of expenses, loan interest and a wear and tear or replacement cost deduction.

An election can be made to be taxed on the excess of receipts above the normal relief entitlement. For example if gross rents received were £8,750 in the relevant tax year, the alternative treatment would tax the balance above the rent a room relief total, so the chargeable amount would be £1,250. Without this election, the individual would be taxed on rental income less expenses.

11.5 Non-resident Landlords

If you are a property investor you will be considered to be Non-Resident Landlord if you spend more than six months in any tax year outside the UK.

In this instance, the Statutory Residence Test or other tax definitions of residence won't apply to Non-Resident Landlords.

Instead, HMRC will look at your usual place of abode. This is where you may stay for more than six months, but it doesn't have to be your main or permanent home.

Under the Non Resident Landlord's scheme, you could have a UK tax residence, though perversely your 'usual place of abode' could be another country.

Tip

Having a PO Box or 'care of' address in the UK will not be enough for you to claim a usual place of abode in the UK.

11.5.1 NRLS - Agent

Letting agents, tenants and anyone finding tenants for non-resident landlords must pay any tax on rents due to the landlord, unless HMRC has told them not to do so in writing.

Tax is paid on a quarterly basis and an information return is submitted to HMRC by the agent. An annual return must also be submitted by 5 July after each tax year-end (which is 31 March) and a certificate issued to the landlord confirming tax paid.

If a property is rented out by joint owners and one is a Non-Resident Landlord, the profits are split according to the share of ownership of each. But only the share of the Non-Resident Landlord comes under the scheme.

11.5.2 NRLS – no Agent

Where there is no UK letting agent involved in the management of the property, then the tenant who is paying rent to the landlord (who lives outside the UK) must deduct basic rate tax from the rent and pay this to HMRC on a quarterly basis.

- The tax is deducted by reference to the gross rent payable to the landlord, plus any payments made by the tenant where they are not deductible expenses.
- Tenants do not have to operate the scheme if the rent paid is less than £100 per week.
- Where the tenant occupies the property for only part of the year the above threshold is reduced proportionately.
- Where two or more people occupy a property as tenants, the above limit applies to each of them.
- The tenants must make any tax payment plus submit an information return to HMRC confirming tax paid on a quarterly basis, within 30 days of the end of each quarter. The relevant quarter dates are 30th June, 30th September, 31st December and 31st March.

11.5.3 Compliance

Letting agents and tenants should register with HMRC's Non-Resident Landlord Scheme within 30 days of the start of a tenancy.

Tenants should write to:

HM Revenue and Customs
Charities, Savings and International Operations S0708
PO Box 203
Bootle
L69 9AP

Letting agents and tenants should keep records of rent paid, emails or letters to landlords about where they live and details of any expenses paid for the landlord. It's important to keep this paperwork for four years.

Letting agents and tenants can face fines of up to £3,000 for filing incorrect returns to HMRC.

12 Making Tax Digital (MTD)

12.1 An Overview

Making Tax Digital (MTD) is a government initiative to 'transform the tax system and see the end of the tax return by 2020'.

The changes were first proposed in the **Making Tax Digital roadmap** published in December 2015 based on what HMRC call the '**Four Foundations of Making Tax Digital**'.

One of the main aims of MTD is to give every taxpayer better access to the information HMRC hold about their business in order to encourage better tax compliance.

Whilst it's recognised that the majority of taxpayers want to pay the right tax, HMRC estimate that the amount of tax not collected due to avoidable taxpayer errors and carelessness has risen to over £8bn a year. In addition, because of the penalties imposed, taxpayers can often feel punished unfairly for lack of compliance.

The roll out of MTD has already started with taxpayers (both businesses and individuals) having access to a digital tax account to check their records and manage their details (see more about this **here**).

12.2 Major changes

The MTD initiative involves both businesses and landlords and the major changes for those businesses are:

- Businesses will need to report their information quarterly to HMRC using software or apps
- HMRC will improve its business tax portal so that business have better visibility of their tax affairs

In order to simplify the requirements for a lot of small businesses, HMRC have drastically increased the number of businesses who can use cash accounting.

12.2.1 Quarterly Reporting

The requirement for businesses and landlords to report their figures quarterly is one of the most radical changes to tax in a generation.

Going forward any business reporting under MTD will need to use digital tools (eg software or apps) to record their income and expenditure.

If you currently use spreadsheets to record your income and expenditure, you can continue to do so as long as these meet HMRC's requirements.

HMRC have said they won't provide their own software but will make sure that basic apps and software are available for the most straight-forward businesses.

How this will work in practice is still under review - you can read more about this **here**.

Many businesses will probably look to use commercial software such as **FreeAgent** or **Xero** (the two software packages we recommend for our clients) in the same way as a lot of businesses currently use software for quarterly VAT reporting.

HMRC are aware that a small minority of taxpayers will not be able to use digital tools and exemptions to this requirement will be allowed based on age, religion, disability or remoteness of location. HMRC have stated they will consider exemptions on a case by case basis.

12.2.2 Improved taxpayer portal

Along with quarterly reporting, HMRC recognise the need for taxpayers to have better visibility of their tax affairs and the information which HMRC hold.

So by 2020 taxpayers will have a single digital account where they can see all their liabilities in one place.

They will also be able to offset overpayments in one tax with underpayments in another.

12.3 Benefits of MTD

Whilst there are concerns from the wider community regarding MTD (HMRC aren't known for their successful and stream-lined IT implementations), if MTD is implemented correctly then there could be many benefits such as:

- Being able to plan more effectively as your tax will be calculated in real-time
- Having a full picture of your tax affairs in one account
- Less hassle as you can interact with HMRC digitally (HMRC already have Webchat available for most taxes)

For those who are more cynical about the reasons for the implementation of MTD, HMRC have produced a '**Making Tax Digital: Myth-Buster**'.

12.4 Timescale

The current timescale is as follows:

- April 2017 – HMRC will be trialling the new Making Tax Digital requirements with a very small number of businesses
- April 2018 – Self-employed and landlords turning over more than the VAT threshold will begin reporting quarterly
- April 2019 – Most other self-employed and landlords will begin reporting quarterly and VAT will get combined with quarterly reporting into a single reporting requirement
- April 2020 – Limited companies start quarterly reporting

In order to make MTD easier for small businesses, the limits for cash accounting for sole traders and partnerships have increased significantly.

12.5 Exemption threshold

HMRC have confirmed that landlords and unincorporated businesses with a gross income of less than £10k will be exempt from the quarterly reporting requirements.