Buy-to-Let Basics
2023/24

Letting out a residential property in the UK explained

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Buy-to-Let basics: Letting out a residential property in the UK explained

The purchase of your first buy-to-let property is often an exciting moment. You have found the perfect property and are looking forward to starting your latest business venture.

However, when it comes to working out your tax liabilities it can suddenly feel like an intimidating process.

In this comprehensive guide, we breakdown what you need to know, and the basics of letting out residential property in the UK (including furnished holiday accommodation) for the tax year beginning 6 April 2023.

The letting of commercial property is not covered in this guide, but our tax experts are always happy to advise on that area of investment on an individual basis.

Tax issues relating to buy-to-let property can be complex - it is strongly advised that you speak to an expert before taking any action.

Buying your buy-to-let property

Different taxes apply to the purchasers of property in different parts of the UK: Stamp Duty Land Tax (SDLT) in England and Northern Ireland, Land and Buildings Transaction Tax (LBTT) in Scotland and Land Transaction Tax (LTT) in Wales. Each tax has its own thresholds and rate bands.

When purchasing a residential investment property, the SDLT nil rate threshold is £250,000. For LTT it is £180,000 and for LBTT it is £145,000.

If you buy a second home for £40,000 or more, which is not a replacement for your main home, you must pay a land tax supplement on the entire purchase price. For SDLT this is an extra 3%, for LTT it is 4% and LBTT it is an extra 6%.

For example, if in October 2023 you buy your main home in England for £400,000, you will pay SDLT of £7,500, but if you buy the property as a second home or to let, the total SDLT charge will be £19,500.

If you buy your residential properties through a company (see 'How to hold your property' below), that company must pay the 3%, 4% or 6% land tax supplement on all purchases of over £40,000. Where the company acquires residential property in England or Northern Ireland for more than £500,000, the company may have to pay SDLT at 15% if it does not intend to use the property for a commercial or charitable purpose.

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

Where a company holds a residential property located anywhere in the UK, which is not commercially let to an unconnected tenant or acquired for development, it may have to pay the Annual Tax on Enveloped Dwellings (ATED). This annual charge starts at £4,150 for 2023/24 and applies to properties acquired for more than £500,000, or which were valued above that level on 1 April 2022. Higher value residences can attract significantly higher charges.

From 1 April 2021, any non-resident buying UK residential property in England or Northern Ireland normally has to pay a further 2% SDLT supplement. The definitions of non-residence for SDLT purposes are different to normal statutory rules, so it is possible for an individual or company that is otherwise UK resident to be subject to the supplement.

What are you taxed on?

As an individual landlord you must pay income tax on your 'property income'. This is the sum of the rents you receive less the tax-deductible costs (see 'Tax allowable expenditure'). Property income does not include the profit you make when you sell the property and it doesn't take into account any costs of buying, selling or improving the property.

All of the income you receive from letting property in the UK, both residential and commercial, is combined and taxed as one property investment business. A loss on one property can be relieved against profits made from another in the same tax year or in later years. Overseas property and furnished holiday lets are treated as separate businesses.

Ownership by an individual of a buy-to-let property

If you hold the let properties in your own name, you will be taxed on the income and gains arising from those properties. You can't normally transfer the income before tax to another person without first transferring an interest in the property to that person.

You should declare all the income and expenses from your UK let properties in the property income section of your self-assessment tax return. If you make a loss from the letting, you need to declare that loss on your tax return so that it can be deducted from the profits you make from letting in a later period.

How are overseas properties treated?

If you let properties that are situated overseas, the income and expenses from those properties must be shown on the foreign income section of your tax return. Profits or losses from overseas properties need to be calculated separately from those arising from UK properties.

Joint owners of a buy-to-let property

Where a let property is held in the joint names of a married couple or civil partners, it can provide a useful income stream if one of the couple has little or no other income.

In England and Wales you can own a property as 'joint tenants' (where both owners hold an equal interest in the whole property) or as 'tenants in common' (where each owner holds a separate and identifiable share, say 10% and 90% of the property). There are different rules for properties located in other countries, including Scotland.

When a legally joined couple (married or civil partners) own property as joint tenants, any income from that property must be split equally between them for tax purposes and declared as such on each person's tax return.

If the same couple hold the property as tenants in common in unequal shares, they can make a declaration on HMRC's Form 17 to have the property income taxed in the proportion that reflects each partner's beneficial interest in the property. Without the Form 17 declaration, the couple will each be taxed on an equal share of the income from the property. The Form 17 election is irreversible, so once you have elected to be taxed on your actual share, the election will remain in place unless your beneficial interest in the property changes.

Where the joint owners of a property are not married or in a civil partnership, they can agree to share the income from the property in whatever ratio they choose, although this profit-sharing ratio would normally reflect the underlying beneficial ownership of the property.

If you want to split the property income in unequal shares, instruct your solicitor to acquire the property as tenants in common in the ratio of ownership desired. Where you already own the property as joint tenants, it is quite simple to change to a tenancy in common, but there can be a land tax charge where the property is mortgaged.

When the property is sold, any capital gain arising must be split according to the beneficial ownership of each owner.

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Ownership by limited company of a buy-to-let property

A limited company pays tax at 26.5% or 25%, when profits exceed £50,000 and £250,000 respectively. If the company's annual profits do not exceed £50,000 those profits are taxed at 19%. In contrast, most individuals pay tax on rental income at rates between 20% and 45% (19% and 47% in Scotland). Individuals also pay Capital Gains Tax (CGT) on residential property gains at 18% or 28%.

Unlike individuals, companies do not suffer a restriction on the deduction of interest and finance charges (see 'Interest paid').

However, there may be further significant tax and National Insurance charges when you extract funds from your company. If you already own a company which holds surplus funds, investing in buy-to-let property can make commercial sense, provided the company can secure a mortgage for the balance of the purchase price. However, where the trade may become overshadowed by the value of the properties it holds, it may no longer be classified as a 'trading' company, which would mean it is no longer eligible for a number of tax reliefs, including business asset disposal relief.

What to do before letting your buy-to-let property

Once you have acquired your first property and it is available for letting, you need to start identifying the costs that are deductible from the rental income (see 'Tax-allowable expenditure').

"Available for letting" means the property is in a condition where it can be let, subject to cleaning, furnishing and drawing up letting agreements. If the property is in such a poor state that it cannot be let, it can't be treated as part of your property letting business. The expenses connected with renovating a property to bring it up to the standard to meet that "available for letting" condition aren't deductible from your rental income but may be deductible when you sell the property (see 'Capital costs' below).

Expenses incurred before the first tenant moves in, such as advertising or minor repairs, can be deducted from the rents you receive in the first tax year if:

- The expenses are classified as revenue costs rather than capital
- The costs are incurred within seven years of the start of the property letting business

Once your property letting business has started, any later expenditure leading up to the letting of second and subsequent properties is part of your lettings business and can be deducted, as long as it represents revenue expenses.

Tax-allowable expenditure

You need to sort your expenses into categories of 'capital' costs connected with buying, selling or improving your properties and other costs that recur as the tenants change, known as revenue expenses.

The page opposite sets out the main types of revenue expenses, but it is not a complete list. Ask us about any other costs you have incurred that don't fall under one of these headings, as they may be deductible. If your tenant is responsible for paying certain costs – such as energy and council tax bills – you can't claim a deduction for those items.

If your rental income is no more than £150,000, you are expected to account for the income and expenditure from your properties on a 'cash' basis. This means deducting allowable revenue expenses paid from the rents you actually receive in the tax year. You can opt out of the cash basis and use normal accruals accounting if you wish. Companies and Limited Liability Partnerships (LLPs) are not permitted to use the cash basis.

Allowable revenue expenses can include

- Accountancy fees for drawing up the property business accounts
- Advertising for tenants
- Ground rent and service charges for leased property
- Heating and lighting costs
- Insurance for the buildings and contents
- Legal fees for drawing up tenancy agreements or collecting debts, but not those connected with acquiring properties
- Letting or managing agents' fees
- Maintenance and repairs
- Motor expenses for travelling to the property
- Replacement of furnishings
- Stationery, telephone calls and use of your office or home
- Water charges and council tax

Interest paid

None of the finance charges (such as loan interest and arrangement fees) you pay in respect of your let property are deductible from rental income. This applies if you let residential property as an individual or jointly with other individuals, but companies can deduct all finance costs. There are different rules for furnished holiday lettings (see 'Holiday lettings' below).

Where you have disallowed finance costs, you can claim a tax credit to set against your Income Tax bill. The tax credit is equal to 20% of the finance charges you paid in the year, even if you pay a higher rate of tax on your rental income (see Example 1).

Where this tax credit exceeds your tax bill for the year, the excess amount is carried forward and added to any tax credit available for finance costs in the following years.

If you have significant loans connected to your let property business, your taxable profits will be much higher than your actual accounting profits. This could have knock-on effects for other taxes and charges you have to pay.

Example 1

Maddy lets a property in England for £18,000 per year and pays £10,000 in interest per year. She has no other property expenses, but she is employed on a salary of £34,000. Maddy's tax position for 2023/24 is calculated as follows:

Income

- **Salary** £34,000
- **Letting income** £18,000
- **Interest deduction** Nil
- **Net income** £52,000
- **Less personal allowance** (£12,570)
- **Taxable income** £39,430

Tax

- **Tax charged @20%** £7,540
- **Tax charged @40%** £692
- **Less tax reducer –** *see below* (£2,000)
- **Total tax payable** £6,232

Maddy's tax reducer is calculated as:
20% x 10,000 = £2,000.

Maddy is making an annual profit of £8,000 (£18,000-£10,000) from her property, but as the interest deduction is restricted, she pays tax on £18,000 of property income. This pushes her total income into the 40% tax band this year.

Capital costs

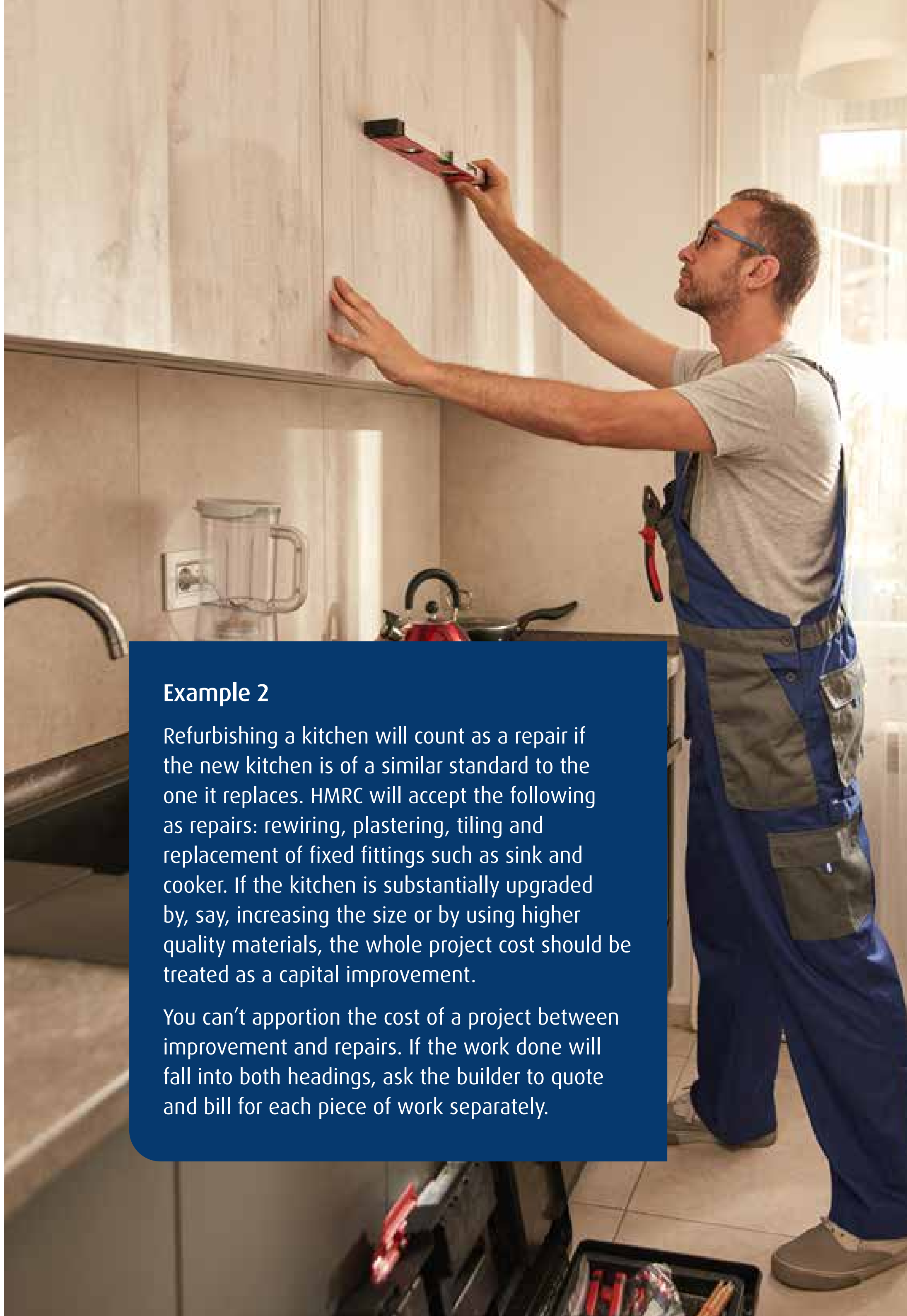
Any capital costs, such as improvements, can only be deducted from the sale proceeds of the property. You need to keep track of which capital expenses relate to which let property and retain all the relevant receipts and contracts.

Furnishings

You can deduct the actual cost of replacing furnishings used in your let property. This covers the cost of replacing items such as carpets, curtains and free-standing white goods, but not the initial cost of those items. The cost of replacing items that are fixed to the property should be claimed as repairs (see below).

Repairs

The cost of repairs is always deductible from rental income, but the cost of improving a property is a capital cost that is not immediately deductible (see Capital costs). The difference between a repair and an improvement is that a repair restores what was originally there without adding new functionality – everything else is a capital improvement.



Example 2

Refurbishing a kitchen will count as a repair if the new kitchen is of a similar standard to the one it replaces. HMRC will accept the following as repairs: rewiring, plastering, tiling and replacement of fixed fittings such as sink and cooker. If the kitchen is substantially upgraded by, say, increasing the size or by using higher quality materials, the whole project cost should be treated as a capital improvement.

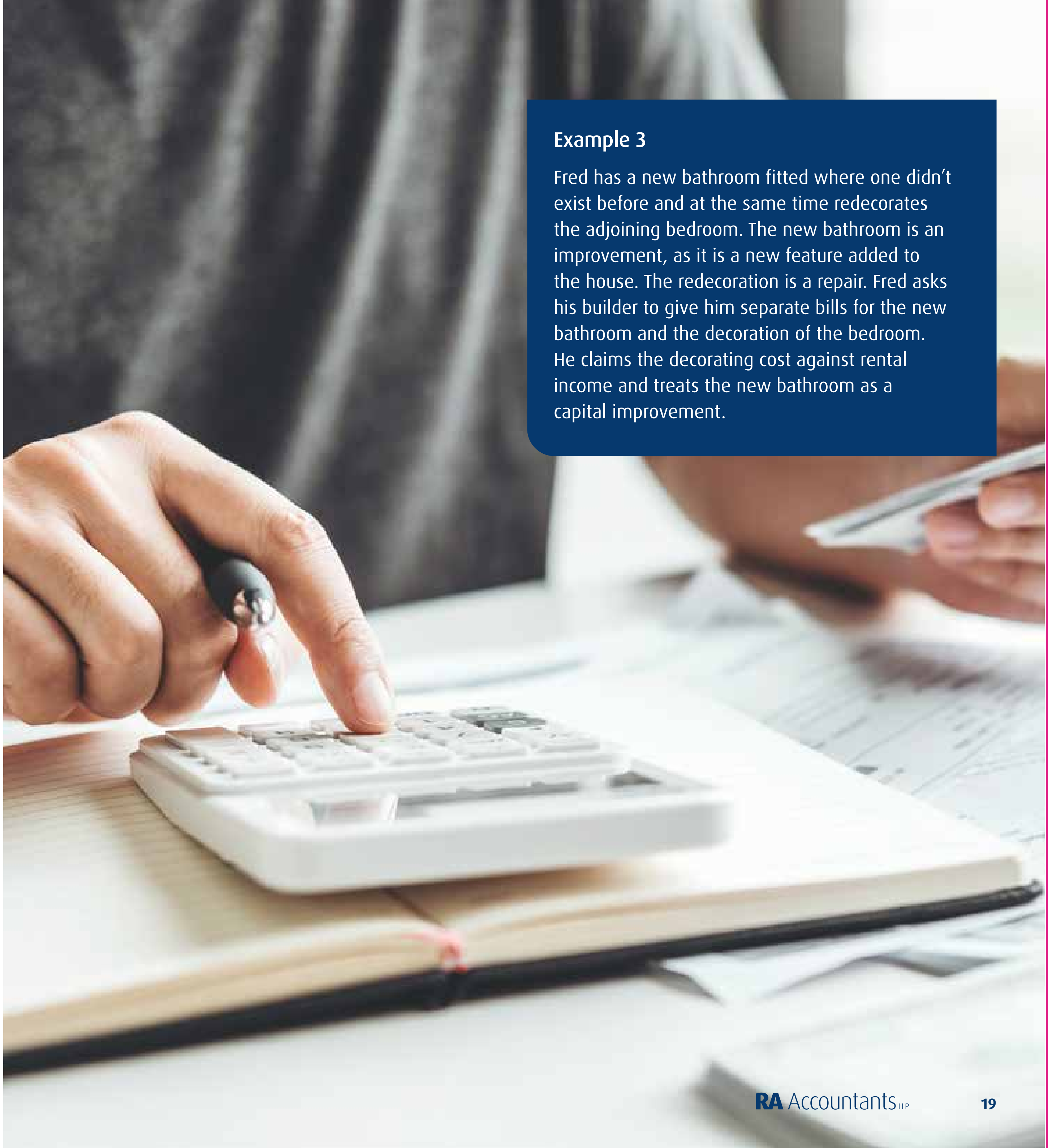
You can't apportion the cost of a project between improvement and repairs. If the work done will fall into both headings, ask the builder to quote and bill for each piece of work separately.

Record keeping

You must keep adequate records to enable you to report your profits or losses accurately to HMRC, without recourse to estimates. You should retain a record of every relevant expense, but these can be scanned copies of documents. Deposits will relate to individual tenancies, so record when each tenancy commenced and ended and how much of any deposit was retained or returned.

Note down details of any personal assets you use for the letting business, such as the date and distance of car journeys, or the time spent on administration at your own home.

All the records relating to your property business must be kept for at least five years after the submission date for the tax return in which you reported that the property was let or sold, in case HMRC ask about those figures. Documents relating to the tax year to 5 April 2024 should be retained until 31 January 2030.



Example 3

Fred has a new bathroom fitted where one didn't exist before and at the same time redecorates the adjoining bedroom. The new bathroom is an improvement, as it is a new feature added to the house. The redecoration is a repair. Fred asks his builder to give him separate bills for the new bathroom and the decoration of the bedroom. He claims the decorating cost against rental income and treats the new bathroom as a capital improvement.

Holiday lettings

If you let your furnished property for a large number of short periods, it could qualify as a Furnished Holiday Letting (FHL). The property doesn't have to be in a holiday centre; it can be situated in any part of the UK or even in another European Economic Area (EEA) country. Following Brexit, the Government may seek to restrict the favourable FHL treatment to UK properties only, but nothing has yet been announced on this.

Qualifying as a FHL allows you to deduct interest and finance charges fully from the rental income and claim capital allowances for many items used inside and outside the property.

Also, when you sell the property, it may be possible to defer CGT due on gains by buying another business asset. If other conditions apply, business asset disposal relief can reduce the rate of CGT to 10% when you close your FHL business. Note, however, that FHLs do not normally qualify for any Inheritance Tax reliefs.

Conditions for Furnished Holiday Lets (FHLs)

The property must be let for short periods, of no more than 31 days each, on a commercial basis to the general public (not just to family and friends). These short lets must total at least 105 days in the year and the property must be available for short-term lets for at least 210 days in the year. For the remaining five months of the year it can be let for longer periods.

The 105-day total can be averaged over a number of properties and a two-year 'period of grace' can be claimed on an individual property where the 105-day condition is not met in a particular year, if the other conditions apply. The latter was particularly useful where owners were unable to let their property much due to the pandemic.

Disadvantages of Furnished Holiday Lets (FHLs)

The profits and losses for an FHL business are calculated in a similar way to those for an ordinary lettings business, but losses can only be set against other FHL profits.

Your total costs for a FHL property may be higher, as the turnover of tenants is more frequent. However, you can claim for the initial purchase of items such as a fridge in an FHL property, usually in the year of purchase.

If your annual turnover is over £85,000, you will have to register for VAT, as holiday lettings are subject to the standard rate of VAT (20%), whereas normal residential letting is exempt from VAT. As a VAT-registered business, you will have to submit VAT returns using MTD-compatible software and keep all your VAT records in a digital format.

Selling your buy-to-let property

Your property letting business finishes when you no longer have any properties available for rent and are not looking for tenants. This may be because you have decided to occupy the last property yourself, or you are keeping the property empty prior to sale.

You can't deduct any revenue expenses which are incurred after the last property has been withdrawn from the lettings market. Thus, the costs of sprucing-up the property post-letting but pre-sale are not tax-deductible.

Capital gains

When you sell your let property, you would expect to make a profit, after deducting allowable costs. Gains made from selling residential property, which are not covered by an exemption or other relief, are subject to CGT at 28%, except to the extent that the seller has basic rate band available, when the rate is 18%.

The gain must be reported to HMRC online within 60 days of the completion of the sale. The team at RA Accountants can do this report for you, but we need to know all the details of the transaction as soon as the sale is completed. Penalties will apply if this 60-day deadline is missed.

You must also pay your best estimate of the CGT due on the disposal within 60 days of the completion date.

If all the capital gains you make in the tax year (not just from property disposals) exceed your annual capital gains exemption (£6,000 for 2023/24), you must declare those gains on the CGT section of your tax return. This applies even where you have already reported the gain online to HMRC within 60 days of the completion date.

If you give away the property to someone other than your spouse/civil partner, or sell it to someone connected to you at a discount, that disposal is treated as a sale at market value for tax purposes.

Allowable costs

- Solicitors' and estate agents' fees paid on the sale and purchase
- Land tax (e.g. SDLT) paid on purchase
- Costs of improvements

Former home

When you live in a property as your main home, the gains made relevant to your period of occupation are exempt from CGT on disposal of the property. Other periods you spend away from the property may qualify as deemed periods of occupation if you return to live there at a later date – the detailed rules on this can be very complex. The gain relating to the last nine months of your ownership is also exempt from CGT if you have previously lived in the property as your main home.

If you live in more than one home concurrently, you can nominate which property is to be treated as your 'main home' and thus exempt from CGT. You can change that nomination at will, but you must make the first nomination within two years of the date on which you started to use the second property as your home. A husband and wife, or civil partners, can only have one CGT-free main home between them.

Non-resident landlords

If you live outside the UK and let property located in the UK, your letting agent (or tenant where there is no agent) should deduct 20% tax from the rents before paying you. However, where HMRC agrees that you qualify under the non-resident landlord scheme, you can receive the rental income without tax deducted. You have to promise to declare the income from your let properties on a UK tax return and pay any tax due on the profits.

Gains arising from the disposal of UK property are subject to CGT in the UK, even where the landlord lives in another country. The gain must be reported to HMRC and the tax paid within 60 days of the completion date, as described above. However, non-resident landlords must also report disposals where there is no tax to pay or a loss is incurred.

Inheritance Tax

The value of all your possessions, including the home you live in and your buy-to-let properties, are all potentially subject to Inheritance Tax (IHT) on your death. However, the first £325,000 ("nil rate band") is effectively exempt from IHT, and any unused nil rate band may be inherited by your spouse or civil partner. There is an additional residential nil rate band of £175,000 per person that can be deducted if you leave the value of a home to one or more of your direct descendants, but this is not available if the property has always been rented out. Any unused amount of this residential nil rate band is also transferrable to a spouse or civil partner.

There are exemptions for gifts made more than seven years before you die and amounts left to your spouse/civil partner or to charities.

It is essential to have a well-drafted and up-to-date Will to take full advantage of IHT exemptions and reliefs.

At RA Accountants we are experts in helping clients manage their property tax liabilities. We offer a complimentary, initial online consultation to discuss your personal circumstances and to see how we can help. Get in touch to book your appointment today.

This booklet is for guidance only and professional advice should be obtained before acting on any information contained in it.

No responsibility can be accepted for loss occasioned howsoever to any person as a result of action taken or refrained from as a result of reading.

Tax planning services for buy-to-let landlords and developers

At RA Accountants, we work closely with buy-to-let landlords and developers to navigate the complexities of property tax to remain compliant and to minimise their tax burden.

Talk to our tax team at about:

- When to use a Limited Company to save tax
- Trading income versus Capital Gain considerations and advice
- Capital Gains rollover and holdover considerations
- Stamp duty planning
- Tax efficient mortgage structures
- VAT considerations of property deals
- Making the most of the Principal Private Residence election
- Tax issues on the sale of part of your residence
- Second homes
- Inheritance Tax considerations

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