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Private client news - spring edition: Taxation of UK residential property and its income

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In addition to the new 'residence nil rate band', a raft of other changes has been introduced over the past few years which affect the ownership of UK residential property. This has certainly become far more complex and, in almost all cases, far less beneficial to the taxpayer. The following is a brief summary of the changes, which may affect UK resident and domiciled individuals as well as the 'non-doms' who, in many cases, were the original targets of the changes.

Properties owned through corporate or other 'non-natural' holding structures

Stamp duty land tax ('SDLT')

A 15% SDLT charge applies on the acquisition of residential properties by companies and other non-natural persons (but not trustees) where the consideration is more than £500,000. Moreover, unless the property is subject to the 15% rate, the additional buy-to-let SDLT charge referred to further down applies to companies which purchase even a single residential property in England or Wales.

Annual tax on enveloped dwellings ('ATED')

An annual charge is imposed on 'high value' residential property owned by a company, partnership or collective investment scheme, unless the property is let out to an unconnected person or other reliefs apply. An ATED return has to be completed even where reliefs do apply and the property has to be re-valued every five years. The charge now applies to properties worth more than £500,000 and the annual charge from 1 April 2016 ranges from £3,500 for a property worth between £500,000 and £1m, to £218,200 where a property is worth more than £20m.

Capital gains tax ('CGT')

Tax is now charged at 28% (subject to the principal private residence exemption, where applicable) on gains on all UK residential property owned by UK resident trustees, companies within the ATED charge and higher rate taxpaying individuals; basic rate tax payers are taxed at 18%. By comparison, the rates for CGT on most other assets are now only 20% for trustees and higher rate individuals and 10% for basic rate payers.

In addition, although generally only UK residents pay CGT, the tax is payable by non-UK residents (including individuals, companies and trusts) when they sell UK residential property.

Buy-to-let and second homes

Stamp duty land tax (again)

Supposedly in an attempt to make more low value properties available for first-time buyers, higher rates of SDLT now apply on the purchase of 'additional' residential properties, such as second homes and buy-to-let properties. This applies to purchases by individuals (or their spouses, civil partners or minor children), companies and the trustees of certain trusts. Companies purchasing a residential property in England or Wales are subject to these new higher rates, even though they only own one residential property; and so are trustees of discretionary trusts.

Deductions and reliefs

Another change to hit owners of buy-to-let properties relates to the treatment of mortgage interest payments when calculating income tax on the rent. At present, mortgage interest payments are deducted from rental income before income tax is charged. However, from 6 April 2017, relief for mortgage interest (and other finance costs) will be restricted so that the tax relief will only be available up to the 20% basic rate of tax. This will have a significant impact on the profitability of many property rental businesses.

This restriction will be phased in between April 2017 and April 2020 and it applies to individuals, trustees and partnerships. It does not, however, apply to companies owning property or to commercial properties. Ironically, therefore, individuals wishing to purchase residential property to let out will need to weigh up the downside of a higher SDLT bill in buying through a company, against the upside of still being able to deduct finance costs against rental income.

This summary is intended to highlight the number of pitfalls that now exist in relation to the ownership and taxation of UK properties. Every situation will of course be different and the lesson should be that existing structures should be kept under review. Everyone should take advice in good time before taking any action in respect to UK property.

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