Property taxation

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Introductory

The three main taxes for property are:

- stamp duty land tax (SDLT) and its devolved equivalents
- value added tax (VAT)
- income tax or corporation tax.

There are also some environmental taxes, local taxes and special provisions for other taxes.

For property taxation, a distinction is usually made between:

- commercial property, and
- residential property.

Property used for charitable properties is usually treated the same as residential.

Land law

To understand property taxation, it is necessary to understand a little about land law. This is a complex subject in its own right, of which just a few points are noted.

Land means the surface of the planet, regardless of whether it is covered with water. Ownership of land automatically means ownership of everything under and above the surface. There are some statutory exceptions, such as for oil deposits and underground trains.

This means that **buildings** are owned by ownership of land on which they stand. This extends to items attached to the ground or to buildings standing on them. In a case of 1872, it was held that attached looms in a factory were part of the land. An item is not attached to land if it is held there by gravity alone.

Trees and plants are part of the land while still growing in land. When harvested or otherwise removed, they cease to be part of the land.

The main body of property law was established in 1925 under **Law of Property Act 1925** with other legislation. This applies to England and Wales, but not to Scotland or Northern Ireland which have separate laws.

Land cannot be owned by **two people** or more. Where land is said to be co-owned, the legal position is that they have formed one trust, and that trust owns the land.

The two or more people may be **joint tenants** who are equally entitled to use the whole property and are equally liable for its responsibilities. When one dies, the other or others

automatically assumer ownership. Alternatively, they may be **tenants in common** who have separate rights that pass according to the will or on intestacy. Tenants in common may also own the property in unequal proportions.

Most land is now **registered** at the Land Registry. Areas were progressively designated for compulsory registration on sale, a process that finished in 1990. From 1998, it became compulsory to register changes in ownership such as by gift or on death. About 5% of land in England and Wales is still unregistered. This is often rural land, and land held by the same person for generations.

The **Land Registry** is a public file, meaning that anyone can read details on payment of a small fee. From 2014, there is an online service. Unregistered land may be sold, but proof of title (who owns it) must first be established. This is often done by looking at old documents such as title deeds.

Since 1925, there are only two forms of **legal estate:**

- fee simple absolute, and
- term of years absolute.

In this context, **absolute** means that no-one has a better title.

Fee simple absolute is a freehold interest. It means that the holder owns the land or, to be more accurate, holds an estate for the crown.

Term of years absolute is what is generally known as a leasehold. The person has a finite time to use the property after which it reverts to the freeholder. A leaseholder pays ground rent to the freeholder. This has traditionally been a nominal amount unless services, such as maintenance and insurance are included. Recently there have been examples of high and rapidly increasing ground rents, for which the government has promised legislation.

A leaseholder may be able to grant a **sublease** to a subtenant.

There is also **commonhold** introduced under Commonhold and Leasehold Reform Act 2002. This is intended for flats and offices in blocks. The leaseholders collectively own the common parts, such as stairs and corridors. Little use has been made of it.

In addition, there are **licences.** These are simply permissions to use a room which fall short of a lease. Examples include hotel rooms and temporary use of buildings.

An **easement** is passive use of land, such as for water pipes and electricity cables.

For property, the **owner** is the person who has title to the land. The **occupier** is the person who possesses it. So a landlord may be the owner but the tenant is the occupier.

New buildings generally need **planning permission** from the local council. This *permits* construction, demolition or extension. It does not require it. The government is concerned at the number of permissions for homes that do not get built.

Building regulations ensure that construction is up to standard. These standards have become stricter over the decades, so many legally built properties (which remain legal) would not comply with modern standards. These are complemented by other provisions relating to energy efficiency, flooding and asbestos.

Ownership of property passes by **conveyancing.** Unlike most other contracts, a sale of land requires a *written* contract. In Scotland, it is common for properties to be sold for a fixed price. The contract comes into buying when they are **exchanged.**

This process of conveyancing typically involves **searches** to check on local transport, local plans, mining and quarrying, utilities and other factors that could affect the price or suitability of the property. They can also check for **covenants,** historic restrictions on land, and obligations under Chancel Repair Act 1936.

The acquisition of a property may be funded by a **mortgage.** Note that the property buyer is the mortgagor; the lender is the mortgagee. The property is still owned by the buyer.

Stamp duty land tax

From 1 December 2003, property transactions are subject to stamp duty land tax (SDLT) or its devolved equivalent. Although still commonly called stamp duty, SDLT is a completely separate tax. In particular, SDLT taxes the transaction, whereas stamp duty taxed the document giving effect to the transaction.

SDLT now only applies to England and Northern Ireland. It is replaced:

- in Scotland by land and buildings transaction tax (LBTT) from 6 April 2015
- in Wales by land transaction tax from 6 April 2018.

These devolved taxes have many provisions in common with SDLT.

SDLT is charged on the acquisition of a **chargeable interest** in land. This is not necessarily a sale. HMRC should be notified on form SDLT1 either on paper or online. This should be submitted and the tax paid within 30 days of the effective date. (Plans announced to reduce this to 14 days from 2017 were postponed to 2018, and now appear to have been postponed again.)

There are many exceptions and reliefs. An important relief is **sub-sale relief.** This applies in situations such as **off-plan sales.** Broadly if A sells land to B who sells a unit to C before it is built, sub-sale relief means that the transaction is taxed as if A had sold it directly to C.

SDLT is now taxed on the **slice basis.** This means that the consideration is taxed at increasing rates on slices of income. There is a zero band where no SDLT is payable at all. There are two sets of rates, for residential and non-residential property.

A **first-time buyer** of a residential property may pay less SDLT from 22 November 2017.

SDLT is increased by 3 percentage points for second homes. There is also a special rate of 15% when a company owns a residential property. Such a property is probably also subject to annual tax on enveloped dwellings.

A **lease** is subject to SDLT on both the premium and annual rent. The premium is taxed as if it were a consideration for a freehold property. The premium (or annual rent) is taxed on its net present value.

A much more detailed summary of SDLT and their devolved equivalents can be found in a separate article on this website.

Value added tax: warning

Value added tax (VAT) on property transactions is an immensely complicated area. Almost every month, there are tribunal decisions where a transaction is held to be subject to VAT at 20% where the parties believed it was zero-rated or exempt. This can create a large additional burden on highly priced contracts where margins may be small.

It is therefore essential to obtain professional advice for all but the most straightforward transactions.

Particular problems have arisen regarding:

- the difference between a new building and an extension
- exactly what qualifies as a village hall
- commercial developments that include residential property.

These notes should be seen as simply an overview to enable understanding. They will not necessarily provide the correct answer to a particular supply.

A general summary of VAT can be found in a separate article on this website.

Value added tax: overview

All VAT transactions can be put into one of five categories. There are property transactions for each one of these categories:

- standard rate of 20%
- reduced rate of 5%
- zero rate of 0%
- exemption
- outside the scope.

The **standard rate** of 20% applies to all supplies unless they are specifically included in a schedule for reduced rate, zero rate or exemption. Supplies of land are generally exempt, but this again is subject to many exceptions.

For VAT purposes, a property business is treated in exactly the same way as any other business. It may claim input tax on all business supplies received. There is no need to distinguish a property business from any other activity of the business.

Standard rated supplies include:

- commercial premises supplied in the first three years of their life, regardless of who makes the supply
- supplies of rent and premises where the landlord has exercised the option to tax (explained below)
- freehold disposals of certain new buildings and partly completed buildings
- engineering works
- supplies under a developmental tenancy or similar
- rights to take game or fish
- hotels, inns and boarding establishments for the first 28 days
- holiday accommodation
- seasonal pitches for caravans and tents
- right to fell and remove timber
- housing, storage and mooring of water vessels, aircraft and similar
- boxes and seats at concert halls and sports grounds
- facilities to play sport
- construction services, unless part of an exempt or zero-rated supply
- building materials supplied separately from construction
- car parking charged separately
- timeshares.

From 2012, HMRC regards these as standard-rated supplies of services and not exempt supplies of land:

- stands at exhibitions
- general storage of goods
- airport lounges.

Reduced rate supplies include conversions of property to:

- an increased number of dwellings, such as turning a large house into flats
- a house in multiple occupation
- special residential, such as hospital or barracks.

Care needs to be taken for mixed development. The inclusion of any residential area in the original property can exclude the supply from reduced rating.

Reduced rating can also apply to supplies of some energy-saving materials and grant-funded installation of heating equipment or connection to a gas supply.

Zero-rating applies to:

- new residential buildings (see below)
- land which is the *first* grant of a major interest in a new dwelling
- new charitable buildings
- annex to a building to be used for charitable purpose
- renovation of a disused residential building
- demolition of total structure save for one wall, or two for a corner plot
- certain adaptations for disabled persons commissioned by a charity
- conversion of a non-residential building to a residential building.

A new residential building must be one where either there was no building at all, or where any previous building has been demolished with only one wall remaining, or two for a corner site. Anything below the ground is ignored, so the presence of a cellar, basement or crypt will not in itself stop a residence above being zero-rated.

Exemption applies to:

- a major interest in land
- letting and leasing, unless the landlord has exercised the option to tax
- stabling for a specific horse, but not stabling generally or for livery services
- accommodation in a hotel or similar from the 29th day.

A major interest in land means a freehold interest or a lease or tenancy of at least 21 years.

Supplies outside the scope of VAT include:

- transfer of property included in a transfer of a business as a going concern
- statutory services, such as fees for planning permission or building regulations
- section 106 agreements required by local authority for planning permission
- tolls for roads, bridges, tunnels etc operated by a local authority
- compensation for vacating a business or agricultural tenancy
- apportionment of rent between landlords when there is a change of landlord
- dilapidation payments from a tenant to landlord at the end of a lease
- interest on late rent (even if the rent is taxed)
- rent-free periods in a lease.

All of these are subject to conditions, which must be checked.

Value added tax: special provisions

The **option to tax** allows a landlord to choose whether to charge VAT at the standard rate on rent rather than exempt the supply. This provision was introduced on 1 August 1989.

If all the tenants are VAT-registered, this can be an attractive proposition. The tenants will pay no more tax and the landlord can claim back all his or input tax. If the tenants are not VAT-registered, the option increases their rents by 20%. This is a matter that must be specifically considered in any leasing agreement.

A landlord may revoke the option to tax after 20 years. The legal provisions were revised in 2008.

Tripartite and multi-party agreements create problems for VAT, as it is necessary to determine who is supplying what to whom. There have been several cases where businesss have been unable to claim input tax as expected. For example, in *Rushgreen Builders [1987],* a building company was unable to claim input tax incurred by a director who sold his house to raise finance for the company.

An approved alteration of a **listed building** was zero-rated until 21 March 2012, from when such alterations are standard-rated, subject to transitional provisions. Maintenance of listed buildings was always standard-rated.

The **listed places of worship** scheme was introduced on 1 April 2001. It allows a building that is listed and used as a place of worship of any religion to seek a grant to offset the VAT charged. From 2012, the total amount of grants is capped at £42 million.

The **capital goods scheme** was introduced in 1997. It is an exception to the general rule that VAT is considered only on what is supplied when it is supplied. It applies when construction work costing more than £250,000 is zero-rated, and within ten years the use of the building changes to one which would have been taxed. The consequence is that a proportion of the input tax is clawed back.

If a business makes both taxable and exempt supplies, it may have to account for VAT under **partial exemption.** This allocates input tax to taxable and to exempt supplies, where possible, and allows full input tax recovery for the former. For other expenses, such as general overheads, a proportion of input tax may be recovered. The proportion is on a just and equitable basis, one of which can be floor space allocated to each activity.

The **DIY builder scheme** is an exemption to the general rule that only a VAT-registered person may claim input tax. If someone builds their own home, they may make a special claim for a refund of input tax on building materials.

Income tax and corporation tax

Income from property, such as rent, is usually charged to income tax or corporation tax. These taxes are imposed according to the nature of the payment. There are four sources that are likely to be particularly relevant:

- trading income
- property income
- investment income
- loan relationship.

In general, a business will want income to be classed as trading income as this is the most favourable in such areas as expenses and loss relief. **Buying and selling property** is a trading activity, even if the property is developed before sale. Repairing and maintaining property is also a trade.

A trader who has **spare accommodation,** such as an unused office or warehouse space, may regard such income as trading income.

A **property business** is when premises are let for commercial or residential use. Refurbishing premises before letting does not turn a property business into a trade.

There can be marginal decisions, depending on what other services are provided. If such facilities as meals and laundry are offered, the letting is likely to be regarded as a trade, such

as for a hotel. There is much case law on this. There are special rules for holiday accommodation.

Holding property for its investment value is an **investment business.**

In addition to rents, a **lease premium** can be partly taxed as income if the lease is for less than 50 years.

A **sale and leaseback** is when a business sells its property for a capital sum and then rents it back from the new owner. This is a perfectly proper commercial arrangement. As it has been used for tax avoidance, there are two anti-avoidance provisions. The first disallows **excess rent.** The second treats a capital sum as income when there is a short (less than 15 years) leaseback on a lease with less than 50 years to run.

Small landlords

A person who has a small income from residential **property income** may claim £1,000 a year against that income. This means that someone receiving rent up to that figure is not taxed on the income. If the income is above that figure, the person may either deduct £1,000 or the actual expenses (such as cleaning, maintenance and insurance).

Before 1 April 2016, it was possible to deduct 10% of rent as **wear and tear allowance** instead of claiming actual expenditure. That option is no longer available for periods from 1 April 2016. From the same date, it is possible to claim **domestic items relief** for replacing such items as carpets, curtains, furniture and domestic appliances.

Furnished holiday lettings are subject to special provisions. The property must be offered for letting for at least 210 days a year, be let for at least 105 days, have no single lettings for more than 31 days, and be charged at the market rate for that area. If these conditions are met, the provider may claim some business reliefs such as capital allowances and rollover relief for capital gains tax. (The rules are different for periods before 7 April 2011.)

The **rent-a-room** scheme exempts income from lodgers from tax to a limit of £7,500 a year. This limit is per landlord per year, regardless of how many lodgers there are or for how long they lived there. The limit was £4,250 before 1 April 2016.

Landlords are restricted in how much **interest** they may claim tax relief for. From 6 April 2016, this interest is progressively restricted to the basic rate of income tax and not to the higher rates. This restriction is being phased in over four years. The government wishes to kill the buy-to-let market. This is one of the ways it plans to do it.

Contaminated and derelict land

For remediation of **contaminated land** or **derelict land**, there is a special provision that allows 150% of the expenditure to be deducted from taxable profits. This was introduced from 11 May 2011 for contaminated land, such as where the land contains oil or other materials from industrial activity. The provisions for derelict land apply from 1 April 2009, where the land has been derelict since acquired and since 1 April 1988.

Capital allowances

An individual or company is not allowed to claim a tax deduction for the capital cost or depreciation on any premises.

Instead, a taxpayer may be able to claim a **capital allowance.** No capital allowances may now be claimed for the building itself (with limited exceptions for enterprise zones). Industrial building allowance was phased out between 2008 and 2011.

A capital allowance may be claimed for plant and machinery. This is equipment *with which* a business operates, as against premises *in which* a business operates. This has led to many cases and to some surprising and almost arbitrary decisions. In 1969, a massive dry dock was held to be plant. In 2010, a gazebo, provided outdoors to keep smokers dry when raining, was held to be plant and not premises. A summary of case decisions is provided in Capital Allowances Act 2001 ss21-22.

From 1 April 2008, plant and machinery capital allowance may be claimed for **features integral to a building (FITAB).**

The scope of FITAB is set out in Capital Allowances Act 2001 s33A(5), namely:

- electrical system, including a lighting system
- cold water system
- space or water hearing system
- ventilation, air cooling and air purification systems
- any floor or ceiling comprised in the two previous items
- lift, escalator or moving walkway
- external solar shading.

FITAB qualifies for the annual investment allowance and an 18% writing down allowance.

Some **energy-saving** plant and machinery and other environment plant and machinery may qualify for a 100% first year allowance.

There are separate capital allowances for dredging and mineral extraction, and an allowance similar to capital allowances for cemeteries and crematoria.

There are generous reliefs for **research and development.** This can, under some conditions, include expenditure on property.

For periods from 11 April 2007 to 31 March 2017, there was also **business premises renovation allowance.**

There is a separate article on this website explaining capital allowances.

Capital gains tax

Capital gains tax is paid on the gain made by an individual or trust when an asset is disposed of. There is no tax on the increased value of property; only when that value is crystallised by a form of disposal.

Companies generally pay corporation tax on gains, except that a company can pay capital gains tax on the disposal of residential property.

A company may claim **indexation** for periods between April 1982 and December 2017. This means that the acquisition cost is increased by a factor to reflect inflation during that period. An individual or trust may not claim indexation.

If an individual or company sells a property and applies the proceeds to buying a new one, the sale proceeds may be subject to **rollover relief.** This means that tax is not paid on the disposal. Instead the proceeds are rolled over into the new premises. A gain may be rolled over any number of times over any period. Tax is only paid on the final disposal. For each rollover, there is a four-year window from one year before disposal of the old premises to three years after.

There is also a **holdover relief** for gifts of property which works in a similar way.

There is a special provision for **small disposals of land** of a value up to one fifth of the value of the land. This treats the disposal as a reduction in costs in computing the gain on the subsequent disposal.

Individuals may claim **main residence relief** for their one main home. There is no minimum period of residence, though very short periods may be difficult to argue in practice. This is an area where there have been many cases. There are periods of absence which may be ignored. The main residence includes any garden up to half a hectare (about 1.2 acres) or larger if in keeping with the residence.

There are separate articles on capital gains tax and corporation tax on this website.

Local authority taxation

Local authorities have the right to charge:

- business rates on commercial property
- council tax on residential property.

Business rates were introduced in their current form in 1990. Each property is assigned a rateable value. The government sets a national rate and the two are multiplied to calculate the rates payable. These are paid to the local authority but allocated by the government. There are proposals to allow some local authorities to keep the rates.

There are various forms of relief from business rates for small business properties, particularly shops and in rural areas.

Council tax applies to residential properties from 1993 when it replaced the unpopular community charge, or poll tax. All properties are put in a band denoted by the letters A to H (or A to I in Wales). Band D is regarded as the average property. Each local authority sets the council tax for a band D property. The rates for other bands are multiples of this figure.

Council tax is not charged in Northern Ireland, where rates are charged on a basis similar to business rates.

Council tax usually includes precepts for any other authorities in the area, the police and for social care.

Inheritance tax

Inheritance tax is charged on property and other assets that pass on death or are put into a relevant property trust. Land and buildings are included at their value. There are provisions allowing for a subsequent loss or value, and for paying the tax in instalments.

Business property and farms may qualify for business property relief or agricultural property relief.

Care is needed when giving away property and retaining some rights, such as giving away a home but continuing to live there. These will often be treated as a **gift with reservation** and not reduce the estate for tax purposes.

From 6 April 2017, there is a **residence nil rate band** where the nil rate band is increased where a personal residence (or proceeds from disposal of such residence) are passed to a son, daughter or other descendant.

There is a separate article on inheritance tax on this website.

Annual tax on enveloped dwellings

Annual tax on enveloped dwellings (ATED) was introduced from 1 April 2013 when a residential property is owned by a company or other collective body.

It is an anti-avoidance measure. Instead of individual owning a property on which stamp duty land tax is payable at several percent, the property may be owned by a company and the property in effect transferred by selling the *company* rather than the property. This attracts stamp duty of 0.5%.

ATED imposes an annual charge of a fixed amount in value bands from £500,000.

Environmental taxes

Landfill tax is a charge introduced on 1 October 1996 on dumping material in landfill. It is a devolved tax now replaced by:

- Scottish landfill tax in Scotland from 1 April 2015
- land disposal tax in Wales from 1 April 2018.

The tax and its devolved equivalents impose a charge at two rates (three in Wales): a low charge for inert waste, and a higher charge for other waste. In Wales there is a third rate for unauthorised disposals.

There are many exceptions.

Aggregates levy was introduced from 1 April 2002 on the commercial exploitation of rock, gravel, sand and anything naturally occurring with them.

Climate change levy is charged on the production of energy.

Other tax matters

A contractor in the construction industry must use the **construction industry scheme** in respect of subcontractors engaged on site. There is a separate article on this scheme.

If an **employee** is provided with accommodation, the employee may be subject to income tax on the value of such accommodation, though there are exceptions. Where there is a tax charge, it is calculated as the sum of:

- the annual rateable value of the property
- a percentage on the amount by which the property cost exceeds £75,000
- 20% of the value of furniture and other assets provided with the property
- direct costs borne by the employer for council tax, utilities, insurance etc.

From 6 April 1993, there is a **relocation** allowance of £8,000 which may be provided tax free when an employee is relocated as part of him or her job.

There are many social security provisions in relation to housing costs.