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POSITION PAPER

Impact of **tax changes** on the private rented sector

This position paper includes recommendations to **incentivise landlords** and increase the number of **properties available to rent**.

Sep 2023

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Throughout the **Coronavirus** pandemic and beyond, letting agents **worked hard** with tenants and landlords to **maintain tenancies** and keep people in their **homes**.

Since the pandemic, there has been a huge increase in demand for private rented property. Supply of properties to rent is the main concern for property agents and is a major challenge facing the private rented sector.

Executive summary

This position paper analyses the impact of tax changes on the private rented sector (PRS) and provides recommendations to incentivise landlords and increase the number of properties available to rent across the UK.

It uses survey data from Propertymark members, and other private and public sector organisations, to highlight the detrimental impact that government decisions since 2015 have had on the tax and financial situation for landlords in the PRS.

The findings include:

- Landlords mortgage, maintenance and running costs have all increased which is putting pressure on rents.
- The decision to restrict mortgage interest relief for landlords has forced many to pay more tax.
- When purchasing a buy to let property, landlords across the UK spend on average £10,808 in additional property tax.
- Cost of living legislation in Scotland has forced many landlords to increase rent in between tenancies to cover anticipated costs due to a fear of ongoing rent control.

The PRS is a key housing provider for people across the UK and governments should be reviewing the impact of tax and financial changes on landlords to develop policies that encourage more investment in the sector and reduce rents for tenants.

KEY STATISTICS

Supply and demand

58%

In October 2022, 58 per cent of respondents to our survey reported that the number of short-term lets within their local area had increased in the past four years. Of those seeing growth in their regions, 38 per cent reported the primary driver being a transfer of property from the private rented sector. [1]

24%

Figures from Propertymark agents survey data in April 2023 showed that the number of new prospective tenants registering per member branch was 24 per cent higher than April 2022 and in the month of May the figure was 15 per cent higher than May 2022. [2]

20-40%

In June 2023, Zoopla said that there are 20–40 per cent fewer homes to rent in most regions than there were before the pandemic, evidencing the increasing mismatch between supply and demand.

COST OF LIVING CRISIS

The Consumer Prices Index (CHPI), including owner occupiers' housing costs, rose by 7.3 per cent in the 12 months to June 2023.[3] Letting agents and their landlords are not immune to the cost-of-living crisis and many are dependent on their rental income in order to pay their mortgages and other costs.

In August 2023 the Bank of England raised the interest rate (Bank Rate) for the 14th consecutive time, to 5.25 per cent.[4] This has a knock-on effect on the price of labour and materials needed for repairing, maintaining and improving homes as well as on business expenses such as pay and other staff costs, overheads for running an office and vehicle fleet bills.

Landlords are also facing significant new costs for investing in existing homes to meet increasing standards for energy efficiency and to achieve the decarbonisation of heating. There has also been a marked increase in local authority licensing schemes where a HMO license can cost up to £1,420. Several additional and selective licensing schemes have been passed in large parts of London and most large English cities. [5]

PRESSURES
on landlords

Alongside these rising costs, the ongoing legislation in the private rented sector with still more proposed changes to come affecting renting and energy efficiency targets, together with the impact of the Section 24 tax changes, higher property taxes when purchasing a buy to let property, and the proposition of 'making tax digital' all adds to disincentivise landlords to continue to invest in housing.

Lack of growth

A big part of this lack of growth in available properties in the private rented market across the UK are the financial implications and barriers that come with purchasing a buy to let property.

Landlords renting properties to long-term tenants in the private rented sector have seen their tax burden increase in recent years:

- Higher rates of property taxes on buy-to-let properties.
- The withdrawal of tax relief on mortgage interest costs and replacement with a 20 per cent tax credit. [6]
- Removal of the ten per cent Wear and Tear Allowance for fully furnished properties being replaced with an at-cost relief. [7]
- Maintaining Capital Gains Tax (CGT) for rented property at 18 per cent and 28 per cent (higher rate taxpayers) and 18 per cent, when it was reduced to ten per cent and 20 per cent (higher rate taxpayers) for other assets. [8]
- A rise in corporation tax from 19 per cent to 25 per cent from 2023. [9]

This has resulted in a system where landlords are unable to offset finance costs against tax liabilities, reducing opportunities for small investors to enter the market. The current system also discourages landlords from being able to actively improve their properties as repairs and maintenance are tax deductible but not improvements.

SPOTLIGHT

Section 24 of the Finance (No.2) Act 2015

In the Summer 2015 Budget the then Chancellor George Osborne announced proposals to restrict the tax relief that buy to let landlords are entitled to claim on their mortgage interest, to be phased in over a five-year period between April 2017 to April 2020. [10]

Previously, landlords could deduct certain finance costs, such as payments on the mortgage or interest on loans funding furnishings for the property, from their rental profits before calculating the tax, something which was not available to homeowners.

Under the rules, landlords can no longer deduct those additional costs from the income they earn on their properties before it is taxed. Instead, landlords can now only get a tax-credit at the basic 20 per cent rate on the lower amount from the following list:

- Finance costs, such as mortgage interest, interest on loans to buy furnishings, and fees incurred when taking out or repaying mortgages or loans.
- Property business profits.
- Adjusted total income.

IMPACT

The decision to phase out costs such as Mortgage Interest Relief from deductible tax may have been the correct decision at the time of implementation in 2016. However, the economic climate is remarkably different in the present day with record high interest rates. At the time the tax rules for landlords were changed, interests' rates were close to zero.

- Thousands of landlords now pay more tax under the changes brought in to restrict Mortgage Interest Relief for residential landlords to the basic rate of income tax.
- Some landlords have been pushed up a tax band despite their income not increasing, as tax will be applied to turnover instead of profit.
- To cover the additional taxes, landlords will increase rents for new and existing tenancies whilst also cutting back on other expenses such as property maintenance.
- As the extra tax mounts up, some landlords will sell up altogether and leave the sector.
- Over the long term this will impact on the value and quality of property tenants rent.

SPOTLIGHT

SDLT, LBTT and LTT when purchasing additional properties

STAMP DUTY LAND TAX (SDLT)

This tax is paid on the purchase of property or land in England and Northern Ireland. People purchasing an additional property (such as a second home or a buy to-let property) may incur an additional charge of three per cent on top of regular SDLT rates.

LAND AND BUILDINGS TRANSACTION TAX (LBTT)

Replaced SDLT in Scotland in 2015. LBTT applies an Additional Dwelling Supplement (ADS) on top of standard LBTT rates if someone is purchasing an additional residential property. As of 16 December 2022, the ADS rate is six per cent of the purchase price.

LAND TRANSACTION TAX (LTT)

Replaced SDLT in Wales on 1 April 2018. Higher residential rates apply for purchases of additional dwellings. Initially, set at an additional three per cent on top of regular LTT rates, it was increased to four per cent in December 2022.

NON-RESIDENT SURCHARGE

Applies to landlords and individuals not classed as UK residents. They may have to pay a two per cent surcharge on top of regular SDLT rates when they purchase residential property. There is no non-resident surcharge under LBTT and LTT.

IMPACT

A Propertymark survey of letting agent members in January 2022 found that 81 per cent reported the additional rates of property tax for buy-to-let property had been the most significant recent tax change for the PRS.

- Under SDLT an aspiring buy-to-let landlord purchasing an additional property for £290,000 (average UK house price) can expect to pay £10,700 in stamp duty. A purchaser buying as main resident only would pay £2,000 in stamp duty.
- Under LBTT an aspiring buy-to-let landlord purchasing an additional property for £185,000 (average house price Scotland) can expect to pay £11,900 in Land and Buildings Transaction Tax. A purchaser buying as main resident only would pay £800 in LBTT.
- Under LTT an aspiring buy-to-let landlord purchasing an additional property for £215,000 (average house price Wales) can expect to pay £9,825.00 in Land Transaction Tax. A purchaser buying as main resident only would pay £0 in LTT.

SPOTLIGHT

Capital Gains Tax (CGT)

The sale of a residential investment property is usually charged Capital Gains Tax (CGT) at 18 or 28 per cent. CGT rates on the sale of assets were reduced to 10 or 20 per cent but these rates do not apply to residential property.

At the Autumn Statement in December 2022, the Chancellor announced that the amount someone can make from the sale of certain assets before paying tax will fall from £12,300 to £6,000 in April and then to £3,000 in April 2024.[11]

Basic rate taxpayers pay 10 per cent CGT on most asset sales and 18 per cent on property. Higher rate taxpayers pay 20 per cent CGT on most assets and 28 per cent on property.

Landlords who manage their buy-to-let portfolio through a limited company and pay themselves in dividends will also be hit by changes to the dividend allowance, which is the amount that an individual can receive in dividends before paying tax on them. The allowance will be cut from £2,000 a year to £1,000 in April, and then halved again to £500 in April 2024.

IMPACT

In March 2016, CGT rates were cut significantly for top rate taxpayers from 28 to 20 per cent, and from 18 to 10 per cent for lower earners. However, landlords were excluded from the cuts meaning that while sale of shares in a company that owns property would incur CGT at 20 per cent, individuals making reasonable gains on the sale of a second property would face the existing 28 per cent.

- The move ignores the positive contribution made by landlords and property companies as the incentive is to invest in companies over property.
- Excluding landlords from Capitals Gains Tax cuts makes this asset class less attractive at a time when the supply of rented homes is tight.

SPOTLIGHT

Rent cap for residential tenancies in Scotland

The Cost of Living (Tenant Protection) (Scotland) Act came into force on 28 October 2022 making two significant changes to the law.[12] Firstly, temporarily placing certain restrictions on evictions from residential tenancies. Secondly, restricting landlords from increasing the amount of rent they can charge on existing residential tenancies. The rent cap was set at zero per cent effectively freezing rents.

The Act was due to expire at the end of 31 March 2023. However, contained within the legislation is power for the Scottish Government, with the approval of the Scottish Parliament, to extend the requirements for two periods of six months.

At the start of January 2023, a further six months extension to the rules was announced and approved. This meant that from 1 April 2023, if a private landlord chooses to increase a tenant's rent mid-tenancy, the increase will be capped at three per cent. An additional extension period has since been approved until the end of March 2024.

IMPACT

Feedback from our members shows that there have been three main impacts following the introduction of the Cost of Living legislation.[13] Firstly, landlords are increasing rents between tenancies to cover their costs and anticipated costs due to a fear of ongoing rent control legislation. Secondly, the financial burden and costs for landlords have increased. Thirdly, investment in the private rented sector has stalled as landlords question whether to stay in the sector and continue to let their private rented property.

- According to the property website Zoopla, in April 2023, rent in Scotland was 13.1 per cent higher than a year ago. This compares to rent in London was 13.5 per cent and the Northwest of England saw a 10.5 per cent increase. [14]
- The Welsh Government have also recently published a Green Paper on the Right to Adequate Housing and Fair Rents, where if rent controls were introduced, the impact seen in Scotland is likely to be similar in Wales.[15]

SPOTLIGHT

Exempting new long-term rental properties from the four per cent **Land Transaction Tax** in **Wales**

Most taxation powers are reserved for the UK Government. However, both Scotland and Wales have powers to change threshold levels of properties including additional properties that could stimulate the market.

The Welsh Government should consider exempting new long-term rental properties from the four per cent Land Transaction Tax (LTT) levy on additional homes. The Welsh Government should also consider wider access to grants and interest free loans available for private landlords to bring empty properties back into use.

IMPACT

By reducing Land Transaction Tax on additional properties, landlords will be incentivised to reinvest in properties and make more homes available. While the Welsh Government have announced funding to bring empty properties back into use, there is no specific funding for landlords who are the most likely to invest in such properties. Data from the Welsh Government reveals that there are 22,000 empty properties in Wales.[16]

Key recommendations

Landlords have faced significant legislative change, costs and tax increases in recent years and governments across the UK should be looking at reviewing the impact of these changes and introducing financial incentives to encourage landlords to continue to invest in the sector.

REVIEW ALL TAXES RELATING TO PRIVATE LANDLORDS

Governments across the UK must carry out a full review of all taxes relating to private landlords in order to develop policies that promote long term investment in the sector and reduce costs for tenants.

SCRAPPING MORTGAGE TAX RELIEF HIKE

This would reinstate the ability of landlords to set the total amount of mortgage interest against rental income before tax is calculated; claim the basic rate reduction of 20 per cent on their mortgages, which is one of the largest costings for landlords; and create a level playing field between landlords who operate in their own name, who are subject to the tax changes, and those landlords who are not as they are set up as a business.

REDUCE ADDITIONAL TAXES ON BUY TO LET PROPERTIES

To boost the supply of rented housing governments across the UK must reduce taxes on additional homes to encourage further investment in the private rented sector. The existing surcharges must be reduced and could be split so a lower percentage is paid by landlords looking to invest in the private rented sector and a higher percentage paid by individuals buying second homes.

REDUCTION OF CAPITAL GAINS TAX THRESHOLDS

To further encourage more investment in the private rented sector the UK Government should unify Capitals Gains Tax rates for property with those relating to other types of investment.

REINTRODUCE A TAX ALLOWANCE FOR LANDLORDS LINKED TO ENERGY EFFICIENCY IMPROVEMENTS

This will help landlords with the cost of energy efficiency works and ensure that tenants benefit from lower bills. Previously, the Landlord's Energy Saving Allowance (LESA) encouraged landlords to invest in energy efficiency improvements by permitting them to offset up to £1,500 per property against income tax or corporation tax for installing energy efficiency measures.

AVOID RENT CONTROL

Propertymark sees no advantages in restricting rent increases or introducing any rent stabilisation measures. Flexible tenancies and rent prices driven by market forces have led to the success of the private rented sector across the UK. It is vital that landlords are not deterred from the market and have finances to invest and improve property standards. Increasing the supply of properties, rather than capping rents will ensure rents fall and landlords stay in the market.

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