30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: post@ciot.org.uk

Office of Tax Simplification Call for Evidence – Property Income Review

Response by the Chartered Institute of Taxation

1 Executive Summary

1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.

1.2 The receipt of property income encompasses an extremely wide range of activities. In each case the tax treatment of property income requires consideration of whether the activity undertaken is that of an investment, a business or a trading activity, and further whether it falls within the tax-favoured furnished holiday lets (FHL) regime. The dividing lines between various types of rental accommodation are quite fine and have become increasingly fluid. The tax treatment of property income therefore presents its own complexities and distinctions that are not always present when considering income from other investments.

1.3 The restriction on deductibility of funding costs for individuals, partnerships of individuals and trustees but not for corporates or corporate partnerships undermines the principle of neutrality in terms of different forms of holding a rental property, promoting one form over another for tax purposes and thereby potentially distorting the economic choice of structure.

1.4 It is not clear whether the underlying policy behind the restriction on deductibility of interest for individual landlords, broadly to promote owner-occupier purchasers in the long term, has been delivered as, in many cases, we understand that owners simply transferred their investment properties to corporate vehicles. Furthermore the policy of promoting owner-occupation is not necessarily consistent across the different regimes, for example the availability of a full deduction for loan interest under the FHL regime may favour investment in holiday lets in geographic areas in competition with owner-occupiers including first-time buyers.

1.5 It is not helpful in terms of consistency and ease of understanding that, between different taxes, HMRC consider property letting can be a business for one purpose and not for another, or that what constitutes a property business as opposed to a passive investment is often a grey area.

1.6 We suggest that in view of the length of time that has elapsed since the introduction of the current FHL regime, and as part of a systematic review of tax measures to assess their effectiveness, the current FHL regime should be evaluated against its policy intent by the government to ensure the current policy objectives are fully articulated and evaluated. This is particularly relevant now in light of the UK's exit from the EU, any changes to tourism and rental patterns brought about by the pandemic and to ensure the policy is consistent with other policy measures that aim to rebalance the UK housing market and seek to enable home ownership for owner occupiers.

1.7 For income tax purposes, spouses or civil partners living together are assessed on income from jointly held property ('the 50:50 rule'). The rule does not apply to a married couple or civil partners who have separated. If the parties actually hold the beneficial interests in the property as tenants in common in a different proportion it is possible to make a declaration to HMRC to that effect. The 50:50 rule was introduced as part of the introduction of independent taxation (such that couples would be taxed separately for income tax purposes). The presumption of entitlement to equal shares was intended to overcome uncertainties in establishing ownership particularly where assets of married couples remained intertwined and determining beneficial interests under property law was complex.

We question whether there is still a need for this deeming provision for income tax purposes 30 years after independent taxation was introduced and 140 years after the Married Women's Property Act. If difficulties in establishing actual ownership remain an issue, consideration might be given to changing to a default position of income tax liability based on actual property ownership shares but with the option to elect for 50:50.

1.8 In terms of assisting landlords in understanding their tax obligations, it may be feasible for letting agents, platform operators or holiday rental agencies to point to the appropriate guidance on GOV.UK or to provide a link to the GOV.UK guidance (ideally located in one place on GOV.UK). There are a number of practical obstacles however to letting agents and others providing data to HMRC on landlords' behalf. Letting agents generally provide quarterly statements to landlords showing rental income and expenses for the quarter supported by copy invoices. Reporting this data to HMRC would need to be in a consistent format and would require subsequent categorisation into deductible and non-deductible expenditure if it were to be used for pre-population or for detailed compliance activity by HMRC. Data in this form would not, for example, reflect the application of the deemed 50:50 rule for joint owners or whether the cash/accruals basis has been adopted so would require cross-referencing.

1.9 We remain concerned about lack of awareness of the start of Making Tax Digital for Income Tax in April 2024 particularly among 'accidental' landlords (a landlord who did not acquire the property with a view to letting, for example on inheritance or because of the inability to sell a former residence following a change in circumstances) or landlords holding only one property. Anecdotally members report that even those landlords who are aware may have put off preparation when MTD was deferred in 2021. Even those who are broadly aware that MTD is on the horizon may not understand the interactions between the mandated £10,000 MTD threshold and rent a room receipts below the £7,500 threshold or property income below the £1,000 allowance level.

1.10 Many UK residents with overseas property income do not necessarily understand what is declarable to the UK authorities – often resulting in nothing being declared - and what deductions can be made for taxes paid overseas. The difference between the UK tax year and the tax year of the overseas state (more often than not the calendar year) exacerbates these issues.

1.11 Where a landlord whose 'usual place of abode' is outside the UK rents out a UK property the agent, or if no agent the tenant, must withhold tax at the basic rate and account to HMRC for the deduction quarterly unless the property owner has applied to receive income gross. In the less common situation where there is no letting agent, a third party tenant wholly unconnected to the non-resident landlord may have no knowledge or means of establishing that deduction of tax is required, or even that their landlord is non-resident. We suspect that few tenants, especially those who have no connection with the landlord beyond that of the landlord/tenant relationship, are likely to become aware of these obligations.

2 About us

2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2.2 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

2.3 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

2.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

3 Introduction

3.1 The OTS property income review[1] considers the current regimes for the taxation of residential property held by individuals, partnerships and micro companies to develop recommendations for simplification and ways of addressing distortions. The primary focus is on income received from property.

3.2 Our stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

[1] https://www.gov.uk/government/publications/review-of-property-income-scoping-document

3.3 Questions 10 and 11 of the review are omitted as these are not directed at tax advisers.

4 Structural aspects

4.1 **Question 1 Do any particular issues arise as a result of differences in the tax treatment of property income and income from other investments, such as OEICs, or quoted shares?**

The receipt of property income encompasses an extremely wide range of activities including:

- renting a room in the owner's own home;
- renting out a home for occasional use by others (such as under Airbnb);
- renting out holiday cottages;
- letting out a property on a short-term lets using an agent to manage the property;
- letting out a property on a short-term basis with the owner managing the property;
- letting out a property on a long-term basis with minimal involvement by the owner;
- buying and selling properties as a trade; and
- buying, developing and selling properties as a trade.

In each case the tax treatment of property income requires consideration of whether the activity undertaken is that of an investment, a business or a trading activity, and further whether it falls within the furnished holiday lets (FHL) regime. The dividing lines between various types of rental accommodation are quite fine and have become increasingly fluid. The tax treatment of property income therefore presents complexities and distinctions that are not always present when considering income from other investments.

Property income and trading income are taxed under different provisions in the tax code. This has practical implications for the taxpayer particularly in terms of the offset of losses, National Insurance contributions and the availability of business assets disposal relief and other CGT reliefs. However determining whether income relates to property or a trade or a part trade is not straightforward despite a body of case law. While some property letting is akin to holding other passive investments many property businesses share more characteristics with trading such that if the badges of trade were applied to some property businesses (and the owning of property was ignored) many of these businesses would be trading. There are fine margins between letting a second home, using an agent to let the property, the owner managing the letting, owning multiple properties and actively managing the process of obtaining tenants, renewing leases, repairs and maintenance and other property matters.

In addition to the differences in tax treatment of property income, some of which are quite subtle, there is the initial complication of determining which tax treatment the taxpayer considers should apply and the risks to the taxpayer if HMRC reaches a different view.

The First-tier Tribunal in *Julian Nott v HMRC* [2016][2] acknowledged these difficulties and demonstrated that subtle distinctions in the type of accommodation, the services provided and owner occupation can affect the treatment of property income.

Question 2 Does the existence of different regimes for taxing property income and other income from investments lead to any distortions in behaviour?

Question 3 Do any particular difficulties or benefits arise in relation to letting activities as a result of the different rules for the taxation of property income and trading income?

The restriction on deductibility of funding costs for individuals[3], partnerships of individuals and trustees but not for corporates or corporate partnerships undermines the principle of neutrality in terms of different forms of holding a rental property promoting one form over another for tax purposes thereby potentially distorting the economic choice of structure**.**

Inevitably different regimes distort behaviour to some extent. Our members report that changes in residential property taxation which have been made as part of government policy to level the playing field with owner-occupiers, notably the restriction on deductibility of loan interest and higher SDLT costs, dampened enthusiasm for investment in the buy to let property sector particularly for landlords with high loan-to-value borrowings. However there remain many landlords and prospective landlords keen to remain in the sector or acquire property for letting because of the perception of a relatively safer and reliable capital growth when compared to other investments. A significant driver, at last initially, is not therefore awareness of the differing property income tax regimes but the perceived investment benefits of the property sector.

The restriction on deductibility of finance costs for a dwelling-related loans (a measure introduced in 2015 without the benefit of full consultation) applies only to an individual (or a trustee) carrying on a property business. It does not apply to a trade or to companies carrying on a property rental businesses or to FHLs. It is potentially distortionary in that tax liability is unrelated to the true economic position and as a result introduces complexity and uncertainty, for example an individual landlord who is a higher rate taxpayer has to factor in unrelieved mortgage interest as an additional cost and the potential knock-on effect on the High-Income Child Benefit Charge, on student loans and the availability of personal allowances. We question whether the complexities of the transitional rules in 2017- 2020 and the current position for 2020/21 (a tax credit restricted to the basic rate) was, or is, well understood by taxpayers. Historically, many unrepresented taxpayers misunderstood that mortgage repayments that include an interest and capital element are not fully deductible. It is difficult to see how those taxpayers would understand the finance restriction and many buy to let owners will not be represented. Making Tax Digital could assist here by incorporating nudges and prompts to ensure that loan interest is correctly treated.

It is not clear whether the underlying policy, broadly to promote owner-occupier purchasers in the long term, has been delivered as, in many cases (as noted in our response to question 4 below), we understand that owners simply transferred their investment properties to corporate vehicles. Furthermore the policy is not necessarily consistent across the different regimes, for example the availability of a full deduction for loan interest under the FHL regime may favour investment in holiday lets in geographic areas in competition with owner-occupiers particularly first-time buyers.

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[2] [2016] UKFTT 106 (TC)

[3]The position differs for universal credit – see https://www.litrg.org.uk/tax-guides/tax-credits-and-benefits/tax-credits/what-counts-income-tax-credits#toc-changes-to-property-income

4.2 **Question 4 What prompts landlords to incorporate their property rental businesses and to what extent are such decisions motivated by tax or non-tax reasons?**

The effective rate of tax differs depending on whether the property is held by an individual or a company and whether income is accumulated in the company or distributed, whether there are borrowings and, in the case of residential property, whether the deductibility of interest restrictions apply and the loan to value ratio. For incorporated property businesses, mortgage interest is dealt with under the loan relationship rules.

The restriction on deductibility of interest for individual buy to let landlords and the ability to retain profits within a corporate entity at lower CT rates in order to reinvest and expand a portfolio has made incorporation more attractive, superficially at least, to taxpayers. However the question of whether it is tax-efficient to incorporate will depend on many factors including corporation tax rates , dividend rates, employment income and national insurance contributions. Anecdotally we understand that many businesses with a larger portfolio of rental properties and businesses previously operating as partnerships have incorporated. Individuals holding smaller portfolios may be less likely to have done so in part because of the CGT, SDLT and ongoing administrative costs of doing so. There are sometimes significant uncertainties in whether a transfer to a company will give rise to CGT and SDLT costs.

For TCGA 1992 section 162 (roll-over relief on transfer of a business), relief is available for the transfer of 'a business as a going concern'. The question of what is a business is considered at https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg65715 including consideration of what is a property business for these purposes and the Upper Tribunal decision in *Ramsay v HMRC* [4].

The manual indicates:

You should accept that incorporation relief will be available where an individual spends 20 hours or more a week personally undertaking the sort of activities that are indicative of a business. Other cases should be considered carefully.

It is not clear how the 20 hours 'rule of thumb;' applies in particular cases – or what the basis for this rule of thumb is at all. For example some members have commented on HMRC's requirement that the activities must be carried on 'personally' so if a managing agent is engaged the activities carried out by the agent are disregarded.

Others have commented that given the modern economy where many people hold multiple jobs or occupations, it is not apparent why an individual spending 10 hours a week managing one property is operating any less of a business than an individual spending 20 hours a week managing two properties – especially if the first individual's property is equal to the combined value of the second individual's properties.

It is understood that HMRC withdrew their non-statutory clearance on this aspect of section 162 some time ago. Given that section 162 relief is automatic if the conditions are met so no claim is required, it is not clear how, and to what extent HMRC are considering whether the section 162 conditions are met in the 'other cases' referred to in the guidance.[5] Perhaps consideration might be given to whether the relief should apply automatically with the option to elect for it not to apply (TCGA 1992 section 162A) or should the relief be claimed such that data around claims can be regularly reviewed for compliance and evaluation.

[4] [2013] UKUT 0226 (TCC)

[5] There is a code for 'Rollover Relief ROR' on the SA return and section 162 is headed '**Roll -over relief** on transfer of a business' but it is not clear whether this code is intended to be used for section 162 and is in fact so used or what disclosure might routinely be made in the white space that would alert HMRC to the application of section 162 relief.

The SDLT costs of incorporation have led to an increased interest in the specific SDLT (and LTT, LBTT) code for land transactions involving partnerships as for SDLT FA 2003 Schedule 15 can give a nil SDLT charge and this takes priority over the FA 2003 section 53 market value charge on transfers of property to a connected company. Therefore there may be an element of distortion in that the choice of vehicle is driven by the SDLT saving.

It is also not clear how the 20 hours 'rule of thumb' applies in the case of a partnership, given that a partnership is, by definition, 'the relation which subsists between persons carrying on a ***business in common*** with a view of profit' (emphasis added) – as confirmed in HMRC guidance such as the Partnership Manual at PM120100. The same applies to Limited Liability Partnerships where those incorporating the entity must declare on the incorporation form that two or more persons are associated for carrying on a lawful business with a view to profit.

For SDLT and ATED purposes there is also relief from ATED and the 15% higher rate for a 'property rental business'. A 'property rental business' is defined by way of a 'property business' for the purposes of CTA 2009 Part 4 Chapter 2, which, in turn, refers to 'every business which the company carries on for generating income from land'. However, the term 'business' is not defined and it is not clear to what extent HMRC adopt a consistent interpretation for different taxes.

It is not helpful that, between different taxes, HMRC consider property letting can be a business for one purpose, and not for another or that what constitutes a property business as opposed to a passive investment is often a grey area in terms of HMRC's approach.

We question whether interpreting the same word ('business') in different ways depending on the particular statute in which it arises results in a clear and consistent tax code that it is possible for taxpayers to follow.

A significant (partly) non tax factor in incorporation is the flexibility offered by incorporation for succession and IHT planning[6] over direct ownership.

4.3 **Question 5 What are the benefits and drawbacks of having a different regime for taxing property income and capital gains from Furnished Holiday Lettings?**

Question 6 To what extent do those owning property taxed under the Furnished Holiday Lettings regime use the property themselves?

The rules for furnished holiday lettings (FHLs) mean that an FHL business (subject to satisfying conditions) has a more favourable 'trading' status for certain purposes[7] than a property business. These rules apply to furnished holiday lets in the UK and in the European Economic Area (EEA)[8]. The rules for EEA furnished holiday lettings continue to have effect after Brexit. The rules restricting the deduction of finance costs in relation to let properties do not apply to a FHL business.

Advantages

[6] There is a body of case law considering the availability of Business Property Relief for IHT purposes in a holiday lettings context including the Upper Tribunal case of *HMRC v Pawson's Personal Representatives* UKUT 050 (TCC). However these cases concern the question of whether the holiday letting business was disqualified from BPR because the business of the company consisted wholly or mainly of making or holding investments.

[7] Broadly loss relief; capital allowances; certain capital gains reliefs and relevant UK earnings when calculating the maximum relief due for an individual's pension contributions.

[8] The EEA comprises the EU states plus Iceland, Liechtenstein and Norway.

- Provides certainty of the tax status for furnished holiday lets, otherwise the dividing line between investment and trade turns on fine distinctions as demonstrated in the cases of *Gittos v Barclay [1982] 55 TC 633* and *Griffith v Jackson [1985] 56 TC 83*.

- The 2010 consultation[9] indicated that the regime was of benefit to the tourism industry in that its complete repeal could have an adverse commercial effect on UK businesses and the tourism industry. Instead the conditions for accessing the relief were tightened with the stated aim of better targeting businesses that are run commercially for profit rather than for personal use.

Drawbacks

- Complexity: The tax privileges available under the FHL regime are complicated as the OTS paper recognises. The different regime benefits the well-advised but provides pitfalls for the unrepresented.

- Complexity: the FHL definitions do not align with the tests for holiday accommodation falling within business rates (instead of council tax) and therefore benefitting from small business rates relief. (Compare the FHLs test that is 210 days available to let/ 105 actually let. For business rates in England from April 2023 in England the test will be available for let 140/ actually let 70 and in Wales available for let 252/actually let 182).

- Profits from the commercial letting of UK FHLs have to be calculated separately from any other part of a person's UK property business, and the profits from the commercial letting of EEA FHLs are calculated separately from any other part of the person's overseas property business. Losses from a FHL business can only be set against income from the same FHL business and there is no set-off between UK and EEA profit and losses. The loss regime for FHL is therefore more restrictive than for an ordinary property business. In the summary of responses to the 2010 consultation the government acknowledged that the treatment of losses for FHL businesses, viewed in isolation, would be more restrictive than for other property businesses, but concluded that the package of FHL rules, taken as a whole, still offered an appropriate incentive for people to invest in the FHL market. However, the treatment of FHL losses contributes to the complexity of the regime as it creates a requirement for further pooling of losses adding to the compliance burden and may create 'marooned' losses.

- Capital allowances on the purchase of an FHL may not be considered in the residential purchase process and without a section 198 election the ability to claim capital allowances at all may be limited. Intermittent qualification for FHL status can also cause problems in relation to the capital allowances rules because there is a deemed disposal of plant and machinery (requiring a valuation) each time a business qualifies or ceases to qualify for FHL treatment as was recognised in the response to the 2010 consultation.[10]

[9] Furnished Holiday Lettings Consultation

[10] Para 4.19 of the summary of responses :The government '… agrees that intermittent qualification causes uncertainty and cost. To address this, it proposes that businesses which meet the occupancy threshold in one year may elect to be treated as having met the occupancy threshold in each of the two following years, providing that they meet certain criteria in each of those two following years. This will reduce the frequency of capital allowances valuation and disposal events (for which existing rules will continue to apply).

- Members report that the VAT treatment of FHLs and Airbnbs is frequently misunderstood or overlooked particularly in relation to non-resident landlords.

In terms of the personal use of FHL properties we have no formal data. However, anecdotally, FHL landlords generally fall into 2 camps: those with second homes who let the property in order to access the benefits of the FHL regime – this group tend to use the property themselves or allow family and friends to use the property, and they tend to have to keep a close eye on meeting the qualifying requirements, secondly those that live near the FHL property (or properties), who take an active role in managing the property, treat it as a trading business, and who do not tend to use the property themselves but may allow, occasionally, family and friends that are visiting to stay in the property.

Post legislative review

The impact assessment published on 3) November 2009[11] considered the option of a complete repeal of the FHL rules and its effect on tourism:

Tourism

Many providers of holiday accommodation (eg hotels, bed and breakfasts and those not satisfying the FHL qualifying conditions) will be unaffected by this change. Those businesses that are affected will still be able to benefit from a range of reliefs available under property income rules. Some businesses may pay more tax as a result of the change, but the impact on continuing, viable, businesses is expected to be limited. For this change to affect the UK tourism industry materially, a significant number of tourists would need to stop using these businesses, or other UK alternatives. This change is unlikely to affect demand for holiday accommodation in the UK. We do not expect this change to materially reduce the overall number of holiday accommodation bed-spaces in the UK. Therefore we do not anticipate that this change will have a material impact upon the wider tourism industry.

The impact assessment concluded that withdrawing the FHL rules after a period of notice has the most positive results for stakeholders and government. However, the consultation in 2010 confirmed that:

2.*6 The Government has listened to the views of businesses and the tourism industry and has decided not to proceed with the previous Government's proposal to repeal the special rules for furnished holiday lettings.*

2.7 The Government has rejected a repeal of the special tax rules for furnished holiday lettings rules because of the adverse affect (sic) this would have on UK businesses and the tourism industry. However, the Government has also decided that it would not be fiscally responsible simply to extend the current tax rules to properties situated elsewhere in the EEA, without other changes. That is why it proposes to introduce changes to the qualifying conditions to ensure that properties that are let as a commercial or full-time furnished holiday lettings business will continue to benefit from the favourable tax treatment.

We suggest that in view of the length of time that has elapsed since the 2010 consultation, and as part of a systematic review of tax measures to assess their effectiveness, the current FHL regime should be evaluated by the government against its policy intent to ensure the current policy objectives are fully articulated and evaluated. This is particularly relevant in light of the UK's exit from the EU and any changes to tourism or rental patterns brought about by the pandemic and to ensure the policy is consistent with other policy

[11] https://webarchive.nationalarchives.gov.uk/ukgwa/20140109143644/http://www.hmrc.gov.uk/pbr2009/furnished-holiday-ia-3760.pdf

measures that aim to rebalance the UK housing market and seek to enable home ownership for owner occupiers.

The FHL day counting for availability and actual letting provides a relatively simple approach to determining deemed trading status for the tax privileged regime. However any review could consider whether a better distinction from an ordinary letting activity may be to recognise the letting only to be tax privileged if the accompanying services provided were sufficient to emulate those provided by a hotel or similar noting that HMRC's current practice is to treat hotels and bed and breakfasts as trades (see BIM22001). However even this distinction may not be easy to apply and was questioned in *Julian Nott v HMRC* [2016] UKFTT 106 (TC) as being 'unduly simplistic' (para 89 of the decision). The comparison may also be somewhat outdated given that, in some hotels, services are largely automated.

4.4 **Question 7 Have you encountered any issues as a result of changes in a property's use or ownership, including varying the property ownership percentages?**

Under ITA 2007 section 836, spouses or civil partners living together are assessed on income from jointly held property in the proportion 50:50 ('the 50:50 rule'). FHLs are excluded: see Exceptions D and DA. The rule does not apply to a married couple or civil partners who have separated. If the parties actually hold the beneficial interests in the property as tenants in common in a different proportion it is possible to make a declaration under section 837 on *Form 17: Declaration of beneficial interests in joint property and income.* (We note in passing that it is not possible to save a partially completed Form 17 which is not ideal.)

The 50:50 rule was introduced by Finance Act 1988 section 34 with effect from the tax year 1990/91 as part of the introduction of independent taxation (such that couples would be taxed separately for income tax purposes). The Married Women's Property Act 1882 introduced separate property ownership for married women. Independent taxation therefore accorded with the 1882 Act. However the presumption of entitlement to equal shares was intended to overcome uncertainties in establishing ownership particularly where assets of married couples remained intertwined and determining beneficial interests under property law was complex.

We question whether there is still a need for this deeming provision for income tax purposes 30 years after independent taxation was introduced and 140 years after the Married Women's Property Act. If difficulties in establishing actual ownership remains an issue, consideration might be given to changing to a default position of income tax liability based on actual property ownership shares but with the option to elect for 50:50 .

Unrepresented couples may not be aware of the 50:50 rule or the ability to make a declaration where the property is actually held in different proportions. Unmarried couples who own a property in different proportions may be similarly unaware of the effect of the deeming provision when they get married or enter into a civil partnership. (We note SA105 note Box 3 only refers to a spouse not a civil partner.) It would be useful to understand how many Form 17s are submitted.

The 50:50 rule applies only to married couples or those in a civil partnership which may raise a question of why it should not apply more widely. The 50:50 rule provides a default for married couples which does not apply to unmarried couples and which may in some cases have advantages, for example a property is held in the proportions 90:10, if individual A holding 10% pays income tax at a lower marginal rate than the individual B holding 90%, the attribution of 50% of the rental income to A is favourable. However, in other circumstances it may be disadvantageous (eg if the lower rate taxpayer actually owned the property beneficially but 50% of the rent was deemed to be that of the higher rate taxpayer).

Overall most (but not all) responding members took the view that it would be simpler and better understood by taxpayers if individuals were taxable on the proportion of rental income matching their share of the beneficial ownership in the property. Others preferred to retain the 50:50 rule unless the owners elect for it to be in a different proportion (reflecting beneficial interest) with some modification to the election, for example, requiring the election to be made before the end of the tax year or on acquisition. A reason for retaining the current position might be because where spouses hold the property as joint tenants and the joint tenancy is severed, the legal presumption is that they would each acquire a beneficial interest in 50% of the property. On being or becoming tenants in common, a document, typically a declaration of trust, would stipulate the beneficial interest which each spouse holds in the property. However, we understand it is not uncommon for the title to be registered at HM Land Registry subject to a restriction indicating that the property is held by the joint owners as tenants in common but there is no document declaring the spouses' respective beneficial interests.

5 Operational aspects

5.1 **Question 8 What factors influence the choice between using the cash basis and accruals basis accounting, where rental income is less than £150,000 a year? How well understood are the implications of using each regime and of moving between these regimes?**

The cash basis appears to be well understood in part because it was the basis being used in practice. Anecdotally a property business with profits below the threshold would generally use the cash basis. Only if profits of a new property business are likely to exceed the threshold fairly quickly would businesses be advised to elect for GAAP at the outset and avoid the complexities of the transitional provisions.

5.2 **Question 9 Are there any difficulties with the operation of reliefs and exemptions available to those with property income?**

The deductibility of repair expenditure for let property with an improvement or upgraded element can be an issue in practice. HMRC accepts that some improvements are not capital in nature where technology has advanced so that the modern day equivalent is the industry norm, such as the well known example of replacing single glazed windows with double glazed equivalent windows. The guidance is generally helpful on this question and well understood by tax advisers but consideration might be given to adding further examples to reflect current developments in green technology and changes to EPC ratings for let property requiring landlords to undertake upgrades. For the unrepresented, embedded nudges and prompts in MTD will be helpful in navigating a complex area.

6 Administrative and compliance aspects

6.1 **Question 12 Are you aware of any information being provided by third parties, for example letting agents or platforms to assist landlords in understanding their tax obligations?**

Question 13 Do you think that third parties, such as letting agents, platforms or holiday rental agency businesses, could assist in easing tax administrative burdens and in what ways?

It might be possible for letting agents, platform operators or holiday rental agencies to point to the appropriate guidance on GOV.UK or provide a link to the GOV.UK guidance (perhaps to the 'Landlord and tenant rights and responsibilities in the private rented sector' at https://www.gov.uk/government/publications/landlord-and-tenant-rights-and-responsibilities-in-the-private-rented-sector although oddly currently this guidance has no reference to tax obligations other than council tax). However, we do not think it is reasonable to expect letting agents or platform operators to provide relevant information to their sellers on the detailed tax rules or their obligations not least because they will not be aware of individual circumstances and may be concerned about liability if they provide advice.

Letting agents will usually provide a monthly or quarterly statement, and potentially a yearly summary. The format of these varies from agent to agent. They are likely to include monies received and monies paid out by the agent. Where the Non Resident Landlord Scheme applies the agent will usually record in the statements the tax withheld. Similarly, online platforms will usually provide statements of amounts received, fees, and amounts paid to the landlords nominated account.

However, while these statements will help with preparing tax declarations they do not help landlords to understand their tax obligations. Agents would not have the detailed information needed to understand a landlord's personal circumstances, so they cannot help a landlord to understand their tax obligations.

We note the recently published HMRC research: Income from property: Testing a proof of concept carried out in January/February of 2016. (It is not clear why the original research has only just been published more than six years after it was undertaken.) The research considered a voluntary withholding process for UK resident landlords, whereby a letting agent would administer and collect tax on income from property on their behalf and pass this to HMRC directly, similar to the Non-Resident Landlord Scheme. The idea was rejected by participant landlords mainly because letting agents' area of expertise is property management, rather than tax and there was an unwillingness to provide a letting agent with other personal information in order to determine the correct level of withholding. It was also seen as potentially duplicating the work carried out by a tax adviser where the landlord was already represented - with consequential cost increases. Participating letting agents were less negative but this assumed that any software provided by HMRC would need to be compatible with their own as having to input all data twice would be onerous.

Letting agents in the study indicated that they may signpost clients to the HMRC website instead of directly discussing taxation aspects with clients. Therefore, there may be scope for adding taxation/appropriate links to the existing guidance at: https://www.gov.uk/government/publications/landlord-and-tenant-rights-and-responsibilities-in-the-private-rented-sector and - How to let - GOV.UK https://www.gov.uk/government/publications/how-to-let/how-to-let so that it can be accessed in one place making signposting by letting agents easier.

6.2 **Question 14 To what extent could it be helpful to landlords if letting agents, platforms or holiday rental agents provided data to HMRC on their behalf?**

Letting agents generally provide quarterly statements to landlords showing rental income and expenses for the quarter supported by copy invoices. Reporting this data to HMRC would need to be in a consistent format and would require subsequent categorisation into deductible and non-deductible expenditure if it were to be used for pre-population or for detailed compliance activity by HMRC. Data in this form would not, for example, reflect the application of the deemed 50:50 rule for joint owners or whether the cash/accruals basis has been adopted so would require cross-referencing.

However it might be used by HMRC to write to taxpayers about what taxes the person may need to register for, what the rules are and what the deadlines are for registration. Any such nudges and prompts would need to be carefully worded, and pitched at an educative / guidance level, to build trust with taxpayers rather than cause alarm. HMRC would also need to be confident that the third party data they have received is correct.

6.3 **Question 15 What is your experience of completing a tax return to report property income? Are there any specific areas that cause difficulty?**

Question 16 Are there any other areas of tax administration that present particular challenges in relation to property income?

As we noted in our response to the call for evidence on the Income Tax Self-Assessment registration for the self-employed and landlords, whilst the notification of liability obligation in TMA 1970 section 7 is well understood by tax advisers, we think that the ordinary taxpayer becoming a landlord for the first time will often only recognise the need to 'register' for ITSA to file a self-assessment (SA) tax return, as explained in HMRC's guidance on GOV.UK[12]. Our impression is that new landlords will not approach a tax adviser or accountant until after the end of the tax year when they get around to thinking about the need to prepare accounts and pay tax, and it is only then that it is realised that HMRC need to be notified of a new source of income. Often the adviser will do this on their behalf. We are aware that sometimes property owners simply do not realise they need to register for tax and instead they wait for HMRC to contact them (sometimes for many years).

It may be possible for intermediaries such as letting/estate agents or business insurance providers to signpost the need to register and notify liability by providing a link to GOV.UK, perhaps to an enhanced 'Landlord and tenant rights and responsibilities in the private rented sector' that covers tax obligations.

We wonder if taxpayers may need to be reminded periodically of the property allowance limit to ensure they take necessary action where their property income exceeds the £1000 limit.

Question 17 Making Tax Digital for Income Tax starts in April 2024 and mandates quarterly electronic updates for most individuals with turnover of over £10,000 for their property (and business) income. Are you aware of these reporting obligations and have you considered how you might comply with them?

Question 18 Are there any other practical, technical and administrative issues in relation to property income that are not mentioned above?

Although question 17 is not directed at our members, who are very aware of MTD for income tax, we are concerned about lack of awareness particularly among 'accidental' landlords (a landlord who did not acquire the property with a view to letting, for example on inheritance or because of the inability to sell a former residence following a change in circumstances) or landlords holding only one property. Anecdotally members report that even those landlords who are aware may have put off preparation when MTD was deferred in 2021. Lack of awareness features in the recently published HMRC commissioned research: Income Tax Self-Assessment: Readiness for Making Tax Digital[13].

[12] https://www.gov.uk/self-assessment-tax-returns/who-must-send-a-tax-return
[13] https://www.gov.uk/government/publications/income-tax-self-assessment-readiness-for-making-tax-digital?utm_medium=email&utm_campaign=govuk-notifications-topic&utm_source=4b9057da-5b0d-47a6-9b1d-6104bc2b02b1&utm_content=daily

It is unclear how jointly owned property (that is, not a partnership) needs to be reported, will two sets of records and two updates be required, or one set with the updates for each owner reporting their share?

Even those who are broadly aware that MTD is on the horizon may not understand the interactions between the mandated £10,000 MTD threshold and rent a room receipts below the £7,500 threshold or property income below the £1,000 allowance level, neither of which will be taken into account on the basis that they are not included in the SA return although the position is not straightforward as the Low Income Tax Reform Group note in their response to this review. They may also not understand that it is necessary to declare property income below £10,000 if they have other income within the scope of MTD that, either with the addition of the property income, or in its own right, is above £10,000.

As quarterly returns have to be submitted on a business-by-business basis, a self-employed individual who owns a buy-to-let property will have eight quarterly updates, two end of period statements, and a final declaration to submit (as compared to a single self-assessment tax return under the existing regime). The position is further exacerbated for other businesses with a diversified portfolio, such as farming. While the process for submitting quarterly updates is expected to be straight-forward, the requirement to meet an increased number of reporting deadlines will inevitably put pressure on those affected.

We suspect a likely source of error in MTD may be landlords declaring net rather than gross rental income (including where a non-resident landlord receives rental income net of deduction of tax by the tenant) particularly if this information is not clear from letting statements.

7 Non-UK aspects

Question 19 Are there any particular issues of concern to non-resident landlords or their tenants (including in relation to the Non-Residents Landlord Scheme)?

Question 20 Do any particular issues arise for UK residents receiving rental income from overseas?

A landlord whose usual place of abode (rather than a person who is not tax resident in the UK see ITA 2007 section 971(2)) is outside the UK rents out a UK property the agent, or if no agent the tenant, must withhold tax[14] at the basic rate and account to HMRC for it quarterly unless the property owner has applied to receive income gross. In the less common situation where there is no letting agent, a third party tenant wholly unconnected to the non-resident landlord may have no knowledge, or means of establishing that deduction of tax is required.

We suspect that few tenants, especially those who have no connection with the landlord beyond that of the landlord/tenant relationship, are likely to become aware of these obligations. It is difficult to see, in practical terms, how they might become aware that these obligations exist – and in some cases they may not even know whether their landlord is non-resident or not. The GOV.UK guidance on 'Landlord and tenant rights and responsibilities in the private rented sector' at https://www.gov.uk/government/publications/landlord-and-tenant-rights-and-responsibilities-in-the-private-rented-sector makes no reference to the tax obligations of tenants (except for council tax).

[14] Subject to a de minimis of an annual rent of £5,200 or less

There is guidance on GOV.UK for Paying tax on rent to landlords abroad. However, there is nothing to alert a tenant to that guidance. (It was last published in December 2014.) In 2019 HMRC issued 'nudge' letters on NRL compliance.

One relatively common situation in which this situation might occur is where a property owner lets a room or rooms in their house to a lodger or via Airbnb and goes abroad travelling for a short period. HMRC's guidance at https://www.gov.uk/tax-uk-income-live-abroad/rent indicates that:

If you live abroad for 6 months or more per year, you're classed as a 'non-resident landlord' by HM Revenue and Customs (HMRC) - even if you're a UK resident for tax purposes.

The fact that the Non-resident Landlords (NRL) Scheme is based on a test of 'usual place of abode' rather than the Statutory Residence Test (SRT) for income tax and CGT is a potential source of confusion. However, the SRT is a backward looking test whereas the need to deduct tax at source is an 'in-year' test so that may explain the need for a different test.

7.1 We are aware that there are problems registering non-resident landlords for ITSA (which includes forms SA1, NRL1 and 64-8). Often registration is done on paper because activation codes (eg for client authorisations) have frequently expired before they reach the client overseas. We understand that some of the delays recently experienced with the processing of the forms by HMRC have been caused by the COVID-19 pandemic, but we also heard of delays prior to the pandemic.

7.2 When agents enquire as to progress HMRC are unable to trace any SA1 because it does not show a UTR (because one has not been issued) and in most non-resident cases there is no NI number. This means there are non-residents wanting to file UK tax returns and pay UK tax and they cannot do so because HMRC are apparently unable to register them on a timely basis.

Many UK residents with overseas property income do not understand what is declarable to the UK authorities – often resulting in nothing being declared - and what deductions can be made for taxes paid overseas. Often no income tax equivalent is reported overseas as they are unaware of the requirements in overseas states. However, many overseas states have local property taxes, and it is often unclear what are deductible as an expense for UK tax purposes and which are not, and which are deductible as a tax credit against UK income tax or UK CGT. They also do not understand how to calculate income and expenses for UK tax purposes (what exchange rates to use etc). Also, the difference between the UK tax year and the tax year of the overseas state (more often than not the calendar year) presents problems for knowing what should be accounted for, and when, in the UK.

8 Acknowledgement of submission

8.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the call for evidence is published.

The Chartered Institute of Taxation

1 June 2022