Office of Tax Simplification (OTS): Property income review – call for evidence
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We welcome the opportunity to provide input into this call for evidence on simplifying the taxation of property income.

1.2 We hope that in this submission we are able to provide some helpful insight and evidence from the perspective of lower income and/or unrepresented taxpayers on various aspects of the current system of taxing property income, including its administration.

1.3 Typically, landlords who tend to fall within LITRG's remit are often referred to as 'accidental landlords'. By this we mean those who have not necessarily made an active decision to build a property rental portfolio, but are in receipt of property income out of necessity (perhaps to supplement their income), or as a result of external factors (such as relocating and deciding to rent a former main residence rather than sell).

1.4 The tax system can be daunting for unrepresented taxpayers, and this can be seen at various stages. For instance, whether a taxpayer is required to register for Self Assessment can be unclear based on the guidance available on GOV.UK.

1.5 We have received queries that demonstrate the worry and confusion some taxpayers feel when navigating the UK tax system without an agent. This is likely fuelled by a lack of clear (yet suitably detailed) guidance, which can put unrepresented taxpayers at a disadvantage.

1.6 By 'disadvantage' we mean not only as regards making use of reliefs and claiming all relevant expenses, but also in terms of ensuring their submissions are free from errors that could give rise to HMRC enquiries and penalties for incorrect submissions.

1.7 The disadvantages suffered by the unrepresented may be more prominent in cases where the tax system is designed to be more favourable in certain circumstances; the Furnished Holiday Let regime being one example of this. In this case, a lack of taxpayer awareness of the potential advantages of letting under the scheme could lead to further distortion in tax liabilities between those who are unrepresented and those able to pay for advice.

1.8 In our experience, the information and letting data provided to taxpayers by letting agents can vary greatly. We do not offer any specific recommendation as to whether letting agents should or could

be involved more with providing guidance to taxpayers on tax obligations, or indeed whether they should be a withholding agent for taxpayers generally. If a broad system of withholding tax were to be introduced, there is a risk that some unrepresented taxpayers could place too much reliance on letting agents and this could lead to further instances of non-compliance or incorrect submissions.

1.9 We suspect that awareness of upcoming MTD requirements amongst unrepresented taxpayers is low, and at any rate think it likely that some unrepresented landlords will put off preparations for MTD for as long as possible. To maximise compliance, HMRC must make a significant effort to reach and educate these taxpayers effectively.

1.10 From our experience, we understand that it is common for older taxpayers to be in receipt of rental income, and we would encourage HMRC to remain alive to the fact some of these taxpayers may struggle digitally. They must continue to be supported and provided with alternative non-digital methods to remain compliant.

1.11 As regards the overseas issues for unrepresented landlords, we feel that understanding of the non-resident landlord scheme is low, particularly where there is no letting agent involved, and particularly by tenants who may have an obligation to withhold tax from rental payments.

1.12 There is also a general lack of understanding, particularly among migrants, that income from overseas property is taxable in the UK, even though tax may have already been reported and paid overseas.

1.13 The complications are further exacerbated by the rules for non-domiciled individuals, the rules for which are notoriously complex. It is almost impossible to imagine a regular migrant taxpayer (perhaps where English is not their first language) being able to confidently understand and correctly navigate this area of the UK tax system without professional advice.

2 About Us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

3.1 We welcome the opportunity to feed into the OTS's review of property income and are pleased to be able to offer our input. The call for evidence sets out 20 questions in four broad areas in relation to property income:

- structural,
- operational,
- administrative and compliance, and
- non-UK aspects.

3.2 We have commented only on questions that we feel are relevant to LITRG's audience, which is taxpayers who are unable to afford professional advice. We generally refer to these taxpayers as 'unrepresented taxpayers' throughout this document.

3.3 Generally speaking, the views contained within this document have been formed from our collective experience, by which we mean:

- Dealing with queries that are received from the general public via our website.[1]
- The experiences of LITRG staff and panel members from working in practice either before or alongside their work with LITRG,
- The experiences of LITRG staff and panel members in a volunteering capacity for the tax charities.[2]
- Anecdotal evidence fed into us by the tax charities directly.

3.4 We think it is important to debunk the myth that those in receipt of property income are necessarily wealthy. For instance, there are some scenarios where an individual on a lower income might be in receipt of rental income and could be considered an 'accidental landlord':

- Having inherited property
- Having decided to retain and let their former main residence when taking up co-habitation with a partner
- Having decided to retain and let their former main residence when relocating for work and moving into rented accommodation in their new location, whether on a short or long-term basis. Often in these instances the property income from the former main residence is then used to meet the cost of renting the new main residence.
- Letting a spare room in their home to supplement household income.
- Moving in with family members and letting their former home they own if it becomes unaffordable for them.

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[1] www.litrg.org.uk. We do not provide specific casework, but signpost taxpayers to relevant guidance and resources.

[2] References to the tax charities refer to TaxAid and Tax Help for Older People.

- Older taxpayers letting property to supplement their retirement income.
- Older taxpayers having moved into residential care and letting out their former main residence to supplement their care costs.

3.5 HMRC will need to bear in mind the digital capability of taxpayers, including some older taxpayers, particularly in the context of MTD. A recent briefing paper[3] prepared by Age UK includes research of older taxpayers in England and their internet usage following the Covid-19 pandemic. The study found that regular internet usage is still much lower in the over 75 age group.

3.6 Unrepresented taxpayers in receipt of property income may make incorrect assumptions about their liability to tax. For example, in our experience with Let Property Campaign disclosures or other forms of disclosure, we have observed the following misconceptions:

- Taxpayers assuming that if they do not make a 'profit' then they do not have a duty to register and report rental income.
- Taxpayers misunderstanding how to calculate that 'profit' in the first place – in particular, assuming that they are able to deduct their mortgage repayments in full, or not appreciating the distinction between capital and revenue expenditure.
- Some taxpayers may be under the impression that Self Assessment is only for those carrying on a business rather than a letting activity.

3.7 For taxpayers who are outside of the Self Assessment system when their letting commences, even if they suspect that they may need to declare their income, they may lack confidence to engage with HMRC.

3.8 A recent query received highlights this lack of confidence and understanding of what needs to be done for a taxpayer who has (it appears) previously only paid tax under PAYE:

> *Hi I am really struggling and worrying what to do regarding tax. I don't want to end up with a big bill or fine. I have rented out my property since October 2019 at £575 a month before Agent fees. My monthly wage from my employer is £1300. I had some repair work done on the house also costing up to £1300 So a) Would I have tax to pay from this? b) If so where do I even begin as I am completely lost. Are there forms to fill in?*[4]

3.9 The fact that the above individual says that they are "struggling and worrying" is concerning. This query is, in our experience, fairly typical, and suggests that there are taxpayers who recognise the difficulty they find themselves in but feel helpless as to how to deal with the situation.

[3] https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/active-communities/digital-inclusion-in-the-pandemic-final-march-2021.pdf

[4] Query received September 2020.

3.10 A further query received to our website:

> *I am a retired woman living [overseas]. My only income is from a small rental property in [the UK]. What tax forms do I fill out? Self Assessment but I'm not a business.*[5]

3.11 It is not clear from the query whether the lady in question had tried (and failed) to find and understand HMRC guidance to answer the question before approaching LITRG. However, the query does suggest a fundamental misunderstanding that Self Assessment is only for "businesses".

4 Structural aspects

4.1 ***Q1: Do any particular issues arise as a result of the difference in the tax treatment of property income and income from other investments, such as OEICs or quoted shares?***

4.1.1 For unrepresented taxpayers, we do not have evidence to suggest that there are particular issues arising as a result of the difference in tax treatment between property income and other investments. See our comments below related to investment choice for such taxpayers.

4.2 ***Q2: Does the existence of different regimes for taxing property income and other income from investments lead to any distortions in behaviour?***

4.2.1 The unrepresented taxpayers falling within LITRG's remit will typically (though not always) have lower capital wealth in addition to being of lower income. This being the case, these unrepresented taxpayers are less likely to be in a position where they would face an investment choice which could be open to distortion. It is also likely that without professional advice, the unrepresented taxpayer would be less like to have an awareness of what investment options are available.

4.2.2 Unrepresented taxpayers who are in receipt of property income are more likely to have become 'accidental landlords', as set out in paragraph 3.4 above. Consequently, the decision to rent out property is likely to have been driven by necessity or opportunity rather than by any regard for the tax system and how different income streams are taxed.

4.2.3 The favourable regime under the Furnished Holiday Let (FHL) rules is perhaps less likely to be a behaviour driver for unrepresented taxpayers, due to a lack of awareness of the tax benefits of this form of letting activity. For instance, an unrepresented taxpayer may not be aware that by letting the property within the parameters of the FHL regime they will potentially be able to access a more favourable rate of capital gains tax (through business asset disposal relief) on the disposal of the property.

4.2.4 Furthermore, an unrepresented taxpayer may not be aware that there is a difference between the income tax rules for FHLs and other let property.

[5] Query received January 2020.

4.2.5 That is not to say some unrepresented taxpayers do not make use of the FHL regime. For example, it could well be argued that some on lower incomes will have a higher regard for rental return than for capital growth and will be willing to undertake the additional work required to let the property as a holiday property, to take advantage of higher pre-tax yields. The tax advantages might be incidental, rather than the objective.

4.2.6 Of course, the above depends on the location and overall suitability of the property in question to be used as an FHL. A property suitable for use as a FHL is likely to be a higher quality property with a higher capital value and this, perhaps, is less likely to arise under the 'accidental landlord' scenarios described above.

4.2.7 In summary, property income is unlikely to be received by unrepresented taxpayers as a targeted investment choice. We would expect that there are some lower-income landlords who let properties as holiday lets, where they have a suitable dwelling. However, it is less likely to be driven by the favourable tax rules as it is for the increased pre-tax yields that tend to be available for this sort of letting activity.

4.3 ***Q3: 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?***

4.3.1 We feel it is positive that the trading allowance and the property allowance are separate allowances. This means, for example, that a self-employed individual with a small amount of property income 'on the side' can still benefit from the property allowance. Those on lower incomes are most likely to make use of these reliefs and it can provide a fairly straightforward way of declaring their rental and/or trading income or, in some cases, can remove the need to declare the income altogether.

4.3.2 In addition, the 'rent-a-room' scheme provides greater relief and, though data is not available[6] as regards the level of usage, this is likely to have a wide up-take for lower income taxpayers receiving rental income. The ability to let a room in one's home to supplement income on a tax-free basis (subject to the rent-a-room limit) is undoubtedly valuable to unrepresented taxpayers. If the allowance were to be withdrawn or did not exist, then this could easily be an area of non-compliance amongst taxpayers.

4.3.3 While on the subject of rent-a-room relief, we would point out that, as mentioned in our paper 'A better deal for the low-income taxpayer'[7] , we feel that in order for the tax system to remain fair and to prevent fiscal drag, there ought to be some form of annual uprating of this threshold.

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[6] See 'Rent a room relief: summary of responses' to the call for evidence by HM Treasury, July 2018. Paragraphs 2.4 et seq. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/723126/rent_a_room_relief_summary_of_responses_web.pdf

[7] https://www.litrg.org.uk/latest-news/reports/201204-better-deal-low-income-taxpayer

4.3.4 It is our experience, the differing loss relief rules for trading income and property income can cause some confusion amongst taxpayers. An example can be seen in the following query we received:

> *I have a flat which I rent out. This is in [location supplied], whereas I live in [location supplied]. I also have income from being… self-employed…. I usually make a slight profit from the flat, and a loss from [self-employment]. Am I allowed to offset one against the other? My old accountant did allow this, I think, but my new accountant doesn't. He says that they need to be treated as two separate businesses. I have looked online, but can't find a definitive answer. I'd be very grateful for your thoughts.*[8]

4.3.5 The fact that this taxpayer does not feel confident in finding the answer to what ought to be a fairly straightforward scenario (and is being assisted by an agent) suggests that the rules, or at least the guidance, are not readily understandable.

4.4 ***Q5: What are the benefits and drawbacks of having a different regime for taxing property income and capital gains from Furnished Holiday Lettings?***

4.4.1 The operation of a qualifying FHL activity usually requires more active involvement and it is sensible that this is reflected in the tax treatment. On the other hand, the differing treatment between ordinary rental activity and FHL activity does mean added complexity.

4.4.2 When dealing with FHLs, there are difficulties that can also arise in the opening years, particularly in the case of capital allowance claims.

4.4.3 For example, if a taxpayer acquires a property for use as a FHL, they may incur significant expenditure qualifying for capital allowances, such as the embedded fixtures and fittings within the property (perhaps subject to a s198 election[9] if the property was previously used as a FHL), as well as the furnishings and other 'plant' required to bring the property up to a fully furnished standard.

4.4.4 The taxpayer in question may commence letting and make the property available for letting in the first twelve months, comfortably meeting the 'availability' requirements of the FHL regime. However, it is conceivable that a FHL business may not meet the 'days actually let' in year one, when the letting business is getting established and before repeat bookings can bolster the day count.

4.4.5 Where a holiday let does not meet the strict letting conditions in year one, there is no mechanism for annual investment allowances (AIAs) to be claimed on the potentially large amount of

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[8] The answer to the above query is further complicated by matters such as whether the trade in question is a genuine trade or a hobby (the trade described in the original query could be considered a hobby in its nature), and whether it is conducted on a cash accounting basis. Clearly these added complications relate to the trading income rules rather than property income rules, but it is a useful example of the way in which a person with a seemingly simple set of circumstances can be faced with complex interactions.

[9] s198 CAA 2001 – an election under this section fixes that value of fixtures attributable to a building between the buyer and the seller, where capital allowances have previously been claimed.

expenditure incurred to fully furnish the house initially or on the furnishings/appliances/integral features included within the purchase of the dwelling.

4.4.6 Once the letting business is established, complications can still arise in terms of those properties subsequently falling outside of the FHL regime. For example, if an established FHL property does not meet the occupation conditions for a number of tax years, and does not otherwise qualify under the period of grace[10] or averaging rules[11], then, the taxpayer will be in a position where they will need to calculate balancing allowances or balancing charges, before subsequently reintroducing these costs if and when the property begins to qualify again in the future.

4.4.7 This possibility that properties can transition between two taxing regimes creates added complexity that an unrepresented taxpayer may not feel confident to navigate, or even have a basic awareness of. It seems to us that the complexity of the FHL regime may leave unrepresented taxpayers at a disadvantage.

4.4.8 Furthermore, it is perhaps not clear cut when a letting activity can be considered a genuine trade in its own right, as opposed to merely a letting activity which happens to meet the conditions of a FHL – for example, where the level of additional services provided are extensive, akin to a holiday resort. Over the last decade or so there have been tax cases that have raised the issue of the availability of business property relief for inheritance tax purposes in the context of holiday let properties, notably *Pawson*[12], *Green*[13] and *Graham*[14]. However, the distinction remains unclear.

4.4.9 This lack of clarity as to when a FHL activity becomes a genuine trade is less likely to affect unrepresented taxpayers and therefore we do not explore this point further, though we do feel a greater level of clarity would be useful.

4.4.10 As regards capital gains advantages of operating as a FHL, clearly the availability of business asset disposal relief is attractive, though we do not expect many unrepresented taxpayers are aware of this and this lack of awareness could result in taxpayers missing out on relief to which they are

[10] Under s 326A ITTOIA 2005 a 'period of grace' election enables a property to be treated as an FHL even if the letting condition was not met. The election can be made provided the landlord did genuinely intend to let the property for the required number of days, and the property met the letting condition in the preceding year or a qualifying period of grace election was made in the previous year. The election can only be made for two consecutive years.

[11] Under s 326 ITTOIA 2005, an averaging election can be used where a landlord lets more than one property as a FHL. If one property exceeds the letting condition, but another does not meet the letting condition, the average rate of occupancy across the properties can be applied instead.

[12] Pawson deceased v HMRC[2013] UKUT 50(TCC)

[13] Green v HMRC [2015] UKFTT 334 (TC)

[14] Graham (Personal Representatives of Grace Joyce Graham) v HMRC [2018] UKFTT 306 (TC)

entitled. Since this call for evidence is focussed on property income rather than capital gains we will not explore this further.

4.5 ***Q6: To what extent do those owning property taxed under the Furnished Holiday Lettings regime use the property themselves?***

4.5.1 Depending on the nature of the property, we would expect it to be very common that a FHL property is used by the owner or by their family/friends at some point during the year. From our experience this is more likely to be the case where there is a property located away from the primary residence of the owner. If the property is located nearby or adjacent to the owner then we might expect it to occasionally be used as overflow accommodation for family and friends.

4.5.2 Where there is private usage of this kind, unrepresented taxpayers may have difficulty in understanding their obligation to restrict certain costs for the private use element.

4.5.3 In addition, the published guidance on what expenses ought to be restricted is limited: HMRC Helpsheet HS253[15] makes only a brief reference to private use restrictions. The notes to SA105[16] does mention that a restriction is required, providing the example of insurance costs, but does not further extend this explanation in the context of other costs that may *not* require restriction. For example, costs of cleaning the property and 'change over', which may not be incurred where there has been a private use stay.

4.6 ***Q7: Have you encountered any issues as a result of changes in a property's use or ownership, including varying the property ownership percentages?***

4.6.1 The different treatment between spouses or civil partners and unmarried joint owners is confusing and counter-intuitive[17]. For example, unmarried tenants in common are placed in a more flexible position in terms of opportunity to split their rental income in a tax efficient manner.

4.6.2 Notwithstanding this skew in treatment, unrepresented taxpayers might be disadvantaged due to not understanding the flexibility available to them, regardless of whether they are married or in a civil partnership.

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[15] https://www.gov.uk/government/publications/furnished-holiday-lettings-hs253-self-assessment-helpsheet/hs253-furnished-holiday-lettings-2020

[16] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1062907/SA105_2022__1_.pdf

[17] Under s836 ITA 2007, those who are married or in a civil partnership (and live together) are, by default treated as entitled to income from jointly held property equally, regardless of actual beneficial interest.

4.6.3 A couple who are married or in a civil partnership who own a property as tenants in common in unequal proportions might well assume that their property income can be split in line with their actual beneficial interests without needing to submit a form 17.[18]

4.6.4 The operation of form 17 and the requirement to submit these within 60 days of signature can also be misunderstood and cause confusion with taxpayers and agents alike.[19] If taxpayers are not aware of the form 17 requirements, then there is opportunity for income to be declared incorrectly. As a consequence of the 60 day time limit to submit form 17, any subsequent attempt to rectify matters cannot apply retrospectively, potentially leading to penalties and interest for the taxpayer.

4.6.5 A further point that may add confusion for taxpayers is that the deemed 50:50 income split for spouses/civil partners only applies for income tax purposes. The treatment for capital gains tax and inheritance tax remains in line with beneficial interest, which could add further confusion to taxpayer understanding.

5 Operational aspects

5.1 ***Q8: 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?***

5.1.1 The default cash basis is conceptually easier for taxpayers to understand. We suspect many unrepresented taxpayers will not make a conscious choice to use the cash basis but will simply do so as they do not have an understanding of the accruals basis of accounting.

5.1.2 We do not expect that many unrepresented taxpayers will be aware of the ability to transfer between the regimes and the implications of doing so.

5.2 ***Q9: Are there any difficulties with the operation of reliefs and exemptions available to those with property income?***

5.2.1 One of the most difficult concepts that unrepresented taxpayers contend with is the restriction for finance costs. For landlords who are unfamiliar with the rules, so perhaps those who have only recently started to receive property income it will be surprising to them that they cannot simply deduct their full mortgage outgoing (including the capital element), let alone that the interest too is restricted (albeit with the tax reducer deduction given at basic rate).

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[18] https://www.gov.uk/government/publications/income-tax-declaration-of-beneficial-interests-in-joint-property-and-income-17

[19] Performing a search on AccountingWeb 'Any Answers' section for "Form 17", this is a discussion topic that is raised regularly, with queries posed by both taxpayers and agents. The search functionality is limited so we have not been able to perform an accurate count. A search preformed on HMRC Community Forums similarly brought up many queries related to jointly owned property where the term "form 17" was referenced.

5.2.2 Although when the finance restrictions were devised it was, in theory, expected that basic rate taxpayers would not be adversely affected. However, the mechanism of the relief increases the top-line taxable value of the property income, which in turn can place taxpayers of all income levels at a disadvantage, due to the interactions with student loan repayments,[20] means-tested benefits, the savings rate band and married couple's personal allowances. An example of this can be seen in the following query received via our website:

> *I'm a landlord, a lower rate tax payer, and I also have student loans plan 1. With the recent tax changes on mortgage interest as an expense, my tax should not have changed, BUT, I am paying considerably more student loan, without having earned the appropriate income. Eg. I'm jumping from student loans being assessed at £20k (near my actual overall income) to around £30k (the amount less mortgage interest expense, which is used for the student loan calculation). As a result I'm paying around £1,000 more in student loan, having earned no additional income to justify that.*[21]

5.2.3 The distinction between capital and revenue expenditure is often misunderstood, and for the unrepresented taxpayer, we suspect is an area where there is a large amount of error – both for and against the taxpayer.

5.2.4 Particular areas that are counter intuitive and, we feel, are easy for unrepresented taxpayers to get wrong include:

- Furnishing a non FHL rental property – if the property is to be entirely furnished then the initial purchase of items of furniture does not attract relief any form of relief. Only on the subsequent replacement of such items would the expenses be deductible as a revenue expense. The treatment of the initial purchase is not, in our experience, well understood by taxpayers and it is likely that those who are not represented will assume that the cost of furnishing the property can be deducted from rental income.

- Where a property is renovated and the works consist of a mixture of capital and revenue expenditure, unrepresented taxpayers may struggle to have a clear understanding of how different types of expenditure should be categorised. For example, a replacement kitchen to a similar but albeit more modern standard is considered revenue expenditure. However, if any additional units, or for example, a kitchen island is added, then this element would be a capital improvement. Therefore, the cost of the kitchen strictly ought to be split between the cost of replacing and the cost of adding the new units.

- Where a property is acquired in a dilapidated state, the entire cost of preparing the property for letting would be considered capital even if, on an elemental level, certain parts of the expenditure would be considered a repair and therefore revenue in nature.

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[20] See Tax Adviser Article prepared by LITRG: https://www.taxadvisermagazine.com/article/student-loan-repayments-and-finance-cost-relief-residential-landlords

[21] Query received April 2019.

5.2.5 The above areas are complex and we feel the public facing guidance available on GOV.UK does not provide sufficient detail for unrepresented taxpayers. In order to obtain more meaningful guidance on such issues, taxpayers would need to access HMRC Property Income Manual[22] or the Property Rental Toolkit[23], neither of which are written with lay taxpayers in mind.

5.2.6 In summary, our main concern for unrepresented taxpayers in receipt of property income is that guidance available that is specifically written for the general public is lacking in detail, and can leave taxpayers feeling confused, frustrated, or may simply lead to incorrect submissions.

5.3 ***Q10: Have you encountered any difficulties in understanding the rules about, or the tax processes involved in, becoming or being a landlord, including HMRC's information and registration requirements?***

5.3.1 In our view the reporting thresholds in relation to property income are certainly not well understood, in no small part because they are not explained clearly on GOV.UK and there is a complex interaction between the property allowance, a non-statutory Self Assessment reporting threshold, and the personal allowance. GOV.UK states[24]:

Property you personally own

The first £1,000 of your income from property rental is tax-free. This is your 'property allowance'.

Contact HMRC if your income from property rental is between £1,000 and £2,500 a year.

You must report it on a Self Assessment tax return if it's:

- £2,500 to £9,999 after allowable expenses
- £10,000 or more before allowable expenses

5.3.2 This guidance is not clear that the 'income' which is tested against the property allowance should be the figure before allowable expenses. The position is further confused by the non-statutory profits threshold of £2,500 (that is the figure after allowable expenses), below which the tax on the income may be collected outside of Self Assessment. The sentence 'Contact HMRC if your income from property rental is between £1,000 and £2,500' uses the word 'income' in both senses simultaneously (that is gross rental income and net profit after expenses). Finally, it is not clear that the logical connection between the final two bullets is 'or' rather than 'and'.

5.3.3 For example, if someone has gross property income of £12,000 and expenses of £11,500, they may conclude from reading the guidance on GOV.UK that they do not need to report the income to HMRC or pay tax on it because their 'income' is only £500 and it is therefore covered by the property

[22] https://www.gov.uk/hmrc-internal-manuals/property-income-manual/pim2030

[23] https://www.gov.uk/government/publications/hmrc-property-rental-toolkit

[24] https://www.gov.uk/renting-out-a-property/paying-tax

allowance. If they had any doubt on what 'income' meant, they might conclude that it referred to amounts after allowable expenses by reading how it has been used in the context of the £2,500 threshold. Their mistaken assumption is then apparently confirmed when they continue reading; they do not consider that they fall in the circumstances where they need to contact HMRC about the income or to report it on a Self Assessment tax return – although gross income exceeds £10,000, they think (again, incorrectly) that they need to meet both conditions to trigger the requirement.

5.3.4 When these thresholds are considered alongside the personal allowance, the confusion steps up a gear. If they exceed the reporting thresholds as described on GOV.UK (having understood them correctly) but they have no tax liability on the income because their total taxable income for the year is within their personal allowance, then it is arguable that they have no liability to notify under Section 7 TMA 1970 (provided they have no other reason to do so). This does not sit well with the imperative 'You must report it on a Self Assessment tax return…'. As explained in our response on the recent Income Tax Self-Assessment registration consultation[25], this is an area that lacks clarity and the differing positions (HMRC guidance and the legislation) are confusing and lead to taxpayer uncertainty.

5.3.5 The complexity is set to acquire an additional dimension with the introduction of the £10,000 turnover threshold under MTD for Income Tax, for which one must additionally consider any gross trading income in combination with gross property income to see if the figure is exceeded and MTD reporting requirements are triggered.

5.3.6 Unfortunately, it is precisely low-income taxpayers who may not be able to afford representation who face having to make sense of this multitude of different interactions at the lower end – others who are very clearly earning in excess of all the relevant thresholds from their property income will generally assume, quite correctly, that the property income simply needs to be reported and taxed under Self Assessment. Clearer guidance, that ensures the registration requirements align with the legislation requiring notification, is therefore required at a minimum, but simplification would be welcome.

5.4 ***Q11: Do you have difficulties in finding out, getting guidance about or understanding how your property income should be taxed?***

5.4.1 Our comments in paragraphs 3.6 – 3.11 outline our thoughts on this point, but to reiterate, it is our feeling that unrepresented taxpayers, particularly those who are digitally challenged or less confident in navigating the tax system can have difficulty in understanding what is required of them.

5.4.2 Looking forward to the introduction of MTD for ITSA, these difficulties could be exacerbated which could cause distress to taxpayers.

[25] See https://www.litrg.org.uk/sites/default/files/220322%20LITRG%20response%20ITSA%20registration%20for%20the%20self-employed%20and%20landlords.pdf paragraphs 4.3.1 onwards.

6 Administrative and compliance aspects

6.1 ***Q12: 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?***

6.1.1 We suspect that some letting agents or platforms may provide some basic guidance to assist landlords in understanding their tax obligations.[26] We would think it unlikely, however, that letting agents would look to provide much beyond this.

6.1.2 We feel it will be important for the OTS to engage directly with letting agents on this point.

6.2 ***Q13: 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?***

6.2.1 It is our experience that the information provided by letting agents to landlords (for example, monthly letting statements) can vary a great deal, and there generally appears to be no standard format. While we do not expect the agent to categorise expenditure for tax purposes, it does seem that some landlords may be at a disadvantage (and not necessarily realise it) if the information provided by their agent of choice is not laid out in a way that is clear, with expenses easy to identify. In particular, it may be unclear what expenses have been set against the monthly rental collections and how these should be categorised.

6.2.2 We have heard anecdotally of a letting agent that simply provides a single figure for 'tax deductible expenses' in the tax year end statement without any description or breakdown of what these might be. It seems unlikely that the agent in question would have undertaken sufficient analysis to be able to say with absolute confidence what expenses are allowable. Even if they had, not providing a breakdown does not allow the taxpayer to easily do their own due diligence in ensuring the deductions are valid and would be deductible to the best of their knowledge and belief.

6.2.3 It is also possible that where invoices are provided to the landlord in addition to the rental statements double counting of expenses occurs when the taxpayer prepares their own tax return and is not aware that the invoices simply back up what is within the rental statement.

6.2.4 Therefore, the improved guidance to letting agents, setting out best practice for the purposes of rental statements may be worth exploring. However, agents might be resistant to change if they already have embedded processes and software solutions.

6.3 ***Q14: To what extent could it be helpful to landlords if letting agents, platforms or holiday rental agents provided data to HMRC on their behalf?***

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[26] For example, see https://chilterns.co/regulations. This agent provides some basic information on its website about tax obligations. We would point out, however, that the information provided by this agent could be considered a little misleading. For example, reading the information on the non-resident landlord scheme (NRLS) suggests that the landlord does not have any legal obligation to pay any tax on NRLS income. It doesn't clarify that the landlord still has a personal obligation to report the income under SA and is still personally responsible for settling the ultimate liability on the income after deducting amounts withheld at source.

6.3.1 Though this may be helpful, it is our view that this would need to be accompanied by an easy and robust mechanism for the taxpayer of rectifying errors. Thought would also need to be given as to whether taxpayers should be able to 'opt out' from being taxed at source – though we suspect that given the option, many would opt out.

6.3.2 We also would query whether letting agents would have the resources or inclination to be involved in this way, in addition to other core services offered. If letting agents and platforms were legally required to provide data to HMRC, perhaps similar to RTI, this increased administrative burden may well culminate in increased letting agency fees for the end-user landlord (or indeed increased rental costs for tenants). There would also surely need to be sufficient evidence of existing non-compliance to warrant the cost of implementing such a system – for HMRC/agents and the taxpayer.

6.3.3 There may also be expenses incurred directly by the landlord (for example, insurance costs) that could be missed if the landlord places too much reliance on the letting agent's data.

6.3.4 We are aware that HMRC has recently published a report 'Income from property: Testing a proof of concept'[27]. This report explores the possibility of property agents withholding tax from rental receipts by landlords, loosely based on the non-resident landlord scheme.

6.3.5 The findings of the report suggests that landlords are largely unsupportive of such a system of withholding tax. Various reasons are cited, but lack of taxpayer trust appears to be a key theme as well as concerns about tax privacy. The possibility of additional administration costs was also raised, and this is likely to be a key factor for lower income taxpayers who would wish to preserve their rental yields as far as possible.

6.4 ***Q15: What is your experience of completing a tax return to report property income? Are there any specific areas that cause difficulty?***

6.4.1 The need for UK FHLs and EEA FHLs to be declared on separate SA105s strikes us as an oddity, it would seem reasonable to expect that, even if it is desired that UK and EEA FHLs are treated as separate businesses, that the reporting of the two separate businesses can be done on a single SA105.

6.4.2 The ability of landlords with total gross property income of less than £85,000 to enter a single figure for expenses in box 29 of the SA105 is certainly straightforward for taxpayers, though we do have concern that this can lead to errors.

6.4.3 Further we think it rather unhelpful that the SA105 guidance notes provided by HMRC[28] go on to say:

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[27] https://www.gov.uk/government/publications/income-from-property-testing-a-proof-of-concept/income-from-property-testing-a-proof-of-concept

[28] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1062908/SA105_Notes_2022__1_.pdf

If you're not sure how to work out the amount to put in box 29, ask your tax adviser.[29]

HMRC are sending the message that it is almost expected that all taxpayers will or should have an agent, and further suggests that HMRC are unwilling to provide sufficient guidance for taxpayers to self-serve.

6.5 ***Q17: 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?***

6.5.1 We suspect that there is a low level of awareness of MTD among landlords. There appears to be very little software specifically directed towards landlords, and this may have a further detrimental effect on taxpayer awareness. However, we notice that FreeAgent have recently launched MTD software for landlords[30] and other software providers such as Xero are publishing articles about MTD for Landlords.[31]

6.5.2 Our experience is that very few landlords with whom we have contact are currently using appropriate software to enable them to meet their upcoming obligations under MTD.

6.5.3 We suspect that some unrepresented taxpayer landlords will put off preparations for MTD until the very last moment, and HMRC will need to ensure that taxpayers are aware of their upcoming responsibilities.

6.5.4 While on the subject of MTD, we also wish to point out the requirement (in some circumstances) under MTD to report rent-a-room income, even if it falls below the threshold is counterintuitive and likely to cause taxpayer confusion.[32]

7 Non-UK aspects

7.1 ***Q19: Are there any particular issues of concern to non-resident landlords or their tenants (including in relation to the Non-Residents Landlord Scheme)?***

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[29] Page UKPN 9

[30] https://www.freeagent.com/blog/introducing-freeagent-for-landlords/

[31] https://www.xero.com/uk/programme/making-tax-digital/landlords-property-income/

[32] As we understand it, if a taxpayer has income in excess of the MTD threshold in addition to rent-a-room income, then the rent-a-room income will need to be reported under MTD, even if it falls below the rent-a-room threshold.

7.1.1 The Non-Resident Landlord Scheme (NRLS) imposes certain obligations on letting agents and tenants. We expect that letting agents will largely be familiar with their obligations under the scheme and will have systems in place to ensure that it is implemented correctly. However, it seems likely that letting agents may inadvertently fail to implement the scheme where the correspondence address for the landlord is UK based.

7.1.2 Though we have no direct data of the number of tenants that are required to deduct tax on behalf of the landlord, we think it likely that the awareness of this is low. It seems a very difficult task for HMRC to effectively reach these tenants and make them aware of their obligations under the scheme. Many in rented accommodation may not have any other interaction with HMRC, particularly is their own affairs are dealt with under PAYE. It strikes us an unreasonable burden to place tax collection obligations on these tenants, and we suspect compliance is low.

7.1.3 An added concern is that HMRC offers no guidance as to what should happen when where a tenant discovers that it should have been deducting tax under the NRLS. This may cause unnecessary worry for a tenant who comes to realise that they should have been deducting tax and is unclear how to rectify matters.

7.1.4 Looking at the scheme more generally, it strikes us as odd that the residence criteria for the NRLS differs to that set out under the statutory residence test.[33]

7.1.5 In our experience it is a common misconception that an application is made for UK rental income to be paid without tax deduction, on form NRL1, the taxpayer incorrectly believes this means the income is not taxable and not declarable. The NRL1 form does explain the position, but there is a risk of unrepresented taxpayers not reading or understanding the form correctly and this leading to instances of non-compliance.

7.2 ***Q20: Do any particular issues arise for UK residents receiving rental income from overseas?***

7.2.1 It is our experience that there is a lack of awareness that UK resident individuals are required to pay UK tax on overseas rental income, particularly where that rental income is already taxed and reported overseas. This situation is not uncommon for migrants coming to the UK.

7.2.2 We appreciate that it may be difficult to reach and educate such taxpayers, particularly if they have no other direct interaction with the UK tax system.

7.2.3 Overseas jurisdictions having differing tax year ends can cause difficulties if a taxpayer has calculated their overseas rental profit based on a different year end as required by the tax authorities in that overseas jurisdiction. Strictly the taxpayer would then need to recalculate their profit to match with the UK tax year, adding a further administrative burden.

[33] Per s 971 ITA 2007, a taxpayer will fall within the NRLS if their 'usual place of abode' is outside of the UK. Within the NRLS1 form, HMRC define this as an absence from the UK of 6 months or more. Therefore it could easily be the case that a taxpayer is UK resident under the statutory residence test (FA 2013, Sch 45, Pts 1-5), but still falls within the NRLS.

7.2.4 There can also be difficulties where overseas jurisdictions differ in terms of allowable deductions. An example of this being in Australia where, as we understand it, a form of property depreciation and mortgage interest are allowable. Since these figures are potentially quite large, it could be the case that under Australian tax rules, a rental property makes a loss, but under UK tax legislation there is a profit. This could easily lead to unrepresented taxpayers inadvertently failing to correctly declare taxable income.

7.2.5 Further oddities may arise when factoring in the interactions with the tax rules for non-domiciled taxpayers. For instance, a taxpayer may have made a property income loss overseas but would still need to calculate their profit under UK rules to see whether they have exceeded the £2,000 limit for the purposes of the automatic remittance basis[34].

7.2.6 In summary, the tax rules affecting non-domiciled taxpayers are complex and we would expect unrepresented migrant taxpayers to have little awareness of these concepts and the potential affect on their filing obligations.

LITRG
26 May 2022

[34] s 809D ITA 2007