Tax implications of buying commercial property as an investment

Commercial property, including student and hotel accommodation is treated differently for tax purposes than residential. Some of these differences are advantageous to an investor, including certain purchase and disposal taxes, which are typically lower than residential transactions. This guide outlines some of the main tax issues to consider when purchasing commercial property.

VAT

Whilst the sale of commercial property is generally exempt from VAT, commercial property owners may choose to tax and charge VAT at the standard rate of 20%. In this instance all supplies connected to the property, which would include rent would also attract VAT.

With regards to the sale of ‘new’ commercial property (a property less than three years old) these are liable for VAT at the standard amount. Student accommodation, including halls of residence are however exempt from this and will not be liable for VAT, provided that the appropriate certification required is met, where necessary.

With regards to hotel accommodation, VAT would be payable unless a long lease is granted for someone else to operate it as a hotel business, unless it has opted to tax. When purchasing a hotel room or suite for investment, this is typically the arrangement that would be in place.

As VAT can be a complex matter, it is always worth obtaining professional advice on this subject, when purchasing commercial property.

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Stamp Duty Land Tax

Like residential property, Stamp Duty Land Tax is payable on the purchase of commercial property, this is due within 14 days of the sale completing. There are no additional rates for subsequent purchases, or if you already own residential property.

Stamp Duty Land Tax rates are as follows:

Property (or lease premium or transfer value) SDLT rate from 1 October 2021

Commercial property		First residential property*		Additional residential properties (over £40,000)	
Up to £150,000	Zero	Up to £125,000	Zero	Up to £125,000	3%
£150,001 to £250,000	2%	£125,001 to £250,000	2%	£125,001 to £250,000	5%
Any portion above £250,000	5%	£250,001 to £925,000	5%	£250,001 to £925,000	8%
		£925,001 to £1.5 million	10%	£925,001 to £1.5 million	13%
		Any portion above £1.5 million	12%	Any portion above £1.5 million	15%

*Note: A first-time buyer buying their main residence of up to £500,0000, is exempt up to a purchase price of £300,000 and pays 5% for any amount above £300,000). Different rates applied to residential property transactions between 8 July 2020 and 30 September 2021 inclusive, due to a temporary stamp duty holiday.

Income derived from letting commercial property is subject to tax. Deductions can be made for valid revenue expenses, including letting agents' fees and loan interest. The rates of tax that will apply will depend on how the purchase is structured and if it is held by an individual, a trust or a company.

Holding property personally

If you hold property personally, you will be subject to income tax on profits at your regular tax rate, which will be between 20% and 45%, less any personal allowances.

Holding property in a limited company

As a limited company you pay Corporation Tax on profits rather than Income Tax . If you wish to take a salary from the company a director can earn up to £8,840 subject to normal tax rules, with no liability for national insurance or tax (assuming no other income). Corporation Tax Relief is also available for pension contributions from limited companies for the benefit of employee directors.

One important point to consider in purchasing commercial properties compared to residential is tax relief for loan finance. If the property is held individually, you will generally still be able to claim tax relief for loan finance costs relating to commercial property (as you can if it is held in a limited company). With residential property held personally on the other hand, mortgage interest relief will result in a tax credit based on 20% of mortgage interest payments.

Capital Gains Tax

If you hold the property personally, you will be liable for Capital Gains Tax on any increase in the value of the property when you dispose of a commercial property (if it is held in a limited company you would instead pay Corporation Tax on annual company profits). Capital Gains Tax is lower for commercial property than residential, if you are a basic rate taxpayer, you would pay 10% (18% for residential property) and 20% for higher rate taxpayers (28% for residential property) when you dispose of the property.

You only pay tax on your overall gains above your tax-free allowance (the Annual Exempt Amount) which is currently £12,300. Furthermore, certain costs can also be deducted, such as Stamp Duty Land Tax and allowable purchase and disposal fees.

Capital Allowances

Capital Allowance Relief can be claimed for commercial property on moveable plant and machinery purchases.

What is often overlooked is that Capital Allowances can also be claimed in respect of plant or machinery ('fixtures') within a commercial property.

Fixtures that can be claimed include:

- Cranes and gantries
- Fire alarms and security systems
- Heating and air conditioning systems
- Lifts escalators and moving walkways
- Sanitary and Kitchen Equipment
- Sprinkler systems

For a temporary period, up to 31 December 2021, the first £1 million of capital expenditure can qualify for 100% tax relief under the Annual Investment Allowance rules (it is then due to decrease to £200,000).

When a property is purchased, it can be elected that a percentage of the purchase price is attributed to these items. This can be up to as much as 25% of the original purchase and refurbishment price in some instances. This can then be set against future profits and in many instances, the result can be that no taxable profit is declared for several years. In order to do so it is important that this is documented as part of the purchase agreement.

Super Deduction Tax Relief

Introduced in Budget 2021, this new 130% Super-deduction First Year Allowance (FYA) reduces tax by around an extra third for expenditure on new main pool plant and machinery. Landlords and Investors were originally excluded form this relief (initially only available for trading companies), however, an amendment to the Finance Bill means that landlords and investors can now claim Super deduction tax relief for qualifying plant and machinery.

In addition to this, the 50% Special Rate First Years Allowance, or SR allowance as it is known, provides an eight-fold increase of tax relief compared to the previously available 6% writing down allowance (WDA) for a variety of other plant and machinery assets.

This is an attractive proposition for landlords looking to invest as there is no upper limit to these enhanced reliefs.

Summary

Whilst there are many similarities with residential investment, owning commercial property has some additional benefits. These include a more favourable rate of Stamp Duty Land Tax on the purchase, the ability to claim greater tax relief on loan finance and a lower rate of Capital Gains Tax, should you dispose of the property, if it has been held personally.

Like residential property, the question of whether to hold the property individually or in a Limited company is dependent on personal circumstances and the VAT element of the purchase will require scrutiny. It is advised that professional advice is always sought as these can be complex subjects to navigate.

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Why Alexander & Co

At Alexander & Co, we have a specialist property tax team that can assist you in weighing up all your options and working out the best solution for you.

Our property experts have a wealth of knowledge in this field and have worked with companies, entrepreneurs, individuals, trusts and organisations in the commercial and residential sectors for many years. If you are looking for a chartered accountant and tax advisor with the right property know-how, then Alexander & Co are here to help.

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