

Walkers chartered accountants

Tel: (01535) 600900 Fax: (01535) 608660

SUITE 3, AIRESIDE HOUSE, AIRESIDE BUSINESS CENTRE, ROYD INGS AVENUE, KEIGHLEY BD21 4BZ

www.walkerco.co.uk

Letting out property

Property letting is a complex area, subject to significant ongoing change. One major development is the restriction on tax relief for landlord interest costs, currently being phased in over a four-year period. Another important change affects the way in which income and expenses are treated for accounting purposes. This briefing examines some of the key issues involved.

Changes to tax relief for landlord interest costs

Tax relief for landlords of residential properties has been changing since April 2017. This will particularly affect the owners of buy to let properties.

Landlords are no longer able to deduct all finance costs from property income. Instead, there is a basic rate reduction from income tax liability. The new rules apply to costs such as mortgage interest, interest on loans to buy furnishings, and fees incurred when taking out or repaying loans or mortgages.

For 2018/19, only 50% of finance costs will be allowable, down from 75% in 2017/18.

Remaining finance costs for each year are given as a basic rate tax deduction, but note that this cannot be used to create a tax refund. Looking to the future, in 2019/20 only 25% will be allowable. In 2020/21, withdrawal is complete, no part of the finance costs being allowed.

Relief for finance costs may be restricted further where either the landlord's total property income, or total taxable income excluding savings and dividend income, is less than finance costs incurred. So by 2020/21, if net property income is £4,500 before interest of £6,000, the landlord thus making a £1,500 loss, £4,500 is nevertheless taxable. Also, the interest relief is restricted to £4,500 at 20%, rather than £6,000 at 20%. The unrelieved interest (£1,500 at 20%) is carried forward and may get tax relief in a later year.

How will this affect you?

Non-allowability of finance costs could affect the level of income at which High Income Child Benefit Charge or tapering of the personal allowance apply.

The finance restriction may push some basic rate taxpayers into higher rates of tax, and it is important to monitor year on year what impact the change will have in your circumstances. Higher tax bills are on the agenda, and we can quantify this for you when your tax return for 2017/18 is submitted. There may be ways in which you can restructure your affairs to accommodate these changes, and this is something on which we would be pleased to advise.

Note that the interest relief restrictions do not apply if you run your business as a company, or operate furnished holiday lets.

Operating as a company

There have been many suggestions in the media that the restrictions on finance costs make it better to operate as a company. This however, is always a complex calculation. If incorporation is something you would like to consider, we should be happy to help you weigh up the implications in your specific circumstances.

One factor in favour of incorporation is that corporation tax rates are low in comparison with personal tax rates. Thus, more funds may be available for reinvestment in additional properties.

However, there are other issues to consider when holding investments in a company, such as:

- Income tax charges if significant rental profits are distributed to shareholders.
- A potential double tier of capital gain on sale of property. Corporation tax is payable on the capital gain. If the gain is distributed to shareholders as a dividend, there is an income tax charge on the dividend paid.

Capital gains have previously been reduced by an inflation adjustment for the period that the company has owned the property. This is known as indexation allowance. But for disposals on or after 1 January 2018, indexation allowance will only be calculated up to December 2017.

- The different treatment of assets held by the individual on death may affect tax paid on subsequent capital gains if properties are eventually sold. If properties are held directly by an individual, inheritance tax (IHT) liabilities are based on value of the properties at death, with the value of



the properties uplifted to market value to calculate future capital gains. If the individual has a property investment company, shares in the property company are valued for IHT purposes at market value, but the properties themselves remain at original base cost.

Transferring an existing property portfolio into a company requires very careful consideration, there being potential capital gains and stamp duty liabilities on the property transfer. All in all, bespoke advice will pay dividends. We would be happy to provide further advice on the impact of running a property investment company.

Property repairs and renewals

There are potentially subtle distinctions when it comes to the tax treatment of money spent by landlords on repairs and renewals. Some repairs and renewals will be treated as revenue costs, which are generally allowable for tax purposes: other items as capital expenditure, which is not allowable.

It is important to identify the asset on which work is undertaken. For example, where a *fixture* in a property is replaced, the asset may be considered as the whole building, not the fixture: thus, replacing a fixture can be treated as the repair of the building. This, however, is an area in which meticulous attention to detail is necessary to avoid expensive mistakes as regards tax treatment. Please do consult with us before incurring any expenditure so that we can advise on the most beneficial procedure.

Tax relief on the *replacement* of an asset will generally only be available if the asset qualifies under the new rules for replacement of domestic items.



Replacement of domestic items relief

From 2016/17, (1 April 2016 for corporate landlords), replacement of domestic items relief replaces wear and tear allowance for furnished lets. It gives tax relief for domestic items (including furniture, appliances,

curtains, carpets, crockery) bought for the sole use of the tenants in the let property, the old item being no longer available.

Essentially it covers like for like replacement. Where the new item is an upgrade, relief will be restricted. Initial cost of purchase is disallowed for tax purposes, but the full cost of replacement is allowed.

This relief is available to all landlords, not just those letting out fully-furnished property - unlike wear and tear allowance.

Change to basis of accounting for landlords

From 2017/18, profits and losses for unincorporated landlords are calculated on the cash basis, as opposed to Generally Accepted Accounting Principles (GAAP) or 'accruals' basis of accounting. Cash basis is now the default unless a landlord opts out - by making an election on the tax return - or has annual rental receipts in excess of £150,000.

Joint owners are treated as carrying on their own property business. So if eligible for cash accounting, each individual owner makes a decision on joining. Thus, where owners differ, it could mean preparing two sets of accounts for the same business. This is not the case for spouses/civil partners, however. They are required to calculate profits on the same basis as each other.

We can help you decide on the appropriate basis for your business.

Jointly-held property

Where property is jointly held by spouses or civil partners, each is taxed on half the income, unless a special election is made, and it can be shown that each party made a different capital contribution. It is therefore important to check legal ownership. Changing profit shares alone does not alter the tax liability.

Additional Stamp Duty Land Tax (SDLT)

For properties in England and Northern Ireland, a higher rate of SDLT is payable on additional residential properties bought on or after 1 April 2016, where the purchase is for £40,000 or more.

Where the additional property replaces the main residence, the higher rate does not apply. If a purchaser buys a new main residence, but the sale of the previous main residence is delayed, higher rate will pertain. The purchaser can, however, obtain a refund for the amount in excess of normal SDLT rates, if the previous main residence is sold within three years. Where the purchaser already has two or more properties, and the main residence is sold, they will not pay higher rate if a new main residence is purchased within three years.

Joint purchases

Where the purchase of additional property is a joint purchase, then if higher rate SDLT would apply to either party, it will apply to both. Spouses or civil partners are treated as joint purchasers, even if the additional property is bought individually by one of the couple.

Example

Bronja owns a house which she and her husband live in as their main residence. Her husband is planning to buy a flat to rent out: this will be in his sole name. As a married couple, all property owned by Bronja or her husband is treated as being owned jointly. The purchase of the flat will therefore be classed as an additional residential property.

Companies

SDLT higher rate also applies to companies purchasing residential property worth £40,000 or more.

Scotland: Land and Buildings Transaction Tax (LBTT)

In Scotland, there are equivalent rules – the LBTT Additional Dwelling Supplement, which is charged at 3% of the total purchase price of the dwelling.

Wales: Land Transaction Tax (LTT)

From April 2018, LTT replaces UK SDLT in Wales, and again higher rates are payable on purchases of additional residential properties.

Capital gains tax (CGT) rates

CGT rates have fallen since 6 April 2016. Chargeable gains within the basic rate band are now taxed at 10% and non-basic rate band chargeable gains are taxed at 20%. However, these rates do not apply to gains on residential properties. CGT rates on chargeable gains on buy to let properties therefore remain at 18% and 28%, depending on where the gain sits within the relevant income tax band.

Commercial property

Commercial property has its own distinct tax rules. These include non-residential SDLT rates and lower CGT rates. The rules on restriction for finance costs (above) do not apply to commercial property. If you are considering investing in commercial property, we would be happy to advise further.

How we can help

Property is a complex area, subject to considerable regulation and change. We have only been able to consider a variety of key areas in this briefing. Please do not hesitate to contact us for further advice on any of the tax and accounting issues involved.