Chair's view, Issue 1

Personal tax

14 December 2015

A warm welcome to this edition of Property Tax Voice

2015 has been something of a year of change in the world of property tax and the Property Taxes Technical Sub-Committee has made a number of representations to HMRC and HM Treasury as a result.

On 1st April the de minimis limit for liability to the annual tax on enveloped dwellings (ATED) dropped to £1,000,000, thereby trawling a significant number of additional residential properties into that tax. That prompted a campaign for a simpler ATED return for those property businesses with a significant number of properties exempt from paying ATED under the rental exemption. A new much simpler return is now being introduced for those properties.

Then the renewals basis of allowances for white goods, carpets etc. installed in unfurnished or partly furnished residential rental properties was withdrawn by HMRC. At first this was not thought to be too serious. Furnished rental properties still had the 10% of rent “wear and tear” allowance available to them and it was thought that items installed in other residential rental properties could obtain relief under sections 68 of ITTOIA 2005 (individuals) or 68 of CTA 2009 (companies). These provide a relief for replacing any “tool”. That does not sound promising but a tool is defined as including any implement or article, and arguably a refrigerator could meet that description. However, HMRC then announced that they regarded the sections 68 as covering only low value, high turnaround items such as small tools.

This resulted in a significant protest from the professional bodies and interested parties and now we have a complete revamping of the relief for items installed in rented residential properties. The renewals basis is back for all such properties, but the quid pro quo is that furnished properties have lost the age old “wear and tear” allowance.

There are still issues, not least how to apportion expenditure on a replacement item where an improvement is involved. As it is almost impossible to buy something nowadays that has not been improved (a cathode ray TV to a flat screen internet enabled model for instance) the requirement to exclude the value of improvement is bound to involve landlords in disputes with HMRC.

Finally, the chancellor made the surprise announcement in the budget that tax relief is to be restricted from April 2017 for finance costs incurred in residential property letting businesses. Much coverage has been given in the financial press to a restriction of tax relief on interest, but note this extends to all costs of finance including arrangement fees etc., which can be quite substantial.

The restriction works by disallowing finance costs in calculating the taxable rental profit, and then introducing a tax credit equal to 20% of the disallowed costs.

There is a form of transitional relief because the disallowance and credit are being phased in over four tax years, so that the full effect of the restriction will not be felt until tax year 2020/21. There is a view that HMRC could

have gone further here and not applied the restriction to let properties already bought by budget day, after all these would have been bought on the basis of a tax treatment which is now being altered. Sadly, the chances of any further relaxation to the restriction are highly unlikely.The restriction is likely to significantly increase tax liabilities on rental profit and decrease the net rental profit after tax. In slides presented at the CIOT's recent webinar on the subject (see note below for further detail), I showed an example where the net rental profit decreases from 21% of gross rents in 2016/17 to 9% of gross rents in 2020/21. The disallowance of finance costs also increases taxable income, so could have a knock on effect greater than the restriction of relief to 20%, e.g. loss of personal allowances, tax credits, savings allowance etc. Some trusts may be in the position of having insufficient money to pay all of interest, expenses and tax.

What can a highly geared “buy to let” residential landlord do, other than simply liquidate their business at fire sale prices? They could move into commercial property renting, but that is a more specialised field. They could incorporate their letting business, because the restriction covers only individuals, trustees and partnerships (also including limited liability partnerships). The subject of possible incorporation is a whole technical article in itself. However, incorporating a residential property letting business is not exactly without difficulty, including:

SDLT on the market value of properties transferred into a company, possible CGT on properties transferred (depending on the level of involvement in the business the individual may be able to claim incorporation relief under s 162 TCGA 1992),
increased tax on profit extraction (in view of the increase of tax on dividends from April 2016 also announced in the summer budget), possible double charge to tax on exit.

Not exactly slam dunk planning is it? Members will need to consider carefully all their clients with geared residential property letting businesses and provide tailored advice to each.

The Property Taxes Technical Sub-Committee has had a busy year. Whilst we can hope 2016 is a year more of consolidation and less of upheaval the announcements by the chancellor in his autumn statement of a change to SDLT and the acceleration of CGT payments in April 2019 (see CIOT / ATT press releases) do not augur well.