Whittingham Riddell

Chartered Accountants

Changes to Taxation of Property Income

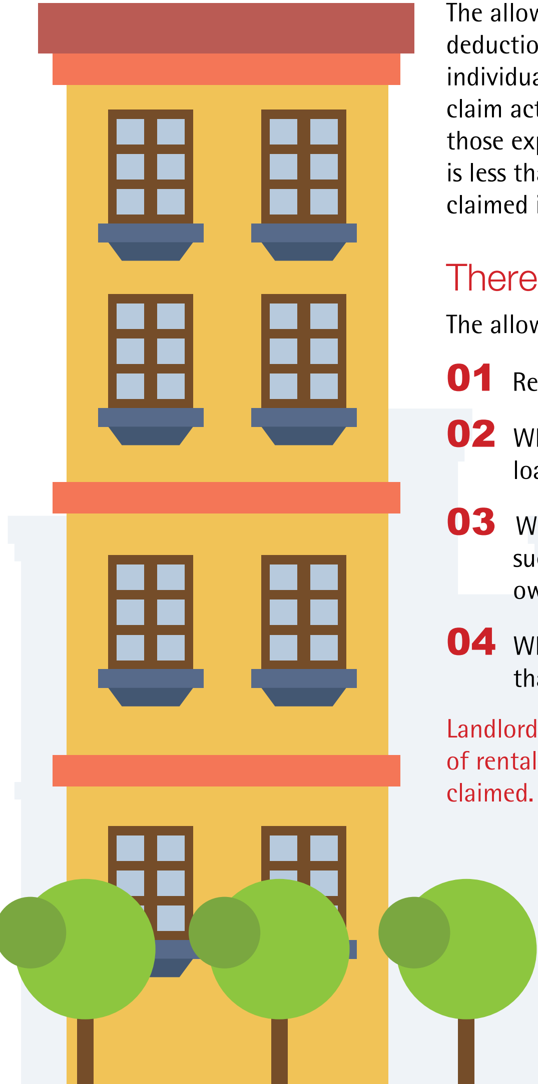
Recent years have seen a number of significant changes in the taxation of property income. While some of these bring welcome benefits others will prove to be costly to many property owners and all have a number of complex provisions which make understanding their real impact challenging.

What's inside?...

Property Allowance

From April 2017, individuals are entitled to claim a £1,000 property allowance against their gross rental income. Where a property is jointly owned, each owner is entitled to claim the full allowance against their gross rental receipts.

CLAIM £1,000 property allowance



The allowance is instead of, rather than in addition to, deductions for other allowable expenses, so whether an individual should chose to claim the allowance rather than claim actual expenses incurred will depend on the level of those expenses. For example, where the total gross income is less than £1,000, the maximum amount that can be claimed is the total gross income.

There are a number of restrictions...

The allowance cannot be claimed where:

01 Rent A Room relief is being claimed;

02 Where the individual is claiming a tax reduction for loan/mortgage interest;

03 Where the rent is received from a connected party such as a company you or someone connected to you owns, controls or is employed by; and

04 Where income is received through a partnership rather than as an individual.

Landlords remain under an obligation to maintain records of rental income and expenses even when the allowance is claimed.

Our View...

In practice for many landlords the relief will be of limited value, but for those with small amounts of rental income (e.g grazing income) the allowance may represent a welcome benefit.

Cash Basis

From 6 April 2017, where property income receipts are below £150,000 they will automatically be taxed using the cash basis. Those landlords with property income receipts exceeding £150,000 will have to continue to use the accruals basis. Trusts must also continue to use the accruals basis to calculate their taxable income.

When calculating property income using the cash basis, income is taxed as and when received and expenses/capital allowances are allowable as and when incurred.

The individual may, on an annual basis, opt out of using the cash basis and continue to calculate their property income using the accruals basis. However, if a property is owned jointly and the owners are married/in a civil partnership, both must use the same method for calculating their taxable income. If you chose to opt out of using the cash basis for a particular year, this must be notified to HMRC on the tax return.

UK property income and overseas property income can be calculated using different methods. There are certain restrictions on deductions for finance costs when using the cash basis.

Our View...

These changes represent a welcome simplification for many landlords, but care should be taken to ensure that the restrictions on deductions for finance costs do not create an unexpected tax cost.

Finance Interest Restrictions

From 6 April 2017, there will be restrictions to the amount of relief that an individual can claim in respect of finance costs for residential rental properties. This includes interest and costs associated with obtaining finance (i.e. loan arrangement fees).

Where the property is a residential property, the method of relief is moving from relief by deduction to relief as a basic rate tax reduction (20%). The restriction is being phased in over 4 years and while the methodology is not entirely straightforward in the majority of cases the net effect is as follows:

Higher rate relief restricted to **75%** of the interest and finance costs

Higher rate relief restricted to **50%** of the interest and finance costs

25% will attract higher rate relief

Relief is given wholly as a basic rate tax reduction with no higher rate relief

There are restrictions on the deduction of finance costs that apply broadly where the outstanding debt exceeds the market value of the property at the time it was first let plus any enhancement expenditure since.

Our View...

This restriction has been known for some time but the initial effects will only be felt as landlords file their 2017/18 returns, and the full force only in 2020/21 returns. Those landlords with large, highly leveraged portfolios should consider the potential impact of the restrictions now.

Replacement of Domestic Items Relief

From 6 April 2016, individuals can claim the cost of replacing items in a residential rental property that is unfurnished, fully furnished or part furnished. This new relief replaces the old wear and tear allowance which was abolished at the same time.

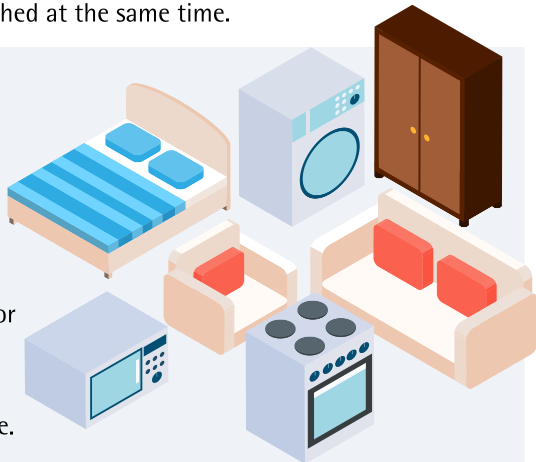
Items Covered...

Items covered by the relief comprise

- Movable furniture
- Furnishings (curtains, carpets etc)
- Household appliances
- Kitchenware

The new item must be made solely available for the tenant of the rental property and the old item must no longer be available.

The initial purchase of an item is not allowable.



Where the cost of replacement relates to an improved item, the deduction will be limited to the cost of buying an equivalent replacement (i.e. if you replace a washing machine with a washer dryer, the allowable cost would be an amount equivalent to purchasing a washing machine of the same standard). Where a modern equivalent is purchased (i.e. a washing machine with improved energy efficiency) then the full cost of replacement is allowable.

What's included...

The allowable cost includes the cost of purchase, the costs associated with removal of the old item, delivery and installation of the new item less any amounts that may have been received for part exchange or sale of the old item.

Our View...

The old wear and tear allowance had the benefit of simplicity for landlords to apply. We suspect HMRC felt the old allowance was too generous which implies this new relief will be less so. The new rules will also add an administrative burden to landlords.

Not included...

This relief cannot be used for items purchased for a furnished holiday let (capital allowances will be used for these) or where rent a room relief is claimed.

Rent A Room Allowance

This relief is available where an individual lets furnished accommodation in their only or main residence which includes a B&B or guesthouse. It is not available if the accommodation is separate (i.e. an annex).

The relief is £7,500 per annum (which increased from £4,250 on 6 April 2016) and, where the property is jointly owned, is split between owners. Currently there are no minimum letting periods to meet in order to claim the relief.

Our View...

Rent a Room relief is now significantly more generous but also potentially under-utilised by those who may be entitled to it. At the same time HMRC's response to the application of the relief to AirBNB lets may have unintended consequences for other lets which currently qualify.

2018 Autumn Budget Update

The Chancellor Philip Hammond presented his second Autumn Budget on Monday 29 October 2018. This included some Property related updates, which are as follows:

Private Residence Relief

When you sell a property, you may have to pay capital gains tax (CGT) if you have let your property out. The amount you pay depends on how long you lived there. You pay tax on your "chargeable gain," which is your gain, minus any private residence relief (PRR) you are eligible for. PRR is the tax relief that keeps people's main homes out of the CGT net. Currently you don't pay CGT for the years you have lived in the property, plus an additional exemption for the final 18 months that you owned it. From April 2020 this final period exemption will be cut to nine months.

Lettings Relief

This relief currently provides up to £40,000 of relief (£80,000 for a couple) to people who let out a property that is, or has been in the past, their main home. From April 2020, lettings relief will only apply where the owner is sharing occupancy of the home with a tenant. The precise details of this change are not yet known but it is clear the future use of this relief will be very substantially reduced.

How can Whittingham Riddell help?

Our specialist personal tax compliance team have considerable experience of the impact of these changes.

To give you assurance that you are complying with the new rules while maximising the opportunities there are, we are able to offer a one-off review of your property income calculations for £80 plus VAT*.

If you are interested in using this service or would like further information, please do not hesitate to contact a member of the tax compliance team.

* This cost is for a review calculations covering a maximum of 2 properties.

Our other services include:

- Book Keeping
- Residential & Commercial Service Charge Accounts
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We also have in-house financial planners to provide investment, insurance and mortgage advice

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