

TAX AND PROPERTY: AN OVERVIEW OF KEY CHANGES



The government has announced a series of changes to the property tax regime in recent times. This factsheet considers the latest situation, and provides an overview of the tax implications of owning property.

BUY-TO-LET PROPERTIES

Income tax

The income that you receive from your rental property will generally be treated as arising from a business, but you are not actually treated as trading. However, if the income is from Furnished Holiday Lettings (FHLs) or the provision of services such as hotels and guest houses, it is classified as trading income.

Particular expenses will reduce the taxable income of buy-to-let properties. These expenses include interest on mortgages which are financing the purchase or improvement of buy-to-let properties, letting agency fees, utility bills and property and contents insurance premiums.

Buy-to-let landlords have historically received relief on interest payments against rental income. This has effectively given them relief at their top rate of income tax – which could be up to 45%.

In a move which the previous Chancellor George Osborne stated would 'level the playing field', landlord tax interest relief is now being reduced in a series of stages, from April 2017 onwards.

Restriction of finance costs relief for individual landlords

Finance costs include mortgage interest, interest on loans to buy furnishings, and fees incurred when taking out or repaying mortgages or loans. The change will restrict relief for finance costs on residential properties to the basic rate of income tax, and is being introduced gradually from April 2017 over a period of four years.

Landlords will no longer be able to deduct all of their finance costs from their property income to arrive at their property profits. They will instead receive a basic rate reduction from their income tax liability for their finance costs.

In 2017/18 the deduction from property income was restricted to 75% of finance costs, with the remaining 25% being available as a basic rate

tax reduction. Over the subsequent years the direct deduction of finance costs is being reduced by 25% each year, reaching 50% in 2018/19, until 6 April 2020 when all finance costs incurred by a landlord will be given as a basic rate tax deduction.

Annual property income allowance

A new £1,000 annual property income allowance has been introduced, meaning that from 6 April 2017 where the allowance covers all of an individual's relevant income (before expenses), they do not need to declare or pay tax on this income. Those with higher incomes have the choice of deducting the allowance from their receipts, instead of deducting the actual allowable expenses. The new allowance does not apply to income from a property business in partnership, and is not in addition to relief given under the Rent-a-Room legislation.

Repairs and replacements

The previous 10% wear and tear allowance has been replaced with a relief allowing all residential landlords to deduct the actual costs of replacing their property furnishings. This enables all landlords of residential dwellings to deduct the costs they actually incur on replacing furnishings, appliances and kitchenware in the property, but excluding fixtures.

The relief given is for the cost of a like-for-like (or nearest modern equivalent) replacement asset, plus any costs incurred in disposing of, or less any proceeds received for, the asset being replaced.

Fixtures integral to the building that are not normally removed by the owner if the property is sold (such as baths or fitted kitchen units) are not included because the replacement cost of these would be a deductible expense as a repair to the property itself. Landlords no longer need to decide whether their property is sufficiently furnished to claim the new replacement furniture relief, as they had to when claiming the wear and tear allowance. This is because the relief applies to all landlords of residential dwellings, no matter what the level of furnishing. This deduction is not available for FHLs because capital allowances will continue to be available for them.

The furniture replacement relief does not apply to FHLs and letting of commercial properties, because those businesses receive relief through capital allowances. However, owners of all other residential properties can claim a deduction for the replacement cost of furniture, furnishings, appliances and kitchenware.

Stamp Duty Land Tax (SDLT)

SDLT on the purchase of residential properties is charged on the portion of the purchase price which falls within set rate bands in England and Northern Ireland. Higher rates of SDLT are charged on purchases of additional residential properties (above £40,000). The higher rates are three percentage points above the current SDLT rates. In Scotland, property transactions are governed by the Land and Buildings Transaction Tax (LBTT). From April 2018, property transactions in Wales are governed by the Land Transaction Tax (LTT).

First-time buyers in England and Northern Ireland paying £300,000 or less for a residential property no longer pay SDLT. Those paying between £300,000 and £500,000 pay SDLT at 5% on the amount of the purchase price in excess of £300,000. Those purchasing property for more than £500,000 are not entitled to relief and pay SDLT at the normal rates.

In the 2018/19 Scottish Budget, Finance Secretary Derek Mackay confirmed that a new relief for first-time homebuyers is planned for purchases up to £175,000. Where a property costs more than this amount, first-time buyers will benefit from relief on the portion below the threshold. The relief is expected to come into force some time during 2018.

Furnished Holiday Lettings (FHLs)

Income from FHLs can qualify for some important tax concessions. FHLs are treated for tax purposes as if they were trades. You may be able to claim capital gains tax reliefs including Business Asset Rollover Relief, Entrepreneurs' Relief or gifts relief. You may be entitled to claim capital allowances on certain items of furniture, and income counts as earnings for pension contribution purposes.

a period of allowable absence. In these circumstances, the associated lettings relief of up to £40,000 (£80,000 for a couple) could be utilised.

Forthcoming changes

In the Budget, the Chancellor announced that the planned introduction of the 30-day payment window for gains on residential property disposals will be deferred until April 2020. This will not affect gains on properties which are not liable for CGT due to Private Residence Relief.

Business use of your home

If you use part of your home exclusively for business, interest and running costs on the relevant portion of the home will be allowed as a business expense. A similar proportion of the CGT exemption will be lost. However, if you use some rooms exclusively for business for most of the time, but also for non-business purposes for some of the time, the full exemption will normally be preserved.

Property and your business

If the purchase and sale of properties amounts to a trade (e.g. a property developer), property disposals will be taxed as income. For other businesses, the sale of a property that has been used for business will be subject to CGT, but tax reliefs may reduce or delay the amount payable.

Entrepreneurs' Relief

For sole traders or business partners, this relief can help to lower the CGT bill, meaning that you pay tax at 10% on qualifying assets, rather than the rates of 10% or 20% (2018/19) which apply to gains other than residential property not qualifying for Private Residence Relief, carried interest or ATED. These will continue to be charged at 28% and 18%.

Most let properties will not qualify for Entrepreneurs' Relief; however, FHLs count as business assets and so the relief may be available. There are a number of conditions that need to be satisfied for Entrepreneurs' Relief. Please contact us for further information.

INHERITANCE TAX (IHT)

IHT and your home

IHT is payable at 40% on the proportion of an estate valued at more than £325,000. The government has introduced an additional nil-rate band, the main residence nil-rate band (RNRB), which may effectively take the family home out of IHT. It applies when a main residence is passed on death to one or more direct descendants (including a child, stepchild, adopted child or foster child) of the deceased and their lineal descendants. It also applies if the property is passed to a current or surviving spouse/civil partner of a direct descendant.

The allowance has effect for relevant transfers on death on or after 6 April 2017. It is set at £125,000 for 2018/19 and will rise by £25,000 annual increments thereafter, reaching £175,000 in 2020/21. There will be a tapered withdrawal of the RNRB for estates with a net value of more than £2 million (at a withdrawal rate of £1 for every £2 over this threshold).

The nil-rate band is also available when a person downsizes or ceases to own a home on or after 8 July 2015, and assets of an equivalent value are passed on death after 5 April 2017 to direct descendants.

IHT and your business

Businesses will normally attract business property relief of 100%, allowing your business to be passed on with no IHT liability. Business assets owned by you but used by a partnership you are a part of, or a company you control, attract business property relief at 50%. Similar reliefs apply to agricultural property.

We can advise on all aspects of tax and property.

RENT-A-ROOM RELIEF

Under the 'rent-a-room' scheme, income from letting furnished rooms in your only or main residence is exempt from tax if the gross annual rent does not exceed £7,500 (£3,750 each if you share the income).

The measure includes receipts for any meals and cleaning services paid for in relation to the use of the room. It may also be relevant where an individual rents out rooms in a guest house, bed and breakfast or similar, providing that this is their main residence. Where rents exceed £7,500 you can choose to pay tax on the excess, or on the total rent less expenses in the normal way.

CAPITAL GAINS TAX (CGT)

CGT and your home

Your main residence is normally automatically exempt from CGT when you sell it, subject to certain conditions and provided it has been your only or main residence during the whole period of ownership (or since 31 March 1982). Various rules allow periods of temporary absence to be disregarded.

If you are a UK resident and own more than one home in the UK, you can elect which is to be your main residence within two years of acquiring the additional residence. As long as the home has, at some time, been your main residence for CGT purposes, the last 18 months of ownership will be included in your exempt period.

The situation may be complicated where a principal private residence has been let other than during the last 18 months of ownership or during