Taxation of rental properties

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Better Ideas. Sharper Results.

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Introduction to Shorts

- 1890 - Founded by Samuel Edward Short
- Originally traded in Chesterfield
- 1998 - Shorts Financial Services was formed
- 2002 - Sheffield office opened
- 2012 - Chesterfield office development
- 2014 - Sheffield office development
- Currently 12 Partners / Directors and c100 staff

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Developments in Management Accounting for Landlords

- Management information is the information you need to run your business. It tells you how your business is doing and why.

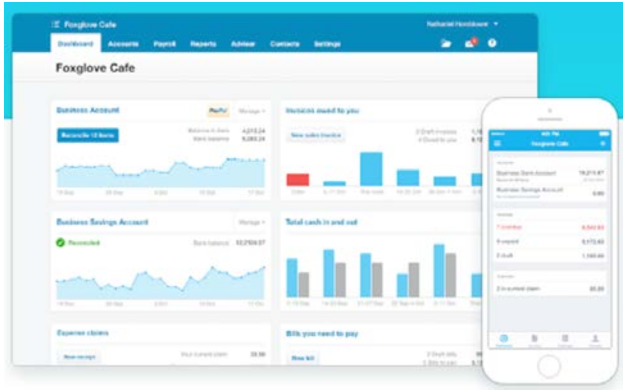
- The accountancy market has changed over the past few years. Accounts packages are cloud based and have add-ons and extra functions aimed at making your life easier and giving you better information.

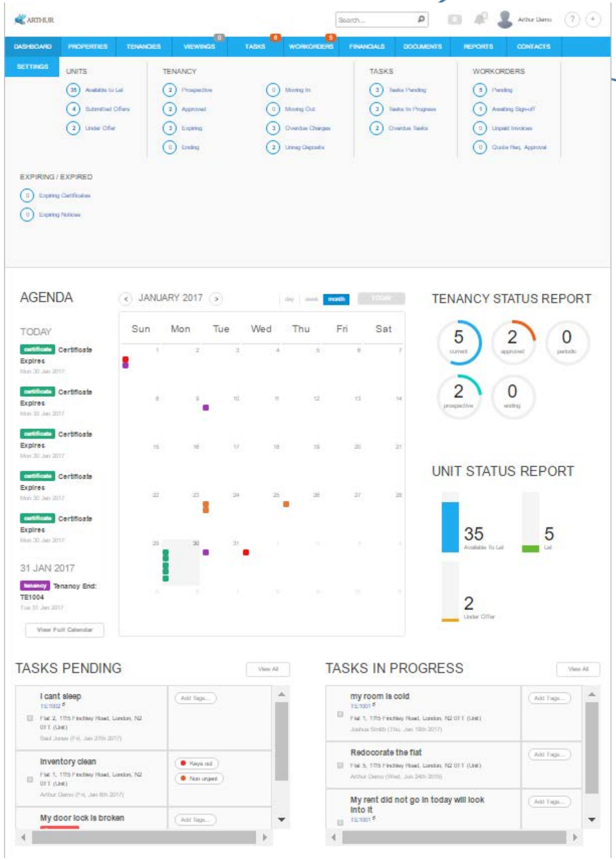
- Xero is a cloud-based accounts package, it can be accessed anywhere. It has some great time saving features e.g. it automatically links with your online bank, it emails and tracks rent invoices and it attaches scans of your purchase invoices to your accounts, so no more pieces of paper!

- AutoEntry, is a receipt and purchase invoice application. You simply scan or take a photo of your receipt or invoice and it automatically reads the content and pushes it through to your Xero accounts for you to simply click approve. All the scans are HMRC approved so there is no need to retain the invoices.

- Finally, Arthur is a complete property management software solution. It automates various tasks e.g. booking and confirming viewings, scheduling repairs, receiving and accepting quotes. It also allows the tenant to inform you about issues with the property, allows documents to be easily shared and links with Xero to allow profitability reporting by property.

Developments in Management Accounting for Landlords





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Allowable Expenditure

- Obvious allowable expenditure paid by the landlord include council tax, ground rent, insurance, letting agent and accountancy fees.
- Pre letting expenditure on repairs is allowable unless the repairs include expenditure necessary before the property can be bought into use.
- Expenditure necessary to bring the property into use, building extensions and installing central heating are added to the capital cost of acquiring the property.
- Replacement windows e.g. wood to uPVC or single to double glazed units are accepted as repairs by HMRC.
- Generally, HMRC now accept that if the replacement is part of an "entirety" and is like for like or the nearest modern equivalent then the expenditure is allowable.

Changes to the Allowances for Furniture

- Until 5 April 2016 relief for expenditure on property let fully furnished was available either on a renewals basis or the optional 10% Wear and Tear allowance.

- The majority of landlords opted for the 10% Wear and Tear allowance because it was generally more beneficial over time and it reduced the need for detailed record keeping.

- From 6 April 2016 the Wear and Tear allowance was abolished and only the renewals basis is available.

- No tax relief is available for the initial expenditure on the purchase of furnishings and white goods.

- If an improvement is purchased, only a deduction equal to the cost of similar item is allowable. E.g. if a washer/dryer replaces a washer, only the cost of a washer would be allowable.

Interest Relief Restriction

- After 5 April 2017 profits are to be calculated without deduction for any interest payments.
- Instead, a new tax reduction will apply and will be introduced over the next three years which will proportionally restrict tax relief to the basic rate of tax.
- The restriction will apply in full from 6 April 2020.
- Complications can arise if the tax reduction relief cannot be used in the relevant year.
- Non-residential properties are not affected by the new restriction.
- Companies who let out residential properties are not affected by the new restriction.

Interest Relief Restriction; Example 1

- An individual owns a number of residential properties which generate a profit before interest of £40k and annual mortgage interest of £35k is paid. The profit is therefore £5k per annum.

	Old Rules	New Rules
Rental income before Interest	40,000	40,000
Mortgage Interest	(35,000)	(35,000)
Cash in hand before tax	5,000	5,000
Interest not deductible	n/a	35,000
Taxable income	5,000	40,000
Tax at 40%	(2,000)	(16,000)
Tax reducer	n/a	7,000
Net cash in hand	3,000	(4,000)

- The landlord will be £7k worse off under the new rules (from 2020), and will make a loss from the property business.

Interest Relief Restriction; Example 2

- An individual has a salary of £11,500, dividends of £2,000, savings interest of £250, £45,500 of rental income and pays £10,500 in mortgage interest.

	Old Rules	New Rules
Rental income (before interest)	45,500	45,500
Mortgage Interest	(10,500)	(10,500)
Taxable income	35,000	45,500
Tax due		
33,500 at 20%	(6,700)	(6,700)
1,500 at 40%	(600)	
12,000 at 40%		(4,800)
Tax reducer (£10,500 at 20%)	n/a	(2,100)
Tax payable	7,300	9,400

- The landlord will be £2,100 worse off under the new rules (from 2020).

Changes to Capital Gains Tax

- After 5 April 2016 the calculation of the amount of the chargeable gain remains unchanged.

- For disposals of residential property which are not eligible for private residence relief, the rates of CGT remain at 18% (for lower rate taxpayers) and 28% (for higher rate taxpayers).

- The rates of CGT applicable to the chargeable gain on the sale of non-residential properties have been reduced to 10% and 20%.

Inheritance Tax ("IHT")

- Rental Properties subject to IHT when the owner dies
- IHT due at 40% on person's estate on any value above the Nil Rate Band (currently £325,000)
- 'Seven Year Clock' if any properties given away
- No relief available

Stamp Duty Land Tax ("SDLT")

- Increase of 3% on standard residential SDLT rates
- Where more than one property owned at the end of the day
- Second homes (or a company's first property) or buy to let
- Applicable to purchases by Individuals and companies.

Purchase Price of Property	Rate of Stamp Duty	Buy to Let/ Additional Home Rate (from April 2016)
£0 - £125,000*	0%	3%
£125,001 - £250,000	2%	5%
£250,001 - £925,000	5%	8%
£925,001 - £1.5 million	10%	13%
£1.5 million+	12%	15%

Incorporation

- Historically properties were held personally due to two layers of tax in a company
- Pensions unable to own residential properties
- Company ownership becoming more attractive due to interest relief restriction (but watch increased dividend tax rates).
- CGT, Stamp Duty Land Tax and mortgages (among many other things) to consider
- Could be worth incorporating property business or purchasing new properties in a company
- Personal circumstances will dictate whether incorporation is beneficial
- Seek advice before doing anything – relief is not automatic

Incorporation V Personal; Example 1

	Personal	Company
Profit (before interest)	40,000	40,000
Interest	-	(35,000)
Profit	40,000	5,000
Income tax due at 40%	16,000	
Corporation Tax at 19%		950
Tax reducer (for interest - £35,000 at 20%)	(7,000)	
Tax liability	9,000	
Net cash in hand	(4,000)	4,050

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Incorporation V Personal; Example 2

	Personal	Company
Profit (before interest)	100,000	100,000
Interest		(40,000)
Profit	100,000	60,000
Income tax due at 40%	(40,000)	
Corporation Tax at 19%		(11,400)
Tax reducer (for interest)	8,000	
Tax liability	(32,000)	
Net cash in hand/available for distribution	28,000	48,600
Dividend taxable at 32.5%		(15,795)
Net cash in hand	28,000	32,805

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Trusts

- Ideal way of making gifts to younger generation, relief could be available to defer any CGT charge.

- Could reduce IHT liability.

- Trusts could provide additional protection from future bankruptcy and/or divorce of the younger generation.

- Generally only suitable when original owner does not require the rental income or capital value now or in the future.

Wills

- Often overlooked
- Ensure properties and estate go to the people you would like to benefit
- Intestacy could result in properties going elsewhere or creating an unnecessary IHT liability
- Watch jointly owned properties

Summary

- We often find people do not give as much thought to property letting as they would do with their business
- Recent changes in legislation should give another reason to review how properties are owned
- More detailed records will need to be kept to ensure all expenses can be claimed and justified to HMRC.
- Every person has different circumstances and bespoke advice to optimise all taxes is usually required – we are happy to help

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