BUY-TO-LET TAX CHANGES

Buy-to-let landlords are potentially set for steep increases in the tax they pay on their rental properties as a result of the taxation changes being phased in. With this in mind, we wish to give you a useful guide of how these may impact those who own rental properties or are planning to enter the buy-to-let market.

What are the buy-to-let tax changes and when do they apply?

Effective from April 2015

- As a non-resident selling a UK residential property you need to report and pay Capital Gains Tax within 30 days of conveyance.

Effective from April 2016

- The 10% wear and tear allowance for fully furnished residential properties has been replaced with the Replacement of Domestic Items relief. This relief is for costs incurred on replacing furniture, furnishings, appliances (including white goods) and kitchenware provided for the tenant's use in the property. The new relief is available to corporate and non-corporate landlords of residential property and in respect of expenditure on unfurnished or part or fully furnished property.
- You will normally have to pay 3% on top of the normal Stamp Duty Land Tax rates for purchases of additional residential properties, such as buy-to-let properties and second homes. However, transactions under £40,000 are not subject to the higher rates.
- The cut to capital gains tax will not be applied to landlords. The basic rate of capital gains tax has reduced from 18% to 10%, while the higher rate has fallen from 28% to 20%. Profits made from assets such as stocks and shares will now be subject to these lower rates of tax but the same is **not** true of properties. Landlords (and homeowners) who have a chargeable gain when selling their property are subject to an 8% surcharge that those selling other assets do not.
- Properties owned by non-natural persons (e.g. a company) which are worth over £500,000 will be brought into the scope of Annual Tax on Enveloped Dwellings (ATED). This band brings significantly more properties into the scope of ATED annual tax and ATED related Capital Gains Tax. ATED applies to high value UK residential property owned on, or acquired after 1 April 2013.
- Rent a room allowance increased to £7,500. The Rent a room scheme allows a person to let out furnished accommodation in their home tax free up to the threshold of £7,500 per tax year. This allowance is halved if the income is shared. You can let out as much of your home as you want. The tax exemption is automatic, if you earn less than the threshold. This means you don't need to do anything. You must complete a tax return if you earn more than the threshold.

Effective from April 2017

- 75% of finance costs will be allowable as a deduction against rental profits, with remaining 25% being available as a basic rate tax deduction on residential lettings. (See more detail below).
- A £1,000 annual tax allowance comes into effect. Individuals with property income below the allowance will no longer have to report or pay tax on that income. Individuals with property income exceeding the allowance can choose to deduct £1,000 from their income instead of deducting the actual allowable expenses. The new allowance will not apply to a property business in partnership and is ideal for those renting car park spaces or other areas within their home.

Effective from April 2018

- 50% finance costs deduction and 50% given as a basic rate tax deduction on residential lettings.

Effective from April 2019

- 25% finance costs deduction and 75% given as a basic rated deduction on residential lettings.
- Capital Gains Tax to be reported and paid within 30 days of a residential property sale. This will apply to a buy-to-let property and second homes where the gain is not covered by private residence relief.

Effective from April 2020

- All financing costs incurred by a landlord will be given as a basic rate tax deduction on residential lettings.

Other proposals

- The *Making Tax Digital* project, which will see taxpayers providing HM Revenue & Customs with quarterly updates on their income and expenditure figures rather than filing a yearly return. This was originally intended to be brought in from April 2018, but has now been parked. It is not known at this present time how long this proposal will be delayed by.

Restricting Mortgage Finance Cost Relief

Restrictions on finance costs are being phased on from 6th April 2017. The full effect of these changes will be implemented from **6 April 2020,** whereby tax relief for finance costs will be fully restricted to the basic rate of income tax, currently 20%. Relief will be given (provided certain conditions are met) as a reduction in tax liability instead of an expense against rental income.

Who is affected?

- These new rules only apply to individuals with residential property businesses.
- They do not apply to companies.
- They do not apply to land and property dealing or development businesses, commercial lettings or furnished holiday lets.

Conditions for 20% tax reducer relief

The maximum finance costs relievable at 20% **in a tax year** are capped to the lower of:

a) Finance costs not deducted against income
b) Rental profits
c) Taxable income

Examples

For ease in 2020/21 say - Salary £20k, Rent income £15k, Other expenses £8k and Finance costs £10k. The taxable rental profit is £15k - 8k = £7k, therefore the maximum Finance costs relievable is capped at £7k @ 20%. The remaining £3k (£10k - 7k) is carried over to next year. Cash flow for a higher rate taxpayer would result in a shortfall of £15k - £8k - £10k - £1.4k (Tax) = £4.4k. Meaning tax of £1.4k payable on a £3k loss!

2021/22 say - Salary 20k, Rent income £15k, Other expenses £3k and Finance costs £10k. The taxable rental profit is £15k - 3k = £12k, therefore Finance costs of £12k are relievable @ 20% made up from £10k this year and £2k brought forward from 2020/21. This leaves £1k to carry forward to 2022/23. Cash flow for a higher rate taxpayer would be a shortfall of £15k - £3k - £10k - £2.4k (Tax) = £400.

Practical considerations

- The increase in rental profits will lead to an increase in total income liable for tax. The changes mean that basic rate taxpayers could find themselves pushed into a higher rate tax band as a result or that capital gains become taxable at 28% instead of 18%.
- The effects depend on your circumstances - other income, capital gains and available reliefs.
  - For example, there is an impact for anyone claiming tax credits or if you or your partner claims child benefit and the change increases your adjusted net income above £50,000. If so then child benefit can be clawed back under the High Income Child Benefit Charge.
- You may be able to reduce your taxable income by investing into a pension or by making charitable donations by claiming Gift Aid. Gift Aid donations can be carried back to the preceding tax year.

Various options

- Set up a company and sell your properties to it – although this will trigger Capital Gains Tax and Stamp Duty liabilities and you will need to re-mortgage.

- Sell properties that are no longer profitable and reduce loans. The changes should prompt landlords to reassess their holdings, with a view to selling up or paying off some of the loan. Where you have a portfolio, it may make sense to sell one property and reduce the borrowings on others.
- Attempt to cut costs to offset the extra tax you will be paying.
- If you don't own properties yet but you are thinking about it, you might want to consider buying them in a Limited company structure and pay dividends of £5,000 with no tax charge (assuming you have no other tax dividends). There is however a potential double tax charge to withdraw company funds on a sale.
- Exploit your spouse's personal allowance or lower rates of taxation. Where you make profits, if your spouse is not working or is taxed in a lower bracket than yourself, you may be able to assign part or all of the rental income to them. This will allow you to potentially save income tax as a family by using their lower tax bands. Consideration must be taken for capital disposals so not to lose an Annual Exemption of a spouse when selling a property.
- Re-mortgage – by re-mortgaging you may be able to save annually on your interest bill. Consider fixing to avoid any potential shocks if you would suffer from a rate rise. If you re-mortgage before 6th April you will benefit from an extra 25% of arrangement fees at a higher tax saving until the full restriction is in place.

Getting Expert advice

As you can see there have been substantial buy-to-let tax changes recently, both to the stamp duty (SDLT) you now pay when you buy an investment property, and also the way that tax is calculated on rental income. Buy-to-let can be quite complex, particularly if it's your first investment property, so ideally you need to get expert advice on your circumstances. It's always best to get professional advice to ensure you understand what changes may affect you, as this will vary greatly depending on your income and personal circumstances.

How can Rawlinson Pryde & Partners help?

- Guide you through the complex tax changes.
- Help you work through your options e.g. should you make the change to a Limited company? The answer depends on a number of factors such as how many properties you hold, whether you need the income quickly and how long you want to hold the properties for and your individual circumstances.
- Assist with the preparation of your self-assessment tax return for timely and accurate submission to HM Revenue & Customs.
- Prepare calculations to assist you with investment decisions
- Assist with ATED (Annual Tax on Enveloped Dwellings) and ATED related Capital Gains Tax returns and liabilities and liaise with HMRC in relation to such returns.
- Advise on how best to structure in light of ATED and the forthcoming changes from April 2017 and how to unwind structures in the most tax efficient way.
- Plus many more ways, we are always on hand to answer your questions.

There are two main benefits of using an accountant: ***peace of mind*** and ***saving money.*** With regard to peace of mind, if you have an accountant working for you, you know that everything is in order; all the tax returns will have been sent, and that you are doing everything above-board. The second reason for using an accountant is saving money. If you are letting or selling a property, you will need to pay tax; an accountant can devise a scheme that is tailored to your situation and, where possible, trim your overall tax bill by applying their knowledge of the property tax system to your specific situation.

Rawlinson Pryde & Partners offer a wide range of services, provided by qualified accountants and specialist Chartered Tax advisers at competitive prices. For a free initial consultation please contact:

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