Buy-to-Let Taxation Changes

There have been many tax law changes announced for properties and in particular Buy-to-Lets.

Proposed Timetable

Effective from April 2015

- Capital Gains Taxation to be reported and paid by Non UK Residents within 30 days of a sale

Effective from April 2016

- Abolition of the 10% wear and tear allowance for furnished properties and the introduction of a new replacement of domestic items relief available for an unfurnished, part or fully furnished property
- 3% Stamp Duty surcharge for purchases of £40K or more
- Capital Gains Tax at 18% (10% + 8%) basic rate taxpayer or 28% (20% + 8%) higher rate taxpayer
- Annual Tax of Enveloped Dwellings compliance threshold reduced to properties valued at £500k
- Rent-a-room allowance increased to £7,500

Effective from April 2017

- 25% of total finance costs restricted to 20% relief on residential lettings
- £1k Property related rentals allowance introduced e.g. a driveway, garden, shed/store.

Effective from April 2018

- 50% of total finance costs restricted to 20% relief on residential lettings
- Introduction of Making Tax Digital

Effective from April 2019

- 75% of total finance costs restricted to 20% relief on residential lettings
- Capital Gains Tax to be reported and paid within 30 days of a residential property sale

Effective from April 2020

- 100% of total finance costs restricted to 20% relief on residential lettings

Restriction of Finance Costs

Issues

The introduction of these laws has potential taxation issues.

- Negative cash flow due to the tax increase including possible taxation on overall property losses.
- Change in your marginal (highest) tax rate.
- Tapered loss of child benefit from having an adjusted net income (ANI) in excess of £50k.
- Tapered loss of personal allowance if your ANI breaches £100k.
- Reduction in savings allowance for a Higher Rate Taxpayer - e.g. if you had £1k of interest and went into the higher rates by £1, you would have an additional tax liability of £100 for that £1!

From April 2017 finance costs will be gradually restricted from your marginal tax rate to a 20% tax reducer with the full restriction in effect in April 2020. There's a further complication whereby the maximum finance costs relievable at 20% 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.

In the 2 years there has been a cash flow shortfall of £4.8k, so if highly leveraged and with minimal sources of other/disposable income this may become unsustainable, which is shown in Scenario 3.

Scenario 1 - A basic rate (20%) taxpayer is dragged into becoming a higher rate (40%) taxpayer resulting in the £1k savings allowance being reduced to £500, and the child tax benefit being partially withdrawn.

Scenario 2 - A higher rate (40%) taxpayer who was comfortably below the £100k threshold falls into the 60% tax range as the personal allowance is abated at a rate of £1 for every £2.

Scenario 3 - A highly leveraged landlord who's used increases in property values to build a large portfolio.

Tax Planning

A range of tax planning opportunities exist for Income Tax (IT), Capital Gains Tax (CGT) and Stamp Duty Land Tax (SDLT) (although mortgage implications should be considered). A non-exhaustive list includes:

- **IT** If you have a spouse whose marginal rate of taxation is lower than yours; you could consider transferring a share of the property to them via the HMRC Form 17 and a Declaration of Trust.
- **IT** Re-mortgage before 6th April to benefit from extra 25% of arrangement fees at a higher tax saving.
- **IT** Make personal pension contributions from relevant earnings (excludes rental profits).
- **IT** There are no restrictions to Commercial land and buildings nor Furnished Holiday Lets.
- **IT** Purchase new properties in a Company and pay dividends with no potentially no tax charge. Potential double tax charges to withdraw Company funds on a sale.
- **CGT** Incorporation relief available for a "business" - Ramsay case.
- **CGT** Sale of company shares are at 10% and 20% for basic rate and higher rate taxpayers respectively.
- **CGT** Use EIS deferral relief to convert a gain to a lower tax rate. The investment value can go up or down.
- **SDLT** Avoid the 3% stamp duty surcharge on properties of £39,999 or less. Purchase with unconnected persons – where you each having a £39,999 share could save a total SDLT saving of £3,600. However, you should always have a written agreement to cover any dispute and we can recommend solicitors.
- **SDLT** Multiple Dwellings relief - transfer of 6 or more properties to a company.
- **SDLT** Incorporation of a partnership or preferably a Limited Liability Partnership.

Services

Whether it is a one off rental property review, tax planning exercise or you wish a professional adviser to complete your Tax Return or assist you with incorporating to a limited company we pride ourselves on a quality service provided by a qualified accountant and/or tax adviser at competitive prices.

Disclaimer

As with all tax law it is subject to change and this is to be only used as a guide for illustrative purposes to help show how the changes may affect you as they stand. It is no substitute for proper tailored advice for your individual circumstances and you should always consider seeking a professional before acting.