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TAX AND PROPERTY: AN OVERVIEW OF KEY CHANGES

The Government has announced a series of changes to the property tax regime in recent months. This factsheet considers the tax implications of owning property and looks ahead to some of the reforms planned for 2016 and beyond, including changes to Stamp Duty Land Tax (SDLT), the Land and Buildings Transaction Tax (LBTT) in Scotland, rent-a-room relief, landlord tax reliefs and the proposed reform of the wear and tear allowance.

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.

Forthcoming changes

Currently, buy-to-let landlords get relief on interest payments against rental income. This effectively gives them relief at their top rate of income tax – which could be up to 45%.

In a move which Chancellor George Osborne promised would 'level the playing field', landlord tax interest relief will see a phased reduction over four years, starting from April 2017, which will eventually bring the effective rate of relief down to the basic tax rate of 20%.

Repairs and replacements

Where a property is let either partly furnished or unfurnished, tax relief is currently given for repairs to the property, such as repainting the interior or exterior. If an 'integral fixture' is replaced (e.g. bath, washbasin, toilet etc), tax relief is also given. Under the existing rules, there is no relief for the replacement of furnishings, although this is set to change (see right).

Where a property is let fully furnished, tax relief is currently given for the repair of the property – this also includes the replacement of integral fixtures. In addition, an allowance is available to cover wear and tear on certain items such as suites, beds, carpets, curtains, linen and crockery. For such items it is possible to claim an annual wear and tear allowance equal to 10% of the rents received (less certain expenses) to cover the cost of replacement furnishings.

Forthcoming changes

From April 2016 the wear and tear allowance is set to be replaced with a new relief that allows all residential landlords to deduct the actual costs of replacing their property furnishings.

HM Revenue & Customs (HMRC) has also proposed extending the tax break to include partly furnished or unfurnished properties. The new 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.

SDLT and LBTT on additional properties

SDLT and LBTT on the purchase of residential properties are now charged on the portion of the purchase price which falls within set rate bands.

Forthcoming changes

From 6 April 2016, higher rates of SDLT and LBTT will be charged on purchases of additional residential properties (above £40,000), such as buy-to-let properties and second homes. The higher rates will be three percentage points above the current rates.

Furnished Holiday Lettings

A number of different tax rules apply to income from FHLs, which can qualify for some very 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.

Rent-a-room relief

Under the 'rent-a-room' scheme, income from letting furnished rooms in your main residence is exempt from tax if the gross annual rent does not exceed £4,250 (£2,125 if you share the income) in 2015/16.

Forthcoming changes

From 6 April 2016 the limit for rent-a-room relief will be increased to £7,500 per year. The change is expected to remove some individuals from the requirement to complete a Self Assessment Tax Return. If you rent out rooms in a guest house or bed and breakfast you will still qualify for the relief, providing the property is your main residence.

Capital gains tax (CGT)

CGT is a tax payable on any profit that is made when selling or disposing of a property – but reliefs may be available.

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

Forthcoming changes

From April 2019, a payment on account of any CGT due on the disposal of residential property will be required to be made within 30 days of the completion of the disposal. This will not affect gains on properties which are not liable for CGT due to Private Residence Relief. Draft legislation will be published for consultation in 2016.

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. In these circumstances, 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. if you are a property developer) then 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 of CGT payable.

Entrepreneurs' Relief

For sole traders or business partners, this relief can help to lower the CGT bill, meaning that you will pay tax at 10% on qualifying assets, rather than the normal rates of 18% or 28%. 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.

Tip

It may be beneficial for a married couple to own a non-exempt residence jointly as each person will be entitled to the annual CGT exemption, which is currently £11,100.

Inheritance tax (IHT)

IHT is currently payable at 40% on the proportion of an individual's estate valued at more than £325,000.

IHT and your home

Many individuals have found that historical increases in property values mean that their estates could be liable for IHT when they die.

The Government has announced plans to introduce an additional nil-rate band, which may effectively take the family home out of IHT. It will apply 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 will also apply if the property is passed to a current or surviving spouse or civil partner of a direct descendant.

Forthcoming changes

The new allowance will take effect for relevant transfers on death on or after 6 April 2017. It will serve to reduce the tax payable by an estate on death. Initially set at £100,000 for 2017/18, the allowance will rise by £25,000 annual increments to reach up to £175,000 in 2020/21.

There will be a tapered withdrawal of the main residence nil-rate band for estates with a net value of more than £2 million (at a withdrawal rate of £1 for every £2 over this threshold).

It is proposed that the new nil-rate band will also be 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 provide advice on all aspects of tax and property – please contact us for help with planning ahead.