SPECIAL REPORT

2015 Summer Budget Update:

Key Changes To Property Taxation Over The Next Few Years

By Lee Sharpe

PROPERTY TAXINSIDER

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'2015 Summer Budget Update: Key Changes To Property Taxation Over The Next Few Years' - Published August 2015.

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1 About Lee Sharpe

Lee is a creative Chartered Tax Adviser with nearly 20 years' experience of advising property investors and family businesses on tax matters.

He is also an experienced tax writer: As well as writing for taxationweb.co.uk, Lee is a lead writer for Property Tax Insider (taxinsider.co.uk) and its sister publications, and is Technical Editor of '101 Property Tax Secrets Revealed'. He has written a number of specialist property tax saving reports that are available through the Tax Insider website.

2 Chancellor Invites You to Pay Tax on Profits You Didn't Make...

The Summer Finance Bill 2015 as proposed in early July by the Chancellor of the Exchequer, George Osborne, is relatively short – only 50 clauses – but several parts deal with changes which may have significant tax implications for landlords.

My initial summary of the latest Finance Bill was that Mr. Osborne had grabbed with both hands the opportunity to demonstrate how inventive he could be at getting round the Conservative Party's election pledge – not to raise either Income Tax or National Insurance rates – so as still to relieve UK taxpayers of yet more of their hard earned cash.

And make no mistake, this Budget is rather more about raising money for the Exchequer than anything else: it aims to net in excess of £6billion a year, by 2020/21 – **with more than 10% of that coming from just one of the measures aimed at landlords and set out below.**

We shall now look at the following matters raised in the 2015 Summer Budget, roughly in order of priority:

1. Disallowing Tax Relief for Mortgage and Other Finance Costs – Residential Properties
2. (Property) Companies and Increased Taxes on Dividends Paid to Shareholders
3. Abolition of "Wear and Tear Allowance" for Fully Furnished Residential Properties
4. Inheritance Tax Uplift on the Main Home (Implications for Property Investors)
5. Rent a Room Relief Increase
6. Annual Investment Allowance (Predominantly Commercial Lettings)
7. Non-Domiciled Persons and Inheritance Tax on UK Property

3 Restricting Tax Relief on Mortgage Interest and Related Finance Costs

The Chancellor has announced that tax relief will be restricted for mortgage interest, etc., incurred for the letting of most types of residential property, or "dwelling houses", by individuals. The restriction is not a complete disallowance but is likely to disadvantage many residential property landlords. In order to soften the blow, the disallowance is being introduced in stages over several tax years – "death by approximately four cuts", if you will.

Once fully implemented, this single measure is expected to cost landlords more than £660million in additional tax.

3.1 Will it Affect Me?

There is more than a good chance that many residential property landlords will be caught by the new rules. Those who think they will be unaffected because they make only relatively small rental profits should consider carefully the effect of these changes as set out in the **Examples** below.

The new rules affect:

- Finance costs – interest, anything economically equivalent to interest, and incidental costs of obtaining finance, including to

    o Buy a dwelling to let out, or any interest in such a property and even to -

    o Develop land or existing property, to be let out as an ordinary dwelling(s), incurred in relation to -

- "Dwelling houses" – not defined in the legislation but most types of residential accommodation, including its gardens or grounds, by -

- Individuals – which will include individuals acting jointly (see also Partnerships, Companies and Trusts below)

Where the finance costs are incurred only partly for residential letting, then they are to be apportioned on a 'just and reasonable basis'.

When the measure was announced, the government said that it expected that roughly only 20% of individual landlords would be adversely affected. I suspect that is nonsense. Given that HMRC also estimates that there are around 1.5million landlords in the UK, even this would represent a very large number.

However, the real number of landlords likely to be affected will probably be much higher, since the government appears to have factored in only taxpayers using "Buy-To-Let" ("BTL") mortgages. Most readers will be well aware that there are very many properties which are let out on normal mortgages – or at least not BTL mortgages – for various reasons.

Interest on any loan applied for a Furnished Holiday Letting business (or part of a larger letting business) will be unaffected by the new rules. Hotels are not property businesses from a tax perspective but trades, so will also be unaffected.

3.2 Partnerships, Companies and Trusts

The original guidance, which was published at the beginning of July, indicated that only individuals would be 'caught' by the new rules. Companies were not mentioned, nor were partnerships. The legislation itself, however, says **that interest will be disallowed for all property businesses subject to Income Tax.**

Individuals, partnerships and Trusts therefore seem all to be caught by the new rules.

Companies are specifically excluded, except when acting in a fiduciary or representative capacity. This means that non-Resident Company Landlords will generally escape the new restriction.

However, Trustees should note in particular that the provisions which give Basic Rate tax relief (see below) makes no mention of trusts.

3.3 How Will it Affect Me?

In effect, if you are a 40% or 45% taxpayer, then an extra £1 of tax relief from loan interest saves 40p or 45p respectively. Restricting the tax relief to only 20% - 20p per £1 – means that this measure will effectively cost 20p or 25p in the £1 for Higher and Additional Rate taxpayers respectively.

The restriction will work by disallowing the finance costs entirely in the calculation of taxable rental profits (this part is being phased in over several tax years) and then separately most* taxpayers will instead be able to claim Basic Rate tax relief of 20% on at least some of their disallowed interest costs. (A partner's share of the rental profits determines his or her share of the tax deduction).

There are, however, various restrictions to the 20% tax credit. This makes the calculation complex but the rationale appears to be that the tax credit is only used against 'full' 20% tax, rather than going against only 7.5% 'new' dividend tax, or savings which might be covered by the new so-called "Allowances" for savings and dividend income. The adjustments appear to turn a blind eye to losses set against total income, however, which seems quite wasteful.

Most people will concentrate on the loss of Higher / Additional Rate tax relief, but disallowing finance costs and thereby increasing taxable rental income seems likely also to affect people on relatively modest incomes for:

- Student loan repayments
- Tax Credits entitlements

*The Income Tax deduction is available to individuals who are subject to Income Tax on an affected residential rental property business. This may prove problematic for Trusts which make discretionary payments of income to individual beneficiaries.

3.4 When Will it Affect Me?

The new rules will be phased in from April 2017:

- 2017/18 75% of finance costs allowable as in the past, and 25% gets only 20% tax relief
- 2018/19 50% of finance costs allowable as in the past, and 50% gets only 20% tax relief
- 2019/20 25% of finance costs allowable as in the past, and 75% gets only 20% tax relief
- 2020/21 No finance costs allowed against rental profits, 100% gets a maximum 20% tax relief

3.5 Examples (based on current understanding of draft legislation)

1. Bill is an employed IT programmer and earns £50,000 a year. He is a 40% taxpayer. He also lets out the property he used to live in, before he moved in with his spouse, and that property generates £5,000 a year net rental income after £3,000 interest deductions on an interest-only mortgage.

Tax Year:	2016/17	2017/18	2018/19	2019/20	2020/21
	£	£	£	£	£
Earnings	50,000	50,000	50,000	50,000	50,000
Net Rent after Mortgage	5,000	5,000	5,000	5,000	5,000
Add-back Rental Finance	0	750	1,500	2,250	3,000
Total	55,000	55,750	56,500	57,250	58,000
Tax Liability	11,200	11,340	11,640	11,940	12,240
Original	0	-150	-300	-450	-600
Rental 20% Tax Credit	11,200	11,190	11,340	11,490	11,640
Net Tax	0	-10	140	290	440
Tax increase on 2016/17					

In the end, Bill is paying almost 50% tax on his rental profits, when all of his interest costs have been added back. The disallowance of loan interest relief at his main tax rate costs him far more in tax than the new 20% saving adjustment.

2. James is a full-time property investor, running 15 residential properties. He is heavily geared and his interest repayments eat up about 50% of his rent roll. Let's also assume that his interest costs of £40,000 a year increase by 5% per annum, as rates are expected soon to rise:

	2016/17	2017/18	2018/19	2019/20	2020/21
	£	£	£	£	£
Net Rent after Mortgage	40,000	40,000	40,000	40,000	40,000
Add-back Rental Finance	0	10,500	22,050	34,728	48,620
Total	40,000	50,500	62,050	74,728	88,620
Tax Liability					
Original	5,800	9,240	13,860	18,931	24,487
Rental 20% Tax Credit	0	-2,100	-4,410	-6,946	9,723
Net Tax	5,800	7,140	9,450	11,985	14,764
Tax increase on 2016/17	0	1,340	3,650	6,185	8,964

This example shows why landlords cannot ignore these new rules, even if they currently pay only 20% tax. Critically, the mortgage interest disallowance is enough to make James a 40% Higher Rate taxpayer anyway, because his interest costs are so high. **By 2020/21, James' taxable profits are more than double his actual profits because by this point his interest costs are fully disallowed.**

3.6 What Should I Do?

This might seem like an open invitation to incorporate your property business – and in fact incorporation can offer numerous benefits, depending on the circumstances – but, as many readers will know:

- Companies generally find it harder to secure finance for BTL property

- Interest rates are usually significantly higher for corporate loans

- There may be significant "one-off" costs to incorporating an existing business, such as legal fees, Stamp Duty Land Tax and Capital Gains Tax, although Incorporation Relief may be available, thanks to the **EM Ramsay case**

- In terms of running your own company, dividend income is about to get a lot more expensive (see next Budget development)

If you have both a trade and a residential property business, then it would make sense to ensure that any finance costs are incurred more in respect of the fully deductible trading activity than the residential property business. Taxpayers and advisers may well want to re-acquaint themselves with the guidance on tax relief on funding capital introduced into a business, in HMRC's Business Income Manual at BIM45700.

A similar approach might benefit those with both commercial and residential properties but 'partitioning' interest costs may be more difficult. HMRC may well try to argue that, if the rental business is an aggregation for tax purposes, the interest should be apportioned rather than specifically allocated to commercial lettings which escape the disallowance. It is sometimes possible to own property in different capacities so that the net incomes are not aggregated but care and advice will be essential, with an eye in particular to the potential loss of flexibility of rental losses.

Will some landlords ditch residential property completely in favour of commercial letting? I suspect it will increase the appeal of commercials.

3.7 Why is the Government Doing This?

The Finance Bill Explanatory Notes argued that this measure would "...ensure that landlords with higher incomes no longer receive the most generous tax treatment." Which is clearly nonsense, since those landlords with higher incomes will enjoy those higher incomes precisely because they have relatively fewer (or lesser) costs and by implication, lower interest repayments. It appears instead to be a politically astute revenue-raising exercise.

4 Companies: Increased Tax On Dividends To Shareholders

The Chancellor announced some sweeping changes for dividends, which will be of interest to corporate landlords.

4.1 Will it Affect Me?

It will affect everyone who is in receipt of dividends – whether from your own company, or from BT, or any company in between. Those most affected are likely to be individuals who run their own companies – be it property investment or otherwise – and who have traditionally paid themselves a modest salary "topped up" with dividends.

4.2 How Will it Affect Me?

Dividends will be taxed more heavily:

• Basic Rate Band	7.5%	(i.e., previous effective tax rate of 0% + 7.5%)
• Higher Rate Band	32.5%	(i.e., previous effective tax rate of 25% +7.5%)
• Additional Rate Band	38.1%	(i.e., previous effective tax rate of 30.56% + 7.5%)

However, the first £5,000 received each year will be tax-free, and there will no longer be a 10% notional tax credit.

4.3 When Will it Affect Me?

The new regime will apply from April 2016 – but it is possible that you will want to take steps now to accommodate these changes.

4.4 Practical Points

The guidance on this new measure is extremely limited, even though it is intended to commence early next year. This is probably deliberate, to give people little opportunity to avoid the impending tax hike.

Now that the line has been crossed, how long will it be before the additional 7.5% becomes 10%, or even more?

4.5 What Should I Do?

Certainly, anyone who is contemplating incorporation – for instance, to circumvent the new restrictions for interest relief – will need to factor in the significantly increased tax cost of dividends.

For those who have not previously maximised their use of dividend income in the Basic Rate band, (where the tax rate – for the rest of this tax year at least – is effectively nil), then making 'pre-emptive' dividend payments could improve tax efficiency. But professional advice should always be sought to ensure that this manoeuvre really will prove beneficial.

4.6 Why is the Government Doing This?

These measures will increase the tax cost of having your own limited company. The Chancellor suggested that the new lower Corporation Tax rates he had introduced were creating "rapidly growing opportunities for tax planning" so something had to be done. I suspect that most small company owners would have preferred that he simply not bother introducing his new low Corporation Tax rates, but it seems he was more interested in attracting overseas multinationals than worrying about small companies and their owners. **The changes are supposed to net a staggering £2.5billion to the Treasury next tax year**, so his argument that "85% of those who receive dividends will see no change or be better off" clearly belies the fact that a lot of people are going to be very much worse off.

Legislation has not yet been published but, based on the scant guidance available, the following comparison has been made for various levels of dividend income:

	2015/16	**2016/17**	**2015/16**	**2016/17**	**2015/16**	**2016/17**
	£	**£**	**£**	**£**	**£**	**£**
Salary	10,000	10,000	10,000	10,000	10,000	10,000
Net Dividend	30,000	30,000	60,000	60,000	120,000	120,000
Total Income	40,000	40,000	70,000	70,000	130,000	130,000
Total Tax Cost	213	1,800	7,713	10,800	27,098	35,125
Extra 2016/17		**1,587**		**3,087**		**8,027**

5 Abolition Of Wear And Tear Allowance For Fully Furnished Residential Properties

The guidance issued with the Summer Budget Statement announced that the Wear and Tear Allowance would be 'reformed' by replacing it with "a new relief" which would allow landlords to claim a deduction for the actual cost of replacing furnishings.

The guidance actually said:

"Currently, landlords of furnished properties can deduct 10% of their rent from their profit to account for wear and tear, irrespective of their expenditure. This means landlords can reduce their tax liability even when they have not improved the property."

It would perhaps be appropriate to point out:

- The Wear and Tear Allowance is available only to fully furnished properties
- It was never meant to encourage landlords to improve a property but simply to allow for the cost of maintaining its furnishings, etc.

It is also worth bearing in mind that the Wear and Tear Allowance was originally intended to cover items that a tenant or owner occupier would normally provide in unfurnished accommodation, e.g.:

- movable furniture or furnishings, such as beds or suites;
- TVs;
- fridges and freezers;
- carpets and floor-coverings;
- curtains;
- linen;
- crockery or cutlery;
- other white goods which, in unfurnished accommodation, a tenant would normally provide for himself (for example, cookers, washing machines, dishwashers).

In case any reader is experiencing a strong sense of déjà vu, the list is an almost verbatim lift from the venerable IR150 booklet – now deemed obsolete.

5.1 Will it Affect Me?

While the abolition of the Wear and Tear Allowance will affect only fully furnished residential properties, the "new relief" is likely to affect all residential properties, including those only partly furnished.

At the moment, HMRC's position is that the cost of replacing free-standing furnishings is not allowable, which is a deviation both from decades of former practice and their initial guidance published in December 2011.

Many tax advisers (including this one) disagree that the renewals basis, which (amongst other things) allows the cost of replacing free-standing furniture in a furnished property, was ever abolished by the withdrawal of either of the Extra-Statutory Concessions B1 or B47. Nevertheless, it seems likely that it will be less contentious to claim relief for such items, once the "new relief" is introduced.

5.2 How Will it Affect Me?

The following example illustrates the changes.

5.3 Example

Jennifer owns a flat which she lets out on a fully furnished basis, for £1,000 a month. As she owns much of the contents of the flat, she has a separate contents insurance policy which costs £500 annually. (As contents insurance would ordinarily be the tenant's burden an adjustment is required to the Wear and Tear Allowance claim). In 2015/16, she replaces a television for £500. In 2016/17, she replaces the living room suite for £1,400.

	2015/16			**2016/17**	
	£	**£**		**£**	**£**
Gross Rent		12,000			12,000
Less:					
Replace TV/suite	N/A*			1,400	
Contents insurance	500			500	
Other costs	2,500			2,500	
		3,000			4,400
Net Rental Profit		9,000			7,600
Wear and Tear:					
Gross Rent	12,000			N/A	
Less: Contents Insurance	500			N/A	
				N/A	
	11,500			N/A	
Wear & Tear @ 10%	10%			N/A	
		1,150			0
Tax-Adjusted Profit		7,850			7,600

*As Jennifer is letting the flat fully furnished – i.e., it has been let with sufficient furniture for normal residential use – she is allowed to claim the Wear and Tear Allowance if she prefers. Where her actual costs are lower, then it clearly suits her to do so – but she cannot also claim the cost of replacing items which are 'covered' by the Allowance. (In fact, since April 2013, HMRC would say she cannot claim for the replacement of free-standing items anyway although, as mentioned above, that is a contentious issue).

Once the Wear and Tear Allowance is abolished and effectively replaced by the new relief, it seems likely that free-standing items will become claimable again, as per the example above.

5.4 When Will it Affect Me?

The Wear and Tear Allowance is being abolished from April 2016 – the "new regime" should take effect from the same date. A consultation on the new regime is planned for Summer, this year.

5.5 Practical Points

The 10% Wear and Tear Allowance was intended to cover the costs of replacing furnishings, and not to benefit or to disadvantage claimants, although there might be some individual landlords who could derive a net benefit if the Allowance exceeded their annual costs of replacing furnishings.

The Wear and Tear Allowance was very simple to administer and, while a simple 'replacement basis' will also be a straight forward concept, it presents the following challenges:

- Recording and claiming the cost of all the many small items which will now have to be identified individually – cushions, spoons, cuddly toy, etc.

- Although some tenants will keep landlords informed as the tenancy progresses, it seems likely that there will be peaks of expenditure between tenancies – effectively when making good for a new tenant – compared to the relatively flat deductions previously enjoyed under the Wear and Tear Allowance

- This is in turn likely to exacerbate problems with finance costs as above, since the limited benefit of the replacement tax deduction is broadly restricted to no more than net rental profits for the year

The above example assumes that HMRC's statement that the new relief will "enable all landlords of residential property to only deduct costs they actually incur" can be taken at face value.

The new regime is unlikely to be called "the renewals basis". It may prove entertaining to cynical tax advisers to watch HMRC try to distinguish the new regime from the renewals basis which HMRC says it abolished in 2013.

5.6 What Should I Do?

If currently claiming Wear and Tear Allowance, make the most of it. Bearing in mind that future relief relies on actual cost but the Wear and Tear Allowance requires only that the property be satisfactorily furnished, it would seem sensible to delay incurring any further replacement costs, at least until after the new regime is introduced, where practical to do so.

5.7 Why is the Government Doing This?

It could perhaps be argued that the new regime is more equitable than the simple Wear and Tear Allowance, which landlords could potentially abuse by limiting actual renewals expenditure. According to the Summer Budget 2015 Notes, this measure is expected to yield a further £160million+ per year from 2017/18 onwards.

6 Inheritance Tax Uplift On The Main Home

A new additional Nil Rate Band for Inheritance Tax (IHT) was announced, which would increase each individual's tax-free estate to up to £1million – with further enhancements possible by virtue of the Transferrable Nil Rate Band (TNRB) between spouses / civil partners. The measure is to be phased in over several years. Meanwhile, the standard Nil Rate Band (NRB) will remain at £325,000 per person until at least 2020/21.

6.1 Will it Affect Me?

Quite possibly. The current IHT NRB means that basically the first £325,000 of one's net estate on death is free of IHT. Between couples, the first spouse to die can leave any unused NRB to the second; this tends to mean that it should be relatively straight forward to achieve £650,000 free of IHT on the joint net estate. Ignoring special reliefs such as Agricultural or Business Property Relief, any excess net value will normally be taxed at 40% on death.

The problem for property investors is that the NRB has loitered around £325,000 for years, while property values march apace.

The Residential Nil Rate Band (RNRB) is an enhancement to the existing NRB such that those with a net estate of up to £1million (but basically not much more than £2million) can potentially benefit.

6.2 How Will it Affect Me?

The RNRB is potentially available to add up to £175,000 per person to the existing NRB and to reduce exposure to IHT so long as the claimant leaves at least one of their residences to a close relative. The additional element of the RNRB is tapered off at a rate of 50% once the value of the net estate exceeds £2million, so there is a chance that substantial estates will not benefit at all from this new measure (note the standard NRB is not tapered).

There is scope to transfer unused proportions of both the standard NRB and the RNRB element to the surviving spouse. As a couple, up to 2 x (£325,000 + £175,000) is available, which takes the aggregate net estate to potentially £1million free of IHT.

6.3 When Will it Affect Me?

The RNRB is being phased in as follows:

- 2017/18 £100,000
- 2018/19 £125,000
- 2019/20 £150,000
- 2020/21 £175,000

And thereafter to rise in line with inflation – the CPI – alongside the main NRB.

6.4 Practical Points

This measure will not start to protect £1million in property, etc., until 2020/21 – by which time portfolios will have increased even further in value.

There are welcome provisions in the legislation which protect the value of a previous, more valuable residence, even when someone down-sizes to a 'smaller' residence and it is that smaller property which is transferred on death.

6.5 What Should I Do?

This new RNRB will potentially protect additional value of up to £350,000 per couple. While it requires a residence to be transferred to a close relative, (a direct lineal descendant), it can still benefit property investors because the additional RNRB may be allocated to the residence, leaving more of the standard NRB(s) to cover investment properties. Investors should be looking to make sure that the deemed value of the residence is at least as much as the RNRB they are looking to utilise, to maximise IHT savings.

6.6 Why is the Government Doing This?

This measure is forecast to cost the Chancellor almost £1billion once the new relief is fully available in 2020/21. It seems clear that the press and hence the government were alive to the effect of spiralling house prices on Inheritance Tax for people who just wanted to stay in their own home. The saving made by keeping the main NRB at £325,000 has not been included in the Summer Budget publications; it may prove that the Chancellor is still a net winner, since the OBR originally forecast an increased IHT take of 70% over the next few years – roughly £2billion extra – before this measure was announced.

7 Annual Investment Allowance Changes

The Annual Investment Allowance (AIA), which gives businesses immediate 100% tax relief for the full capital cost of eligible plant and equipment, was originally set to be reduced to just £25,000 a year, from £500,000 a year. The Summer Budget announced that the landing would be much softer, to a more palatable £200,000 a year from January 2016.

7.1 Will it Affect Me?

While it is true that landlords who acquire commercial property with lots of eligible fixtures and fittings are more likely to be pleased that the AIA limit will be £200,000, it is wrong to say that residential property landlords should ignore AIA. Although Capital Allowances generally are prohibited within dwellings themselves, residential landlords normally have cars, vans, tools, laptops and other office equipment which may all be claimable. (Ordinary cars are ineligible for AIA but can be claimed for general Capital Allowances).

7.2 How Will it Affect Me?

AIAs allow businesses to claim an immediate 100% tax deduction for the acquisition of plant, equipment and machinery, in the year of purchase. It can apply to office equipment, vans, furniture, lifts and, in commercial premises, heating, lighting, air-conditioning and other services also become eligible. Without AIA or Capital Allowances more generally, there is no tax relief for such capital acquisitions.

7.3 When Will it Affect Me?

Potentially, it will affect businesses right now. While changing the annual AIA threshold from £25,000 to £200,000 is good news in itself, there is a quirk in the AIA legislation which means that, where an accounting period straddles a change in the AIA threshold (in this case 1 January 2016), **AIAs in the period with the lower threshold are heavily restricted.**

7.4 Example

Anya buys an office development in the 2015/16 tax year. Her specialist surveyor identifies that there is up to £175,000 of installed heat, light, HVAC and IT infrastructure available to claim, subject to the appropriate elections and agreement with the vendor. Anya is delighted, since this will potentially wipe up to £175,000 off her taxable profits in the 2015/16 tax year. But Anya needs to check the fine detail of the way AIA works:

Aggregate AIA in 2015/16: (take as 12 months to 31 March 2016)

April 2015 - December 2015	9/12 x AIA of £500,000 per year	£375,000
January 2016 - March 2016	3/12 x AIA of £200,000 per year	£50,000
Aggregate AIA for the Year		£425,000
However:		
Maximum eligible spend	April 2015 - December 2015	£425,000
Maximum eligible spend	**January 2016 - March 2016**	**£50,000**

7.5 What Should I Do?

If you are contemplating the kind of expenditure which may stretch the maximum AIA spend in the tail-end of the accounting period straddling 1 January 2016, then you can:

- Ensure that the unconditional obligation to pay for the eligible asset(s) is triggered before 1 January 2016 so that the expenditure sits in the earlier period running up to December 2015; or

- Defer the point at which there is an unconditional obligation to pay until after the end of the straddling period (not necessarily March 2016 if a corporate landlord); or even

- Deliberately end your Accounting Period early (basically applicable only to companies) so that the expenditure is deemed to be incurred in a ‘fresh’ period where the full £200,000 per year is available.

Of course, given the amounts potentially involved, direct advice from a suitably qualified professional is strongly recommended.

7.6 Why is the Government Doing This?

The Chancellor said in the March Budget that he had listened to the serious concerns expressed by businesses that £25,000 a year would be nowhere near sufficient.

Softening the reduction in AIA at the beginning of next year to an annual threshold of £200,000 is not going to leave the Chancellor much change from £1billion a year. But it is worth pointing out that the main beneficiaries of this generosity, by far, will be mainstream trading businesses, rather than property investors – and particularly residential landlords.

8 Rent A Room Relief Increase

The Chancellor announced that Rent a Room Relief will be increased from £4,250 per year, to £7,500 per year, from 6 April 2016. The change is forecast to cost the Treasury just £10-15million a year.

Rent a Room Relief is available to individuals who let out a room (or rooms) in their only or main residence. Basically, where gross rental income does not exceed the threshold, then the Relief applies and the rental income is not taxable – there is no need to work out expenses and net profit. If the gross rental income exceeds the limit, then the Relief may be deducted from that income to derive a taxable profit, as an optional alternative to formally calculating net rental income using the conventional method.

The Relief applies where the landlord is in occupation as his or her main residence alongside the lodger at any point in the tax year, (although temporary absences may be permitted) so it is not applicable to separate rental investment properties.

However, it is a genuinely useful relief for many people trying to meet the costs of buying and running their home, and it has stagnated at £4,250 for far too long, so a substantial increase is welcome and in fact long overdue. Airbnb users will likewise be delighted.

9 Non-Domiciled Individuals – Inheritance Tax On UK Property

A number of changes are coming in from April 2017 to tighten up on the “non-dom” regime, which very broadly applies to people who were born to parents who were born outside the UK. Alongside the various measures introduced over the last few years to discourage offshore ownership, the government aims to apply Inheritance Tax to the UK properties of “non-doms”, even when they are also not resident in the UK, and including property they hold indirectly through an offshore structure. This is forecast to net around £100million a year to the Exchequer.

The rules for domicile and for offshore property ownership can be very complex and tailored advice from a suitably qualified professional is highly advisable. Many people think the “non-dom” regime applies only to a remote elite but it is perhaps worth pointing out that, as individuals and their families have become increasingly internationally mobile over the last couple of decades, more and more UK residents will in fact be domiciled without the UK. If you think you may be affected, you should seek tailored advice.

10 Conclusion - Are Landlords The New Bankers?

The Chancellor also announced in the Summer Budget that the Office of Tax Simplification, originally set up on a temporary basis, was to be made into a permanent office of HM Treasury. Perhaps some readers, having regard to some of the above measures, will agree that Mr. Osborne appears to have done his level best to keep its staff busy for some time to come.

Some big banks’ threats to leave the UK appear to have rattled the Chancellor, who slashed their levy and said it “risks doing damage to Britain as a financial centre”. Of course, UK landlords will struggle to move their business overseas!

The Chancellor’s comment that “Buy-to-let landlords have a huge advantage in the market as they can offset their mortgage interest payments against their income, whereas homebuyers cannot” echoes several press comments. But it overlooks that practically all business, such as taxi drivers, hairdressers and farmers, can claim their finance costs and therefore enjoy a ‘competitive advantage’ against private individuals. It also ignores the fact that most homeowners enjoy an enormous advantage when it comes to selling property: a complete relief from Capital Gains Tax. Landlords, however, are exposed to almost 30% tax on their capital gains – much of that gain being purely inflationary.

It remains to be seen how landlords will react to these measures, which seem certain to significantly increase their costs. **I do not share the government’s confidence that rents will not increase.**