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Cardiff Landlord Forum

Tax Changes & Solutions for Buy-To-Let Investors

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Changes To Property Taxation for Buy-To-Let Investors

Restriction on Interest Relief

Overview

- Deductions from rental profit for finance costs, such as mortgage interest, will be restricted for landlords from April 2017
- The restriction will apply to higher rate taxpayers letting residential properties and will be phased in over three years
- By 2020/21 all financing costs incurred by a landlord will be given as a basic rate tax deduction only
- For those affected, in most cases, tax liability likely to increase by 20% of finance costs

Who's affected?

- All higher rate tax payers – those who own BTL property with a large mortgage will pay substantially more tax

*"'It is estimated that a higher rate tax payer whose mortgage interest is 75% or more of their rental income (net of expenses) will see **all profits wiped out by tax**"*

- Basic rate tax payers may also be impacted as the new rules can move them into higher rate tax bands

Practical Examples

HIGHER RATE TAX PAYER

	Current rules (£)	New rules (£)
Net rents received (after other expenses)	50,000	50,000
Less interest charges	(30,000)	-
Taxable rental income	20,000	50,000
Tax @ 40%	8,000	20,000
Less basic rate tax deduction for interest	-	(6,000)
Net Income Tax due	***8,000***	***14,000***

With no change in property business cash flow, same rents same costs, the tax bill under the new rules would increase by £6,000

** Assumes personal allowance and basic rate bands utilised by other sources of income*

BASIC RATE PROPERTY INVESTOR

	Current rules (£)	New rules (£)
Net rents received (after other expenses)	75,000	75,000
Less interest charges	(50,000)	-
Less personal allowance	(11,000)	(11,000)
Taxable income	14,000	64,000
Tax @ 20%	2,800	6,400
Tax @ 40%	-	12,800
Income Tax due	*2,800*	*19,200*
Less basic rate tax deduction for interest	-	(10,000)
Net Income Tax due	***2,800***	***9,200***

With no change in property business cash flow, same rents same costs, the tax bill under the new rules would increase by £6,400

Implications

- Reduced profits for BTL investors due to higher tax charges
- Potential loss of personal allowances
- Higher income Child Benefit charge may apply (taxable income over £50k)
- Increased income for Tax Credits calculations
- Mortgage lending criteria for BTL adversely affected – mortgage cover up to 145%!
- Future changes to mortgage interest rates would have significant impact on BTL investors
- Long term likely to push up rents or force BTL investors to sell

Wear & tear allowance abolished

Overview

- From 1 April 2016 a tax deduction of 10% of rental income for property let fully furnished will no longer be available
- Generous tax deduction - given regardless of expenditure incurred
- Tax relief now given for actual cost of replacement furniture only
- Tax deduction is restricted to original cost of furniture replaced – no tax deduction for improvements

Who's affected?

- Owners of let furnished property adversely affected e.g. Student accommodation or HMOs
- Partly furnished property owners will now benefit from tax deduction for replacing furniture

Impact

- Higher tax bills for owners of furnished accommodation
- Requirement for landlords to keep additional records
- Unlikely to affect existing supply of furnished property or future supplies of HMOs / Student lets
- Could furnished property attract higher rents?

Practical Tip

If furnishing a newly acquired property, consider replacing furniture in existing BTL and using old furniture in new property. A tax deduction would be allowed for the new furniture as it is replacing existing furniture

Stamp Duty Land Tax (SDLT) - Higher rates for purchasing additional properties

Overview

- Higher rates of stamp duty land tax (SDLT) apply to purchases of additional residential properties from 1 April 2016
- The higher rate is **3%** above the standard rates of SDLT
- Does not apply to purchases of additional properties under £40k (rules to prevent abuse of this exemption)
- Aim to discourage BTL investment??

Who's affected?

- Anyone who purchases a residential property in addition to their main residence is liable for the surcharge even if the property is not let out.
- Additional charge also applies to companies
- Exemptions for replacement of own home

Implications

- BTL investment less affordable and distinctly less attractive for potential investors
- Increase supply of houses but reduce supply of rental properties….push up rents? / lower house prices?
- More expensive for parents to help children on to property ladder

SDLT soon to be LTT in Wales

- A bill was introduced to the National Assembly for Wales on Monday 12 September to replace SDLT in Wales with Land Transaction Tax (LTT)
- The new scheme will be introduced from April 2018 and will be broadly the same as SDLT
- New rates are likely to be announced closer to April 2018
- 3% charge for additional residential properties is under consultation for LTT

Capital Gains Tax (CGT)

Note: CGT is charged rather than income tax on disposal of investments

- Capital gains tax (CGT) rates will decrease from 28% to 20% for higher rate taxpayers and from 18% to 10% for basic rate taxpayers from 1 April 2016
- **Excludes disposals of additional residential properties**, which will continue to be chargeable at current CGT rates 18% or 28%
- Own homes unaffected – continue to get Private Residence Relief (PPR)
- No increase in Annual CGT Allowance £11,100
- In the 2015 Autumn Statement, the Government announced plans to reduce the payment window for CGT in respect of gains on residential property **to 30 days**
- Currently, tax is payable by 31 January after the end of the tax year in which the sale took place – allowing a window of up to 22 months
- The Government is still consulting on the proposal, but the changes are expected to take place from April 2019

Solutions

What can you do to limit the tax implications of the new rules?

Minimise debt on residential property lets

- Sell property to reduce mortgage interest payments and retain higher percentage of rental profits
- Reorganise portfolio finances to maximise commercial property debt v residential debt

Diversify Portfolio

- Consider purchasing commercial properties or holiday lets (no interest restriction)

Transfer beneficial ownership of jointly held property

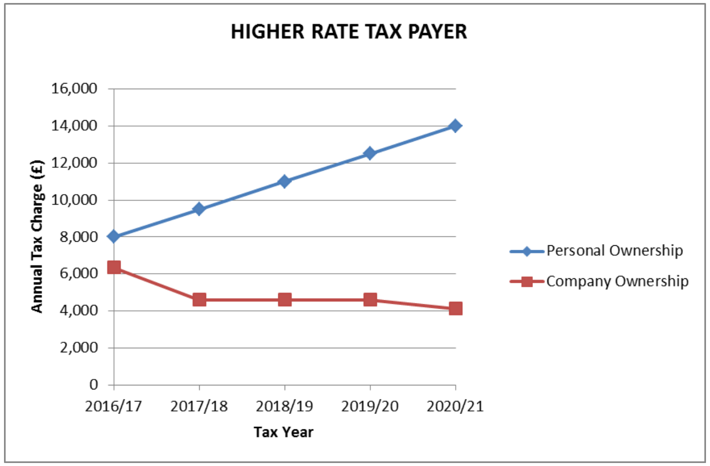
- Where property is owned jointly it may be possible to change the split of income or gains between owners
- Change from 50/50 to 70/30 or 99/1 *(CGT may be applicable*)
- Effective tax planning for husband and wife property ownership

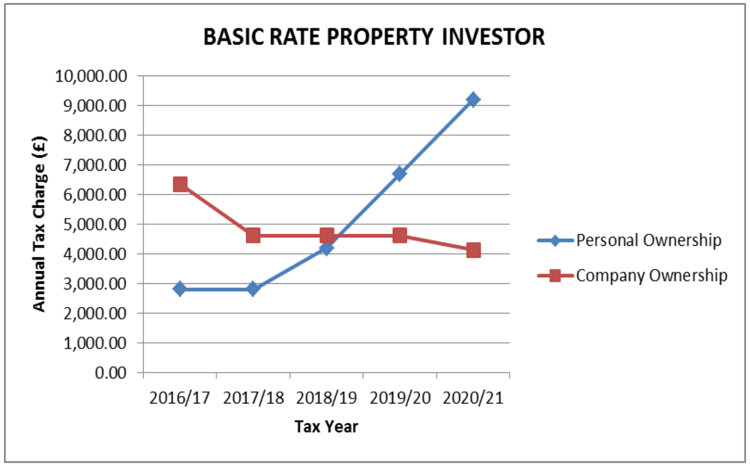
Maximise allowable tax deductions

- Ensure that you have included all allowable property letting expenses e.g. repairs, travel, use of home as office etc

Incorporation

- Many BTL owners are transferring their property portfolios to a Limited company
- Companies are not affected by interest relief restrictions
- Corporation tax rates as low as **17%** by 2020 *(Currently 20%, 19% from 1 April 2017)*
- Significant annual tax savings achievable





✓ *Annual saving **£10k** by 2020 – All profits reinvested*
✓ *Annual saving **£5k** by 2020 – All profits extracted*

✓ *Annual saving up to **£5k** by 2020 – All profits reinvested*
x *Tax neutral by 2020 – All profits extracted*

Notes

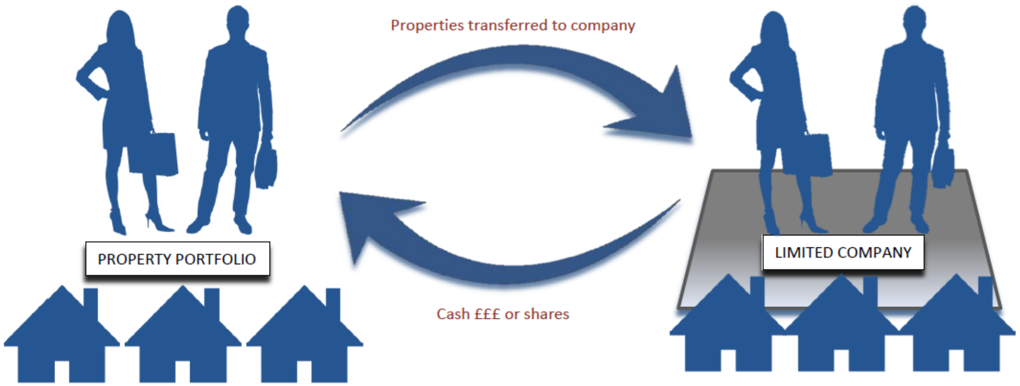
- *Includes an estimate of year 1 incorporation costs*
- *Assumes finance costs the same in company and personal ownership*
- *Assumes no changes to personal tax rates and allowances*

Incorporation – Who would benefit?

- Higher rate tax payers
- BR tax payers with a highly geared residential portfolio
- BR tax payers investing for the future - 'Personal money box'

Incorporation - How does it work?

- Property is affectively sold to a new or existing Company owned by the investor
- The price paid by the Company for the properties is deemed to be **market value**
- BTL investor receives cash or shares in consideration for the properties



*****Warning**** Incorporation may give rise to SDLT or CGT tax charges**

Capital Gains Tax implications?

- Capital Gains Tax is payable on the difference between the purchase price (including improvement costs) and the open market value at the date of transfer to a connected company
- Properties that have risen considerably in value would result in significant additional tax charges
- Tax payable on gains at 18% or 28% (first £11,100 exempt)
- In most cases, no cash is actually received to pay the tax due

Incorporation relief

- Incorporation relief may be claimed to hold over any charges to CGT
- To qualify for incorporation relief, all the assets of a '**business**' are transferred to a company wholly or partly in exchange for shares issued in the company
- Gains on the property are transferred to the shares when (if ever) they are sold
- Incorporation relief not always the most tax efficient route, particularly for property investors with minor growth in the value of a portfolio

Practical Tip – ***Where equity in a portfolio is greater than the capital gain a tax planning opportunity exists. It is possible to reorganise finances prior to incorporation to create a loan owed to the shareholders. The loan may then be withdrawn from profits in the company tax free.***

What is a property business?

- An ordinary property investment business is not a trade for tax purposes
- Passive investment v investment business?
- Where sufficient additional activities are undertaken on a regular basis that can be distinguished from what a normal property investor would do, a property business will exist (actively manage the investments)
- Case of Elisabeth Moyne Ramsay TC61871 gives a clear indication of what level of activities the Courts regard as sufficient to constitute a business

Key indicators of a property business

- Active participation in the operation of the property lettings
- Several properties or rental units in the business portfolio (Mrs Ramsay only 1 x HMO)
- Spend on average 20 hours per week working in the business e.g. arranging new tenancies, repairs/maintenance, maintaining business records, debt management, identifying and negotiating new acquisitions, keeping up to date with industry compliance etc
- Obtain advanced clearance from HMRC

Stamp Duty Land Tax implications?

- SDLT is payable on the market value of property portfolio at the date of transfer to the company
- Additional 3% surcharge payable if more than one property transferred
- Can trigger significant SDLT tax charges which may be prohibitive
- *Multiple dwellings* relief available for transfers of 6 or more properties
- Partnerships may be able to achieve incorporation without a SDLT charge

Multiple Dwellings Relief (MDR)

- Where 2 or more residential properties are transferred in one transaction (or linked transactions), MDR is available
- MDR works by calculating the SDLT on each property by reference to the average price of all the properties **(additional 3% charge still applies)**
- Where 6 or more properties are transferred in one transaction (or linked transactions), option to apply commercial property SDLT rates to total value of properties
- Upfront cost for long term tax benefit?

Partnerships

- There are provisions in tax law that allow partners in a partnership to transfer property to a connected company without an SDLT charge
- To obtain relief in full from SDLT, a **property business partnership** must exist

What is a property business partnership?

- A partnership is defined as "The relationship which subsists between persons carrying on a business in common with a view of profit"
- For there to be a partnership there must be a '*business*'
- Merely holding property jointly or receiving a share of income does not constitute a partnership
- Obtain advance clearance from HMRC

Advantages & Disadvantages of Incorporating a Property Business

COMPANY OWNERSHIP	PERSONAL OWNERSHIP
Corporation tax rates as low as 17% from 2020	Income tax rates 20% to 45%
CGT paid at corporation tax rates	CGT paid at 18% to 28%
Payment of CGT could be up to 21 months after sale	Expected 30 day deadline to be introduced
No interest relief restrictions	Interest relief restrictions for higher rate tax payers
Additional tax on extraction of profits to shareholders	
Reinvested profits not subject to additional tax - could be used to make other tax efficient investments	All profits taxed even if reinvested
No IHT relief for Investment Companies	No IHT relief
Flexibility to pass on ownership to family members	
Additional administration and accountancy costs in running a company	Minimal administration and accountancy costs
Finance costs may be more expensive in company structure	Retain existing finance deals
Upfront costs to incorporate	
Limited liability	Unlimited liability

Each tax payers personal circumstances are different - seek professional advice to ascertain the right structure for holding your investment properties ***(act now while reliefs are available)***

Commercial Property Capital Allowances

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DID YOU KNOW...
TAX RELIEF IS AVAILABLE ON YOUR CAPITAL COSTS VIA **'CAPITAL ALLOWANCES'**?

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http://www.kilsbywilliams.com/capital-allowances/

Identifying capital allowances is complex and requires the specialist skills of surveying and knowledge of tax legislation. Kilsby & Williams is the only independent Welsh firm of Chartered Accountants with the combination of skills to provide a complete capital allowances service.

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