Property Agent Matters

DRIVING LIFELONG PROSPERITY

Summer 2017

INTEREST RELIEF RESTRICTION FOR RESIDENTIAL LANDLORDS

When Chancellor George Osborne (remember him?!) announced in his 2015 Summer Budget that interest relief would be restricted for residential landlords, many clung on to the hope that he would see sense and reverse the decision before it commenced phasing in from April 2017.

Well, here we are, in June 2017, with new Chancellor Philip Hammond in situ, the new rules are in place and are starting to impact on the effective rates of tax being paid by landlords.

As a recap, between 2017 and 2020, there will be a phasing in of the new rules, such that, for 2017/18, 75% of the finance costs are deductible in full, with 25% only being relieved at the basic rate of tax. This moves by 25% each year so that, by April 2020, 100% of the finance costs are only relieved at the basic rate of tax.

Many landlords think that this will not affect them, perhaps because they are only basic rate taxpayers. However, they may be in for a nasty shock, due to the way the calculation works.

Take, for example, a landlord with rental income of £150,000 and finance costs of £110,000 (highly geared, I know!). Prior to 2017, the rental profit of £40,000, assuming it is their only income, would be taxed as follows (using 2016/17 rates):

£11,000 at 0%	£0
£29,000 at 20%	£5,800
Total tax	£5,800

In 2017/18, the calculation works as follows:

Income	£150,000
75% finance costs	£82,500
Rental profit	£67,500
£11,500 at 0%	£0
£33,500 at 20%	£6,700
£22,500 at 40%	£9,000
25% finance costs at 20%	(£5,500)
Total tax	£ 10,200

That is an increase in tax of £4,400, for someone who, beforehand, would have considered themselves a basic rate taxpayer.

Moving on to 2020/21, the tax take, using 2017/18 rates and allowances, looks like this:

Rental income	£150,000
No personal allowance	
£33,500 at 20%	£6,700
£116,500 @ 40%	£46,600
Finance costs at 20%	(£22,000)
Total tax	£31,300

That is an effective tax rate of 78.25% for someone who previously only paid tax at the basic rate.

This may be an exaggerated example, but it does demonstrate how it impacts basic rate taxpayers and the effective rate of 78.25% is not untypical of situations we have seen. Indeed, the worst effective tax rate has been 183%!!

Action can be taken to lessen the impact of the new rules. Moving properties into joint ownership with your spouse or family members, or perhaps introducing into a family partnership is one way, whilst full incorporation into a limited company is another.

With both routes, consideration needs to be given to capital gains tax and stamp duty land tax. Depending on the individual circumstances, it may be possible to transfer without incurring either, with HMRC's blessing.

What is clear, however, is that doing nothing can result in some nasty tax rates in the future, so it is important to take advice, sooner rather than later.

MAKING TAX DIGITAL

Not content with hitting landlords in the pocket through interest relief restrictions, the Government has also introduced Making Tax Digital (MTD) to increase the administrative burden as well.

MTD is expected to come into force on 6 April 2018 and, despite all reports that HMRC will be woefully unprepared for it, it seems as though they are adamant there will be no delay to its introduction.

Initially, it was going to apply to any partnership, sole trader or landlord with turnover in excess of £10,000. That has been increased so that, in 2018, it will only apply to those with turnover in excess of the VAT registration threshold of £85,000. However, that only buys those under that limit an extra year to prepare, because they will have to comply from 6 April 2019.

SO, WHAT IS REQUIRED?

Rather than just submitting an annual return once a year, you have to submit four quarterly returns, breaking down income and expenses. You must then submit an end of year statement within ten months of the financial year end, increasing your administrative burden fivefold.

The quarterly returns do not, according to current legislation, have to be accurate, they merely need to be complete. The end of year statement, however, does need to be accurate.

After you submit your quarterly returns, HMRC will calculate your likely tax bill, but you don't have to pay it, unless you particularly want to. Your only requirements will be to make your payments on account and final sweep up payment in January.

You will need to file this information digitally, so, either have software that speaks to HMRC's tax accounts, or use an adviser that has such software. Spreadsheets can be maintained, but you will still need software that links from those spreadsheets to HMRC's digital accounts.

This is all being introduced on the back of George Osborne's 2015 March Budget announcement where he hailed the 'end of the tax return'. Many taxpayers cheered the apparent reduction in tax administration costs. Then, they saw the MTD requirements and you have to question how this is a good thing.

On the plus side, it will encourage taxpayers to keep up to date records, rather than having a mad scramble through paperwork on 30 January to collate what's needed to file the tax return; but is that all the government wants?

Our current view is that this is all a pre-cursor to real time information and payments, as with the PAYE system. Once fully introduced, it won't take much for the government to state that, as you are filing quarterly, you might as well pay quarterly, aiding the tax cash inflow into the Treasury.

For those affected, April 2018 will come around very quickly, so you need to ensure that you have everything in place to conform with the new rules. We can help reduce the pain of the new regime by taking the administration away and acting as a safeguard between you and HMRC. There is no doubt that MTD will make HMRC more powerful than they already are, so, in the words of the Scout movement, "be prepared".

NICK HAINES
Partner and Head of Team
01242 237661
nick.haines@hazlewoods.co.uk

JOHANNE TISDALE
Senior Manager
01242 237661
johanne.tisdale@hazlewoods.co.uk

MEGAN LEWIS-BOURKE
Manager
01242 237661
megan.lewis-bourke@hazlewoods.co.uk

KATIE HASLAM
Senior Associate
01242 237661
katie.haslam@hazlewoods.co.uk

Windsor House, Bayshill Road, Cheltenham, GL50 3AT
Tel. 01242 237661 Fax. 01242 584263

www.hazlewoods.co.uk / @Hazlewoods

HAZLEWOODS
DRIVING LIFELONG PROSPERITY