Landed Estates Update

DRIVING LIFELONG PROSPERITY

Autumn 2017

Welcome to the current edition of Landed Estates Update, our publication for landowners and those advising on Landed Estates. Many estates include a residential property portfolio and in this edition we look at the taxation of residential property, where there have been a number of changes recently.

MORTGAGE INTEREST RELIEF RESTRICTION

From 6 April 2017, new rules restricting tax relief for costs of finance such as mortgage interest have been introduced. The change is being phased in over four tax years and applies in full from April 2020.

Currently, full relief is given for costs of finance when calculating the profits of a property rental business. From April 2020, the costs of finance will no longer be an allowable deduction when calculating the rental profit. Instead, tax will be paid on the profits before costs of finance and a deduction made against the resulting tax liability at up to 20% of the cost of finance.

There will be restrictions to the deduction where there are losses or the rental income falls within the personal allowance. Where there is a restriction, any finance costs which have not been used to calculate the tax deduction are carried forward to future years.

The phasing in of the changes means that from April 2017 it is only 25% of the cost of finance that is subject to the new rules, with the remaining 75% deducted from profits in full. From April 2018, the split is 50% new rules, 50% old rules; from April 2019, 75% new rules, 25% old rules and from April 2020, 100% new rules.

The new rules apply to individuals and trusts but not to property owned in a company, commercial lettings or furnished holiday lets. There are limited ways to avoid the charge and it could be that a review of the property portfolio is required, with poorer stock sold off to enable debt to be repaid. Alternatively, it may be possible to transfer the residential property portfolio to a company, but both capital gains tax and Stamp Duty Land Tax need to be considered, as well as consulting the bank about transferring the debt.

RENEWALS ALLOWANCE

From April 2016 the 'Wear and Tear' allowance has been abolished. The allowance, 10% of the net rent, was deducted from the profits of fully furnished residential property, regardless of whether any expenditure was actually incurred.

With effect from 6 April 2016, all residential landlords can claim the new 'Replacement of Domestic Items' relief. The main items qualifying for relief in unfurnished property are likely to be free standing white goods and the actual cost of replacing them can be claimed. For fully furnished accommodation the cost of other furnishings can be claimed but this is likely to be lower than the wear and tear allowance.

ANNUAL TAX ON ENVELOPED DWELLINGS (ATED)

The ATED charge was first introduced in April 2013 and applies where residential property is owned by a company or a partnership with a corporate member. The charge initially applied to properties worth £2million or more, but this was dropped to £1million in April 2015 and £500,000 in April 2016.

For 2017/18 the charge is £3,500 for properties valued at more than £500,000 but not more than £1million, rising to £220,350 for properties worth more than £20million.

There are a number of exemptions from paying the ATED charge. The main ones applicable to landowners are where the property is let to a third party on commercial terms, or it is occupied by a farmworker or former long serving farmworker. This should ensure that most houses are not caught, but any occupied by family members would not qualify for the relief. There is also an exemption for houses that are open to the public for at least 28 days a year, which could exempt the main house on the estate.

Whether ATED is payable or relief is claimed, a return must be submitted to HMRC. This has to be done between 1 and 30 April, at the beginning of the tax year.

The value for ATED was taken at 1 April 2012 or the date of acquisition, if later. For ATED returns for 2018/19 onwards the valuation date is 1 April 2017 and any estates that are liable for the ATED charge will need valuations for affected property at that date.

STAMP DUTY LAND TAX (SDLT)

From April 2016 higher rates of SDLT apply where additional residential property is purchased, increasing the liability by 3% of the purchase price.

The life tenant of a pre March 2006 Life Interest Trust is treated as the owner of the property within the trust. This could mean that they have to pay the surcharge when they buy their own home. If the trustees of a discretionary trust purchase property, they are treated as the owner and are subject to the same rate as a company.

Relief is available where mixed use property i.e. both commercial and residential property is purchased, with the SDLT capped at 5%. The most common scenario is where both agricultural land and residential property are purchased together. Where more than one property is purchased at the same time Multiple Dwellings Relief may apply. This ensures that SDLT is paid on the average price per property rather than the total amount spent.

CAPITAL GAINS TAX (CGT)

From April 2016, the rates of CGT dropped to 10% for basic rate tax payers and 20% for higher and additional rate tax payers. The one exception to this was for residential property where the rates remained at 18% or 28%. Where property is owned by a company, indexation relief is still available with any gain being subject to corporation tax, currently 19%. However, if the property has been subject to the ATED charge, a proportion of the gain will be subject to tax at 28% in the company.

Prior to 6 April 2015 UK based property owned by a non UK tax resident was not subject to CGT. From that date, residential property is now subject to UK CGT and a return must be submitted to HMRC within 30 days of completion of the sale.

INHERITANCE TAX

Residential property does not qualify for relief from inheritance tax unless it is either occupied for the purposes of agriculture i.e. a farmworkers cottage or is part of a business that is wholly or mainly trading. A business that meets the trading requirement should qualify for 100% Business Property Relief (BPR). BPR gives relief from inheritance tax on the value of the business, including the let property within it. For many estates, structuring themselves to meet the qualifying conditions is of utmost importance. With ever changing property values, this is something that needs to be kept under regular review.

Historically, debt was deducted from the value of the asset on which the loan was secured regardless of what the funds were used for. Typically funds were borrowed against the main house or residential property portfolio and used to purchase land, which qualified for Agricultural Property Relief or BPR. From 6 April 2013, where the funds are used to purchase assets that qualify for relief from IHT, the debt has to be deducted from the value of those assets, and not the property on which the debt is secured. The old rules continue to apply for debts that were taken out pre April 2013. Any changes to the debt can result in it becoming a post April 2013 loan, and the IHT consequences should always be considered.

From April 2017, the Residential Nil Rate Band (RNRB) is being phased in. It is currently worth £100,000 rising to £175,000 per person from April 2020. The relief only applies where a residence is left to a direct descendant. For death estates worth more than £2million the RNRB is tapered away at £1 for every £2 excess. The value of most landed estates will mean that the owner will not qualify for the relief. However, there may be planning opportunities to enable the relief to be obtained and careful Will drafting is needed.

From April 2017, the value of UK residential property held by offshore structures comes within the UK Inheritance tax net. The main impact will be on non UK domiciliaries, who are not currently subject to IHT on offshore assets. This will affect properties held in offshore companies either directly or through an offshore trust.

EPC CERTIFICATES

From 1 April 2018 there will be a requirement for any properties rented out privately to have a minimum energy performance rating of E. This applies to all renewals and new tenancies initially, with existing tenancies being caught from April 2020. For some properties it may be necessary for work to be done to enable it to meet the requirements. As well as impacting on cash flow, there may also be tax consequences. If the work can be classified as repairs, the cost can be deducted against income giving immediate tax relief. If the work is an improvement or capital expenditure, the cost can only be deducted against the proceeds on a future sale. Clearly it will be beneficial for the work to be repairs as far as possible. This can include larger projects, such as replacing single with double glazed windows.

CONCLUSION

Whilst most estates will not be affected by all the changes, it is likely that they could bite at some point. It may not be possible to avoid them, but careful planning can hopefully minimise the impact of them.

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