

# Property Focus

Laying the foundations to future prosperity

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# The Good, the Bad and the Ugly



## Three Summer Budget Changes to Property Tax

**The 2015 Summer Budget contained three changes to the taxation of property income (not including the increased inheritance tax relief). From the point of view of the landlord these can be categorised into the three (slightly clichéd) categories.**

### The Good

Rent-a-room relief is to be significantly increased from April 2016. The relief, which is available to those who are renting out a room in their own house and the amount that can be received tax free has been static at £4,250 since 1997. The revised tax free amount will be nearly double that at £7,500.

The relief also covers Bed & Breakfast receipts as long as the rooms are in the landlord's main residence. The Treasury expects 10,000 people to no longer need to complete self assessment tax returns as a result of the change.

### The Bad

George Osborne announced the removal of the Wear and Tear allowance, which is the deduction available for furnished residential property landlords. This allowance has not been in the legislation for long; it was only enshrined in law from April 2013 after being an extra statutory concession prior to that, so it was unexpected to see any change in this Budget. Under the current rules, landlords can deduct 10% of their rental receipts to account for the depreciation and replacement

of furnishings. This is now changing from April 2016.

The current system will be replaced with a new relief where landlords can only claim the costs that they actually incur when replacing furnishings in their property.

The ostensible upside is that the new relief will be available to all landlords, not just those with furnished properties. However, the landlords of unfurnished or partly furnished properties were already able to claim for the costs of furniture in their properties through the 'tools' provisions in the current legislation.

The overall result of the new rules is therefore that the landlords of furnished properties will no longer be able to claim the Wear and Tear allowance, the effect of which was to smooth rental profits over periods. Those who are spending large amounts on furniture may be better off in the longer term, but those who do not replace furniture regularly will lose out.

### The Ugly

The final property tax announcement was definitely 'Ugly'. 'Ugly' for property landlords who will see their tax relief reduced and 'Ugly'

for us as the calculations that will be required to get property income right on tax returns are pretty complex and convoluted.

In simple terms, tax relief for mortgage interest payments on residential properties will be restricted to the basic rate of tax. This means that landlords who are higher or additional rate taxpayers will see their tax bills increasing. The Chancellor announced that this measure would be phased in gradually from April 2017. The cynical amongst us may suggest that this is to avoid the inevitable property selling spree and associated damage to house prices that would result from an immediate cliff edge style introduction.

We won't bore you with the detailed mechanics of the restriction but, broadly, in 2017/18 higher/additional rate relief will only be available on 75% of a landlord's mortgage interest, with the remaining 25% attracting basic rate tax relief only. This proportion will increase by 25% each year until 2020/21 when 100% of a landlord's mortgage interest will only get basic rate tax relief.

George Osborne said that this was 'a big Budget for a country with big ambitions', but based on the three measures explored above, this was definitely not a Budget for landlords.

# £1 million Tax Free!

(The Small Print)

The Chancellor's 2015 Summer Budget was one of the most surprising for a while as not many of the policies had been leaked in advance. However, that did not apply to the much publicised, discussed and debated change to inheritance tax on the family home. The headlines in the newspapers have been along the lines of 'inheritance tax limit raised to £1 million'. As always with tax though, this isn't quite the full story.

The announcement was that from April 2017 an inheritance tax Main Residence Nil Rate Band (MRNRB) will be introduced. This will be in addition to the current Nil Rate Band (NRB) of £325,000. Unlike the current NRB, the new MRNRB will only be available against the value of a residential property that has been the individual's home and only if that part of the estate is being passed to the individual's direct descendants. Here, direct descendants are the individual's children (be it biological, step, adopted or foster children) and their lineal descendants.

The MRNRB will be introduced gradually, starting at £100,000 per person in 2017/18, increasing to £125,000 in 2018/19, £150,000 in 2019/20 and reaching £175,000 in 2020/21. It will then increase in line with the consumer price index. The existing nil rate band of £325,000 will remain frozen until 2020/21. At this point the total IHT nil rate band for a husband and wife will be up to £1 million, which is how this ties in with the oversimplified newspaper headlines.

As with the current nil rate band, the MRNRB will be transferable between spouses if not used on the first death and a claim will need to be made on the second death. Where an individual owns more than one qualifying property the executors will need to nominate to which house it will apply.

A further level of complexity is that, where an individual's net estate exceeds £2million, the MRNRB will be tapered by £1 for every £2 meaning that, from 2020/21, when the full MRNRB is in force, those with net estates

in excess of £2.35million will not benefit from this measure.

There was concern that the higher relief for homes would deter the elderly from downsizing, which would result in less larger properties being freed up for families. To counteract that the MRNRB will also be available where a person downsizes or sells a home on or after 8 July 2015 and assets of an equivalent value up to the MRNRB are passed on death to direct descendants. This element is going to be subject to consultation as to how it will work in practice.



# Stamp of approval

The Chancellor's rabbit out of the hat in the 2014 Autumn Statement was a radical reform of Stamp Duty Land Tax (SDLT) with the aim of boosting the housing market. From 4 December the calculation of SDLT on purchases of residential property changed to a progressive tax, much like the income tax system. There were no changes to the calculation of commercial or mixed-use property.

The old system was a 'cliff edge' approach such that once the house price tipped over into the next band the new rate applied to the whole price. For example, a house sold for £500,000 would have had

a SDLT rate of 3% costing £15,000, but if it exchanged hands for £500,001 the 4% rate would have applied costing the purchaser £20,000, i.e. an extra £5,000 of tax for a £1 increase in price!

With the same example, under the new system, there will be no tax payable on the first £125,000, 2% on the next £125,000 and 5% on the remaining £250,000 i.e. total SDLT of £15,000 whether the purchase price is £500,000 or £500,001. This is a

big improvement and a very welcome announcement for most. It should certainly help with houses valued just over the old bands of £250,000 and £500,000.

#### The new progressive rates are:

0 - £125k	0%
£125k - £250k	2%
£250k - £925k	5%
£925k - £1.5m	10%
Above £1.5m	12%

The majority of people purchasing a residential property should benefit from the new system, up to a price tag of £937,000, which the Chancellor estimated should cover 98% of property purchases. Those buying houses at a higher price than this will pay an increased amount of SDLT. The tax on a £2.1m property would have been £147,000 under the old system, whereas £165,750 of SDLT will now be payable.

Overall, however, it is a tax giveaway. It is forecast to save house-buyers about £800m of SDLT per year. This should be a boost for the residential property market and will be a big help for first-time buyers.



# Property held outside the Trading Company

Holding a property outside the trading company in which it is used is not an uncommon structure. There may be commercial reasons for structuring in this way; however, the tax consequences of doing so should also be considered.

## Tax considerations

A future disposal of the property would result in the individual being liable to tax on any capital gain realised. Entrepreneurs' relief may be available such that the gain would be taxed at a rate of 10% as opposed to 28% but complex restrictions first need to be considered. For example, all or part of the gain may not be eligible for the 10% rate where the individual has historically received rent from the company for the property and/or there was any non business use of the property.

In addition, legislation was introduced in the latest Budget such that a disposal of a property held outside the company would also need to be accompanied by a disposal of at least 5% of the shares in the company to qualify for Entrepreneurs' relief.

Income tax would be due on any rental income received for the property whilst holding it outside the company and it would also form part of the individual's estate which could lead to a 40% inheritance tax liability on death (depending on the availability of any reliefs).

Selling the property to the company may result in the company owing the individual money which could later be extracted free of tax. In addition, the shares held by the individual in the company should not be subject to inheritance tax in the future providing certain conditions are met.

Any transfer of property to the company would need to be weighed up with any taxes imposed as well as any other commercial reasons for holding the property outside the company. There may be opportunities to structure the transfer of the property to the company such that any capital gains tax and stamp duty land tax (SDLT) liabilities are minimised and, in some cases, reduced to nil.

## Where we can help

If you hold a property outside your trading company, we can assist by undertaking a review of the most tax efficient holding structure. We can also advise on any tax implications of transferring the property to the trading company and obtain advance clearance from HMRC on the SDLT position, where appropriate.

# Oh yes – Multiple Reliefs

We all like a good tax relief, but what if you can have multiple reliefs? Surely that would result in a scream of delight! And yet it seems that, often, Multiple Dwellings Relief is being missed and, as a result, too much SDLT is being paid.

The relief was introduced for transactions effected after 19 July 2011 and applies where there is an acquisition of an interest in at least two "dwellings". Prior to its introduction, an acquirer would have to pay SDLT on the aggregate consideration, because the various purchases would have been "linked". Now, you look at the average price attached to each dwelling and apply the rate to the whole consideration.

As an example, four dwellings are acquired for a total consideration of £1m.

Under the old rules, SDLT would have been paid at 4% on £1m ie £40,000.

Under the current rules, you take the average price per dwelling, which is £250,000 (£1m divided by 4). The SDLT effective rate, under

the new regime detailed earlier, would be 0% on £125,000 and 2% on £125,000, so total SDLT of £2,500, which gives an effective rate of 1%. SDLT is then calculated by applying that rate to the whole consideration, so £1m at 1%, equals £10,000.

As a result, in this scenario, a purchaser is paying £30,000 less, merely by claiming a relief allowed for in the legislation.

But the good news doesn't stop there. If you look at the definition of a dwelling, it not only includes a building used or suitable for use as a single dwelling, but also one that "is in the process of being constructed or adapted for such use".

The definition is, therefore, widely drawn and can lead to some quite interesting planning opportunities.

If you're making an acquisition that consists of a number of units, make sure you get advice. It would be a crying shame to miss out on the pleasure of multiple reliefs!







## Services

The services we provide include:

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- Taxation planning
- Management accounts
- Strategic planning
- Audit
- Raising finance
- Sage advice and training
- Financial planning
- Payroll assistance to include bureau service
- VAT
- Stamp Duty and SDLT mitigation
- Inheritance Tax and estate planning
- Transactions, planning and support
- Benchmarking and profitability advice
- Incorporation

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