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LANDLORD TAXATION

Features

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STAMP DUTY LAND TAX

By Dorian Payne

From the Government's Autumn Statement, an announcement was made that from 01/04/2016 , there is to be a 3% increase in stamp duty for second property.

Band	Existing residential SDLT rates	New additional property SDLT rates
£0* - £125k	0%	3%
£125k - £250k	2%	5%
£250k - £925k	5%	8%
£925k - £1.5m	10%	13%
£1.5m +	12%	15%

*Transactions under £40,000 do not require a tax return to be filed with HMRC and are not subject to the higher rates.

The higher rates will apply to most purchases of additional residential properties in England, Wales and Northern Ireland, where at the end of the day of the transaction, individual purchasers own two or more residential properties and are not replacing their main residence.

This newsletter is too short to explain every possible scenario but the important things:

1. Married couples and civil partners living together are treated as one and will pay the higher rate, even if divorced and still on the deeds. Unless separated were deemed permanent and the charge only relates to the other spouses position.

2. You may be able to claim a refund if you purchase a second property to replace your main residence as long as it's sold within 36 months.

3. If contracts were exchanged on or before 25.11.2015 but not completed, the higher rates will not apply.

4. Surcharge will still apply if your main home is abroad.

5. Purchasing a property for a child, and being named on the deeds will result in the higher charge. A gifted deposit is still acceptable.

6. Even if one of the parties in a joint purchase owns another property, the higher rates apply.

See appendix 1 for a flowchart diagram illustrating when the charges are payable.

CAPITAL GAINS TAX

Why the increased taxes and charges for landlords and investors?

The chancellor may have been tempted to tax buy-to-let more heavily as his last tax raid had little – if any – impact on the number of investors piling in.

By Dorian Payne

The Council of Mortgage Lenders revealed in early November that the number of buy-to-let mortgages granted had jumped by 36 per cent in the previous 12 months. In contrast lending to first-time buyers was up just 10 per cent

HOW ITS PAID

One of the main changes to capital gains tax (CGT) for lenders is the way that the tax is actually paid. Currently CGT is not due until the end of the tax year, however from April 2019 the tax will be payable 30 days from the sale of the property.

THE RATES

Another change for CGT is the fact that all other investments will now attract a lower tax rate of 10% (down from 18% for basic rate taxpayers) and a lower rate of 20% (down from 28% for higher rate taxpayers). However the original CGT Rates remain unchanged for property investments.

INCOME TAX

FINANCE COSTS

A huge change that was set out by the government which is really set to hit landlords of residential property is the permission to claim relief for finance costs (Mortgage interest) incurred on their let property, giving tax relief at 40% and 45% for landlords paying tax at the higher and additional tax rates. This tax relief will be restricted to the basic rate of income tax (20%). Implementation of this will be phased from April 2017. See Appendix 2 for an illustration.

EXPENSES

An allowable expense for landlords renting furnished properties called Wear and Tear allowance, will be replaced by a new system from April 2016. The past system allows landlords to deduct (broadly) 10% of their rental income in calculating taxable profit to allow for wear and tear. The new system allows landlords to deduct only the actual costs incurred on replacing furnishings in the tax year.

TAX COMPUTATION

Tax will now be calculated on the income of the property and then a tax credit awarded for the basic rate.

See appendix 3 for a tax computation that details the income tax changes when they are fully in affect.

ESTABLISHING A COMPANY

There has been a lot of controversy around the fact that a limited company property business could be a better method by which to trade.

By Dorian Payne

A limited company is a separate legal entity of which is owned by the shareholders and managed by the directors. There are pros and cons of establishing a company in general but in this article I will talk about how some landlords are achieving favourable results by incorporating.

I will start with the pros.
Firstly, it is completely legal to set up a limited company.

INTEREST RELIEF

A reason some investors are incorporating are because they are higher and additional rate taxpayers, and with the new changes in place, instead of getting a 20% credit from 2017; the full interest is deductible for a company.

TAXATION RATES

Taxation for a company is a lot lower, currently 20% and is set to reduce to 17% in 2020.

Dividend relief also means that £5,000 is tax free from the company on top of the personal allowance.

DIFFICULT?

It is not difficult to set up a company, however there are a few things to consider.

1. SDLT is payable

2. There is additional filing requirements for a company

3. A company is a separate entity and would have to purchase the properties at market value, potentially incurring a capital gains tax charge

4. Incorporating may only be attractive to higher and additional rate tax payers as basic rate taxpayers wont be as affected by the tax changes. It may not benefit those with only one buy to let property either.

5. You may not be able to keep the same mortgage with the same lender. Unless a Beneficial Interest Company Trust is utilised.

6. Mortgage rates are potentially higher for company buy to let.

7.Greater flexibility in terms of IHT planning

8.Liabilities are limited to the value of the company. Mortgage lenders often require personal guarantees but there are many other liabilities that are ring fenced as a result of incorporation.

See Appendix 4.

CONCLUSION

In terms of Limited Company or Sole Trader / Partnership, the scenarios are too vast to be able to state if it is a favourable decision or not. The best advice I can give is that anyone interested in the idea needs a comprehensive review of their current portfolio with forecast calculations and future tax liabilities under both scenarios to illustrate if it is worthwhile or not. This should be undertaken by a tax advisor with experience in the property sector. (I can refer if need be)

Also it is very important to note that due to the complexity of the topic I have not been able to mention everything in this article and I have only covered the key points. So please use this as an informative guide but do not rely on it fully. Please note as well that there is not just the options of incorporating or not, there are many other ways to reduce tax liabilities, such as a management company that I have not covered.

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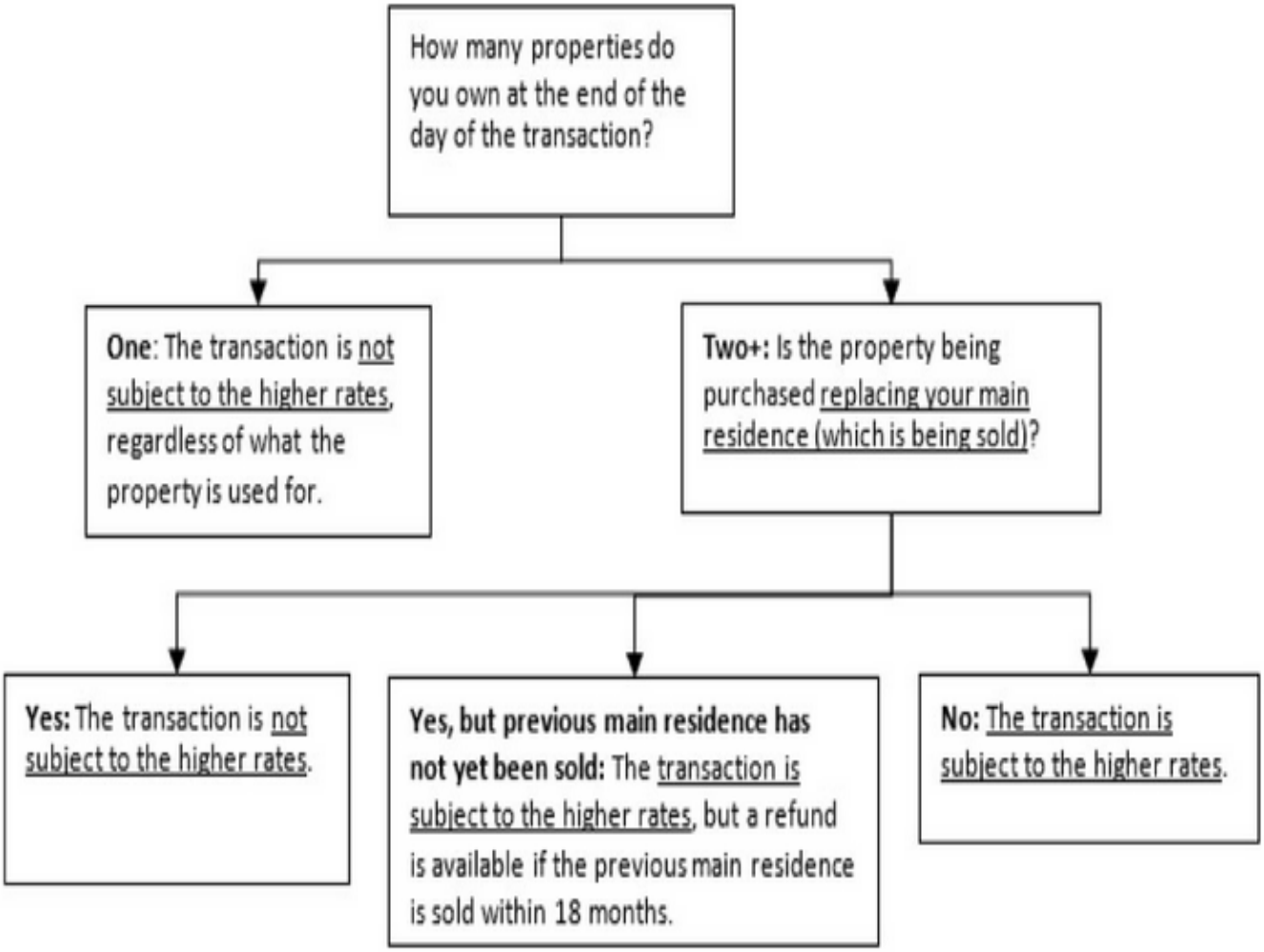
Appendix 1



Please note that the refund given on the sale of a previous main residence was 18 months. However this has now been increased to 36 months following March 2016 budget.

Appendix 2

- tax year 2017 to 2018: the deduction from property income will be restricted to 75% of finance costs, with the remaining 25% being available as a basic rate reduction

- tax year 2018 to 2019: the deduction from property income will be reduced to 50% of finance costs and 50% will be given as a basic rate reduction

- tax year 2019 to 2020 the deduction from property income will be reduces to 25% of finance costs and 75% will be given as a basic rate reduction

- tax year 2020 to 2021 no deduction for higher rate tax on finance costs will be available and all financing costs incurred by a landlord will be given as a basic rate reduction

Finance costs include: mortgage interest, sums which are equivalent to interest and the incidental costs of obtaining finance by means of the loan, for example the fees incurred when taking out or repaying mortgages or loans.

Appendix 3

Interest Relief Pre Changes:

£20,000 Rent

£12,000 Mortgage Interest

£1,000 Wear & Tear allowance

£7,000 Taxable

£1,400 Basic Rate

Basic Rate	Higher Rate	Additional Rate
£1,400	£2,800	£3,150
Tax Due	Tax Due	Tax Due

Interest Relief AFTER Changes:

£20,000 Rent

£0 – No actual costs on replacing items.

£20,000 Taxable

20% Interest credit due back

+2,400 tax credit.

Basic Rate	Higher Rate	Additional Rate
£1,600	£5,600	£6,600
Tax Due	Tax Due	Tax Due

Difference

Basic Rate	Higher Rate	Additional Rate
£200	£2,800	£3,450
Tax Due	Tax Due	Tax Due

Appendix 4

Tax Consequences of Incorporation

Incorporation

Capital Gains Tax (CGT)

Property gets transferred into company = CGT Liability on the difference between the open market value of the properties and the base cost (purchase price + capitalised improvements)

Gain is then charged at 18%/28% depending on tax bracket.

However s162 of Taxation of Chargeable Gains Act 1992 states that providing the landlord is running a business, (he or she spends 20 hours or more per week running the business). If this condition is met then at the point of incorporation, the equity in properties is converted into shares into the company. The value of those shares can be offset against the capital gain using the relief.
Therefore, providing the equity in the property portfolio is greater than the capital gain, there is no CGT Payable.

Stamp duty land tax (SDLT)

Property businesses can claim a relief from the higher rate, such as residential letting of properties (HMRC SDLTM09555) which means they will be charged at the original rate

Selling the properties –

Any disposal would be taxed twice potentially.

Once sold corporation tax would be liable at the applicable rate (20% currently)

Then the extradition of moneys would also give rise to another tax liability in the form of income tax through dividends or capital gains tax depending on how the funds are distributed.