Summer 2015

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Letter from the Editor | Dividend Tax Credit | Pensions and IHT Planning | Direct Recovery of Debts (DRD) | Unexpected Announcements for Residential Property Landlords | Annual Tax on Enveloped Dwellings - £1m+ Properties to File by 1 October 2015 | Inheritance Tax (IHT)

LETTER FROM THE EDITOR

Welcome to our Private Client Briefing.

We have the "novelty" of an "emergency Budget" delivered in July 2015 to consider this year. There are significant changes to the domicile rules, Inheritance Tax and also the tax treatment of dividends.

We summarise these, and other issues, in this Summer 2015 edition; please do not hesitate to contact me if you have any queries regarding the topics covered, or any other issues.

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DIVIDEND TAX CREDIT

The 10% notional tax credit will be abolished from April 2016 and will be replaced with a tax free dividend allowance of £5,000. The Treasury has now indicated that the £5,000 allowance will form part of the basic rate band instead of being a separate additional allowance.

	£		£
Dividend	60,000		
Less personal allowance	(11,000)		
	49,000		
Dividend allowance	5,000	@ 0% =	0
	27,000	@ 7.5% =	2,025
Basic rate band	32,000		
Higher rate	17,000	@ 32.5% =	5,525
Total tax due			7,550

The dividend tax rates for basic rate taxpayers are 7.5%, for higher rate taxpayers it is 32.5% and for additional rate taxpayers it is 38.1%.

The 2015 Budget introduced the Savings Rate of Tax of 0% on savings income of up to £1,000 for basic rate tax payers and £5,000 for higher rate taxpayers. It seems that this will not apply to 45% rate taxpayers. The combination of this and the new dividend allowance means that it is even more valuable for couples to ensure that their incomes are equalised.

PENSIONS AND IHT PLANNING

Previously when your defined contribution pension was passed on following your death, before 75, it was subject to tax at 55%. You can, since April 2015, pass this on to anyone you choose, including non-dependents, free of tax.

For people who die over the age of 75 benefits can be passed on to anyone but will be subject to tax at 45%. From April 2016 the rate of tax charged will be linked to the beneficiary's marginal rate of tax.

DIRECT RECOVERY OF DEBTS (DRD)

The introduction of these measures will allow HM Revenue & Customs (HMRC) to recover cash directly from the bank or building society accounts and cash ISA's of debtors who owe £1,000 or more.

The safeguards that HMRC have put in place to ensure undue hardship is not caused are as follows:

- Only taking action against those who have established debts, are too late to appeal and who do not respond to HMRC.
- Every debtor will receive a face to face visit from a HMRC agent before their debts are considered for DRD to confirm:
  - ◇ Who they are
  - ◇ Is it their debt
  - ◇ What they owe
  - ◇ Discuss options to pay the debt
  - ◇ Whether they are vulnerable
- Always leave a minimum of £5,000 in the debtor's account.
- Clear procedures have been put in place to enable debtors to appeal their case.

UNEXPECTED ANNOUNCEMENTS FOR RESIDENTIAL PROPERTY LANDLORDS

There were some unexpected and some might say unwelcome announcements for residential landlords in the Chancellor's summer 2015 budget. The headlines were grabbed by the removal of the wear and tear allowance and restrictions on tax relief for mortgage interest.

WEAR & TEAR ALLOWANCE

Residential landlords letting furnished property will see their tax affairs become more complicated from April 2016 following the Chancellor's decision to abolish wear and tear allowance.

Currently instead of claiming for the cost of buying or replacing furniture and furnishings in their let residential property, landlords can simply deduct 10% of the gross rents after adjusting for the cost of utilities and rates they have paid on the tenant's behalf.

The government has explained that it is abolishing the tax allowance so that landlords instead will get tax relief for their actual expenditure. The Chancellor argued that by giving tax relief regardless of whether any expenditure was incurred gave no incentive for landlords to spend money improving their properties. Additionally the wear and tear allowance is based on rental income, so was disproportionately more beneficial to property located in certain areas.

REPLACEMENT FURNITURE RELIEF

From April 2016 wear and tear allowance will be replaced by Replacement Furniture Relief.

Essentially there will be no longer be a difference between letting furnished and unfurnished residential property. There will still be no deduction for the original cost of an asset such as a bed, washing machine or sofa. However all residential landlords will be allowed to claim for the cost of replacing assets provided in the property. Records will need to be kept of such assets acquired each tax year for inclusion in the accounts.

It is intended that Replacement Furniture Relief will apply to the same type of assets as currently covered by wear and tear allowance. These include:

- movable furniture or furnishings, such as beds or sofas,
- televisions, washing machines, fridges, freezers and other appliances,
- carpets and floor-coverings,
- curtains and linen,
- crockery or cutlery,
- beds and other furniture

The government is consulting on how to implement rules on upgrading white goods, for example replacing an old washing machine with a new washer/dryer. At present they propose to require landlords to claim only for the cost that would have been incurred in replacing the old asset on a like-for-like basis. For example replacing a washing machine with an identical model would cost £400 and a new washer/dryer would be £600. Under current proposals, the landlord would deduct £400 against their profits, being the cost of replacing the original asset. The extra £200 relating to the "upgrade" will not qualify for any relief.

There is some good news for landlords with previously unfurnished or part-furnished properties which historically did not meet the criteria for claiming wear and tear allowance. The new Replacement Furniture Relief will apply to all residential properties. Claims will now be allowed for replacing assets where they would not previously have been permitted.

Commercial landlords and those letting property which meet the criteria for furnished holiday lettings will not be affected by the new rules. Wear and tear allowance was not available on these types of property. Instead they will still be able to claim capital allowances for assets purchased and used in their letting businesses.

RESTRICTIONS ON MORTGAGE INTEREST

Commencing in April 2017 residential landlords will have tax relief restricted on the mortgage interest they claim in connection with their let property. Rather than receiving tax relief at their marginal rate, all landlords regardless of their tax position will in effect receive a maximum of 20% tax relief once the proposals take full effect in April 2021.

Marginal rate tax relief will be phased out over a four year period with a reducing proportion of loan interest being deducted against rental income.

Tax Year	% of interest deductible against profits
2017/18	75%
2018/19	50%
2019/20	25%
2020/21	-

Subject to certain criteria, any interest not already deducted against profits can be deducted from the taxpayer's basic rate tax liability.

In practice this means the tax deduction will be restricted to the lower of:

- 20% of the interest not deducted against profits (i.e. 25% of the interest in 2017/18 through to 100% in 2020/21),
- 20% of the profits of the rental business in the year, or
- the taxpayer's total income where that exceeds the personal allowance.

As well as mortgage interest, the restriction applies to other finance costs such as interest on loans to buy furniture as well as fees incurred with re-mortgaging and paying off debts.

Tax relief on finance costs is not restricted for loans in connection with properties meeting the criteria for furnished holiday lettings.

The rules will be difficult to calculate and more landlords will require the services of a professional accountant to help calculate the correct amount to claim.

RENT A ROOM RELIEF

There was some good news for landlords amongst the budget announcements. Those who take in lodgers and claim rent a room relief will be pleased to see the tax-free allowance will increase to £7,500 from 6 April 2016.

Rent a room relief is available for letting a room in your main residence. Any rent and/or contribution to household expenses is only taxable if it exceeds the threshold which will now increase from its current level of £4,250. Where two people receive the rental income jointly for a property they occupy and let out a separate room, they are each entitled to half of the annual threshold.

In certain circumstances Rent a Room relief can also apply to guest houses and B&Bs, providing the individual lives in the property as their main residence. However it may be beneficial to these taxpayers to claim for their actual expenses if they exceed more than £7,500 per year which is the alternative to claiming Rent a Room relief.

ANNUAL TAX ON ENVELOPED DWELLINGS (ATED)

£1M+ PROPERTIES TO FILE BY 1 OCTOBER 2015

The Annual Tax on Enveloped Dwellings (ATED) now applies to UK residential properties with a value (at April 2012 or acquisition date, if later) of £1m or more, owned by companies or other "non-natural persons". ATED returns for these properties must be filed by 1 October 2015, where the tax is due for payment (£7,000), and payment of the tax due must be made by 31 October.

In an attempt to reduce the filing burden for companies with properties with a value of £1-2m claiming a relief from ATED, HM Revenue & Customs (HMRC) has very recently published its new "Relief Declaration forms". These reliefs include where a company operates a property rental business or a development business or the property is open to the public. These forms require fewer details than the full ATED return for properties with a value of £2m or more, or for properties of £1m or more where tax is due. In addition, one relief declaration form will suffice where a company owns a number of properties where the same relief is being claimed.

The extension of the ATED regime to residential properties with a value of £1-2m does of course dramatically increase the number of companies required to file a return or a relief declaration. From April 2016, properties with a value of £500,000 or more will also be subject to ATED. Penalties will be due for late submission of returns or declarations, and for late payment of ATED tax.

Contact Katharine Arthur for further details, advice on ATED and the relevant reliefs and exemptions, and assistance with preparing and filing ATED returns and relief declarations.

INHERITANCE TAX (IHT)

ANNUAL EXEMPTION

The existing nil rate band of £325,000 will be fixed until the end of 2020/21.

An additional £175,000 exemption will be introduced over 4 years from 2017 for individuals who wish to pass on their home to family members who are direct descendants. The £175,000 can be passed to spouses meaning that on the second death, a family home valued at up to £1m can pass free of IHT. The relief will be withdrawn for estates worth more than £2m.

UK RESIDENTIAL PROPERTY

Currently, an individual who is not UK domiciled is subject to IHT only on property situated in the UK. If the property was owned by an offshore company, which is not situated in the UK, for example, then IHT would not be chargeable.

The measures propose that with effect from April 2017 all UK residential property will be subject to IHT whether owned directly or through an offshore structure such as a company. This applies to all non-UK domiciliaries whether resident or not. Other UK assets are unaffected.

DEEMED DOMICILE

The rules have previously been that if you are resident in the UK for 17 out of 20 tax years you will be deemed to be domiciled for IHT purposes only.

From April 2017 an individual who has been resident for 15 out of 20 tax years will be treated as UK domiciled for income tax (IT), capital gains tax (CGT) and IHT.

For IT and CGT purposes the effect of this is that the "remittance basis" of taxation for non-domiciled individuals will no longer be available after 15 years of residence. Tax will therefore be paid on worldwide income and gains as they arise.

An individual will therefore have to be non-resident for 5 years to re-set the "clock".

NON-UK DOMICILIARIES

New rules are to be introduced to make individuals who have a foreign domicile of choice, but who were born in the UK to UK domiciled parents, UK domiciled as soon as they resume UK residence.

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