DUFTON KELLNER
CHARTERED ACCOUNTANTS

INVESTOR IN PEOPLE

ICAEW CHARTERED ACCOUNTANTS

WINTER 2015

Private Residence Relief –Don't Lose The Plot!

The capital gains tax (CGT) relief on disposal of an only or main residence (or 'private residence relief' (PRR)) will be familiar to many taxpayers. However, the legislation is far from straightforward. This can lead to misunderstandings and misconceptions about the circumstances in which the relief is available.

Garden or grounds

In addition to PRR being available on the disposal of an individual's only or main residence, the relief can also apply to the disposal of 'land which he has for his own occupation and enjoyment with that residence as its garden or grounds' (up to a 'permitted area' as defined in the legislation).

These requirements must be met at the date of disposal of the land. Thus if part of the garden is sold some time after the residence, on a strict interpretation of the legislation a gain on that later sale will not attract relief. This follows from the High Court decision in Varty v Lynes [1976] 51 TC 419. In that case, the taxpayer sold his house and part of the garden in June 1971. He sold the remainder of the garden in May 1972. The taxpayer was assessed to tax on the later disposal, and the High Court subsequently dismissed his appeal.

However, if the garden or grounds are sold separately before the disposal of the dwelling house, the disposal may qualify for PRR if the other relief conditions are satisfied.

Dividing up the residence and garden

It is not uncommon for homeowners to divide their residence and garden into plots, to build a new private residence on one of the plots, and to sell the remaining plots including their old residence. However, if the plots are not divided up and/or sold in the correct order, PRR may be lost in respect of them.

In Fountain & Anor v Revenue & Customs [2015] UKFTT 419 (TC), the taxpayers lived at a property (D), part of which was divided into five building plots prior to its disposal. Plots 1 and 5 were sold in March 2006. Plot 3 was gifted to the taxpayers' son in June 2006. The taxpayers built a new home on Plot 4, into which they moved in January 2007. D was sold in February 2007.

Plot 2 was sold in December 2009. PRR was claimed on the disposal; on the basis that Plot 2 formed part of the garden or grounds of Plot 4, on which the taxpayers' new private residence had been built. HMRC considered that PRR did not apply to the disposal of Plot 2. The taxpayers appealed. The First-tier Tribunal considered whether, when Plot 2 was sold, it formed part of the garden or grounds of the appellants' new house constructed on Plot 4. The tribunal held it did not follow that because Plot 2 once formed part of the grounds of D, it then became part of the grounds of Plot 4 when the taxpayers moved to their new home. Furthermore, the fact that Plot 2 and Plot 4 may have been part of the same title registered with HM Land Registry was irrelevant. The tribunal concluded that Plot 2 had never formed part of the garden or grounds of Plot 4. The taxpayers' appeal was dismissed.

Practical Tip :

The facts that were key to the tribunal's decision in Fountain were that, at the time of sale, Plot 2 had been levelled, and was uncultivated; Plot 2 was separated from Plot 4 by Plot 3 (which at the relevant point had a house built on it), and Plot 2 was fenced off. The tribunal found that Plot 2 did not 'adjoin' or 'surround' Plot 4.

Taxpayers who are considering dividing up their residence and garden into plots should bear in mind the *Varty v Lynes and Fountain* cases in terms of maximising potential PRR claims.

IN THIS ISSUE

FEATURE ARTICLE

Private Residence Relief – Don't Lose The Plot!

- Residential Property Landlords: New Rules For Renewals
- One-Man Companies To Lose Employment Allowance
- Reduce Your Employer's NIC Bill By £2,000
- Portfolio Mortgages
- Extend The Loss To Capital Gains

Dufton Kellner Limited
Barnston House,
Beacon Lane,
Heswall,
Wirral
CH60 0EE

Residential Property Landlords: New Rules For Renewals

The rules for the costs of replacements of items such as fridges, furniture, carpets, and curtains in residential property were fairly simple and well-understood until April 2013. HMRC then decided to change the rules from that date, and the result was so much chaos and annoyance that they have had to change them back again.

The good old days

Until 2013, a landlord could claim the cost of renewing furniture, white goods, carpets, curtains, and so on as an expense against the rent. The claim was reduced by anything received for the old item, and had to be adjusted if the new item was an improvement on the old – a washer-dryer instead of just a washer, for example. The original cost of the first items bought when fitting out the property was not allowed, only the cost of replacing them.

In the case of fully furnished lettings, there was an alternative in the form of the 'wear and tear' allowance. The landlord could claim 10% of the rent on the property, regardless of any expense actually incurred, as an allowance to cover the costs of replacing the items referred to above.

Certain items – known as fixtures – are actually part of the fabric of the property itself. Examples would be baths, toilets, boilers, and fitted kitchens. Replacing these is treated as a repair to the whole property, and this will remain the case.

Moving goalposts

In 2013 (or rather in 2012, but with effect from April 2013), HMRC announced that they had decided the renewals basis was not covered by the legislation. HMRC announced that from April 2013, landlords could no longer claim the cost of 'renewals'.

HMRC's 'abolition' of the allowance for renewals produced a very unfair result. Landlords of fully furnished accommodation could still claim the 10% wear and tear allowance, but landlords of unfurnished or part furnished property could claim nothing at all.

This led to such an outcry that HMRC promised to 'review' the position – and at a local level, some of them took a more practical attitude. This applies where the old item is so badly damaged that it cannot be repaired, so it is replaced instead. In other words, this began with HMRC's head office making up the law in one way, and ended with local tax officers making it up again in a different way.

The proposed change will mean that, from April 2016, we will be back to the old rules for 'renewals' exactly as described above, and (as before) they will apply to all landlords of residential property, furnished or unfurnished. The wear and tear allowance will be abolished.

Landlords should note that none of this applies to commercial properties, or to furnished holiday accommodation, both of which have their own, different, rules.

Planning Tip :

If you are a residential property landlord, it might make sense, if possible, to postpone any replacements of furniture, TVs, carpets, curtains, and so on, until after April 2016. If you claim the wear and tear allowance, note that 2015/16 will be the last year for doing so.

One-Man Companies To Lose Employment Allowance

The National Insurance employment allowance was introduced from April 2014 and provides employers with a reduction in their secondary Class 1 National Insurance bill up to the amount of the allowance. The allowance was set at £2,000 for 2014/15 and 2015/16.

In his summer 2015 Budget the Chancellor announced that the allowance is to be increased to £3,000 a year from April 2016. However, from that date, companies where the director is the sole employee will no longer be able to benefit. The loss of the allowance will affect the calculation of the optimal salary calculation for personal companies.

Optimal salary – 2015/16

It is generally efficient for a tax and National Insurance perspective for a director of a one-man company to pay a small salary to preserve the director's entitlement to the state pension and certain contributory benefits and to withdraw any remaining profits as dividend. To preserve pension entitlement the salary must be at least equal to the lower earnings limit for National Insurance purposes. For 2015/16 this is set at £112 per week. This means that the annual salary must be at least £5,824 for this tax year.

As employee Class 1 National Insurance contributions are payable at a notional zero rate, it is possible to pay a salary of up to £8,060 (the annual level of the primary threshold) for 2015/16 free of both tax and National Insurance, as long as the director's personal allowance remains available.

Once the salary level exceeds £8,060 the director will have to pay Class 1 National Insurance contributions of 12%. Normally, employer contributions of 13.8% would also be payable once the salary exceeds the level of the secondary threshold, set at £8,112 for 2015/16. However, as one-man companies can currently claim the employment allowance, the employer does not pay any contributions until the NIC bill for the year exceeds £2,000. The impact of the allowance means that as the personal allowance is available, for 2015/16 it is better to pay a salary of £10,600 and pay employee's National Insurance of £304.80 than to pay a salary of £8,060 and take the rest of the profits as dividends. At this salary level, no employer National Insurance is due as it covered by the annual allowance. However, as the salary is deductible for corporation tax purposes, the additional salary of £2,540 paid above the primary threshold saves corporation tax of £508 (£2,540 @ 20%) for the cost of the employee's NIC of £304.80 – a net saving of £203.20.

It is not worth paying a salary in excess of the personal allowance, despite the employment allowance, as any salary above this level will be taxed. The combined effect of the income tax and employee's NIC will outweigh the corporation tax deduction.

Optimal salary – 2016/17

For 2016/17, the employment allowance will not be available to one-man companies where the director is the sole employee. Where this is the case, the benefit of paying a salary in excess of the primary threshold is lost (other than to the extent that the secondary threshold is higher than the primary threshold) as the combined employee and employer National Insurance cost will outweigh the corporation tax deduction.

Tip:

From April 2016, in one-man companies where the director is the sole employee, the loss of the employment allowance means that the optimal salary for 2016/17 is one equal to the higher of the primary threshold and the secondary threshold. The loss of the employment allowance from 2016/17 means that it is no longer beneficial to take a salary once both primary and secondary contributions are payable. If only primary contributions or only secondary contributions are payable, the NIC hit is offset by the corporation tax deduction.

However, for companies that have other employees the employment allowance remains available next year and it will continue to be beneficial to pay a salary up to the personal allowance (set at £11,000 for 2016/17) as long as this remains available.

Practical Tip:

If the director is under 21, it will remain beneficial to pay a salary equal to the personal allowance, as where the employee is under 21 no employer's NIC is payable at this level.

Note:

The rules for taxing dividends are reformed from 2016/17 and this will impact on the dividend strategy.

Personal Tax

Reduce Your Employer's NIC Bill By £2,000

Employers are able to claim an NIC allowance of up to £2,000 for 2015/16 to set against their employer's NIC bill. The allowance is given as a reduction in the employer's NIC paid to HMRC, rather than by way of a cashback.

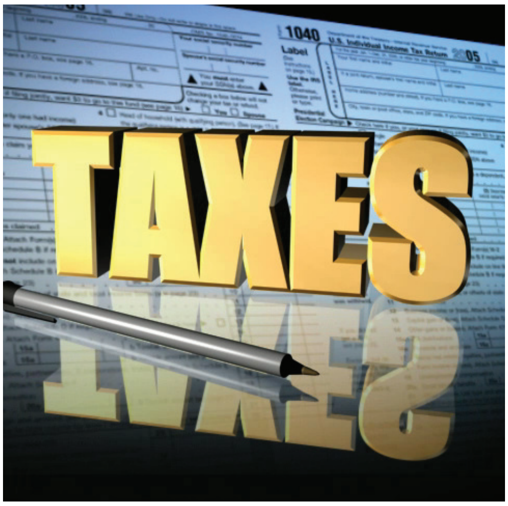
For 2015/16, the allowance is available to most employers, including one-man companies, although there are a small number of organisations that are not eligible, including employers of persons employed for personal, household or domestic work and those carrying out services of a public nature, such as GPs.

The allowance is claimed through the RTI process by means of the employer payment summary.

Note – The allowance is to increase to £3,000 for 2016/17. However, it will no longer be available to personal companies where the director is the sole employee. '

Case Study:

XYZ Ltd has a monthly employer's NIC liability of £600. For 2015/16 the company is eligible to claim the NIC employment allowance of £2,000.
As a result, the employer's NIC liability is reduced to nil for months 1, 2 and 3 and to £400 for month 4. From month 5 onwards, the full employer's NIC liability must be paid over to HMRC. The allowance is claimed each month until it is fully utilised via the employment payment summary.
By claiming the allowance, XTZ Ltd reduces its annual employer's NIC bill by £2,000.



Property Tax

Portfolio Mortgages

Tax relief is allowed on interest paid on mortgages/loans taken out to finance the purchase of assets held within a business. Landlords who own two or more properties are deemed to own a 'portfolio' of business assets.

Lenders have designed products that treat the 'portfolio' as one single business account regardless of the number of properties purchased or whether the full amount of capital has been utilised. The individual properties may have separate mortgages each with different interest rates charged but the 'portfolio' is treated as one single business account. 'One portfolio' means one agreement, one monthly payment and one mortgage statement.

Should not all of the capital be used, tax relief on interest payments is still fully allowable because the original reason for the mortgage/loan remains, namely to finance the use of capital by a property business.

Planning Point: As from 6 April 2017 tax relief at higher rates on interest paid is being phased out over a four-year period such that by the tax year 2020/21 only basic rate relief will be claimable.

Case Study:

Avril owns six properties with a total value of £2m. With a portfolio mortgage outstanding of £1.7m there is a 'shortfall' of £300,000. This amount is not the equity found in any one property, but in the portfolio spread over the six properties.

Therefore £300,000 is available for further investment; the interest will be fully tax deductible.

Business Tax

Extend The Loss To Capital Gains

If relief for a trading loss is claimed against other income for the current or previous tax year, the claim can be extended by election to capital gains tax if there is insufficient income in the year to fully utilise the loss.

This can be useful in some circumstances.

This relief allows an unused loss to be set against the chargeable gains for the year, reducing the capital gains tax payable for the year. However, the loss is set against gains before utilising the annual exemption and consequently a claim will not always be worthwhile.

Case Study:

Paul makes a loss in 2015/16 of £25,000.

He has no other income in that year, but makes a capital gain of £80,000.

He elects to extend the loss to capital gains. The loss is set against the capital gain of £80,000 saving him capital gains tax of £7,000 (£25,000 @ 28%).

As his remaining gains (£55,000, being the £80,000 gain less loss relief of £25,000) exceed the capital gains tax annual exempt amount of £11,100 for 2015/16, using the loss in this way does not waste this exemption.

Email:post@duftonkellner.co.uk • Tel: 0151 342 6405 • www.duftonkellner.co.uk