

TAXguide 14/18

Property income - webinar Q&A



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This TAXguide answers a selection of the key questions raised by viewers of the Tax Faculty webinar 'property taxes update', broadcast on 9 July 2018, together with answers provided by Sue Moore.

The Tax Faculty has also published a detailed guide to property letting in **TAXguide 01/17**. Written by Rebecca Cave, this was first published in January 2017 and was updated in July 2018 to reflect changes introduced by the 2017 Finance Acts.

The **webinar recording** is available members of the Tax Faculty and Faculties Online.

Edited by **Jane Moore**

TAXguides are published by the Tax Faculty to provide practical guidance to tax practitioners on important developments to tax practice and policy.

CONTENTS

Cash basis	2
Finance costs	3
Replacement fixtures, fittings, furniture	4
Property allowances and rent a room relief	5
Making tax digital	6
Jointly owned property	7
Capital gains	8
Miscellaneous	9

CASH BASIS

- 1. Question:** If we use the cash basis, is it correct that there is a tax advantage for residential landlords to overpay mortgage interest in 2017/18, 2018/19 and 2019/2020?

Answer: Overpayments on the mortgage are likely to be treated by the mortgagee as a repayment of capital and not of interest that has not yet been charged, so the additional payment will not appear in the rental statement, it will just reduce the loan outstanding. See the Tax Faculty's [TAXbite on the cash basis](#).
- 2. Question:** How do you opt out of the cash basis?

Answer: If you are using GAAP then you need to tick box 5.2 for furnished holiday lets (FHLs) and 20.2 for other rental business on the UK property pages of the self assessment (SA) tax return. For foreign property rental income, box 14.2 is the opt-in for GAAP.
- 3. Question:** Can you explain why the cash basis is disallowed for trustees?

Answer: We would have expected the same and recommend that you/your client uses the estimated income feature as that should lead to a code adjustment. We shall refer this to HMRC.
- 4. Question:** My tax software has allowed an accruals basis for a client who has gross income of less than £150,000 for residential property. Can you confirm this is incorrect?

Answer: Landlords can opt into the accruals basis if their gross rental income is below £150,000. Without knowing your software or what you have input we cannot comment.
- 5. Question:** In transition to the cash basis, will profits fall through a gap?

Answer: No, income is taxed once and expenses allowed once. It may be necessary to do a transitional adjustment to be reported in 2017/18. See HMRC's *Property Income Manual (PIM)* at [PIM1096](#).
- 6. Question:** Is the accruals basis available where a client is renting out only commercial properties but with gross income less than £150,000?

Answer: Anybody can claim the accruals basis but it applies to the entire rental business.
- 7. Question:** Can a taxpayer opt for the accruals basis for his or her trading Income (business) but the cash basis for property income?

Answer: Yes.
- 8. Question:** Can you change from one basis to another?

Answer: Yes. You may need to do transitional adjustments going in and out, see [PIM 1096](#) and [PIM1098](#).
- 9. Question:** If you use the cash basis one year, how easy is it to change to UK GAAP basis in a future year?

Answer: You may need to make transitional adjustments.
- 10. Question:** Is the cash basis now the default for FHLs?

Answer: Yes.
- 11. Question:** Cash basis seems onerous to administer, especially if a managing agent is involved and you have to get receipt dates from them. Is there any real advantage in it?

Answer: It is billed by HMRC as a simpler alternative: "The simplification provided by the cash basis is expected to make it easier and cheaper for landlords to calculate tax liabilities by no longer requiring them to compute profits in accordance with GAAP. It is expected that many landlords will avoid the need to carry out time-consuming accruals-based adjustments at the end of each period" ([Income tax: simplified cash basis for unincorporated property businesses](#)) is likely that many landlords have been operating an unofficial cash basis for many years.
- 12. Question:** Where letting agents collect rents on behalf of the landlord, is the date that the agent receives the money the effective date for a cash receipt or is it the date the landlord receives the net receipt?

Answer: It is the date the agent receives the rent. (However, MTD regulations allow the summary from a property agent to be treated as the prime record, which means there is no

requirement to record the date of each individual transaction, which seems to us contradictory to the property income legislation.)

13. Question: There is some confusion with regard to loan interest. The cash basis has a restriction, L/V where V = value of properties when first introduced plus capital improvements, L = loans outstanding. I have seen several examples demonstrating this as being a disadvantage for the cash basis BUT saying the restriction not applicable when using GAAP. I am not convinced this is the case. What is your view?

Answer: Under the cash basis for trades, loan interest is restricted to a flat £500 so some businesses would be at a disadvantage and GAAP may give a higher deduction. This £500 restriction was not transferred over into the cash basis for property businesses and the finance cost can be calculated in the normal way but is then subject to the new finance cost restrictions.

FINANCE COSTS

14. Question: What happens if the basic rate of income tax changes in the future?

Answer: The calculation of the credit for the restricted finance costs under s274A, Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005) uses the basic rate of tax, so if the basic rate changes the restricted finance cost relief changes in line with it.

15. Question: How does the restriction work for partnerships with, say, a 30 September 2017 period end with property rental income and a mortgage? Do we apportion interest paid before and after 5 April 2017 and then restrict only the interest payable post 6 April 2017? The examples on HMRC's website don't cover this.

Answer: Under the GAAP basis, the basis period for a property business chargeable to income tax is the year to 5 April. There are two exceptions to using the fiscal year: the letting of surplus accommodation by a trader or professional partnership (this is likely to be commercial property so no interest restriction), or where the property business is actually a trade, in which case the income would be reported as trading income not rental income.

16. Question: Do you only claim 75% of the finance costs in the property profit and loss account or is the 25% deducted elsewhere in the SA return?

Answer: Starting in 2017/18, the finance costs relievable as an expense in the property profit and loss account are restricted. The restriction in 2017/18 is 25%, in 2018/19 it is 50% and in 2019/20 it is 75%. From 2020/21 no finance costs can be deducted as an expense in the property profit and loss account; the restricted finance cost is instead used to calculate a tax credit to deduct from the tax liability.

17. Question: When doing 2017/18 tax returns will 75% of the finance costs go into box 26 on the tax return and the 25% go into box 44?

Answer: Yes, 75% in box 26 and 25% in box 44.

18. Question: Please go over again the £2,500 tax credit in example 1.

Answer: The restricted finance was £12,500. The deduction under s274A is 20% of the lower of:

- The amount restricted – £12,500
- The taxable profits of the rental business after losses b/fwd – £32,500
- Adjusted total income for the year (adjusted net income less savings income, dividend income and personal allowance) – £107,250

So it is 20% of £12,500, which is £2,500.

19. Question: How would finance cost restrictions apply to a semi-commercial property, typically a high street property with a shop on the ground floor and flats above. I have been hearing mixed views on this. Some say you can treat the whole interest as 100% deductible and others say the property's square footage needs to be broken down between residential and commercial and 100% interest can be claimed on commercial and on the residential it will be restricted.

Answer: The apportionment of finance costs between residential and non-residential parts of a property has to be done on a just and reasonable basis. The *Property Income Manual* at **PIM2056** gives different examples using different bases for the split (square footage, rent received, how the loan is spent).

20. Question: Can you explain the £1,000 adjusted total income in example 2?

Answer: The adjusted total income is the adjusted net income from step 2 of s23, Income Tax Act 2007 less savings income less dividend income less personal allowance less blind person's allowance. In this example that is:

Adjusted net income of £38,500 (£26,000 + £17,000 - £4,500)
less savings income £26,000
less personal allowance £11,500.

The restricted finance was £1,500. The deduction under s274A is 20% of the lower of:

- The amount restricted – £1,500
- The taxable profits of the rental business after losses b/fwd – £12,500
- Adjusted total income for the year – £1,000

So the restriction is 20% of £1,000, which is £200.

21. Question: Will HMRC online SA100 software do the interest restriction calculation for us?

Answer: Yes it will, the finance cost has to be split 75:25 but the rest of the calculation is done by the program. However, it does not seem to offer a facility to carry forward excess interest into the next year, so it will be necessary to keep a separate record of that.

22. Question: What is the situation in the final year where the restricted amount of interest is not able to be carried to a future year?

Answer: It is our understanding that there will be no tax relief for this excess interest.

23. Question: Regarding the interest on additional borrowing on rental property that has been offset in the past (as the additional borrowing did not take total above the property value): can you carry on offsetting (taking into account the new restrictions)? Or does this apply after April 2017? Do we need to go back and correct?

Answer: We are still waiting to hear from HMRC as to whether or not there has been a change in its approach on whether relief is available on interest on additional loans. It could be that there is no change. If HMRC has changed its view, then it could be argued that the taxpayer can retain the tax relief claimed in the past under legitimate expectation.

24. Question: Does the finance cost restriction apply to FHLs?

Answer: The restrictions do not apply to an FHL.

25. Question: Are the finance cost restrictions affecting individual landlords of residential property likely to be extended to companies in the future?

Answer: The loans in companies are covered by the loan relationship rules. We are not aware of any intention to change this.

REPLACEMENT FIXTURES, FITTINGS, FURNITURE

26. Question: What if the replacement is more expensive than previously paid?

Answer: Provided it is like-for-like, the cost of the replacement is allowable.

27. Question: How do you work out how much of the cost is due to the improvement?

Answer: On a just and reasonable basis.

28. Question: Does this mean if it is a better and/or more energy efficient dishwasher, I can claim the whole cost rather than writing off the extra £200 to capital?

Answer: If the replacement is like-for-like but simply a more up-to-date version that is more energy efficient then the full cost can be claimed.

29. Question: What if an expensive fridge costing £800 is replaced with a fridge freezer costing £500?

Answer: If the new item is of broadly the same quality/standard as the old item and doesn't represent an improvement then the deduction is the cost of the new item. Where the new item is not substantially of the same standard/quality as the old item, so a fridge/freezer compared to a fridge, the deduction is equal to the lesser of:

- the cost of the new item; and
- the cost that would have been incurred if the old item had essentially been replaced like-for-like.

If the cost of a like-for-like fridge is now, say, £900 due to inflation then the full £500 actually paid for the fridge/freezer can be claimed.

30. Question: Re replacement of like-for-like. Do I now have to ask my client about his new replacement fridge to ascertain if it has a freezer section and whether the old one had a freezer section? Surely not!

Answer: It is a good idea to ask your client for a detailed inventory of the furniture in the property as at 6 April 2016 (1 April for companies) and you will then be able to compare this to the invoices when a replacement item is purchased, so provided you have sufficient detail at the outset you will not need to revert to the client for confirmation it is like-for-like.

31. Question: A client buys a replacement bed. Do I need to ask what size is it and what size the old one was? Would a double replacing a single have an element of improvement?

Answer: There is probably an element of improvement.

32. Question: Must a property new to the property portfolio be let for a period before claiming replacements, or can it be improved immediately, still claiming replacement expenditure?

Answer: Pre-letting expenses, such as advertising or repairs, incurred no more than seven years before the business started to trade, can be deducted from the rents received in the first tax year if two conditions are met (s57, ITTOIA 2005):

- the expenses would have been deductible if they had been incurred after the property rental business started; and
- they are not otherwise allowable as a deduction for tax purposes.

HMRC might query high repair and maintenance costs incurred before letting began, because expenses connected with renovating a property to bring it into a habitable condition are capital costs, so are not tax deductible. To achieve a tax deduction for these costs the landlord needs to demonstrate the property was in a fit state to be let before the sprucing-up began. Whether it could be let at the same level of rent charged after the makeover is irrelevant to whether a tax deduction applies.

33. Question: Does the original cost refer to the first time the owner incurs the expenditure on an item? For example, if someone buys a property and replaces the carpet before they let the property out is that classed as 'original' cost even though it is replacing an item?

Answer: As with all expenditure incurred prior to renting the property out for the first time, the question is, could it have been rented before the item was replaced/repared? If the answer is no then the expenditure cannot be claimed against income. It may be eligible as capital expenditure to offset in the capital gains tax (CGT) computation on disposal.

PROPERTY ALLOWANCES AND RENT A ROOM RELIEF

34. Question: How do you claim the £1,000 allowances?

Answer: If the gross income (property or trading) is less than £1,000 there is no need to report. Listen to the Tax Faculty's [trading allowance podcast](#).

35. Question: Am I correct in my understanding of an article I read where it suggested that wayleaves cannot be included in the £1,000 allowance?

Answer: The tax treatment will depend on the use of the land:

- If the owner of the land is using it for a trade, the wayleaves will be taxed as part of that trade, see BIM67600.
- If the owner is using the land for a property business the wayleaves will be taxed as part of that property business, see PIM1118.
- If the land is used for neither a trade or a property business, the wayleaves will be taxed under s346, ITTOIA 2005.

36. Question: Does each individual get the property allowance? For example, will two owners get £1,000 each?

Answer: Unlike rent a room relief the allowance is not split, so (assuming they each meet the conditions) they will each get £1,000.

37. Question: I've heard the property allowance isn't available for properties with mortgage interest/finance costs – is that correct?

Answer: If the interest is claimed for the basic rate deduction then the property allowance is not available, see [PIM4460](#).

38. Question: How do you make an election for the £1,000 property income relief?

Answer: If an individual qualifies for the full relief the gross receipts of £1,000 or less are not liable to income tax and there is no obligation to notify HMRC. If they do not qualify for full relief and excess gross receipts above £1,000 are taxable, then HMRC must be notified. This would be via the individual's self assessment. If the property business was loss-making then again the taxpayer may choose to make an election to disapply the property allowance. See [PIM4440](#).

39. Question: Can I clarify that the property allowance cannot apply even if rent a room is disclaimed?

Answer: We are not sure why you would want to claim £1,000 property allowance when you could instead claim up to £7,500 rent a room relief. See [PIM4458](#). The restriction is to prevent the property allowance being claimed against one relevant property business while deducting expenses in another relevant property business.

40. Question: If you care for your parent in your home and they are prepared to pay you rent, would rent a room relief apply?

Answer: Yes.

41. Question: Can rent a room relief be claimed by a tenant living in the property, if he or she has sublet part of the property?

Answer: Rent a room relief can be claimed by tenants of a property, you do not have to be the owner to claim it.

MAKING TAX DIGITAL

42. Question: What software is suitable for rental businesses?

Answer: You will just need to research what is on the market and what will fit in with your existing practice. Many of the tax software houses are introducing their own supplementary packages for MTD. ICAEW is holding an MTD Live event in October, with different software providers demonstrating their products, and we have more information on our [MTD hub](#).

43. Question: If the landlord is a partner in a VAT-registered business but not in his or her own right, does the landlord get caught by MTD in April 2019?

Answer: The partnership will be required to comply with MTD for VAT from 1 April 2019 if its taxable turnover for VAT is above the VAT threshold. MTD for income tax will not become mandatory until April 2020 at the earliest and neither the partnership nor any of the individual

partners will have MTD for income tax obligations until MTD for income tax becomes mandatory. The MTD for income tax pilot is not yet open to partnerships.

44. Question: Will all rental businesses be required to register for MTD?

Answer: The answer to this question will not be known until the MTD for income tax regulations are finalised. The indications during the consultation process were that businesses with a turnover of less than £10,000 would not be required to comply with MTD for income tax but the level at which this exemption will be set is still to be decided by the government (the figure is left blank in the draft regulations).

45. Question: What quarter-end will be for MTD – the 5th of the month?

Answer: Yes. Because the basis period for income from property is always the tax year it follows that the quarters for MTD will be to the 5th of the month.

JOINTLY OWNED PROPERTY

46. Question: Does the basis for the split of rental income apply for both tenants in common and joint tenants?

Answer: By definition a property owned as joint tenants is owned 50:50 so for a married couple the rent will be split 50:50. This can only be changed if the joint tenancy is split, a proportion of the property is gifted by one spouse to the other and form 17 is completed. For unmarried joint owners the capital split will be 50:50 but the owners can choose to split the income in a different ratio.

47. Question: I thought jointly owned property (not married couples) could be split based on how the income is received (eg, whose bank account it goes into) not necessarily on the capital ownership?

Answer: For joint owners who are not married or in a civil partnership it is possible to split beneficial ownership and entitlement to income in different proportions. The property must be owned as tenants in common to split the beneficial ownership anything other than 50:50.

48. Question: Does the form 17 split need to reflect the actual ownership proportion?

Answer: Yes.

49. Question: Form 17: does apportioning the rental income have a knock-on effect for CGT purposes?

Answer: It will do but the ownership share could be changed and the form 17 amended prior to sale.

50. Question: If someone has signed form 17 to split property income 90:10 and underlying ownership 50:50 in previous tax years, how should this be remedied?

Answer: Form 17 only applies to married couples or civil partners. The property must be owned as tenants in common, not joint tenants which presumes 50:50 ownership. It contains a declaration regarding the percentage of the property beneficially owned (a declaration of trust to this effect may be helpful), and the income is then split according to the beneficial ownership proportions. It is not clear how the taxpayer could have declared one split for beneficial ownership and a different one for income.

51. Question: For jointly owned property where the owners are not married: if the rental split was changed from, say, 60:40 to 50:50, does that create a CGT chargeable event?

Answer: For jointly owned property where the owners are not married or in a civil partnership, the income can be split in a different ratio to the underlying capital, so if the property-owning partners agree to a change in the income split it does not have to alter the ownership proportions. Gifting a proportion of the property would be a separate decision which could trigger CGT.

CAPITAL GAINS

52. Question: How do we know the value of a property as at 6 April 2015?

Answer: You will need to get a valuation.

53. Question: Do capital losses on residential properties and losses on other assets have to be carried forward against gains from the same types of asset due to differential CGT rates on gains?

Answer: No, current year losses are set against current year gains. You can choose to offset losses against gains chargeable at the higher rate first.

54. Question: After April 2020 when will CGT be payable on mixed use properties, eg, a shop downstairs and living accommodation upstairs?

Answer: CGT on the disposal of residential property on or after 6 April 2020 by a UK resident must be paid within 30 days of completion. Where there is a mixed use property the split of the gain is on a just and reasonable basis and the tax on the non-residential part of the gain will be payable under the normal rules, ie, on or before 31 January following the end of the tax year in which the property was sold. The actual sale date is determined by the date of exchange not the date of completion.

55. Question: If a person is non-resident now and rents out their former home, do they get private residence relief (PRR) when they sell?

Answer: A non-resident is only liable to gains arising from 6 April 2015. If the house qualifies as a principal private residence (PPR) for any period after then PPR will be available for that period.

56. Question: If you rent and live in one property but own another country residence, is PRR available on the country property?

Answer: Yes if you have an election in place, otherwise the PPR is determined as a matter of fact as to where you live regardless of whether or not you have an economic interest in the property. The election has to be made within two years of having more than one property available for use but Extra-statutory Concession D21 may be in point in a case like this, allowing a late election provided it is made within two years of the person being aware that an election is possible.

57. Question: If land is sold separately to buyer A on the same day as the house is sold to buyer B, is PRR available on the land?

Answer: It depends. It may be difficult to argue that the garden was part of the PPR as the PPR has been sold. It is much better to sell the garden the day before the house when there is to be a split sale.

58. Question: I am confused by the comment about selling plots of garden exceeding 0.5 hectares. Surely it is not required for enjoyment if you can sell it?

Answer: It could have been required for the enjoyment of the property initially but not now; for example, age and infirmity may now prevent the owner from tending the large landscaped gardens.

59. Question: Is lettings relief available where the rental period occurs before using the house as the PPR?

Answer: Yes, the lettings relief provision does not specify if the occupation is before or after the use as a private residence.

60. Question: If a capital gain has been rolled over into in an FHL, can it come back into charge if the property ceases to be an FHL?

Answer: There is no deemed sale of the asset when the FHL trade ceases, so the gain is not brought back into charge at that point. However, the property has ceased to be a business asset so the gain cannot be rolled over again. The gain will only come back into charge on the actual disposal of the FHL.

61. Question: Is there a minimum amount of days a property can be let so that lettings relief can be claimed? For instance, if a client uses a series of AirBnb lets to make up, say, 30 days of letting, can they then claim the relief against the CGT on disposal?

Answer: The lettings relief is included in s223(4), Taxation of Chargeable Gains Act 1992, which says:

“Where a gain to which s222 applies accrues to any individual and the dwelling house in question or any part of it is or has at any time in his period of ownership been wholly or partly let by him as residential accommodation, the part of the gain, if any, which (apart from this subsection) would be a chargeable gain by reason of the letting, shall be such a gain only to the extent, if any, to which it exceeds whichever is the lesser of:

1. the part of the gain which is not a chargeable gain by virtue of the provisions of subsection (1) to (3) above ...; and
2. £40,000.”

There is no restriction on the timescale but it is restricted to “the part of the gain, if any, which (apart from this subsection) would be a chargeable gain by reason of the letting”.

MISCELLANEOUS

62. Question: If a person living in England acquires a property in Scotland (furnished holiday or normal rental) does this affect how the English resident reports the income? Are they subject to Scottish tax?

Answer: The income will be reported as normal; basically you are only a Scottish taxpayer if you are resident in Scotland, see the definition in the *Scottish Taxpayer Technical Guidance* at [STTG2000](#).

63. Question: Can you claim actual mileage cost if this is greater than 45p?

Answer: It is an option to claim 45p per mile; actual cost is the default. Generally the mileage that is wholly and exclusively for the rental business is so low it is unlikely to be time-efficient to record all vehicle expenses and claim the relevant proportion. See [PIM2220](#).

64. Question: How does inheritance tax (IHT) apply to FHL?

Answer: There have been several cases looking at whether or not business relief is available where a significant part of the value of the business is land. The starting point for HMRC is that such businesses are investment businesses and not trading.

There were several caravan site cases where the courts looked at what additional services were provided beside the actual plot of land where the caravan was sited. These cases went against the taxpayer and IHT business relief was denied.

A more recent case is *Pawson* in 2013 which concerned an FHL. Although the taxpayers won at the outset the decision was overturned and no relief was given. [*HMRC v Pawson* [2013] UKUT 50]

More recently still, in the *Vignes* case the executors won at the First-tier Tribunal (FTT) in their claim that the livery business run by the deceased qualified for business relief; this case goes to the Upper Tribunal in 2018. [*Executors of M Vignes v HMRC* TC06068]

In the *Graham* case in 2018 the FTT decided that the additional services provided by Mrs Graham went beyond mere renting and so relief was given. [*The personal representatives of Graham (dec'd) v HMRC* TC06536]

It is very much ‘watch this space’ as case law develop, but passive letting of a property will not qualify for relief, as in the *Pawson* case where the additional services provided were merely incidental to the letting and no more than would be expected. The more services are provided, the more likely it is that the activity can be viewed as a trade.

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