



Letting Business Income Changes

There have been three changes to the way in which letting business income may be assessed with effect from 6 April 2017.

1. Cash basis

This change will not affect limited companies, trustees and partnerships with at least one non-individual partner. All other businesses with rental income of less than £150,000 essentially have a choice: either account for letting profits using a 'cash basis' (when money is received or paid); or an 'accruals basis' (when amounts relate to the relevant period).

Pre 6 April 2017 all letting businesses, apart from those with letting income of less than £15,000, would have used the accruals basis. Those businesses which prepare formal accounts under GAAP (Generally Accepted Accounting Practice, which includes the accruals basis), often to satisfy existing finance obligations with banks and similar institutions, must continue with the accruals basis. This leaves all other letting businesses with the opportunity to consider which of the two methods will suit their situation after each year has ended.

Potential advantages of the cash basis:

General simplification of accounting; the opportunity to claim any unused Capital Allowance pool and the ongoing potential to claim specific capital costs instead of Capital Allowances; and paying tax on rents received, instead of rents due, which may be particularly relevant for those with unreliable tenants.

Potential disadvantages of the cash basis:

No facility to provide for expenses incurred but not paid until the following tax year, eg on repairs; and tax cash flow, year on year, may become irregular.

Complications

Any change to or from the accruals basis requires consideration of the previous year's figures to ensure income or expenditure is not included more than once, excluded income is brought in as a one-off charge and double counted expenditure is reckoned only once.

In the cases of joint ownership, not including spouses, each party has the opportunity to decide the basis specific to their personal share of the results.

In short the two different accounting principles may affect the timing of when letting profits are taxed. Therefore the choice should be based on the regularity of income and expenditure as well as the level of other taxable income in the same year which you should discuss this with your usual Chavereys' contact and ensure your Tax Return for that year indicates which principle has been used.

2. Finance deductions

A restriction will be applied in respect of Income Tax relief for finance costs on 'dwelling-related' loans for individuals. Therefore it will not apply to companies, commercial property or furnished holiday lettings, property development trades or loans secured on a let dwelling but used for trade purposes. However for those affected, the restriction is being phased in over a four year period, starting with 2017-18.

The costs to be restricted are loan interest plus incidental costs of obtaining finance. The restriction is applied by initially limiting the amount allowable as a deduction in calculating the profits of the property business as follows –

Tax year	% of costs of dwelling-related loan allowable as a deduction	Non-deductible costs
2017-18	75%	25%
2018-19	50%	50%
2019-20	25%	75%
2020-21	0%	100%

A tax reduction is then applied in calculating the individual's Income Tax liability essentially equivalent to a Basic Rate Tax deduction for the non-deductible costs.

So in 2017-18, 75% of the finance costs will be deductible in full against profits and thus relievable at the taxpayer's marginal tax rate and the remaining 25% will be relievable at the Basic Rate of tax only by means of a tax reduction.

In 2020–21 all the costs will be relievable at the Basic Rate only. However, the relief cannot exceed the property income profits for the year at the Basic Rate or, if lower, the adjusted total income for year at the Basic Rate (this would apply where the profits are partly covered by the personal allowance).

Any excess costs, which cannot be relieved in a tax year, are carried forward and used to calculate the tax reduction in future years, even if the loan has been repaid.

The restriction on deductible costs also applies to interest on a loan to invest in a partnership on a ‘just and reasonable basis’, if that partnership carries on a UK or overseas property business which generates income from a dwelling house.

Where a trustee receives property income in which beneficiaries have an interest in possession, the individual beneficiaries will be eligible for the Basic Rate tax reduction. However, where trustees have the power to accumulate or discretion over that income, they will obtain the Basic Rate tax reduction where finance costs have been restricted in calculating their accumulated or discretionary income.

In addition to the increase in the rate of tax which could arise from the restriction of these costs, the increase in relevant annual income could affect the following entitlements which might have been available pre 6 April 2017:

- Child Tax Credits and Working Tax Credits
- Child benefit, income exceeding £50,000
- Personal Allowance, income exceeding £100,000
- Pension contribution annual allowance, income exceeding £110,000

Therefore due consideration should be given to way in which affairs might be restructured to mitigate the impact of these changes.

3. £1,000 property income allowance

This is aimed at those who receive small amounts of property income from ad hoc lettings during the year from both the UK and overseas.

The allowance is not available on relevant income of partners in a partnership. It is also not available on rent received by a partner or participator from a partnership or close company; where rent-a-room relief is, or could be, claimed; or where a tax reduction is claimed for ‘non-deductible’ finance costs, as mentioned above.

Where the total receipts from all property businesses in the tax year are less than £1,000, the allowance is given automatically in full so that no tax is payable and the income does not have to be declared, although records must be retained. This is subject to an election via the Tax Return which can be made for full relief not to be given. For example if expenses exceed receipts resulting in a loss to be carried forward.

Where the total receipts from all property businesses in the tax year exceed £1,000, an election can be made via the Tax Return for the allowance to be deducted from the receipts instead of deducting actual allowable expenses, ie when the allowance exceeds the expenses.

Please contact your usual Chavereys contact if you have any specific questions on the above.

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