client
BRIEFING

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Credit: Istock/ CathyDoi

Are you getting it right on rent?

Between 1.75 and 2 million people in the UK are landlords, the majority of whom are private individuals with only one rental property.

Not surprisingly, many such landlords are unaware of their tax responsibilities relating to their rental income. You might not even think of yourself as a landlord. This could be because you've inherited a property, just rented out a flat to cover your mortgage payments, or moved in with someone and have therefore had to rent out your house. HM Revenue & Customs (HMRC) has been running a let property campaign for several years and has recently updated its examples of errors that landlords often make.

Moving in together: You might have moved in with your partner and decided to rent out your own property rather than selling it. Even though your rental income is only just covering mortgage payments, you may still be making a profit. When calculating rental profit, only the interest element of mortgage payments is an allowable expense, and it is restricted for higher rate taxpayers. The interest element is likely to be fairly low for a repayment mortgage that is several years old.

Inheriting a property: You may have inherited a property and decided to rent it out. Even if you use a letting agent to find tenants, collect rent and organise repairs, it is still your responsibility to declare the rental profit.

Property bought as an investment: Perhaps you have invested in a property in order to capitalise on increasing property values. If the property is rented out, however, the profit is taxable. Or you could have bought a property jointly with the aim of renovating and then renting out. The rental expenses have to be divided between you properly. You cannot just decide to allocate all the allowable expenses to whichever of you is paying tax at the higher rate so as to minimise the tax.

Divorce: You could have rented out your jointly owned property, with each of you then moving into smaller accommodations. Again, the rental profit will be taxable and will normally be split between you, based on your respective shares in the property. You will both have to declare your share of the profit.

Relocation: Maybe you have had to relocate because of work, renting out your old property. Although there can be an exemption from capital gains tax when relocating, there is no such relief for income tax. Even if you relocate overseas, the rental profit will still be taxable in the UK.

Care home: Perhaps your parents have moved into a residential care home and, in order to pay the care home fees, have rented out their property. The rent is still taxable even if all the rental profit received is going towards the fees. Care home fees are not an allowable expense.

Property bought for a child at university: If your son or daughter stays rent free, then there are no tax consequences. However, should rent-paying friends move in with them, the situation changes – even if the arrangement with the flatmates is informal. Tax will be due if the rent is more than the mortgage interest (restricted for higher rate taxpayers) and any other allowable expenses.

If any of these situations apply to you, then please get in touch with us.

It may be necessary to tell HMRC about any undeclared rental profit by making a voluntary disclosure – probably going back for up to six years. This will avoid the risk of higher penalties down the line if HMRC subsequently discovers the omission. Disclosure should also be made if you have not been declaring rental profits from an overseas property, or have been letting out a room in your own house for more than the annual exemption of £7,500.

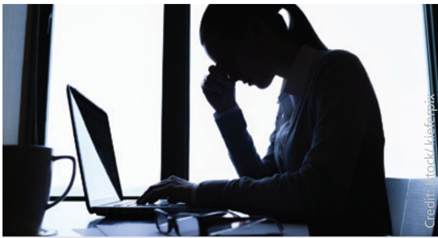
Credit: Istock/SvetaZi

Keeping up with employment changes

The September 2017 Finance Bill contains two measures that will affect both employers and employees.

Termination payments

Originally announced in the 2016 Budget, the new rules will now come into force from 6 April 2018 and introduce a new concept of post-employment notice pay (PENP). This effectively excludes from the £30,000 exemption any amounts that would have been subject to PAYE and national insurance contributions (NICs), if the employment had continued. It will do away with the distinction between contractual and non-contractual payments in lieu of notice (PILONs), and may result in tax on payments of compensation for loss of office.



Example

Stephanie earns £64,000 and is entitled to three months' notice. Her employment is terminated without notice and she is paid £25,000 compensation for loss of employment and £16,000 as a non-contractual sum in lieu of notice.

The PENP is £16,000 – the amount Stephanie would have earned if working the notice period.

So of the total payment of £41,000, £16,000 is taxable and £25,000 is covered by the £30,000 exemption. Under current rules, £11,000 would be taxable after deducting the £30,000 exemption from the whole payment.

Also from 6 April 2018, all taxable termination payments will be subject to employer's NICs. So in the example opposite, Stephanie's employer will have to pay NICs on £16,000, whereas under present rules there is no NIC liability. Employers will need to factor in the additional cost when planning termination payments.

In addition, the foreign service relief for termination payments to internationally mobile employees will be abolished and replaced by a more limited exception in certain cases of non-UK employment.

Pension allowance cut

Another measure that has reappeared in the Finance Bill currently before Parliament is the reduction from £10,000 to £4,000 in the money purchase annual allowance (MPAA) for pension contributions. The normal annual allowance is £40,000. The MPAA is not triggered if the individual only draws the tax-free lump sum, or purchases an annuity.

The change affects individuals who flexibly access their pension benefits, but make further contributions to a money-purchase scheme. The reduction to the MPAA has been backdated to 6 April 2017, the original start date before it was dropped from Finance Act 2017.

If you have exceeded the £4,000 MPAA, you must report the excess on your tax return and it will be subject to tax.

Wherever you lay your hat? New domicile rules

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Non-domiciliaries (non-doms) may have been deemed UK domiciled for all tax purposes since 6 April 2017 – possibly without knowing it – under retrospective changes contained in the September 2017 Finance Bill.

When the measures were dropped from Finance Act 2017, there were calls to delay them until April 2018 to provide non-doms with some certainty on their status, but they have not been heeded.

Non-doms will now become 'deemed domiciled' and lose the tax benefits of their status after they have been resident in the UK for at least 15 out of the previous 20 tax years.

A person who is deemed domiciled will generally be subject to income tax, capital gains tax (CGT) and inheritance tax (IHT) on the same basis as someone who is UK domiciled. Until 5 April 2017, deemed domicile status applied only to IHT and an individual had to be UK resident for 17 of the previous 20 tax years to be deemed UK domiciled. People who were born in the UK with a UK domicile of origin and who return to the UK after obtaining a domicile of choice elsewhere are also now deemed domiciled.

Remittance basis taxpayers who become deemed UK domiciled under the new 15-year rule will be able to rebase their overseas assets to their market value at 5 April 2017. This means that any gains accruing up to 5 April 2017 will not be charged to CGT. Remittance basis taxpayers will also be able to rearrange their overseas mixed funds to allow them to segregate amounts of income, gains and capital within these funds, so that they can remit capital (not liable to tax) ahead of income and gains.

Also from April 2017, IHT will be charged on UK residential property even when indirectly held by a non-dom through an offshore structure. This affects three categories of property: a closely held company, an interest in a partnership or the benefit of certain loans used to acquire, maintain or improve UK residential property. An interest of less than 5% in the structure is exempt.

Because the changes have been backdated, there is transitional relief for chargeable events that are reportable or would have interest accruing on unpaid IHT from a date on or before the end of the month after the date when the Act comes into force.

If you are affected by any of these changes, we can help you review your arrangements now.

Planning for the dividend allowance cut

The dividend tax allowance cut has reappeared in the September 2017 Finance Bill, reducing the level from £5,000 to £2,000 from April 2018, despite hope that it would not go ahead.

At present, individuals pay no tax on the first £5,000 of dividends they receive, under rules introduced in April 2016. Dividend income above £5,000 is taxed at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. These rates remain unchanged.

The £3,000 cut in the allowance will leave shareholders who receive more than £2,000 of dividends worse off by up to an annual £225 (basic rate), £975 (higher rate) or £1,143 (additional rate) depending on their income. Those likely to be hardest hit are director/shareholders who take remuneration from their company mainly in the form of dividends. For a couple who share the running of their company, the 'loss' in the figures above is doubled to £450, £1,950 or £2,286 depending on their tax rate.

Dividends remain advantageous compared with salary for basic rate taxpayers because of the lower income tax rate – 7.5% rather than 20% – and the employee's national insurance contributions (NICs) of 12% and employer's NICs of 13.8% on salary or a bonus. If you pay tax at the higher or additional rate, however, the effective rate of tax on dividends is only about 3.6% below that on salary, taking NICs into account as well.

Company owners who have not made full use of the £5,000 dividend allowance in 2017/18 should make up the difference by 5 April 2018, if they are in a position to do so. Remember that a company can only pay a dividend if it has enough reserves to cover the payment.

Also adversely affected by the cut in the dividend allowance will be anyone who relies on income from their investment portfolio to supplement their earnings or, in many cases, their pension. If you currently receive more than £2,000 in dividends, you might benefit from switching to investments that give capital growth rather than income.

Making Tax Digital moves again

The government has extended the timetable for the introduction of Making Tax Digital (MTD) after listening to widespread concerns.

The previous timetable for MTD would have seen the self-employed and landlords using the new system from April 2018 for income tax and NICs purposes if their turnover was over the £85,000 VAT threshold. For others, the start date was going to be April 2019. This was also when MTD would have been introduced for VAT purposes.

Credit: Istock / Jirsak

Under the new timetable, MTD will initially only be introduced for VAT obligations, and the start date will be 1 April 2019. And even then, you will not be required to use MTD if your turnover is below the VAT threshold, but you are voluntarily VAT registered. If you are initially required to use MTD, then you will have to continue to do so if your turnover subsequently drops below the threshold.

Easing in with VAT

With VAT, the move to MTD should be less problematic than it will be for other taxes. VAT returns already have to be filed online, and businesses will not initially need to provide information to HMRC more regularly than they currently do. The move to MTD will not affect the use of retail schemes or the flat rate scheme, and it will still be possible to file only one annual return where the annual accounting scheme is used.

Under MTD, however, it will be necessary to use third party software rather than HMRC's software – which is currently used to file around 90% of VAT returns. The software will need to keep and preserve your VAT records digitally for up to six years. So you will no longer be able to keep manual VAT records. The use of spreadsheets should still be possible, but this is likely to involve combining the spreadsheets with your MTD software.

The government does not intend to widen the scope of MTD beyond VAT until the system has been shown to work, and not before April 2020 at the earliest. This means that all businesses and landlords have at least two years before being required to keep digital records for income tax and NICs, although you can opt into MTD before then if you want to.

Making the most of fringe benefits

Changes introduced from April 2017 have largely removed the tax and national insurance contribution (NIC) advantages of many salary sacrifice arrangements.

You and your employees can still benefit, however, if salary sacrifice is based around pension contributions, childcare, low-emission cars or health-related benefits such as cycling to work.

Salary sacrifice is still tax efficient if it's used to finance employer pension contributions. Employees paying higher rates of tax could give up £5,000 of their salary in return for the employer paying an equivalent amount into their pension scheme. This will save employer NICs at the rate of 13.8%, whilst the employee will save 40% income tax and 2% NICs. This type of arrangement is very tax effective because employer pension contributions are not a taxable benefit in the employee's hands. The same principle applies to childcare vouchers. Although these are being replaced by tax-free childcare, employers still have until April 2018 to set up a new scheme.

Salary sacrifice to finance the purchase of a company car also escapes the new restrictions if the car's CO_2 emissions are 75g/km or less. Although not exempt from tax, the taxable benefit for such cars is fairly modest – at between 9–16% of the car's list price. From April 2020, electric low emission cars will also be a factor. Ultra-low emission cars that can travel a high distance on just electric power will then be taxed very favourably.

There are, of course, tax advantages to providing fringe benefits outside salary sacrifice. It might be worth employers focusing on wellness with their benefits package, with tax-free benefits including:

- A company gym, provided free or at a subsidised price.
- Healthy food in a company canteen.
- Annual health checks, counselling and eye tests (where an employee is required to use a computer).

If a wellness benefit is not tax free, such as third party gym membership or where employees are provided with health monitors, there should still be a saving on employee NICs.

As work changes, there are additional opportunities to engage employees with the workplace.

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