journal

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The pros and cons of incorporation for buy-to-let landlords

Tax changes announced during 2015 will increase costs for many buy-to-let landlords and may make some lettings unprofitable. But there may be ways of mitigating some of these costs.

The summer 2015 Budget ushered in the removal of higher and additional rate income tax relief on the costs of buying residential property for letting, a change that will be phased in over four years starting in 2017/18. At present, loan interest is deducted from rental income, together with other costs of letting, and tax is charged on the resulting profit. This means that owners receive tax relief for the interest at their highest rate or rates of tax. For example, if rental income before interest is £30,000 and the owner pays interest of £20,000, the profit of £10,000 is currently subject to income tax. For a higher rate (40%) taxpayer that would result in tax of £4,000. From 2020/21 the same owner will pay tax of £8,000 – i.e. 40% of £30,000 less 20% basic rate tax relief on the £20,000 interest.

Owners of commercial property and furnished holiday lettings will still be able to get full tax relief for interest, so one way of avoiding the restriction will be to diversify into these types of properties. However it can be difficult to meet the qualifying conditions for furnished holiday lettings.

Holding properties in a company

Companies won't be affected by the restriction on interest relief and by 2020/21, the corporation tax rate will have fallen to 18%. A company with rental income of £30,000 paying interest of £20,000, as in the example above, will therefore pay tax of £1,800. Against this benefit must be set some costs. There will be more tax to pay if income is drawn from the company, although from April 2016 every individual will have a tax-free dividend allowance of £5,000. Dividends that an individual receives above that amount will be taxed at 7.5% basic rate, 32.5% higher rate or 38.1% additional rate. To reduce tax on distributions, you could spread ownership of the company's shares among family members, especially those who do not pay more than basic rate tax. The 18% corporation tax rate will normally also apply to a company's profits on selling properties. Furthermore, companies benefit from an indexation allowance which reduces their chargeable gains. However an individual who withdraws the profits will have to pay further tax, so the low

corporation tax rate is most valuable if the profits end up being reinvested within the company.

A major downside to incorporation could be the capital gains tax (CGT) and stamp duty land tax (SDLT) charges on transferring properties to a company because these taxes will be based on the market value of the properties. A corporate structure is therefore likely to be most useful for new investment in residential property. The administrative burden is likely to be heavier where a company is used, and banks may charge a higher interest rate. Further tax liabilities will arise in the case of a company holding residential properties worth over £2 million.

The Autumn Statement 2015 included two further changes that will affect buy-to-let investors. From 2019 payment of CGT on residential property will be brought forward to 30 days after completion, and by 2020 most landlords will have to keep track of their tax affairs digitally and update HMRC at least quarterly. These changes seem unlikely to apply to companies. However, the 3% added to SDLT rates on purchases of buy-to-let property will be imposed on both companies and individuals, though the government is considering some exemptions. If you are thinking of investing in property, do consult us first because there are many factors to consider.

PAYE: a warning and an opportunity

Payrolling has become an increasingly popular way for employers to pay the tax due on benefits provided to employees.

The use of payrolling means that your employees will not find themselves in the tricky position of having to pay the tax on two or three years of benefit at the same time. Taxable benefits are put through your payroll on a current basis in the same way as cash earnings. The employee therefore pays the correct amount of tax when the benefit is received. You, as an employer, will have less administration, and self-assessment will be simpler for those employees who need to complete a tax return.

Until 5 April 2016, payrolling was allowed by HM Revenue & Customs (HMRC) on an informal basis, but be warned that on that date any existing informal arrangements will have to stop (except if you have previously been payrolling benefits in respect of living accommodation, beneficial loans, vouchers and credits cards. Then you will be able to continue to do so, and P11Ds will still be necessary).

In order to payroll benefits for 2016/17, you must register with HMRC by 5 April 2016 using the online Payrolling Benefits in Kind (PBIK) service. It will not be possible to register after the start of the tax year.

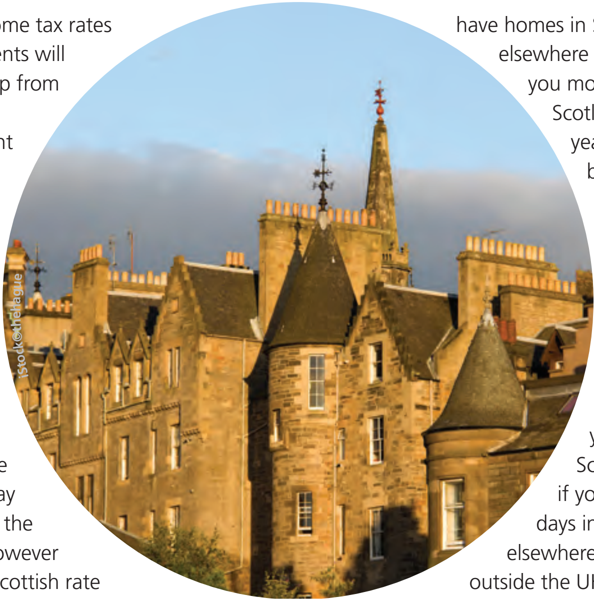
Of course, you should ensure that your payroll software can payroll benefits before registering. With informal payrolling, it was still necessary to include payrolled benefits on P11Ds, but you will now not have to report payrolled benefits. If you cannot use the PBIK service, then benefits will have to be reported on P11Ds.

If you have not previously payrolled benefits, the flexibility offered by the PBIK service gives you the opportunity to now do so. Most benefits, including company cars, can be payrolled; the exceptions are living accommodation, beneficial loans, vouchers and credit cards. You can choose which benefits to include and any employee who does not wish their benefits to be payrolled can be excluded. The payrolling of company car benefits will avoid the need to complete P46 (car) forms. Once you have registered to payroll a particular benefit with the PBIK service, then that registration is automatically carried forward to future tax years. But once the tax year has started, you will have to continue to payroll that benefit for the whole tax year.

We are here to help so please get in touch with us.

Scottish tax residence rules coming in

People living in Scotland will soon pay part of their income tax to the Scottish government, a move that could result in them paying a different rate of tax from other UK residents.



The main UK income tax rates for Scottish residents will be reduced by 10p from 6 April 2016. The Scottish Parliament will then set the Scottish rate of income tax to be paid on top of the UK rate. For 2016/17 the Scottish government has proposed a rate of 10p, in which case people in Scotland will pay the same rates as the rest of the UK. However if, in future, the Scottish rate is set at 11p, for example, Scottish taxpayers will pay 21% (10% + 11%) basic rate, 41% (30% + 11%) higher rate and 46% (35% + 11%) additional rate tax. Similarly, with a 9p Scottish rate, the combined rates would be 19%, 39% and 44%.

The Scottish rate will not apply to savings income, such as bank interest, or dividends, which will continue to be taxed at the UK rates. It will not affect income tax allowances and thresholds.

Whether you are subject to the Scottish rate will normally depend on where you live. It will make no difference where you work or where your employer is based. For people with just one home this is straightforward, but if you have homes in Scotland and elsewhere in the UK, or if you move in or out of Scotland during the year, it will normally be your main residence that determines whether you are a Scottish taxpayer. If you cannot identify your main residence, you will be a Scottish taxpayer if you spend more days in Scotland than elsewhere in the UK. Days outside the UK are ignored. Your Scottish residence status can change from one tax year to the next, but it will not alter during the year. Only people who are UK resident in the first place can be Scottish taxpayers.

From 2016/17 Scottish employees will have a tax code prefixed by an 'S' so that employers can deduct the correct amount of tax. HM Revenue & Customs (HMRC) will identify Scottish employees from their address and so it is important that they tell HMRC if they move home.

We can advise if you are not sure whether you or a family member qualify as a Scottish resident or on how the Scottish rates will affect you, so please get in touch.

A ten mile distinction on business claims

The latest update to HM Revenue & Customs' (HMRC's) advisory fuel rates sees 1p reductions to several petrol and LPG rates.

Engine size	Petrol	Diesel	LPG
1400cc or less	11p	9p	7p
1401cc to 1600cc	13p	9p	9p
1601cc to 2000cc	13p	11p	9p
Over 2000cc	20p	13p	13p

These rates can be used where an employee is reimbursed for business mileage driven in their company car, and will be reviewed again on 1 March 2016.

When employees use their own car for business mileage, a rate of 45p a mile can be paid for the first 10,000 business miles driven each tax year, with 25p a mile thereafter. Reimbursement up to these amounts is tax free, and, if the amount is not reimbursed, the employee can claim a tax deduction.

The big question, of course, is which journeys count as business mileage? The current rules are complex, especially when an employee travels from home to a location near to their normal workplace. A basic rule is that if a journey is essentially the same as the employee's normal commute, then it does not count as business mileage.

HMRC normally applies a ten mile rule, and it is increasingly reinforcing this when checking on mileage claims. For example, an employee's normal commute to her employer's office is 20 miles. One day, she drives past the office to meet a client based a further 12 miles away. Although the total of 32 miles includes the normal commute, the entire journey qualifies as business mileage. The ten mile rule is, however, not relevant where an employee needs to travel in a completely different direction to their normal commute.

If the visit occurs on the way to the normal workplace, then the classification of the journey comes down to whether or not it is substantially the same as the normal commute. For example, where a client's premises are situated three miles along a four and half mile commute, then the trip to the client will not count as business mileage because the journey is not substantially different to the normal commute. Conversely, the trip will qualify if the client's premises are three miles along an 18 mile commute.

Regardless of the treatment of the initial journey, any distance between a client's premises and the employer's premises will always be business mileage.

End of permanent non-domicile status

Government proposals will bring permanent non-domicile status to an end from 6 April 2017.

However, the government has shied away from complete abolition, and is introducing a deemed domicile rule instead. A person will be deemed to be domiciled in the UK for all tax purposes once they have been resident in the UK for at least 15 out of the previous 20 tax years.

Deemed domicile status will apply from the 16th year of UK residence. For inheritance tax (IHT), a person will therefore be deemed to be domiciled in the UK one year earlier than is currently the case.

The 15 out of 20 year rule means that some planning may be possible. For example, you could be UK resident for 15 years, then you could be non-resident for six years, and then you could be resident for another 15 years without becoming deemed domiciled for any of these years.

Domiciled in the UK

Once anyone is deemed to be domiciled in the UK, they will generally be taxed on exactly the same basis as a person who is UK domiciled. They will therefore have to pay income tax and capital gains tax on their worldwide income and gains – and the remittance basis of taxation for overseas income and gains will no longer be available to them. IHT will be payable on worldwide assets instead of just on a person's UK assets.

However, the proposals include protection for offshore trusts provided the trust has been set up before a person becomes deemed domiciled. Income and gains retained within the trust will be protected from the tax implications of the settlor becoming deemed domiciled. Offshore trusts will also remain effective for IHT purposes. So if you have surplus assets, consider transferring them into trust before being caught under the deeming provisions. Of course once you have been deemed to be UK domiciled, the exemption will not apply where you, your spouse or your children receive any benefit from the trust.

If you are not UK domiciled but you are UK resident for 15 or more years, you might need to think about leaving the UK for a long enough period to reset the year count. If you are already overseas, you will now need to plan the date of your return to the UK with care.

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Top up your pension income

Pensioners who will miss out when the new state pension is introduced have just been given the chance to top up their pension entitlement by up to £25 a week.

The scheme will be of particular interest to women and the self-employed who may have little, or no, additional state pension entitlement.

Do you qualify?
Those who reach state pension age before 6 April 2016 will qualify.

How and by when? You need to make a one-off lump sum class 3A voluntary national insurance contribution by 5 April 2017, and you can apply online or over the phone.

How much does it cost? This depends on your age when you make the payment. Rates are gender neutral. For example, the full £25 a week – £1,300 a year – costs £22,250 for a 65 year old, but only £16,850 for someone ten years older. It may therefore make sense to wait until your next birthday.

Is it inheritable? In most cases a surviving spouse or civil partner will inherit between 50% and 100% (depending on your date of birth) of the pension following your death. Children or other people cannot inherit the benefit.

Other advantages and disadvantages?
The top-up pension is inflation proofed (although not quite to the extent of the normal state pension) and it is guaranteed for life. However, it is taxable and so not such a good deal if you are taxed at higher rates. The additional income could also impact on income-related benefits.

Is it a good deal? Ignoring tax and inflation proofing, a 65 year-old needs to live for 17 years to recover the contribution, and a few years more if tax is taken into account. So it's probably a good deal if you are in good health, not paying tax at higher rates and have a spouse or civil partner who will inherit when you die. It is not quite so good for single people, although women gain from a longer life expectancy.

Good advice is essential so please get in touch with us to discuss your options.

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