

Welcome to the August monthly tax newsletter.  
These newsletters are designed to keep you  
informed of the latest tax issues.

We hope you enjoy reading the newsletter; remember, we  
are here to help you so please contact us if you need further  
information on any of the topics covered.

## BREXIT – WHAT ARE THE TAX IMPLICATIONS?

One of the main reasons that individuals voted “leave” was to restore fiscal sovereignty to the UK so that we are able to set our own laws, in particular tax law, without interference from Brussels.

Significant tax changes currently require “State Aid” approval and we have seen many recent tax changes forced on us by the EU such as the extension of Furnished Holiday Letting treatment to EU properties and the extension of EIS and EMI to companies with a PE in the UK instead of trading wholly or mainly in the UK.

## NEW CHANCELLOR, A NEW TAX STRATEGY?

George Osborne, a leading member of the “remain” campaign, pledged to cut corporation tax to encourage investment in the UK in response to the referendum result. In an interview with the Financial Times, the former chancellor said he would reduce the rate to below 15%, although he did not mention any timescale and may not remain chancellor post Brexit. It will be interesting to find out whether the new chancellor Phillip Hammond will adopt a similar approach to corporation tax

VAT is the one tax that is likely to see the most significant changes as a result of leaving the EU. However, it is well known that it will take 2 years following the UK’s notification of Article 50 before we leave the EU. So until then, businesses will trade as normal, with business to business trade (“B2B”) in the EU being largely VAT and Duty free.

### POSSIBLE VAT CHANGES

VAT is a European tax. Withdrawal from the EU means that UK VAT law will no longer be governed by the EU VAT Directive.

In Budget 2016 it was announced that VAT would raise £138bn revenue for the UK Treasury in 2016/17, second only to income tax and about £100bn more than corporation tax. Therefore, it is expected that VAT or something equivalent will remain in place as an important revenue raiser for the UK, but the UK will in future have more freedom to set VAT rates. On the plus side, more zero-rating may emerge, whereas on the downside VAT may be raised above 20%, to cope with a possible recession and to generate additional revenue.

The biggest VAT impact will be the change to Intra-EU trade. At the moment B2B transactions are zero rated for VAT purposes. In future such sales will be imports into the EU and subject to EU VAT, which has a number of potential consequences. On the plus side, there will be no more Intrastat or European Sales Lists (ESLs) for UK business to complete.

**However, businesses and their advisers will need to consider the following points:**

- Will a local EU VAT registration be required?
- There will be increased freight agent costs of arranging imports and exports. There will be a requirement to “enter and clear goods”;
- Whilst UK businesses should still be able to recover VAT on overseas expenses, the system is paper based and is a more onerous and lengthy procedure.

## POSSIBLE CUSTOMS DUTY CHANGES

This potentially has a major impact and very much depends on the negotiation of a Free Trade Agreement (“FTA”) with the EU.

Without an FTA, the normal WTO tariffs apply.

For example, for a UK car manufacturer selling cars to its’ French subsidiary would result in a 10% duty tariff, being imposed on the transaction. Therefore, an FTA is critical to businesses with EU supply chains.

## NEW RULES FOR BUY-TO LET LANDLORDS

The 2016 Finance Bill sees the introduction of important tax changes for property investors that were originally announced in the 2015 Budget.

From 6 April 2016 onwards there are important tax changes affecting the replacement of furnishings for buy to let landlords. 6 April 2017 will see the start of mortgage interest being restricted to basic rate only.

## WEAR AND TEAR ALLOWANCE ABOLISHED

Until 5 April 2016 landlords who were letting residential property on a fully furnished basis were able to claim a 10% “wear and tear” allowance towards the cost of the depreciation of furnishings.

This simple allowance was an alternative to claiming a deduction for the actual cost of replacing furnishings which was a concession that applied up until April 2013.

So for example, where the gross annual rent was £9,000 there would have been an allowable deduction of £900.

This change seems to be inconsistent with the government’s stated desire to simplify the tax system.

### THE NEW RELIEF FOR REPLACEMENT OF FURNISHINGS IN PROPERTY BUSINESSES

Up until April 2013 it used to be the case that where furnishings were replaced in a property rental business there was deduction for the cost of the replacement items in arriving at rental profits.

This was never a statutory deduction and was accepted by HM Revenue and Customs on a concessionary basis. That concession was controversially withdrawn at relatively short notice in 2013 so for a three year period, unless landlords were eligible for the “wear And tear” allowance there was no relief for furnishings.

As the result of extensive lobbying by the accounting profession, and the residential landlords association, the relief has been restored on a statutory basis from 6 April 2016 by the latest Finance Bill.

The new relief provides a deduction for the actual cost of replacing furniture, furnishings, appliances and kitchenware for the use of the tenant in the let property.

Note that there is no allowable deduction for the initial fitting out of the rental property, just the cost of replacement items. Furthermore the allowable tax deduction applies on a like for like basis so if there is any significant improvement then the tax relief will be restricted. So, for example, where a washing machine is replaced with a washer/dryer costing £600, tax relief would only be available for the cost of the equivalent washing machine costing say £400.

## NO RENEWALS RELIEF FOR OTHER BUSINESSES

Although the renewals basis has been reintroduced for rental businesses from April 2016, it has been withdrawn for other trading business. This relief was previously referred to as the “loose tools” deduction.

Consequently there is no longer relief for the replacement or alteration tooling. In future HMRC would expect such expenditure to be dealt with through the capital allowances rules, most likely by making a short life asset claim.

### NO CHANGE FOR FURNISHED HOLIDAY LETTINGS

The above changes to the renewals basis do not apply where the property rental business falls within the definition of a qualifying furnished holiday lettings (FHL) business.

Such businesses continue to qualify for capital allowances when plant and machinery used in the course of that business is acquired and would benefit from the 100% write off under the Annual Investment Allowance rules.

There are strict conditions for the property business to qualify as FHL, the most important condition being that the property is let for at least 105 days (15 weeks) in the tax year, and comprises a series of short term lets.

Note that under the capital allowances rules, relief is not just available for replacing assets but also for the initial furnishing of the holiday property.

## INTEREST RELIEF RESTRICTION STARTS 6 APRIL 2017

As previously announced the current deduction available for mortgage interest and other finance costs starts to be phased out from 6 April 2017. In 2017/18 only 75% of finance costs will be deductible in arriving at rental profits, the remaining 25% will only qualify for basic rate tax relief.

In 2020/21 there will be no deduction against rental profits for finance costs, just a basic rate tax reduction. This will not only affect higher rate taxpayers but will also have the effect of pushing some landlords into higher rates of tax.

Currently where a buy to let landlord has £10,000 a year net rental profits after deducting £30,000 mortgage interest, in 2020/21 his rental profits would increase to £40,000.

If his other income is £25,000 a year, the rents would currently be taxed at basic rate 20%. Assuming his other income stays the same, his taxable income would increase to £65,000 with a significant portion being taxed at the 40% higher rate. The £30,000 mortgage interest would only qualify for a £6,000 (20%) set off against the 2020/21 tax liability.

Note again that the restrictions do not apply to any part of the amount borrowed for the commercial letting of furnished holiday accommodation. Furthermore, the restriction does not apply to loans for property development trades, or loans secured on a let dwelling house which are applied for the purposes of a trade.

## SEED EIS RELIEF DENIED

The Enterprise Investment Scheme (EIS) and the recently introduced Seed EIS provide generous tax breaks for investors who subscribe for shares in qualifying companies provided the correct procedures, and in particular the correct forms, are used to claim tax relief.

Seed EIS provides income tax relief of 50% of the amount invested and EIS 30% relief, both given by way of a deduction from the investor’s income tax liability. Furthermore there is an exemption from capital gains tax when the shares are sold after 3 years.

In a recent case before the Tax Tribunal, tax relief for Seed EIS investors was denied by HMRC and the Tribunal as the directors had filled in the wrong HMRC forms! They tried to save costs by not using professional advisers – a very costly mistake!

### TAX DIARY OF MAIN EVENTS

DATE	WHAT’S DUE
1 <sup>st</sup> August	Corporation tax for year to 31/10/15
19 <sup>th</sup> August	PAYE & NIC deductions, and CIS return and tax, for month to 05/08/16 (due 22 August if you pay electronically)
1 <sup>st</sup> September	Corporation tax for year to 30/11/15
19 <sup>th</sup> September	PAYE & NIC deductions, and CIS return and tax, for month to 05/09/16 (due 22 September if you pay electronically)

## FURTHER INFORMATION OR ADVICE

If you would like further information or advice about any of the issues raised in this newsletter or any other tax-related matter then Steve Bird would be delighted to hear from you.

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