'Airbnb', 'rent a room' and the 'professional property owner'

It is fair to say that there is much innovation and change in the world of property letting. Many fiscal changes to 'buy to let' property, the 'furnished holiday let' and the 'rent a room' scheme together with the explosion onto the property scene of Airbnb, have resulted in a perfect storm of change and fresh thinking. Also throw into the mix the result of Brexit and the impact on property and it is necessary to look at the tax reliefs in the round.

Restrictions of loan interest on buy to let property

The new rules involve the gradual withdrawal of income tax relief on finance costs (essentially loan interest paid) starting 6 April 2017. There is time to plan a strategy around commercial and income tax efficiency. There is no doubt that such changes could be a negative for new potential landlords (professional property owners) wanting to enter the buy to let property market and will result in the consideration of other property income alternatives.

- From 2017 the tax relief will apply to buy to let property;
- In 2017– 18, the deduction from property income (as currently allowed) will be restricted to 75% of finance costs with the 25% that remains having a basic rate tax deduction;
- In 2018–19, 50% of finance is allowed with 50% at the basic rate tax deduction;
- In 2019–20, 25% finance cost is allowed with 75% at the basic rate tax deduction.
- In 2020–21, all financing costs incurred by a landlord will be allowed as a basic rate reduction at 20%.

There will obviously be some complex calculations surrounding the property alternatives to contemplate, however this article attempts to look at solutions and strategy at an early stage in the tax changes.

Airbnb

It would appear that professional property owners have turned to Airbnb in record numbers as a result of the tax changes. Airbnb was set up in 2008 to allow homeowners to let spare rooms or entire properties for short periods. It would appear a growing number of landlords are using the website as a business. Many consider that the website is changing the whole hotel and property letting industry. The question to be asked is what is the tax treatment moving forward?

Rent a room scheme – Maximise the advantage

Some of the property lettings will be covered by the "rent-a-room" relief and can be considered as an area of tax protection. Rent-a-room relief provides a tax-free amount of rental income that can be received for letting furnished accommodation in the taxpayer's own home. The limit of the relief was set at £4,250 per annum for years, but it was raised to £7,500 per annum from 6 April 2016. The higher amount makes a claim for rent-a-room relief far more attractive, so it is important to clarify for clients when rent-a-room relief can or cannot be used. For example, the relief cannot be used when:

- The area is not a furnished room (eg a garage or driveway); or
- The room is let as an office not as residential accommodation; or
- The home is not occupied by the person who receives the rent.

The rent-a-room provisions cannot, however, be applied to an activity carried on in partnership. This would preclude a trade from qualifying in this situation, unless it could be shown, as a matter of fact, that it is the wife who carries on the trade as a sole trader, using a jointly-owned asset.

Even though the rent-a-room threshold may have been exceeded, it is still possible to dduct the threshold amount as notional expenses as an alternative to claiming actual expenses. The threshold amount (which will be shared equally between a married couple) is £4,250 for tax years up to 2015–16, but is £7,500 from 2016–17 onwards.

HMRC can argue that contributions paid by adult children towards the household bills of the family home should be taken into account for the rent-a-room relief calculations. This is nonsense, as rent-a-room relief is there to provide a tax exemption for income which would otherwise be taxed as profits (s786, Income Tax (Trading and Other Income) Act 2005). The financial arrangements between a parent and child are never intended to create a trading profit, so should be excluded from rent-a-room calculations.

HMRC guidance (tinyurl.com/z4jdgb2) confirms that relief is also available if the letting activity amounts to a trade, 'for example, if you run a guest house or bed and breakfast business, or provide services, such as meals and cleaning'.

Substantial letting income – A trade

Whether the activity of property letting is a trade is a question of fact, which will be determined by reference to what other services, if any, are provided in addition to the accommodation. A guest house or bed and breakfast, for example, would be regarded as a trade. Another point to consider is the occupation of the property, eg a bed & breakfast or hotel – this is a trade.

A plan for claiming expenses if the activity is a trade would be to claim all of the household running costs, reduced by an appropriate amount under the fixed rate scheme, as set out in Income Tax (Trading and Other

Income) Act (ITTOIA) 2005, s941 ('Premises used both as a home and as business premises').

Furnished holiday let

One alternative to 'buy to let' is to use Airbnb income as a FHL. There are many who are advising the consideration of furnished holiday accommodation as an alternative to buy to lets and some argue that this is being fuelled by the Airbnb website. The owners of FHL also consider that they have been persecuted. In 2009 the tax rules changed so that any losses on the FHL could no longer be offset against total income but carried forward. The Inheritance Tax (IHT) reliefs have come under persistent attack from HMRC. However, what has remained are the positive capital gains tax (CGT) reliefs.

One consideration is therefore to turn the buy to let property into an FHL with help from Airbnb so that the loss of tax relief on interest is less punishing. With the new rules starting in less than one year's time (April 2017), there is time to plan towards this. There is amuch misunderstood point about FHLs which is how positive the CGT position is. The disposal of the property can qualify for rollover relief, hold-over relief and Entrepreneurs' Relief. This could provide the disenchanted buy to let owner the way out they are looking for.

Digital recording and simplified cash basis

Small landlords are likely to be exempt from having to update HMRC quarterly or keep their records digitally. HMRC is considering the extension of the cash basis to some types of landlord, giving them the choice to use the cash basis rather than the accruals basis. This will include most individual landlords and some partnerships where all the partners are individuals. Unlike the cash basis for trading income, HMRC is not proposing a turnover limit for landlords, as their business complexity does not necessarily rise with increased turnover.

Repayment and removing financial costs

A possible consideration for the buy to let landlord is to sell other assets (eg stocks and shares) which from 6 April 2016 benefit from the 20% rate of capital gains tax and to utilise the annual CGT exemption (currently £11,100) to repay loans. Where there is a portfolio of buy to lets, the consideration is to sell the property which has the least potential CGT liability and then repay part of the borrowings.

Clearly such a scenario is where investment advice and tax advice will merge and possibly conflict. Landlords must take good investment advice to help with the decision making. There is then the consideration of moving some of the property already held to furnished holiday accommodation in order to claim the maximum tax relief on the interest.

Action plan

The question of letting or trading with property income is at a crossroads in terms of tax treatment, opportunity (eg Airbnb) and decisions over best returns. There is no doubt that some of the recent tax changes – for example, the rent-a-room increase and the reduction in tax relief in loan interest, are going to leave taxpayers reviewing commercial considerations. Much professional advice isneeded for the best decisions for tax savings, increasing returns of income and embracing commercial legal efficiency. More complex decisions of moves to the corporate structure are on the horizon for larger operations. Good luck to all those involved in the decision making…

*Supplied by **Julie Butler** F.C.A. Butler & Co, Bennett House, The Dean, Alresford, Hampshire, SO24 9BH. Tel: 01962 735544. Email: j.butler@butler-co.co.uk. Website: www.butler-co.co.uk*

***Julie Butler** F.C.A. is the author of* Tax Planning for Farm and Land Diversification *(Bloomsbury Professional),* Equine Tax Planning *ISBN: 0406966540, and* Stanley: Taxation of Farmers and Landowners *(LexisNexis).*

Editor: GR Williams, Solicitor

Editorial consultants: Julie Butler, Chartered Accountant, FCA Butler & Co, J Neil Porter, Solicitor, Frank Nash, Taxation partner, Burgis & Bullock, Chartered Accountants, Oliver Stanley, Barrister, Director of Rathbone Brothers plc, Angela Sydenham, Solicitor, Birketts Solicitors

Sales: James Littlejohn • 020 7551 9744 • james.littlejohn@informa.com

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