



RESIDENTIAL LANDLORDS ASSOCIATION
RESPONSE TO THE CONSULTATION ON THE HMRC CONSULTATION
REPLACING WEAR AND TEAR ALLOWANCE WITH TAX RELIEF FOR
REPLACING FURNISHINGS IN LET RESIDENTIAL DWELLING – HOUSES

(07th October 2015)

About the Residential Landlords Association (RLA)

The Residential Landlords Association (RLA) is the premier national landlords association operating in England and Wales. We represent over 20,000 members. Our members own or control over 250,000 units of accommodation. Primarily our members are landlords in their own right but a number are managing and letting agents, some of whom are also landlords. Our members operate in all sub-sectors of the Private Rented Sector (PRS). Properties are rented out to families, working people, young professionals, the elderly, students and benefit claimants.

Introduction

Properties and their contents devalue as they are lived in and periodic refurbishments and replacements are essential if property standards are to be maintained. The tax system currently allows no relief for depreciation except for the wear and tear allowance for fully furnished properties and even this is now to be scrapped if the Government's proposals are adopted. We are opposed to the loss of the wear and tear allowance, although we welcome the proposals to allow relief for replacement of furniture, white goods etc for partly furnished properties and unfurnished properties.

We do not feel that scrapping this depreciation allowance altogether will improve standards in the PRS overall and alongside this with other taxation changes such as Mortgage Interest Relief being phased in from 2017; many Landlords will have less income to reinvest into the maintenance and improvement of their properties and their contents.

The extra tax to be extracted from the private rented sector will make the retention of quality and standards very difficult. In the longer term instead, if the Government is serious about providing a high quality PRS the RLA believes that there should be a scheme of capital allowance for repair and refurbishment not just the revised allowance for replacement of white goods and furniture etc., to prevent properties from falling into disrepair or their contents becoming out of date.

Consultation questions

4.1) Do you have any comments on the proposed scope of the new relief?

We welcome the reversal in policy that the Treasury seems to have made on the scrapping of the White Goods tax relief that was abolished in April 2013 for those Landlords renting unfurnished / part furnished properties. We felt that this move in the long term would ultimately lead to a decline in the standard of unfurnished / part furnished accommodation, and rent increases as Landlords have to cover cost for items such as carpets without relief, and that Landlords would either simply switch to fully furnished accommodation to claim the 10% wear and tear allowance or would stop providing these items.

Carpets, Curtains and basic furnishings should be allowable expenses against tax regardless of whether the rest of the property has other fully furnished items; Landlords cannot be expected to literally provide a shell after all.

We do accept that in one sense the new changes will make it an easier and simpler system for Landlords now that they will no longer need to decide whether their property is sufficiently furnished to claim the new replacement furniture relief. We also see that it will be easier for Landlords as they will no longer need to be concerned with whether the item being replaced is a fixture (and therefore a repair to the property) or not. As in either case, the cost can be deducted from their rental income to arrive at the profits of their property rental business. Nevertheless, we do not believe that the search for simplicity justifies the removal of the current wear and tear allowance.

We recognise that in some parts of the country, 10% is not sufficient to cover the actual costs incurred, therefore, we welcome the promise that the proposals will ensure landlords can claim their actual costs.

However, we do regret the disappearance of any kind of depreciation allowance for the purpose of furnished lettings. Although we agree that the current system of a 10% allowance of rental income is broad brush it is good accountancy practice to allow for depreciation of assets over time, as their value reduces. It has provided a straight forward way of claiming relief without the need for detailed record keeping or for significant administrative work being required on the part of HMRC. Indeed, this is the very reason why the 10% approach was introduced in the first place. At the time, tax inspectors had to spend a lot of time and effort looking at claims for allowances for replacement furniture etc. This led to arguments with tax payers over the correct classification of claims. This resulted in a great deal of effort on the part of tax officials, tax payers and their advisers.

In the lettings market the reality is that over time items such as carpets, sofas etc do depreciate as a result of significant wear and tear so some other ways of working out an allowance for depreciation could have been explored.

For example, for 'Fully Furnished' properties *only*, there could be a two option approach, similar to the old system where Landlords could opt for the tax allowance system that is most appropriate to their circumstances. This could be to claim the actual cost of the replacement (as proposed) or to have the option to claim the allowance either as a percentage of the 'passing rent' or as a 'flat rate' allowance. We would suggest that this could work by capping the 10% allowance in cash terms and then adjust this cap annually to allow for inflation. Alternatively, a fixed rate relating to the average annual cost of replacement expended by landlords could be chosen. Here are simple illustrative examples,

Percentage Formula

Work out the total *actual cost* in a typical situation to replace items by category over typical life cycles, and then divide this by ten. In this way you could present a maximum figure that could be recoverable in a tax year, for example a cap of £750 per property.

So if your rent was £3,000 a year you could claim £300, but if your rent was £12,000 a year you could not claim £1,200 it would be capped at £750. This cap would be designed so that higher rental Landlords did not benefit above the actual standard national cost based on the *average* cost of replacement goods / furniture etc.

Fixed Allowance

If Government want to depart from the idea of relating the allowance to a percentage of rent then the second alternative would be a flat rate annual fixed allowance, again adjusted annually according to CPI. Using figures for capital allowances for furnished holiday lets adjusted upwards to allow for extra wear and tear (which is the methodology HMRC have used in assessing the increased receipts of tax as a result of this measure) a fixed figure of say £750 could be allowed. This is a purely hypothetical illustrative figure.

This would be an 'Opt in' scheme where you could 'Opt in' or 'Opt out' between the two between the adopted formula or the actual expense say every 10 years. Again this should only apply for Landlords renting Fully Furnished lets, as clearly fully furnished properties are the only type of let that should benefit from the maximum relief available.

We feel that either of these formulae would cut down on administrative costs and burden for HMRC and for private landlords and encourage the provision of more furniture etc., as being an economic advantage but also support a standard of private rental accommodation which is an advantage for tenants as well as promoting a higher standard in the PRS. The flat rate formula reflects the average cost of replacement of furniture etc., over the usual life cycles of these items based on a reasonable expenditure, not luxury expenditure. We do not consider that in reality identifying a property which is fully furnished is a difficult exercise and therefore that this would be a more straight forward and workable approach.

Other ways in which the proposals could be improved are by, allowing landlords to also claim a tax deduction to cover the management time associated with acquiring, checking on, insuring, repairing, replacing and maintaining the furniture in their properties. All of this must bring sufficient financial reward for it to be worthwhile providing furniture.

We would also suggest that if the proposals are to go ahead the Government removes the current Wear and Tear allowance gradually, allowing landlords of fully furnished properties more time to adjust.

4.2) Do you have any comments on the proposals for dealing with any disposal proceeds from the old asset that is being replaced or any improvement element of the replacement asset?

If these changes work as they are intended and Landlords are claiming actual cost for replacement goods and furniture then if the items are damaged beyond repair then it is unlikely that they will want or even be able to sell them on. They are more likely to end up at the local tip or in a charity shop. Therefore, Landlords should not be required to deduct the proceeds from selling off an old asset from their replacement costs. This is yet more complication in the proposals.

We are also concerned with the improvement provisions. We feel that even if there are improvements the full cost of replacement items should qualify for relief so long as the function of the item essentially stays the same. You use the example of the Washer Drier, rather than a washer, the relief would be the cost of a like for like washing machine even if the drier is an improvement. We feel that in circumstances where the tenant could benefit from better energy efficient items that could reduce their bills and improve the overall performance of white goods items like washing machines, then the total cost of this sort of improvement should be included in the actual relief. In the absence of Green Deal funding these tax reliefs will help Landlords to improve the energy costs of tenants.

We also feel that there should be an allowance where the item improves standards of health and safety for legal reasons. For example, in Scotland legally smoke alarms need to be hard wired in the property which comes at a higher expense than a mains or battery operated alarm. From 01st October 2015 Landlords in England will also have to install Carbon Monoxide alarms in high risk rooms with solid fuel appliances and smoke alarms on every floor. For improvements where the health and safety of the tenant are concerned we feel that these improvements should be allowed at full cost as an improvement from when they are first bought which is not currently covered in the guidance. This will tie in with new regulations and we believe not having to deduct for improvements for health and safety as well as improvements to promote energy efficiency and again this will simplify the administrative burden on HMRC.

4.3) Are there additional impacts on *individuals or other businesses* that are not covered in the table of impacts?

You do recognise the impact of the increased administrative burden on private Landlords and Partners due to the requirement of keeping records of actual expenditure under this new system. You have indicated that 750,000 individuals and 50,000 partnerships and companies are currently claiming the wear and tear allowance. This has the consequence that there are a lot of tenants who are likely to be affected due to the number of properties involved. Tenants and prospective tenants face the likelihood of changed provision in their accommodation meaning that they may have to acquire/purchase items for themselves which they would not have otherwise had to do. Over all, as a consequence of these proposals, we are very concerned that tenants face rises in rents directly attributable to such a proposal.

Your impact assessment also fails to recognise the wider tax changes that private landlords are facing. As well as the changes to the Wear and Tear Allowance, Landlords will also see Mortgage Interest Relief reduce to the basic rate of 20% starting to phase in from 2017.

A recent RLA survey found that 63% of our members will fall into the higher tax band (40%) in 2020 as a result of the changes. This is an increase of 27% from the number of landlords who currently sit in that band. This means that as well as no longer receiving the 10% wear and tear allowance, many Landlords will be facing higher overall tax bills so landlords will not have as much money to spend on repairing and upgrading their properties. This generates increased upward pressure on rents that will inevitably rise as a consequence of the new tax rules, which then impacts adversely on tenants. This will have a considerable impact in overheated markets such as in London where there is already significant pressure on rental prices.

It is important to recognise a simple principle of economics that costs of a business are passed onto the consumers of any business as part of the pricing structure. Private landlords are no different. No one wants to run their business at a loss and those operating businesses look at the net return after tax. There is scope for such

increases because currently landlords do not generally increase rents during the course of a tenancy; only at the outset. There is therefore scope for rent increases particularly where there is ongoing market pressure due to landlords' shortage of supply.

We simply do not accept the £100,000 figure ascribed to the cost of administration by HMRC. Clearly we are not able to provide any alternative figure because we are not privy to HMRC's internal cost of operation. Nevertheless, we are extremely surprised at the very low figure that has been put on the extra costs resulting from these measures. Claims will have to be scrutinised and checked even though initially tax is based on self assessment. Enquiries will be made and they will come up with issues involving such claims. We believe that the figure of £100,000 is well below the estimate of the additional costs which will be incurred by HMRC. Experience in the past has shown that as part of these investigations claims of this kind are subject to very detailed and minute scrutiny which takes up a considerable time not just on the part of HMRC but also tax payers and their accountants. This additional impact has not been taken into account.

In the Consultation Paper HMRC say that they anticipate that by restructuring relief it will provide a better incentive for landlords to actually maintain furnishings in their property as they will only be able to claim relief if there is actual expenditure. We have asked members this question and 785 answered. Only 147 (18.73% of the respondents) agreed but 299 (38.09%) said that this would not be the case. 339 (43.18% of the respondents) said that it would remain the same.

We also asked whether the change to the rules would make any difference to the amount that the landlords were prepared to spend on furnishings etc. 783 answered of which only 105 (13.41% of the respondents) said that it would make them spend more. In fact 172 respondents (21.97%) said that they would actually spend less. 506 (64.62%) said that they would spend the same.

The survey asked if overall if it was felt more likely that the respondents would replace items with new items more frequently as a result of these changes. Of 782 respondents to this question only 18.41% said that it would be more likely that they would renew items more often (144 respondents). Nearly a quarter (24.17% or 189 respondents) said that it was less likely that they would do so. Around 449 respondents (57.42%) said that they would do the same as at present. Although it

has to be said that as a result the majority of landlords would probably spend the same there is still a significant number who say they will spend less and this is most certainly more than those who said they would spend more. It is therefore fair to assume that, whatever the impact assessment says, the changes are not going to promote a significant behaviour change for landlords.

At the same time significant extra revenue will be generated for the Treasury from these changes. When taken alongside the restriction of mortgage interest relief at the basic rate, the fact that HMRC expect to take out a significant extra tax take from the private rented sector will have major consequences for tenants as well as landlords.

As we have already pointed out in this response and in our submission to the Treasury relating to the removal of Mortgage Interest Relief for higher (and additional) rate tax payers this means that the sector will have less money for investment, whether the purchase of new/additional properties, improvements to properties, provision of furniture etc or repairs. The tax regime in which a business operates is key. At a time when there is public concern about ever rising rents what the measures would generate are additional costs burdens, leading to upward pressure on rents to the detriment of tenants and prospective tenants.

We are extremely surprised to say the least at the Treasury/Office of Budget Responsibilities say that there will be little or no upward pressure on rents. We believe that this assessment is wrong. After all, the impact assessment assumes that once the changes are fully in force from 2020 onwards an extra £170million of tax will be paid by private landlords due to the removal of the Wear and Tear allowance which will inevitably significantly be passed onto private tenants as an extra cost of operating private rented properties. This is a significant uplift in the overall tax burden on the sector. When taken together with the loss of mortgage interest relief other than at basic rate the resulting burden increases even further.

Landlords may sell and leave the market altogether at a time when demand for housing has never been higher, we would also ask that HMRC consider this impact when looking at the overall taxation landscape for Private Landlords as a result of the 2015 Summer Budget.

Conclusion

In the longer term instead, if the Government is serious about providing a high quality PRS the RLA believes that there should be a capital allowance for enhanced repair and refurbishment not just replacement of white goods and furniture to prevent properties from falling into disrepair.

We welcome the change in policy that the Treasury seems to have made on the scrapping of the White Goods tax relief that was abolished in April 2013 for those Landlords renting unfurnished / part furnished properties.

We recognise that in some parts of the country, 10% is not sufficient to cover the actual costs incurred, therefore, we welcome the promise that the proposals will ensure landlords can claim their actual costs and provide a level-playing field for landlords wherever they operate in the country. However, we do regret the disappearance of any kind of depreciation allowance for the purpose of furnished lettings.

We propose for 'Fully Furnished' properties *only*, there could be a two option approach, similar to the old system where Landlords could 'opt in' to the tax allowance system that they preferred.

We are concerned with the improvement provisions. We feel that improvements should qualify so long as the function of the item essentially stays the same. We believe that in circumstances where the tenant could benefit from improved health and safety at better energy efficient items that could reduce their bills and improve the overall performance of white goods items like washing machines, then this sort of improvement should be included in the actual cost relief.

The Treasury should consider the wider taxation implications of the Mortgage Interest Relief change alongside the loss of the wear and tear allowance on the Landlords ability to spend money on their properties and may increase rents or leave the market altogether, putting pressure on an already over stretched housing market.

If you have any further questions about our submission please feel free to contact me.

Yours Faithfully

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