REPLACING WEAR AND TEAR ALLOWANCE WITH TAX RELIEF FOR REPLACING FURNISHINGS IN LET RESIDENTIAL DWELLING HOUSES

Response by the Association of Taxation Technicians

1 Introduction

1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the consultation document Replacing Wear and Tear Allowance with Tax Relief for Replacing Furnishings in Let Residential Dwelling Houses (‘the Consultation’) published by HMRC on 17 July 2015.

1.2 HMRC has put forward the following three issues with the current Wear and Tear allowance:

(i) Firstly, the allowance is not available unless a property is provided fully furnished so there is a perceived unfairness – especially for those landlords who let properties that are considered to be only partly furnished.

(ii) Secondly, the allowance is available even in years when the landlord does not incur any expenditure on furniture – so it does not offer the incentive for the landlord to renew the furniture provided with a property.

(iii) Thirdly, the allowance is dependent on the amount of rental income received rather than having anything to do with amount spent on furniture in the year, which produces inconsistencies between similar properties (possibly with similar levels of expenditure) but situated in different parts of the country.

1.3 From 6 April 2016, the proposal is that the Wear and Tear allowance will be replaced with a relief that enables all landlords of residential dwelling houses to deduct the costs they actually incur on replacing furnishings in the property. With this new measure, HMRC is aiming to improve the consistency and fairness in the taxation of residential property businesses.

1.4 We provide our responses to the Consultation questions at section 2 but to summarise, we broadly welcome the proposals being made but do have some concerns about the requirement...
that landlords will need to deduct any improvement element from the cost of a replacement item. We will go into more detail about our concerns at sections 2.2.3 and 2.2.4.

1.5 We have also read CIOT’s response to this Consultation and are in agreement with the comments made in that response, particularly the comments raised in sections 4.2 - 4.4 of that response which refers to the requirement for the definition of a dwelling house for the purpose of this new measure being confirmed in statute.

2 Our responses to the questions

2.1 Question 1: Do you have any comments on the proposed scope of the new relief?

2.1.1 We welcome the news that all landlords of residential dwelling houses will be able to claim this relief and we agree that it will provide simplicity over the current system. It is sometimes tricky and time consuming to decide whether the extent of furnishing means that a property is fully or only partly furnished. We will be pleased to see this element disappear.

2.1.2 We can also appreciate that for a landlord who currently lets out a fully furnished property, there does already have to be the annual analysis of all receipts to ensure that an item covered by Wear and Tear has not also been mistakenly claimed as a repair or fixture.

2.1.3 The new relief may act as more of an incentive for landlords to keep their furniture up-to-date, in terms of state of repair and tenant expectations, than under the current basis.

2.1.4 We do think that there will need to be guidance on certain situations where perhaps it is not clear whether the purchase of furniture represents the initial cost or a replacement. For example, if a landlord rents out her former residence and initially lets it out with the furniture that was in the property when she lived there, when she subsequently changes an item of furniture will this immediately be allowable as a replacement? If so, will this be the case even if the furniture is replaced within a very short timescale of the landlord beginning to let out her former residence? Unless this position is clarified, there would be scope for confusion and inconsistency.

2.2 Question 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?

2.2.1 We are happy with the proposal for any disposal proceeds from the old asset to be deducted from the cost of the replacement asset in arriving at the amount that can attract tax relief. This seems logical and it should be relatively straightforward for the landlord to be able to provide the records required for the correct amount of relief to be computed. These comments are made on the basis that HMRC only intend to take into account actual cash proceeds received and do not expect landlords to come up with valuations for any items of furniture that might be removed from a rental property and then, say, used in their own home. This point is made in the CIOT’s response to this Consultation, at section 3.2 of their submission. We are in total agreement that any
attempt to include situations where furniture is appropriated from the rental business would add an extra layer of administrative burden for landlords.

2.2.2 In reality though, we believe there will be very few cases where disposal proceeds are received. In general, when landlords replace items on which Wear and Tear allowance is currently available it is because that item has broken and has gone past the point of being repaired. It is not very often that landlords provide upgrades for the sake of it. Indeed, in some cases, it costs the landlord to have the old item taken away – for example, mattresses, refrigerators and washing machines. Will HMRC recognise such disposal costs as part of the total cost for the replacement item?

2.2.3 We do have concerns about the proposal to exclude the improvement element of the replacement asset from the amount that can attract tax relief. We believe there could be a number of issues with this including the level of detailed records a landlord would need to keep to demonstrate to HMRC whether the new item involved an improvement element or was simply the modern equivalent of the old item.

Section 2.13 of the Consultation rather suggests that improvement involves increased functionality. We think this introduces two potential complications:

(a) Manufacturers of electrical goods (washing machines, etc) are constantly claiming that current models offer increased environmental efficiency, greater functionality, convenience, etc. In such cases, it would be impossible to replace on a like-for-like basis without opting for what was in fact a cheaper and inferior product. We think that departmental guidance would need to provide examples showing that a fairly broad brush approach was appropriate;

(b) If a landlord chooses to replace an old item with a higher brand (ie more expensive) version of the same item without any greater functionality, would there be any restriction in respect of the perceived improvement in quality? If so, on what basis would the restriction be calculated?

2.2.4 We would ask what guidance HMRC is intending to provide on this area. Many landlords do not use professional advisors to deal with their tax affairs. We anticipate that these landlords will be looking to HMRC for some guidance on what is an acceptable enhancement to an item and what would be deemed an improvement. Any guidance of this nature would need to be reviewed on a regular basis to reflect the fact that times move on – tenants’ expectations and technology move on. We have previously seen the replacement of single glazed windows with double glazed windows change its tax status over time from being regarded as an improvement to a property to now being accepted as a repair since double glazing is now what people expect as standard - it is the modern equivalent. We could see many such instances with this new measure that would need be kept under review.

2.3 Question 3: Are there any additional impacts on individuals or over businesses that are not covered in the table of impacts?
2.3.1 We would be grateful for clarification on how the measure will be implemented for partnerships where the property income is taxed on an accounts period basis rather than a tax year basis, therefore the change will come in the middle of an accounts year. We assume it will work as follows: Wear and Tear allowance will be available at 10% of the rental income accruing for the period up to 5 April 2016 and then any expenditure incurred from 6 April 2016 will be an allowance deduction based on the date of purchase shown on the receipt or invoice. If our understanding is not correct, we would be grateful if you could clarify the position. In any case, we think this point should be covered in guidance.

2.3.2 We note the impact on HMRC for implementing this change is estimated to be in the region of £100,000. We assume that this includes the cost of providing guidance on how to determine if a replacement asset has an improvement element, the costs of dealing with queries and perhaps even requests for clearance on specific items and also the cost of policing this measure to ensure that landlords are operating it correctly.

3 Summary

3.1 We trust that you have found our comments in this response useful. We would be happy to take part in any further discussions on this issue.

3.2 Contact details:

Should you wish to discuss any aspect of these comments, please contact our relevant Technical Officer, Alison Ward, on 07762 947 910 or at award@att.org.uk.

Yours sincerely

Paul Hill
Chairman, ATT Technical Steering Group
Note

4.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 7,700 members and Fellows together with over 5,600 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.