Response from ICAS to the HMRC consultation

‘Replacing Wear and Tear Allowance with Tax Relief for Replacement Furnishings in Let Residential Dwelling-Houses’

14 October 2015
Replacing Wear and Tear Allowance with Tax Relief for Replacement Furnishings in Let Residential Dwelling-Houses

About ICAS

1. The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants. We represent over 20,000 members who advise and lead businesses. Around half our members are based in Scotland, the other half work in the rest of the UK and in almost 100 countries around the world. Nearly two thirds of our members work in business, whilst a third work in accountancy practices. ICAS members play leading roles in around 80% of FTSE 100 companies. ICAS is also a public interest body.

General comments

2. ICAS welcomes the opportunity to comment on the consultation ‘Replacing Wear and Tear Allowance with Tax Relief for Replacement Furnishings in Let Residential Dwelling-Houses’ issued by HMRC on 17 July 2015.

3. The consultation states that the proposed tax relief is designed to improve consistency and fairness in the taxation of residential property businesses. Achieving these aims, whilst maintaining certainty in the context of residential furnishings which are easily transferable and often in a state of flux between being business assets and for the landlord’s own use, is likely to require complex legislation that ultimately proves difficult to administer and imposes onerous record keeping requirements on small landlords.

4. ICAS wonders whether any alternatives to the proposal have been considered. Whilst we understand the comments in the consultation about the inconsistencies arising from the existing Wear and Tear allowance for furnished lettings it has been in existence for a very long time, it is well understood by landlords and it is simple to operate. It seems unfortunate that large numbers of small landlords with furnished lettings should be forced into a more complex and onerous system. If the cost of Wear and Tear allowance is an issue has any consideration been given to reducing the percentage from 10% of net rents to a lower percentage, with the option to elect instead for the proposed new regime based on actual expenditure?

5. The problems for unfurnished and partly furnished properties arose from the withdrawal of the non-statutory renewals basis from April 2013. We support the reinstatement of this relief in statute. However the proposals do not address expenditure in the period between April 2013 and the introduction of the new rules. How will this gap be addressed?

Specific Questions

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

Paragraph 2.3 notes that “The relief will apply to landlords of unfurnished, part-furnished and furnished properties.”

The consultation does not consider how the new relief will apply to short-term lettings; for example, a six-month short-assured-tenancy with occupancy reverting to the landlord. The application of the new relief to all relevant costs incurred by the landlord irrespective of the duration of the letting business appears inconsistent with other residential letting taxes.

Paragraph 2.4 notes that “The initial cost of furnishing a property would not be included.”

Taking into account the nature of movable assets, it may be difficult in practice to restrict the application of the new relief to the replacement of existing assets without imposing strict record-keeping requirements (for example, a movable asset register). Even then, it is easy to
envisage landlords circumventing this restriction by purchasing worn-out second-hand furnishings at nominal cost and then claiming the tax relief on their new replacements.

It is noted that the new relief is directed at replacing rather than repairing assets, and therefore its scope is narrower than the current Wear and Tear Allowance.

Paragraph 2.4 notes that “The new replacement furniture relief will only apply to the replacement of furnishings.”

The consultation does not consider whether there will be restrictions on when, or how frequently, assets may be replaced and still qualify for the new relief. A complex set of rules may be required if it is intended to impose restrictions. On the one hand, evidence of wear and tear not necessarily affecting the use of the asset may be too subjective to be enforceable in practice, but at the other extreme, requiring evidence that the asset is no longer economically viable to repair may be too onerous for landlords to satisfy.

Paragraph 2.5 notes that “[Landlords] will be able to claim a deduction for the capital cost of replacing furniture, furnishings, appliances and kitchenware provided for the tenant’s use in the dwelling house.”

Greater clarity is required on what is meant by “capital cost”, “tenant’s use” and “in the dwelling house”.

- The consultation does not consider whether “capital cost” includes assets bought using hire-purchase or lease agreements and, if so, the amount of relief available.
- The consultation’s inclusion of televisions as an example of a qualifying asset may suggest that “tenant’s use” should be widely interpreted to mean tenant’s reasonable enjoyment. It is unclear what limitations (if any) might apply. Does it apply to an actual tenant (who might have particular needs or preferences) or to a hypothetical “typical” tenant?
- It is unclear whether the new replacement furniture relief will extend to exterior equipment. The consultation refers to furniture “in the dwelling house” and does not give any examples of any garden furnishings; for example, barbecues and hedge-cutters left for the tenant’s use.

Paragraph 2.5 notes that “Landlords …will be able to claim a deduction for the capital cost of replacing …linen, crockery or cutlery”.

There may be a degree of overlap with the tax relief already permitted for the replacement of implements and utensils under section 68 ITTOIA 2005 and section 68 CTA 2009.

2.14 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?

Paragraph 2.12 notes that “…the new replacement furniture relief will give relief for the cost of the replacement asset, less any proceeds received from the old asset that is being replaced.”

By referring to “proceeds received”, the consultation suggests that the market value of the assets will not be considered in calculating the amount of the available relief. Greater clarity is required on how this will operate in practice taking into account the nature of movable assets. What will happen, for example, if landlords transfer ownership of assets to their tenants? Or if landlords remove assets for their own personal use?

Paragraph 2.13 notes that “Any element of the replacement asset that represents an improvement would be excluded from the new replacement furniture relief.”

Greater clarity is required on how the value of the “element” of the replacement asset that represents an improvement is to be calculated. The consultation suggests that this will be determined using comparable evidence, but this may be impractical if, say, the supplier of the
replacement asset only sells folding tables and the old table does not fold. Taking into account the wide range of materials and brands available, it may be impossible to determine the improvement (if any).

Paragraph 2.13 notes that “The replacement will include an improvement if the new asset can do more or if it can be used to do something that it could not do before”.

Greater clarity is required on what is meant by “improvement”. Examples of qualifying assets in paragraph 2.5 include televisions, fridges and freezers. Technology advances rapidly, so it will often be the case that replacement assets will either “do more” or “be used to do something that it could not do before”, making it difficult (and potentially undesirable) to find a comparable replacement. It would not be helpful, for example, if a landlord was deterred from replacing an appliance with one which is more energy-efficient or safer (better fire-resistance for example) because they thought that the ‘improvement’ might restrict their relief. The guidance in BIM46925 addresses similar issues arising in a trading context and could presumably be adapted for assets commonly found in let properties.

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

As noted above “tenant’s use” needs further clarification and in particular whether it refers to the actual tenant or a hypothetical tenant. The proposed tax relief could otherwise adversely affect tenants with special needs. For example, if the relief does not take into account a tenant with special needs requiring adapted white goods which would not usually be required in a residential letting business, there may be less incentive for landlords to provide them.