<u>ASSC and PASC UK Submission to the Office of Tax Simplification</u>
<u>Call for Evidence on Property Income Tax</u>

Introduction

Founded in 1978, the Association of Scotland's Self-Caterers (ASSC) is the leading source of knowledge on short-term letting and holiday homes in Scotland. The ASSC is the only trade body representing the interests of the traditional self-catering sector. It has more than 1,400 Members, operating tens of thousands of self-catering businesses throughout Scotland, from city centre apartments, to rural cottages, to lodges and castles.

Founded in 2017 The Professional Association of Self-Caterers UK (PASC UK) supports the professional self-caterer in England and Wales. The founding principles are for a level playing field of applied regulation and taxation across the sector. Our 1300 Members manage over 45,000 properties which vary from small cottages to large holiday complexes, from the traditional bricks and mortar properties to innovative pop-up glamping sites and are located in rural, coastal and urban locations.

The ASSC and PASC welcome the opportunity to provide evidence to the Call for Evidence on Property Income Tax by the Office of Tax Simplification. This submission has been prepared in cooperation with our accountants, FBD Consultancy Ltd.

1. Do any particular issues arise as a result of differences in the tax treatment of property income and income from other investments, such as OEICs, or quoted shares?

There are fundamental differences in these different types of business – so much so that any comparison between property investment and other types of investment (shares or otherwise) would appear meaningless. Specifically, no other investment type involves the following:

- A formal legal process for the acquisition and disposal of investments
- A formal legal process of Registration and searches
- Stamp Duty, Land and Buildings Transaction Tax or Land Transaction Tax
- Supplemental taxes for second or more investments (first purchases for Limited Companies)
- Substantial amounts of tax legislation to regulate the above
- Substantial sets of regulations and rules created by the Financial Conduct Authority in regard to bank lending and fitness for purpose
- Planning rules and processes with Local Authorities
- Licensing rules in connection with approved and proper use (In Scotland and proposed in Wales)
- Specific and complicated exemptions and reliefs according to the nature of the property investment
- Repairing standards
- Health & Safety standards
- Local Authority permissions and related regulations in regard to occupation (HMOs, Serviced and Short Stay Accommodation etc.)
- Local Authority permissions and related regulations in regard to fitness to operate (HMOs, Serviced and Short Stay Accommodation etc.)

This list is not exhaustive, but serves to illustrate the vast differences between the different investment types and why property investment cannot be compared with other types of investment.

2. Does the existence of different regimes for taxing property income and other income from investments lead to any distortions in behaviour?

The decision to invest in property rather than other investments seems to be more governed by:

- The ability to stay in control of one's investments

- The security of investment
- The rate of return on capital employed

Different property investments create different types of return. Some return greater cashflow to the investor, some greater capital. Some require greater investor involvement (or the onboarding of professional services) and others less so.

Where taxes or tax reliefs are introduced to an established industry with longstanding players, there is always an immediate reaction. This is especially true to changes in taxes laws that result in a more punitive tax regime than historically. Often the reaction is more widespread due of misinformation from those considered leaders in the industry:

- training organisations using their limited knowledge of tax and other laws to sensationalise the value of their training
- more successful and more wealthy landlords who have assessed the impact from their perspective only.

Often the message is not filtered or adapted to the impact for all investors at all income levels. For example, when the restriction in finance cost relief for individual landlords was announced in the summer budget 2015, there was huge dissent and an across the board cry to convert all property investments held in individual's names into the names of limited companies, even for those not above the higher rate threshold. The result was a substantial change (a "distortion in behaviour") in the way in which landlords invested in property in the UK.

The provision of tax reliefs such as capital allowances also affects the behaviour of investors, including the decision as to which type of property business an investor might run.

3. Do any particular difficulties or benefits arise in relation to letting activities as a result of the different rules for the taxation of property income and trading income?

We believe this question is too widely constructed. Property income and property businesses range from Buy to Let Investment through to hotel chains. At one end such businesses are considered, from a tax point of view as investment businesses and at the other full trading entities. In between are:

- Houses of Multiple Occupancy
- Serviced Accommodation
- Self-Catered Short Term Lets
- Guest Houses
- Bed and Breakfasts
- Tradesmen – Joiners, Plumbers, Electricians
- Sourcing Agents
- Estate Agents
- Staging Agents
- Developers
- Builders
- Property Lessors
- Renting of Advertising Space
- Car Parks.

There are no apparent benefits pertaining to the rules for the taxation of property letting income. They appear to be more restrictive in all aspects of their application when compared to the taxation of general business trading income.

The difficulties in relation to letting activities arise as a result of a more punitive taxation regime – restrictions in relief for finance costs, limited reliefs for both income tax and capital gains tax (not to mention inheritance tax). Taking these together with other legislation in favour of tenants' rights, repairing standards, rising energy efficiency requirements, increasing health & safety requirements, the inability to recharge normal (as well as statutory) business expenses to tenants (lessees) and the restrictions on rent (price) increases, this represents significantly greater difficulties along with a more challenging and restrictive tax regime.

4. What prompts landlords to incorporate their property rental businesses and to what extent are such decisions motivated by tax or non-tax reasons?

There are five main reasons for incorporation generally and these factors are relevant too for property rental businesses: (a) Limiting of liability to third parties; (b) Mitigation of higher rate taxes; and (c) Flexibility, continuity and legacy. We have prepared a brief summary of each factor below.

Limiting of liability to third parties

Generally, liability to third parties is limited to the assets held within the business. Where a creditor considers there is due cause for financial restitution, any action would be against business assets and not personal assets. An exception to this would be where it is believed the directors have behaved negligently, in which case the veil of incorporation may be lifted by a court.

Another exception is where a personal guarantee has been given by one or more of the directors. This would certainly be the case for small portfolio landlords where a lender would seek such personal guarantees. In some larger portfolios, a floating charge over the assets of the incorporated business (company) may be sought in favour of personal guarantees.

The Rating (Coronavirus) and Directors Disqualification (Dissolved Companies) Act further diminished the protection of Directors where it is considered that Directors have dissolved their companies to avoid paying back debt.

Mitigation of higher rates of tax

Companies currently pay a uniform tax rate of 19% on company profits. Individuals can pay tax rates of topping 60% (taking into account the top rate of tax at 46% in Scotland, National Insurance rates at 3.25% and the losses of both child benefit between £50k and £60k and the loss of the personal allowance between £100k and £125k). This position will remain with the introduction of the Health & Social Care Levy from 6 April 2023.

Whilst this is a very complex area in which business owners currently have various options for extraction of funds from their companies for personal use, there can be reduced tax liabilities where directors' loans are used or where funds are left within the company.

Restriction in finance cost relief

As outlined above, this was considered, an unfair and punitive measure introduced by the government to raise additional tax from individual landlords and to be seen publicly as giving first time home buyers a greater opportunity to "get on to the property ladder". The result of this was to increase the tax take from individual property investors – by pushing lower rate taxpayers over the higher rate threshold and into the higher rate tax bracket or by increasing the tax raised from higher rate taxpayers. There is no such restriction for incorporated businesses.

The impact of this was to encourage many landlords to continue to invest within a limited company structure. Additionally, many large portfolio landlords transferred their BTL property portfolios in limited

companies on a wholesale basis. Such transfers were not without substantial legal and professional costs to the landlords, not to mention significant capital gains tax and land transaction taxes.

Flexibility, continuity & legacy

Companies are generally the most solid of business structures through which one can operate a business. The introduction and removal of directors & shareholders can be done without any change in the business structure or impact on creditors and debtors alike. This allows flexibility in the ownership and management of the company.

As the generations move on and management changes hands or shares are transferred, the business within the company can continue intact and unfettered.

If the changes relate to the handing of management and ownership to children and grandchildren, there is the opportunity to pass jobs, offices and wealth, built up within the company, down the generations by way of legacy.

Transfer of shares, of course, gives rise to capital gains tax liabilities and stamp duty liabilities in the normal way. Therefore, the transfer is not without benefit to the Treasury.

All of these factors are material considerations in motivating a landlord towards transfer and/or continued investment within a limited company structure.

Changing corporation tax rates

The introduction of the higher rate of corporation tax in March 2024 to 26.5% for profits between £50k and £250k is likely to have a significant impact on property investment decisions within limited companies going forward. It is also likely to have significant implications for decisions in connection with the extraction of funds for personal use by shareholders / directors of limited company property investment businesses.

5. **What are the benefits and drawbacks of having a different regime for taxing property income and capital gains from Furnished Holiday Lettings?**

Furnished Holiday Let businesses (FHLs) are deemed trading businesses for income and tax purposes. As such they are subject to a more liberal tax regime than that of Buy to Let property businesses (BTLs).

There are capital gains tax reliefs available to FHLs unavailable to BTLs. Capital allowances are available for newly acquired assets within FHLs, unlike BTLs and profits from FHLs can be used towards pension contributions unlike those from BTLs.

Additionally, there are differences in the way in which capital allowances can be treated for BTLs and FHLs, including potential sideways offset against statutory total income in any one tax year for BTLs as opposed to FHLs, where these capital allowances create losses. Without delving further, the taxation of the two types of property business has further differences – so there are many tax benefits for FHLs over BTLs.

However, there are a number of obvious drawbacks in having a different regime for taxing property income and capital gains from Furnished Holiday Lettings?

The first of those is confusion in the extreme. The rules are widespread (derived from different tax laws, Finance Acts and schedules and both the guidance and the legislation can be badly worded, misleading and confusing.

Even the most experienced of property business owners admit to getting lost consistently in trying to decipher, let alone apply, the correct tax rules attaching to the different types of property businesses they run. Those in only one property business type find it extremely difficult to understand and keep up with the tax regime, the detailed legislation and the ongoing changes. Many accountants in practice, after years of study, require undertaking research before coming back to their clients with definitive responses.

Furnished Holiday Lets – Qualifying Conditions

Add to this that there are a number of tests under the tax rules to qualify each property as an FHL. Failure to meet these tests results in a change of tax regime. This adds substantially to the confusion and increases the likelihood of innocent errors in tax returns.

Worst of all, where the qualifying conditions are not met, landlords can be faced with substantial retrospective balancing charges, such that they could give rise to significant cashflow problems and concomitant financial stress arising from unpaid tax debt.

6. **To what extent do those owning property taxed under the Furnished Holiday Lettings regime use the property themselves?**

We are unaware of the extent to which owners of Furnished Holiday Lettings make use of their own properties. Such a study, were it to be carried out, might shed some light for the OTS on this question. As a membership funded body, it is unlikely that members of ASSC or PASC UK would welcome such a study.

7. **Have you encountered any issues as a result of changes in a property's use or ownership, including varying the property ownership percentages?**

We have identified two issues arising from changes in property use and ownership.

The first relates to lending and the second to taxation. As a result of the tightening of the lending rules by the FCA following the 2007-2008 Global Financial Crisis, lenders have become much more risk averse and much more "careful" in how and to whom they lend. Thus, changes in the use of property and the percentage of ownership now have a significant impact on whether and to whom the bank will extend credit, the extent to which they will fund the property business, and the lending rates applied to any such funding support.

In terms of taxation, where a married couple or civil partnership comprise both a higher rate tax payer and a basic or intermediate rate tax payer, or an additional or top rate taxpayer and a basic or intermediate rate tax payer, there is a motivation to change both the use and ownership of the property to maximise cashflow and minimise (legitimately) the tax liabilities. Changes in ownership or use, given the above, often gives rises to additional legal and professional costs, land transaction taxes and bank penalties. These collectively are material costs and can give rise to short term cashflow and financial hardship challenges.

8. **What factors influence the choice between using the cash basis and accruals basis accounting, where rental income is less than £150,000 a year? How well understood are the implications of using each regime and of moving between these regimes?**

The government has promoted the cash basis for accounting as simple and quick. Whilst this may be true to a degree, the use of the cash basis brings with it certain set allowances that may be claimed against receipts. Tax is then raised by HMRC on the net result.

However, there are many legitimate deductions and allowances set out in the tax legislation, the correct application of which may result in a significantly lower tax liability than would be the case for cash accounting.

We are aware that approximately 50% of business owners are not represented by a tax agent or accountant in regard to their accounts and tax affairs, preferring instead to undertake these duties themselves.

The promotion of the cash basis accounting for tax and its simplicity, alongside the current media marketing by accounting software companies that bookkeeping is simple with their new cloud based software systems, encourages more and more taxpayers to complete their returns themselves. Our anecdotal experience is that taxpayers without support may be reporting their tax affairs incorrectly or may be making unintended mistakes in their calculations and may not be claiming all the allowances and reliefs to which they are entitled under the tax legislation.

We are led to believe that most qualified chartered accountants would adopt an accruals based approach as this leads to more accurate reporting of business performance as well as the business owner's ability to maximise legitimate costs, reliefs and allowances against income streams. So, it would appear that the biggest influence in choosing between the cash basis and the accruals basis is the avoidance of professional fees that accompany the use of tax agents or accountants.

9. Are there any difficulties with the operation of reliefs and exemptions available to those with property income?

As highlighted above, it would appear that the biggest difficulties with the operation of reliefs and exemptions are:

- Knowledge that such reliefs and exemptions exist and are available to the specific property business type
- Where to find these reliefs and exemptions in the guidance and the legislation
- How to apply these reliefs and exemptions in their calculations
- Certainty that the business owners have fully and properly interpreted the rules and the calculations and that there aren't further rules, elsewhere or in sub clauses of the legislation that might disqualify the business from these reliefs and exemptions

This is an area of extreme complexity, one that continues to challenge fully qualified accountants and tax advisers, who deal with and study these rules on a daily basis. It seems unreasonable to expect business owners to have a full command, let alone understanding, of the attaching tax legislation on top of all other legislative demands on the business.

10. Have you encountered any difficulties in understanding the rules about, or the tax processes involved in, becoming or being a landlord, including HMRC's information and registration requirements?

The ASSC and PASC UK have heard multiple stories and examples of confusion, difficulties, conflicting advice and stress suffered by members (landlords and professionals) trying to understand the myriad rules surrounding the taxation of property businesses across the board.

11. Do you have difficulties in finding out, getting guidance about or understanding how your property income should be taxed?

The ASSC and PASC UK have access to highly qualified, professional support in helping it understand how property income should be taxed. However, it must be reported that this is unlikely to be the case across wider membership.

12. Are you aware of any information being provided by third parties, for example letting agents or platforms to assist landlords in understanding their tax obligations?

We are aware of information being provided by letting agents and others. However, as these third-party professionals generally hold no relevant professional tax qualifications, have no ultimate responsibilities for our members tax liabilities nor hold the necessary insurances for any advice pertaining thereto, we do not consider such guidance to be apposite nor competent.

13. Do you think that third parties, such as letting agents, platforms or holiday rental agency businesses, could assist in easing tax administrative burdens and in what ways?

HMRC holds the taxpayers responsible for the correct calculation and declaration of their taxes – not the accountant or tax agent and not third-party platforms or rental agencies.

The platforms and rental agencies do not necessarily have a full picture of all of the taxpayers' earnings or business profits or of their other savings and reliefs. They cannot know taxpayers' pensions status or their overall financial status or other contributing or mitigating factors.

The ASSC and PASC UK, cannot see therefore, how this responsibility would be aided by transferring the burden to such parties and it is unclear in what way it would be possible to involve these third parties without creating additional confusion and an additional burden for taxpayers to ensure that their tax affairs were properly handled.

14. To what extent could it be helpful to landlords if letting agents, platforms or holiday rental agents provided data to HMRC on their behalf?

Such information may be helpful for HMRC to allow for corroboration of information supplied by taxpayers or their agents on their tax returns. However, we cannot see in any way how this might be beneficial to landlords.

Additionally, we see difficulties arising where information is incorrectly reported by such letting agents, platforms or holiday rental agents to HMRC on landlords' behalf. Reported experience suggests that the netting off of figures from these third parties may confuse matters further.

Many letting agents, platforms or holiday rental agents suffer the same level of confusion as reported above when it comes to matters of tax generally and struggle with tax administration in the same way. Thus, ASSC considers the involvement of third parties may serve to further complicate tax administration and result in an increased burden on taxpayers and their agents. This would seem counterproductive to the intention of HMRC.

15. What is your experience of completing a tax return to report property income? Are there any specific areas that cause difficulty?

Members of ASSC and PASC UK have reported challenges in the reporting of property related income in their tax returns. They have, variously, raised the following issues:

- What boxes should be ticked on the initial pages of the return?
- What pages should be completed and which can be ignored?
- What expenses can be legitimately claimed and where do I enter these on the tax return pages?
- Do I fill in the self-employment pages, the sole trader or the partnership pages, the property pages?
- Which property pages should I complete – the general property pages or the ones relating to furnished holiday lets?

- What allowances and reliefs can be claimed? Where do I enter these?
- What period do I report? Calendar year? The year from when I started my business? Or otherwise?
- Do I show net figures or gross figures?
- How do I report voids?
- Which figures go in the profit and loss account and go in the balance sheet (this is an interpretation of the actual confusion)
- What are all the other boxes on these pages for?
- Do I need to fill them in?
- Can I offset losses from one property or property business to another?
- Can I offset BTL profits against FHL profits?
- What can I claim capital allowances on?
- Is there a way I can legally reduce my tax liability for this year?

This list is far from being exhaustive, but serves to illustrate the difficulties our members experience.

16. Are there any other areas of tax administration that present particular challenges in relation to property income?

There is a requirement to file an SDLT return and pay tax relating thereto within 14 days. An LBTT return and payment must be made within 30 days. Likewise, with LTT returns. Whilst generally managed by the conveyancing solicitor, this creates an additional burden on the taxpayer where there are technical or administrative delays.

The government has introduced additional reporting 'in year' for property businesses. There is a relatively new requirement to report gains from disposals within 60 days of sale of a property. Again, technical or administrative delays can give rise to additional administrative burdens and stresses in relation to taxation.

There have been no discussions or references to inheritance tax throughout this call for evidence document. This aspect of the tax legislation and the correct administration thereof has huge implications for some of our older members.

17. Making Tax Digital for Income Tax starts in April 2024 and mandates quarterly electronic updates for most individuals with turnover of over £10,000 for their property (and business) income. Are you aware of these reporting obligations and have you considered how you might comply with them?

We are aware of these new measures being introduced from April 2024.

We are very concerned about the general level of awareness within our membership and equally concerned as to how our members will comply with their obligations. We do not believe all of our members will understand when to and how to determine whether they might be caught by these new measures. Some members may not have adequate computer-based systems to enable them to comply with the quarterly reporting requirements.

Many of our members will have appropriate professional support through their accountants or tax agents. However, many of our members will not have engaged such support and may not be aware that they might require such support.

18. Are there any other practical, technical and administrative issues in relation to property income that are not mentioned above?

As noted above, this paper does not address any of the systems or measures relating to the administration and collection of inheritance tax.

The paper makes no reference to the length of time required to speak to an HMRC officer via the telephone support line. Our members have reported waiting times of up to an hour. We would be grateful if this could be addressed as part of this consultation. Such response times add considerably to tax administration and the burden on our members.

Equally, our members report conflicting advice from these helplines in terms of how to resolve issues with HMRC – often arising from written HMRC communications.

There may remain some confusion with certain members over the Property Allowance. Anecdotally, one or two of our members believed that this allowance was in addition to the net profit arising from the property. There may remain some confusion elsewhere as to the correct application of the rules.

19. Are there any particular issues of concern to non-resident landlords or their tenants (including in relation to the Non-Residents Landlord Scheme)?

The ASSC and PASC UK are aware of the rules relating to the deduction of basic rate tax at source for oversees landlords by UK based agents or tenants. We understand there are a number of ways to confirm overseas landlords' tax liabilities and to recover overpaid tax.   We are unaware of any particular issues of concern in this area.

20. Do any particular issues arise for UK residents receiving rental income from overseas?

The ASSC is aware that there is a requirement to account for and report profits from overseas income via the foreign income pages of the tax return, and that this requires to be split between overseas property Income and overseas FHL income. We are unaware of any particular issues of concern in this area.