

## **Changes to tax relief for letting out partly furnished properties**

Many businesses receive capital allowances to recognise the depreciation of equipment used in the business. However, there are no capital allowances due for equipment bought for use in a residential property. The common types of expenditure under this heading would be beds, furniture, fridges and cookers.

There are exceptions to this rule for property which falls within the definition of a 'furnished holiday letting' and expenditure on assets which are used in the non-residential part of a block of flats, for example the hallways.

However, for many years, pre-dating the idea of capital allowances, HMRC had been prepared to allow some tax relief for expenditure on equipment in residential property which was let. This was by way of a concession.

In simple terms, where a taxpayer lets a furnished residential property, a deduction could be claimed for either:

- a wear and tear allowance of 10% of the 'net rent' from the furnished letting, designed to cover the depreciation of equipment; or
- the net cost of replacing a particular item of furniture, but not the cost of the original purchase. This is known as the renewals basis.

When capital allowances were brought in, no allowances were due for the equipment and furnishings in a residential property, so many letting businesses were limited to one of the above two reliefs. Owners of fully furnished lettings would normally opt for the wear and tear allowance. Owners of partly furnished properties could not use the wear and tear route and so used the renewals basis.

### **A change in April 2011**

In April 2011, wear and tear was put into 'proper law' but the legislation reaffirms that the allowance only applies to a dwelling containing sufficient furniture, furnishings and equipment for normal residential use.

### **Further changes in April 2013**

In April 2013 the non-statutory renewals basis was withdrawn.

This means that where a dwelling is let partly furnished, there are no capital allowances, no wear and tear and no renewals basis.

However, if costs are incurred on equipment and can be classified as a repair, relief will be given for these costs. In some cases, a repair will include the replacement of that item if that item can be regarded as a 'fixture' in the building.

### **So what is a repair?**

Whether expenditure is a repair can be complex and is governed by principles established in a number of tax cases. However, some basic principles apply for all types of repair expenditure.

The first principle is that the replacement of an entire asset is not a repair but if the asset is regarded as a subsidiary part of a larger asset (the building), the expenditure may be a repair. For example, a boiler and radiators installed in a residential property will have become part of the property. Therefore, the replacement of a central heating system would not be the replacement of the whole building and would be a tax deductible cost as a repair of the building.

The second principle, which may not always be relevant, is that buying an unusable asset and spending money to get it back into a usable state is not allowable. This contrasts with the situation of rectification work between tenancies which would generally be allowable. The fact the taxpayer had repairs carried out just after they acquired the asset does not, of itself, mean that the cost of the repair is not allowable but the issue of 'usability' can be important.

The third issue is that a significant alteration or improvement is not a repair and will not be allowable. A good rule of thumb is whether the character of the asset has changed. If it has, then the cost is not allowable.

As you can see, the whole area is difficult. Good records are essential where large costs are involved in order to justify the tax treatment of repairs if HMRC raise an enquiry into a tax return.

Please speak to us if you are considering significant expenditure in the above mentioned areas or if you have any more general questions regarding property income.