

CAN CAPITAL ALLOWANCES BE CLAIMED ON AN HMO — THE DEFINITIVE ANSWER...

By specialist property accountant Stephen Fay FCA

Many investors are confused about whether capital allowances can be claimed on residential properties, and in particular Houses in Multiple Occupation (HMO's). This article aims to clarify the current position (as at October 2015) so that investors have clarity about whether capital allowances are claimable on their HMO property.

WHAT ARE CAPITAL ALLOWANCES, AND WHY ARE THEY USEFUL?

When a property is refurbished, some of the costs will be treated as revenue costs and so offset against rental profits; whereas some costs may be capital and so are instead allocated against the purchase price of the property and tax relief is obtained on the sale of the property.

For landlords who do refurbishments which involve substantial capital costs, claiming capital allowances enables the capital element of the works to be claimed against rental income, as a 'capital allowance', and so are valuable for profitable landlords as such capital costs can be offset against rental profits, i.e. earlier than at some future point when the property is sold.

THE DEFAULT CAPITAL ALLOWANCES POSITION ON 'DWELLINGS'

The default position, in law, is that capital allowances are not claimable for a 'dwelling house' – the HMRC term for a residential property.

The HMRC definition of 'dwelling house' came from the 'Gravesham Borough Council v Secretary of State for the Environment (1982) P&CR 142' case. This case confirmed that *"the distinctive feature of a dwelling-house was the ability to afford to those who use it the facilities required for day-to-day private domestic existence."*

SINGLE-LET AND 'SHARED FACILITIES' HMO'S...

A single-let property is a 'dwelling' in its entirety, and so there are no capital allowances available at all for single-let properties (for the tax boffins, the legislation reference is Section 35(2) of CAA 2001, which states *"The person's expenditure is not qualifying expenditure if it is incurred in providing plant or machinery for use in a dwelling-house"*).

The position for a multi-let property (mainly HMO's, but could also include blocks of flats, student accommodation, etc.) is slightly different.

It is HMRC's 'official' view that capital allowances are not claimable where an HMO consists of a number of individual bedrooms, where the occupants share facilities such as kitchen, lounge and main bathroom – which is the layout for the large



Image: Eyedea.com/Andrew Reid

majority of HMO's. Therefore, just as with single-let properties, such HMO's do not qualify for capital allowances.

HMO'S WITH SELF-CONTAINED ACCOMMODATION...

Where a room in an HMO is entirely self-contained and provides within it all the facilities required for day-to-day private domestic existence, then it is the room that is the dwelling house and, in that context, the room is the part of the building that is the dwelling house. The common areas between each room, which may include hallways and staircases, are the common parts which would not comprise a dwelling house, and therefore capital allowances may be claimed on qualifying plant and machinery in those areas.

The key phrase above is *"all the facilities required for day-to-day private domestic existence"* – this means cooking and washing facilities, such that the occupant would have no requirement at all to access the remainder of the property. In practice, this would probably mean that a loo and shower / bath is required, as well as a kitchenette, so that a reasonable person would regard this as entirely self-contained. However the specifics of what *"all the facilities required for day-to-day private domestic existence"* means has not been tested in a Tax Tribunal.

In practice, the benefits of having a capital allowances survey completed on such a property would probably be fairly modest, given the cost of having a survey completed.

Therefore: **NO** single-let properties qualify for capital allowances, but **SOME** multi-let properties do.

NEW 'POOLING' REQUIREMENT FOR 'INHERITED' CAPITAL ALLOWANCES... APRIL 2014

As of 6th April 2014, capital allowances on second-hand assets are only available where the previous owner has 'pooled' (claimed in a tax return) the capital allowances prior to sale (the 'pooling requirement'), and the past owner and current owner must formally agree a value for capital allowances within two years of transfer (the 'fixed value requirement'), known as a Section 198 (or 199) Election.

In practice, this means that the seller will need to include the value of capital allowances in the seller's legal pack, which the new buyer then 'inherits' as part of the purchase. It is possible to apply to a 'First Tier Tax Tribunal' where the seller will not co-operate regarding capital allowances; however this would rarely be cost-effective.

The new owner of the property must be able to provide a Section 198 (or 199) Election, or a Tax Tribunal decision, to evidence that capital allowances can be claimed on assets inherited from a past owner when a property is purchased – otherwise, capital allowances cannot be claimed.

Note that capital allowances are available for capital expenditure incurred by the new owner for properties purchased after 6th April 2014, assuming that the property is a self-contained HMO (see above).

“Capital allowances are not generally available on residential property – the exception being HMO's with self-contained rooms.”

BUT, I KNOW OF OTHER INVESTORS WHO HAVE CLAIMED CAPITAL ALLOWANCES — HAS ANYTHING CHANGED?

RCB 45/10 was issued by HMRC in October 2010, which sets out the 'official' HMRC view about capital allowances on multi-let properties – as set out above – which significantly reduced the number of multi-let properties that could qualify for capital allowances, given that the large majority of HMO's do not meet

the 'self-contained' requirement. As a result, many landlords were able to make HMO capital allowances claims up to October 2010, whereas now it is quite rare for a claim to be made.

SUMMARY...

Capital allowances are not generally available on residential property – the exception being HMO's with self-contained rooms. As most

HMO landlords offer the usual 'bedrooms + shared kitchen / bathroom' arrangement, the large majority of HMO's will not qualify for capital allowances. For 'self-contained' HMO's, a claim for capital allowance is possible, although often the value of allowances, when considered against the survey cost, means that a benefit is often modest. For properties purchased after 6th April 2014, it is important to ensure that the seller has claimed any capital allowances available, to be passed on to the buyer, so that a claim can be made without the need for a Tax Tribunal (which is unlikely to be cost-effective to pursue).

Visit our website (www.fyldetaxaccountants.co.uk) for useful tools, tax tips and free reports

Is your accountant a property specialist?



Stephen Fay ACA

- ✓ **Specialist property team** led by Stephen Fay ACA
- ✓ **Tax-planning** services for property investors
- ✓ **500+** property clients - property is all we do!



fylde tax accountants
...the property specialists

Tel: 01253 398 082

Web: www.fyldetaxaccountants.co.uk