Dear Sir/Madam

Government consultation: Replacing the wear and tear allowance

Introduction
The British Property Federation (BPF) is the voice of property in the UK, representing businesses owning, managing and investing in property. This includes a broad range of businesses comprising property developers and owners, financial institutions, corporate and local private landlords and those professions that support the industry.

We welcome the opportunity to respond to the government’s consultation on the replacement of the wear and tear allowance.

General comments
The current wear and tear allowance is admittedly arbitrary and as such, we welcome the Government initiative to replace it with a system which reflects how much residential landlords actually spend on replacing furniture and appliances in their properties. In our view, the proposals set out in the consultation paper would be broadly simple to comply with, and are more closely targeted at expenditure actually incurred by taxpayers than the wear and tear allowance.

That said, we are concerned that the government is missing an opportunity to address a significant distortion in the way that residential and commercial buildings are taxed. Broadly, furniture and fittings in commercial properties are eligible for tax relief on both the initial expenditure incurred and any future replacements. However, investors in residential property would only able to claim a tax deduction for ‘like for like’ replacements of furniture and fittings.

Of particular concern is the impact these proposals could have on institutional or large scale investment in the nascent build to rent sector. Much of this investment will involve the development of new homes and therefore the initial fit out and furnishing costs could be quite substantial. Given the government’s aims to encourage investment in and a greater professionalisation of the residential rental sector, the distortion in tax treatment between commercial and residential property seems perverse.

The simplest solution to address this distortion would be to extend the capital allowances regime to investors in residential property. This would not only go some way to levelling the playing field between investors in commercial and residential property; it would also considerably simplify the tax legislation if the same system of relief on capital expenditure treatment applied to all property.

We understand that a primary objective of these proposals was to ensure that the system would not be overly complex for individual buy-to-let landlords, who currently represent the majority of private residential landlords in this country. It has been suggested that this constituency might find the
operation of capital allowances overly complex. However, the capital allowances regime is already used and understood by individual and sole trader businesses in the UK, so it is not clear why residential landlords should be considered less able to understand it. Furthermore, the current proposals would require landlords to maintain records of expenses incurred so to that extent; capital allowances would not impose any greater administrative burden.

Executive summary

- We appreciate the government’s desire to introduce greater fairness and simplicity into the tax system. We are fully supportive of the government’s ambition to introduce a system which provides relief for expenditure actually incurred.

- The Government should use this opportunity to address a significant distortion in tax treatment between commercial and residential property. Under the current proposals, there would be no relief for the initial fit out of residential properties, which from a tax perspective makes investment in residential property relatively unattractive compared to commercial property. This seems counter intuitive given the government’s desire to attract investment in housing, particularly from large scale institutional investors.

- We believe the simplest way to address this distortion is to extend the capital allowances regime to investors in residential property. Allowing the same tax treatment for all properties would also go some way to simplifying the tax legislation in this area.

- Should the government decide to go ahead with the proposals as planned, it will be necessary to address the practical issues associated with only providing relief of ‘like for like’ replacements. In particular, we would recommend that this relief should be available for like for like replacements and modern equivalents.

Detailed responses to the questions raised in the consultation paper are included at Appendix 1.

We remain at your disposal should you have any questions or require further details.

Yours faithfully,

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## Appendix 1: Response to consultation questions

### General comments

**Housing crisis**

It is widely recognised that the present housing crisis in the UK is a result of insufficient housing construction in recent decades. The government has recognised that this needs to be addressed not just by building new homes for sale, but also by increasing the stock of private rented sector (PRS) properties. Indeed, the creation of a taskforce whose specific remit is to kick-start institutional investment in the sector is evidence of the priority that the government ascribes to encouraging large scale institutional investors into this sector. One of the more exciting developments in this area is the prospect of new buildings specifically designed and destined for the rental market (‘build to rent’). The government has also committed seed funding for this purpose.

The PRS has historically been a difficult market to persuade investors into, due to the lack of good quality existing stock, the relatively low net yields compared to commercial property, and the relatively high management costs involved. However, some investors have begun to be attracted to this market by its potential for stable and sustainable income and for long term growth. Many recognise that, in a market traditionally focused on owner-occupiers, building new stock is the best way to create a new investment product (‘build to rent’), but this market is in its infancy at present. Much of the interest so far has been from some of the largest international pension funds and sovereign wealth funds from around the world, and they have needed to team up with domestic developers and property managers with the expertise to deliver and manage the product.

Given this backdrop, it is unfortunate that these proposals do not address a significant distortion in the tax treatment between commercial and residential properties in the UK. This consultation process represents a great opportunity for government to address a significant distortion in the current tax system and help to encourage more and better investment into the housing market.

### 1. Do you have any comments on the proposed scope of the new relief

Our primary concern is that the current proposals would only allow tax relief on the *replacement* of furniture and fittings in a residential property. This represents a key difference compared to commercial property, where investors are also able to obtain tax relief on the initial purchase of furniture and fittings (or plant and machinery in this context) through the capital allowances regime.

Given the lack of existing PRS stock in the UK, investors in this market will not only have to build new developments, they will need to fit out these premises. Under the current proposals, investors in PRS would receive a less favourable tax outcome compared to an equivalent fit out of a commercial property. This distortion seems perverse, particularly given the government’s desire to increase the provision of housing in this country.

In our view, the simplest alternative to the proposals under discussion and the current system would be to enable residential investors to access capital allowances, to encourage more and better quality investment into the market. This will go some way to addressing the housing shortage and also improve the quality and choice of housing options on offer. Furthermore, it would significantly
simplify the tax legislation if all real estate was subject to the same tax relief on capital expenditure. If the government is concerned about the additional cost to the Exchequer that this might entail; the percentage of capital allowances available on residential integral features could be introduced at a lower rate than that for commercial property.

As noted, we do not consider that the capital allowances regime would give rise to much greater complexity than the current proposals; landlords will need to keep records of their expenses in both cases. However, concerns around the potential complexity of the capital allowances regime for small landlords could be mitigated by offering landlords a choice of the basis on which they receive relief for capital expenditure (e.g. through a one off election for either the capital allowances regime or the renewals basis).

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?**

Should the government decide to implement the proposals as set out, we are concerned that the provision of tax relief for ‘like for like’ replacements is far too limited and creates a perverse incentive for landlords not to improve upon the furniture and fittings in their properties.

Any serious build to rent developer or manager would furnish their properties to at least the standard expected by their target market. As demands and expectations change in a particular market, so will the type and quality of furnishings in a residential rental property. If we consider the technological advances that have taken place in recent decades, it is impossible to consider what ‘like for like’ might be in 10 or 20 years time.

Furthermore, it seems illogical for the tax system to differentiate between a landlord that furnishes their properties with the bare minimum (with no element of improvement) and another landlord that considers it necessary to re-furnish every 3 years to ensure that their properties are fitted with the latest mod-cons. They are both making decisions on what type of furnishings are required based on the market they are attracting – but only the landlord replacing their furnishings with the bare minimum (i.e. on a strictly like for like basis) would be eligible for a full tax deduction for their expense.

To take a more extreme example; a landlord replacing fire safety equipment in their rental properties would not get full tax relief for regularly replacing equipment with the latest models featuring the most up to date advances in technology – a highly illogical and perverse outcome. In order to address this issue, we would recommend that the tax relief is made available for like for like replacements *‘or modern equivalents’*.

In respect of dealing with disposal proceeds of the old asset being replaced, we do not think it is unreasonable for residential rental businesses to keep track of disposal proceeds – as would be expected by any other business under the capital allowances regime. In practice, we would expect many used residential furniture and fittings to be replaced because they are broken or out of date and as such, are likely to at best have only nominal disposal proceeds.
3. **Are there additional impacts on individuals or other businesses that are not covered in the table of impacts?**

The table of impacts states that the expected annual and on-going cost to businesses of the additional administrative burden caused by the abolition of the wear and tear allowance is “...expected to be negligible.” In the current proposed form, we do not agree with this assessment. The proposed new relief will require each piece of furniture or fittings to be individually assessed when acquired to determine whether or not the new relief would apply and what element of the expenditure is an improvement.

Where tax relief is available to residential landlords on all expenditure, this burden would be significantly reduced.