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Residential Property Lettings

Changes to tax relief on finance costs

Changes announced in the Summer 2015 Budget Statement to restrict the tax relief on finance costs will be phased in from 6 April 2017.

What finance costs are affected?

- Mortgage interest
- Arrangement fees
- Early Repayment Charges

What are the restrictions?

Currently, the full amounts of qualifying finance costs are allowed as a deduction against rental profits. The measure restricting this relief is to be phased in from 6 April 2017 and replaced with a 20% tax credit, effectively removing higher rate and additional rate tax relief on finance costs.

What relief will be available?

2017/18	75% of finance costs are allowed in full, 25% will attract a 20% tax credit
2018/19	50% of finance costs are allowed in full, 50% will attract a 20% tax credit
2019/20	25% of finance costs are allowed in full, 75% will attract a 20% tax credit
2020/21	0% of finance costs are allowed in full, 100% will attract a 20% tax credit

Example 1

Gross rents £1,000 pcm, mortgage £175,000, interest only @ 2.5%, the individual is a higher rate taxpayer.

Gross rent	£12,000
Agent fees, Repairs, Insurance etc.	£4,000
Mortgage interest	£4,375
Profit before tax	£3,625

	Current rules	**Rules from 2020/21**
Tax Payable	£1,450	£2,325
Profit after tax	£2,175	£1,300

If the whole of your rental profit, excluding a deduction for finance charges, falls within the basic rate tax band, the tax credit, being 20% of your finance charges, will cover the additional tax arising as a result of the change in legislation.

Example 2

With the same circumstances as Example 1, but with interest rates having increased to 4%

Gross rent	£12,000
Agent fees, Repairs, Insurance, etc.	£4,000
Mortgage interest	£7,000
Profit before tax	£1,000

	Current rules	Rules from 2020/21
Tax Payable	£400	£1,800
Profit/(loss) after tax	£600	£(800)

In this example, whilst there is a profit before tax, due to the restriction of tax relief on finance costs, the tax liability exceeds the profit resulting in an overall loss for the year.

Where investment property ownership is highly geared the rise in tax liabilities will be exacerbated due to the increased exposure to finance costs.

What can be done?

Some landlords will consider disposing of part their residential property portfolio to pay off mortgages and reduce their exposure to finance charges. Others may 'switch' to commercial property, which will not be subject to these finance cost restrictions.

In some circumstances it is possible to transfer Buy To Let (BTL) property to a limited company, which will not be subject to this new rule. Careful planning is required to determine whether this is tax efficient, and to mitigate transactional costs so far as is possible.

Are there any other consequences?

As the interest is no longer deducted when calculating your income, your taxable income will be higher. This can have an affect on certain earnings related thresholds, such as for personal allowances, the high income child benefit charge and student loan repayments.

How can we help?

If you wish to discuss any of the matters raised here in more detail to see how they may affect your circumstances please contact your usual McBrides contact or Terry Baldwin on **020 8309 0011** or **terry.baldwin@mcbridesllp.com.**