BUY TO LET LANDLORDS FACE FURTHER TAX CHARGES

Over the course of 2015 the Chancellor has announced a series of measures designed to restrict the benefits for many, of owning more than one residential property. The effects of these measures will be especially felt by individuals, trusts and partnership that own buy to let residential properties.

Measure one: Mortgage interest relief restrictions - Summer Budget 2015

Landlords of buy to let properties are currently entitled to full income tax relief in respect of finance costs and mortgage interest paid at their marginal rate of tax. This means that a top rate tax payer can receive £45 tax relief for every £100 of mortgage interest paid in respect of their rental properties whilst the corresponding relief for a basic rate taxpayer is just £20.

The Chancellor announced during his Summer Budget 2015 that he intended to rectify this imbalance. Therefore, relief for the financing costs of buy to let properties will be restricted to 20% for all individuals, regardless of their marginal rate of tax. This measure will be phased in from 2016/17 onwards:

Tax year	Relief available for finance costs
2016/17	100%
2017/18	75%
2018/19	50%
2019/20	25%
2020/21	0%

Imbalance corrected?

However, the new measure does not mean that all taxpayers will be equal when it comes to obtaining tax relief for mortgage interest, despite the Chancellor's announcement that this will lead to a fairer system for basic rate taxpayers.

This is because from 6 April 2017, mortgage interest relief will be gradually replaced with a tax credit equal to 20% of the mortgage interest paid. This credit will reduce the overall amount of tax payable in respect of rental profits, once the tax due has been calculated. Therefore the traditional mortgage interest relief as a deduction against rental income will be completely phased out.

In reality, the way in which the credit is calculated affects landlords who pay tax at all rates and not just the higher and top rate taxpayers as alluded to in the Chancellor's announcement.

Year 2016/17 Vs Year 2020/21

The example below shows how the new tax credit will

affect all calculations of rental profits, irrespective of the applicable rates of income tax.

	2016/17	**2020/21**
Gross rental profits	£20,000	£20,000
Less mortgage interest relief	£15,000	N/A
Taxable rental profits	**£5,000**	**£20,000**

Taking the example further, if during 2016/17 the taxpayer has other income not exceeding £37,385, the rental profits of £5,000 are not significant enough to push income levels into the higher rate band. Therefore, tax payable in respect of rental income would be just £1,000 (£5,000 x 20%).

However, by 2020/21, the same taxpayer with the same level of income will see a significant increase in the amount of tax they will pay. Applying today's relevant tax bands to the rental profits shown in the example above, tax will be payable as follows:

	2020/21
Taxable rental profits	£20,000
Tax thereon:	
£5,000 x 20%	£1,000
(remainder within basic rate band)	
£15,000 x 40%	£6,000
(amount pushed into the higher rate)	
Tax due:	**£7,000**
Less tax credit for finance costs incurred: £15,000 x 20%	£3,000
Total tax payable on rental profits	**£4,000**

In this example, the taxpayer will be £3,000 **worse off** by 2020/21 as a result of the measure, with no increase in income levels.

It is worth noting that prior to the new rules taking effect the taxpayer's income was within the basic rate band. Therefore, it is clear that this measure will have the effect of pulling many basic rate taxpayers into the higher rate bracket, where traditionally they will have been used to paying tax at a lower rate. This could also have other knock on effects, such as the interaction with Child Benefit which is withdrawn once total income exceeds £50,000.

For those already paying tax at the higher and top rates, there will be a marked increase in the amount of tax they will pay. For 2016/17, higher and top rate taxpayers with rental profits as shown in the example above will pay tax of £2,000 and £2,250 respectively. However, from 2020/21, the comparison in respect of the same rental profits would be as follows:

Higher rate taxpayer:

Tax on rental profits 2020/21	£8,000
Less tax credit for finance	
costs incurred (£15,000 x 20%)	£3,000
Tax payable	£5,000
Increase in tax in real terms	**£3,000**

Top rate taxpayer:

Tax on rental profits 2020/21	£9,000
Less tax credit for finance	
costs incurred (£15,000 x 20%)	£3,000
Tax payable	£6,000
Increase in tax in real terms	**£3,750**

Measure Two: Stamp Duty Land Tax (SDLT) and Capital Gains Tax (CGT) changes for owners of multi properties

Two further stings in the tail were added for individuals who own, or intend to own multiple residential properties as part of the Autumn Statement 2015.

Firstly, a new measure was announced which will see SDLT rates increase by 3% for purchasers of buy-to-let properties and second homes.

In addition, from April 2019, any CGT due on the disposal of residential property will have to be made as a payment on account within 30 days of the disposal, rather than by 31 January following the end of the tax year of disposal.

The government will consult on the policy detail, including whether an exemption for corporates and funds owning more than 15 residential properties is appropraite

Time to plan

Although the changes are not immediate, it would be worthwhile for landlords of buy to let properties and owners of multiple properties to review their affairs now:

- It may become more tax efficient for landlords to use limited companies for property ownership in future especially as the corporate rate of tax looks set to fall again in 2017 to 19% and to 18% by 2020. The implementation of this option would require a full review of circumstances and consideration of future plans.
- In particular, it must be noted that a corporate structure will frequently create a double layer of taxation on the extraction of profits, or capital gains on the sale of a property.
- Landlords may wish to consider selling properties within a portfolio where mortgage levels are high.
- Finance arrangements should be fully reviewed with a mortgage or financial adviser.
- Plans to sell or transfer additional homes will require further exploration and advice should be sought as soon as possible.

For further help and advice, please contact George Lovell, glovell@dtegroup.com or Kirsty MacDonald kmacdonald@dtegroup.com or call 0161 767 1200.

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