MORTGAGE TAX RELIEF EXPLAINED

Written by **Harry Singh**

Harry Singh explores the changes set for April 2017, whereby the amount of tax relief which higher bracket landlords can claim will be gradually reduced until 2020

Starting on 6 April 2017, there are going to be changes to tax relief for buy-to-let property purchasers and pre-existing owners. In simple terms, those likely to be affected are individuals who collect rental income from residential property lettings and pay costs such as mortgage interest.

In money terms, it will restrict relief for 'finance costs' on residential properties to the basic rate of income tax. Finance costs include things like interest on a mortgage, interest on loans to buy furnishings, and any fees charged when taking out or repaying mortgages or loans.

Practically speaking, this means that come April 2017, landlords will be unable to deduct their finance costs from their property income to arrive at their property profits. They will instead receive a basic rate reduction from their income tax liability for their finance costs.

So, if you are a higher rate tax payer, up until 6th April you could claim relief at that level. Moving forwards, only the basic rate of 20% will be applicable. The aim is to ensure that those in the highest tax bracket do not receive the greatest benefit from the tax system.

A NUMBERS GAME

To minimise the shock, the change is to be introduced though a drip-feed system over four years, as follows (figures courtesy of the gov.uk website):

- In 2017 to 2018, the deduction from property income (as is currently allowed) will be restricted to 75% of finance costs, with the remaining 25% being available as a basic rate tax reduction
- In 2018 to 2019, 50% finance costs deduction and 50% given as a basic rate tax reduction
- In 2019 to 2020, 25% finance costs deduction and 75% given as a basic rate tax reduction
- From 2020 to 2021, all financing costs incurred by a landlord will be given as a basic rate tax reduction.

Let's imagine you were to purchase a property for £200,000, using a £50,000 deposit and a £150,000 mortgage, and were, for example, to charge your tenants £800 a month in rent. Right now, you would be the recipient of a net profit of approximately £2,160 a year but under the new system that would reduce drastically to around £960, according to estimates by Nationwide Building Society (detailed examples can be found at www.tmwdirect.co.uk, Nationwide's buy-to-let lending service).

CAN IT BE OFFSET?

Now, we have to be careful here; unequivocally, I am not talking about the possibility of tax evasion but rather sensible tax planning. There are potential ways to offset this new system, and I can't emphasise enough the need to seek trusted, expert advice before you make any changes to how you pay your tax.

If extra food for thought is needed here, consider the fate of a number of celebrities who got on board with the likes of Liberty and Ingenious Media in good faith thinking they were practising good tax planning, but, in reality, were signing up for what appear to be tax avoidance schemes. So be careful and be savvy; if it seems too good to be true, it probably is.

That said, there may be a number of acceptable routes to minimise your tax liability when it comes to the buy-to-let issue, including:

1. Choose (or switch to) a shorter-term, fixed-rate mortgage to get a lower rate of interest; please note, however, that there can be more to these mortgages than meet the eye. For example: starting rates are usually higher than on variable products, as they have higher arrangement fees; if interest rates drop, you won't receive any benefit; and, if you want to end the deal before the agreed date, there is likely to be a high early repayment fee.
2. You could place your property portfolio in a limited company, rather than holding it personally. You would then pay corporation tax, which is lower than income tax. It is important to note, however, that the tax man will treat any transfer of ownership of a property as a sale, so there could be a capital gains tax bill to pay. What's more, company ownership limits your mortgage options, because mortgage providers are less keen to lend to a company.
3. If your spouse is in a different tax band, you could transfer the property into their name, as long as doing that doesn't push them into the same bracket as you.

LOOKING TO THE FUTURE

There are probably more options out there and these may increase as people become better acquainted with the new system, so do stay alert for new opportunities. For the time being, however, you do have decisions to make to ensure you get the best possible deal, and, as always, I urge you to do your homework and seek expert advice before making a change. Her Majesty's Revenue doesn't care if you've been naïve or hoodwinked and forgetting the money owed for a second - think of the cost on your mental health if Hector the Tax Inspector finds anomalies…

The content of this article is for information purposes only and should not be relied upon when making business or legal decisions. It is recommended you seek the help of appropriate professionals to assess your needs fully before making any decisions and/or making changes.

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After qualifying from Leeds Dental School in 1996, Dr Harry Singh followed the traditional VT, associate and principal routes in dentistry, owning three dental practices along the way. Amongst these was 'Aesthetics', an award-winning private practice in Hertfordshire. He started to invest in property and found he was making more money from property and practising dentistry two days a week, rather than full-time. Two years ago he retired from dentistry to concentrate on the property side of his work. Harry wants to 'give something back' to his dental colleagues via the Dental Property Club, which is designed to share with members the information, expertise and knowledge he has gathered along the way.
WEBSITE: www.dentalpropertyclub.co.uk

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