

Buy-to-let landlords

Notwithstanding the increasing changes in the regulatory obligations that landlords have been required to observe in recent years, there have also been quite radical changes to the way in which property businesses are taxed. This fact sheet highlights two of these changes and offers strategies to minimise their effects. We have also added a short section pointing to the impact of HMRC's Making Tax Digital and changes to Capital Gains Tax since April 2020.

Finance charges – loss of higher rate tax relief

Far and away the most significant change has been the gradual withdrawal of Income Tax relief at the higher rates for finance charges, mortgage or loan interest. This process started in April 2017, and completed on 6 April 2020. Finance charges are no longer allowed as a deduction when calculating profits for tax purposes and are replaced by a basic rate tax credit.

There are two impacts to this change in tax relief:

- Higher rate tax payers will likely see an increase in their annual tax bills.
- Landlords who were previously considered basic rate tax payers could be promoted to be higher rate tax payers, and this would occur even if rental profits stayed the same. This again would result in increased Income Tax bills.

The second impact is particularly invidious. It occurs because as deductions of finance charges are gradually reduced (to be replaced with the basic rate tax credit) rental profits before tax will increase.

Consider Jo, whose rents for 2022-23 are £100,000 and loan interest is £80,000. Before the above changes commenced, her taxable profits 2017-18, at the same income and cost levels, would have been £20,000. Once the finance costs are fully disallowed, Jo's taxable income in 2022-23 will be £100,000 (not £20,000). Income Tax will be calculated accordingly, and much will be taxed at higher rates. She will be able to deduct a tax credit, based on finance charges disallowed, but only at basic rate Income Tax.

If rental profits were her only income, and with no increase or decrease in her rental income and costs, Jo's tax bill would increase from £1,800 2017-18, to approximately £11,000 2022-23.

Wear and Tear allowance exits

Since 2016, the 10% of rents wear and tear allowance was abandoned in favour of a new replacement furniture relief (RFR). The new relief does what it says on the tin, it allows you to write off the cost of replacing furniture, subject to a like for like condition.

Make sure you review any replacement furniture and equipment purchases to ensure you qualify for the RFR. Remember, if you sold the replaced item(s) you must deduct any proceeds of sale when calculating your entitlement, and note, this relief only applies to the replacement of existing items not the purchase of new items.



Making Tax Digital (MTD)

Your buy-to-let business is a trade and will be caught by the MTD process at some stage.

Essentially, you will be required to keep your rental business records in an electronic digital format that can be synced with HMRC's digital account that collects information for your tax affairs. Once a quarter you will be required to upload your data to HMRC to comply with the MTD regulations.

MTD for Income Tax is scheduled to commence from 6 April 2024. However, if you do not use accounts software to record your property business transactions (and you will need to confirm with the software supplier that it will be MTD compatible) then you should consider your options now. We can help. We have a number of accounting software options you could use.





Ideas to counter these tax changes

- If you are buying a buy-to-let residential property, consider allocating a nominal amount in the contract for any second hand furniture left in the property. In this way, if you subsequently replace the furniture, you can write off all the expenditure under the RFR. If you do not allocate sums in the contract you will have no legal claim to the furniture and you will not be able to claim RFR when you replace it. This strategy will also save you Stamp Duty Land Tax (Land & Building Transaction Tax in Scotland and the Welsh Land Transaction Tax) as this is not applied to the cost of furniture.
- Consider making a joint property election with your spouse to vary the split of any rental income in a proportion other than 50:50. This is a useful device to allocate income to the spouse with spare allowances or that is taxed at lower Income Tax rates. To be effective, you may need to change the legal or beneficial interests you both have in the property. This strategy will only work if the property is jointly owned.
- In certain circumstances it may be beneficial to incorporate your property business. However, great care should be taken in planning to see if this is feasible and if stamp duty and CGT costs can be legitimately avoided.
- Consider employing family members to assist with the management of your property interests. If there are sound commercial reasons for doing this, you should be able to make a successful claim against your tax. In this way you can reduce your exposure to higher rate tax and provide your family with additional income subject to deduction of tax at lower rates.
- Transfers of property (or a part interest) between spouses are generally free of CGT and IHT charges. This may enable you to direct rental profits into the hands of the spouse taxed at lower rates. Planning is key as in certain circumstances this may trigger a stamp duty charge.

Summary action list

- Consider options to reduce gearing (pay off loans and mortgages).
- Prepare forecasts for the next two to three years to fully understand the impact of tax changes on your property business.
- Consider involving spouse or civil partner in your property business.
- Work through the other planning possibilities set out in the section headed "Ideas to counter these tax changes".
- Take professional advice.

Changes to Capital Gains Tax (CGT) from April 2020

Any chargeable gains on the sale of residential property have to be submitted to HMRC within 60 days (30 days prior to 27 October 2021) of the sale completing. Any CGT due must also be paid in the same 60 day period.

This includes a property that you have not used:

- as your main home;
- as a holiday home;
- as a property which you have let out for people to live in;
- as a property that you've inherited and have not used as your main home.

This does not affect residential property owners where the property is used solely as a private residence and is covered by Private Residence Relief.

Conclusion

The reduction in tax relief for finance charges will have the greatest impact on landlords who have grown their property portfolios by maximising borrowings. In accountancy parlance, you are highly geared. One obvious solution is to reduce your loans and mortgages, but this may involve disposing of property and lead to additional, unwanted tax consequences.

As we have outlined above, ascertaining how your finances will be affected by the changes in tax relief for finance costs is critical. On the one hand you may not be affected if your property income, before and after the changes, is subject to Income Tax at the basic rate. But if your finance charges are significant, the loss of higher rate tax relief or the promotion of your property business into the higher Income Tax rates may require that you act now.

Readers who find themselves in this category should seek professional advice and quickly. We are ready to help, and willing to offer specific advice on any of the matters discussed in this document.

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