Get to know how your Buy-to-let profits will soon be taxed

New tax rules will come into effect on 6 April 2017. They will make buy-to-let less profitable for many.

What is Changing?

Currently, landlords deduct mortgage interest from their rental income, along with other costs so they don't pay tax on the *rent*, they pay tax on the *profit*.

From 2020/21, the rate of reduction is capped at the basic rate of tax, so it will be worth no more than £200 in every £1,000, instead of up to £450 at present. The new tax will be phased in, like this:

	Currently	2017/18	2018/19	2019/20	2020/21
Tax relief available on mortgage interest	100%	75%	50%	25%	0%

Why?

The government wants to encourage first time buyers and this tax change is one measure towards that. Stamp duty on additional residential property purchases rose to 3% at the start of this (2016/17) tax year.

We have yet to see if first time buyers can benefit from these changes. Certainly lots of residential property sales completed in the run up to the stamp duty rise (nearly double the levels from the year before, March 2015). Then, sales reduced again compared to 2015 and we will keep an eye on the trends after the new tax rates start.

What will the changes mean for me?

If you're a higher rate tax payer (40%) or an additional rate taxpayer (45%), you'll see your mortgage interest relief phased out over three years. Then, from 2020/21, mortgage interest relief will be limited to the basic rate of 20% for all rental property owners.

If you're a higher rate taxpayer, and your debt is high compared to the property value - as it is for many landlords - this change could be enough to end your profits.

For a worked example, download the pdf version of this blog post, here.

	Currently	Transitional Rules			New Rules
		2017/18	2018/19	2019/2020	2020/21 etc
Rent (after 'other' costs)	£10,000				
Actual Mortgage Interest costs	-£7,500				
Net Cashflow	**£2,500**				
Allowable Interest Reduces...	-£7,500	-£5,625	-£3,750	-£1,875	£0
...Taxable Profit Rises	£2,500	£4,375	£6,250	£8,125	£10,000
40% Tax calculated at this point	£1,000	£1,750	£2,500	£3,250	£4,000
Rising 20% tax credit reduces tax	£0	-£375	-£750	-£1,125	-£1,500
Tax	£0	£1,375	£1,750	£2,125	£2,500
But - revenue after mortgage cost was	£2,500	£2,500	£2,500	£2,500	£2,500
take off the tax	-£1,000	-£1,375	-£1,750	-£2,125	-£2,500
Cashflow profit after costs	£1,500	£1,125	£750	£375	£0

What should I do with my buy-to-let portfolio?

If you already own a rental property, should you change your mind? Sell? That depends. We do think you should take these three steps

1. Go back to the reason why - Why did you become a landlord?
2. Estimate your new tax liability - How much more will you pay?
3. Decide - Is being a landlord still right for you? Even if there's more tax, it might still suit your long-term plans, the cost could be worth it.
   - The new tax may reduce your net income, but the rent still provides a regular income stream.
   - The new tax doesn't affect capital growth.
   - If you own your property without a mortgage, you won't be affected.
   - 20% tax relief might be enough, especially if you are currently a basic rate taxpayer.
   - Not everyone uses buy-to-let as a business investment. If your aim is to help your children (or even grandchildren) to secure decent accommodation near where they study or work, this change might not be welcome, but may not get in the way.

Another important consideration is how returns on buy-to-let compare with the other options available. Rightly or wrongly, people often see investment in property as low risk; it is a 'real' asset and as such it is easy to understand, with values less volatile than equities. Anyone seeking an alternative safe haven for their money will struggle to find a deposit account offering more than 2% each year.

Tax relief on buy-to-let mortgage interest has always been a key selling point, but under the new regime, if you are a higher or additional rate taxpayers with a buy-to-let mortgage you will see your profits slashed.

At the moment, interest rates seem low, and the squeeze on landlords may only start as interest rates to rise. Selling now could put you in front of that, or you could lose out on more capital growth.

Owners and would-be buy-to-let investors need to consider the costs of managing a buy-to-let property, including repairs and any gaps in tenancy, and the management time, particularly if you self-manage. In addition, a rush to sell could lead to an unwelcome Capital Gains Tax bill – this is 8% higher on buy-to-let property than on other assets.

Whatever your situation, it is important to consider the alternatives before taking any action.
For example:

- Can you (reduce the tax payable on profits by) transferring ownership to a basic rate tax-paying spouse/civil partner? This might trigger a Capital Gains Tax charge and Stamp Duty charges but could be worth it.
- Could it be time to consider a limited company? Rental properties owned by limited companies are subject to a different tax regime it could be a tax-effective alternative to direct ownership. Again, transferring a property you already own could trigger Capital Gains Tax and stamp duty and mortgage options are significantly more limited for limited companies.
- The tax change is being phased in, so your buy-to-let might still make sense for several years.

Take advice
Direct investment in property is not for everyone. It is a long-term financial commitment which must be managed to maintain its value. Unlike stocks and shares, the capital value cannot usually be realised quickly and there are significant costs involved in both buying and selling property. These days there are plenty of options for those who don't want to tie up huge sums of money, but still wish to gain access to the property market. The main message is that it is important to get advice.

Please note: The Financial Conduct Authority does not Buy to Let mortgage or tax advice. The information is based on our understanding of current HM Revenue & Customs guidance which can change. Any reference to taxation is subject to your own personal circumstances and is subject to change.
Think carefully before securing other debts against your property. Your property may be repossessed if you do not keep up repayments on your mortgages.