

KPMG in the Channel Islands

GAT Newsletter: August 2016

Changes to tax relief for residential landlords

On 20 July 2016 HMRC formalised measures, first proposed in the 2015 summer budget, which will restrict the tax relief available for finance costs incurred by non-corporate landlords investing in residential property to the basic rate of tax from 6 April 2017.

What do finance costs include?

- Interest incurred on loans received to buy a property including interest on alternative finance agreements to the extent it represents an arm's length charge.
- In addition, other finance costs incurred for the purposes of the residential property rental business such as interest on overdraft, loans to buy furnishings, fees and incidental costs for acquiring lending.

Who do the rules impact?

- UK resident individuals that let residential properties in the UK or overseas;
- Non-UK resident individuals that let residential properties in the UK;
- Individuals who let such properties in partnership; and
- Trustees or beneficiaries of trusts liable for income tax on the property profits.

These measures do not affect commercial properties and do not impact upon residential property owned through companies (either UK or non-UK resident)

Current rules – Pre 6 April 2017

At present, where an individual or trustee receives income from renting a residential property they can offset allowable finance costs when calculating their tax assessable rental profit. Any unrelieved interest can be carried forward to future years.

Tax relief is granted in full on such costs, so where the recipient of the income is a higher (40%) or additional (45%) rate tax payer, the tax payer gets relief at that rate.



New rules – Post 6 April 2017

From 6 April 2017, the tax relief that landlords of residential properties get for finance costs will be restricted to the basic rate of tax (currently 20%) and finance costs will no longer be taken as a straight deduction from gross rental income when calculating tax assessable income.

Instead, once income tax on property and any other income sources have been calculated, the individual's liability would be reduced by a "basic rate tax deduction". For most landlord's, this will be the basic rate value of the finance costs.

Phasing in the restriction

Initially, not all finance cost deductions will be subject to the relief restriction as this is being phased in gradually. Over the next four years from 6 April 2017, these remaining deductions will be withdrawn and replaced with a basic rate relief tax reduction.

The split between finance costs allowed as a deduction from gross rental income and the amount subject to basic rate tax reduction is as follows:

Tax year	Percentage of finance costs deductible from rental income	Percentage of finance costs subject to basic rate tax reduction
2017/18	75%	25%
2018/19	50%	50%
2019/20	25%	75%
2020/21	0%	100%

How the basic rate tax deduction is calculated

The reduction is the basic rate value of the lower of:

- 1) Finance costs** – costs not deducted from rental income in the tax year, plus any finance costs brought forward
- 2) Property profits** – the profits of the property business in the tax year (after utilising any brought forward losses)
- 3) Adjusted total income** – the income (after losses and reliefs, and excluding savings and dividends income) that exceeds the individual's personal allowance

Please note that the tax reduction cannot be used to create a tax refund.

If the basic rate tax reduction is calculated using either 'property profits' or 'adjusted total income', then the difference between that figure and 'finance costs' is carried forward to calculate the basic rate tax reduction in the following years.

Corporate ownership and an opportunity for the Channel Islands

Corporate ownership of UK residential property has been under increasing scrutiny over recent years. However, these measures potentially give a boost to such structures and in certain circumstances could make owning UK residential property through a Channel Island company attractive.



Should you wish to discuss this topic in more detail, please contact one of our experts.



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