Tax relief changes for Landlords

Tax information is based on our understanding of the proposed tax legislation as at 16 January 2017, and may be subject to change.

No information in this document should be taken as tax advice. For advice you should consult with an independent tax adviser.

To help you understand how the changes could affect landlords, we've illustrated the following scenarios through the use of case studies.

All figures used in the case studies are for illustrative purposes only.

Please seek independent tax advice if you're uncertain as to how this affects your personal circumstances.

CASE STUDY 1 – Single property landlord 20% tax band

David has recently become a landlord and only has one property. His total annual income is £25,000, putting him in the 20% tax band. His income is made up of £15,000 employment income and £10,000 rental income. Currently David's mortgage interest payments are £4,000 and his running costs are £2,000 per year, leaving him with £4,000 gross profit from his rental property.

With current legislation, David is only required to pay 20% income tax on his £4,000 gross profit, rather than his rental income of £10,000. As a result of this David is only due to pay £800 income tax on his gross profit for 2016/2017 leaving him with a net profit of £3,200.

Once the tax relief changes have been fully implemented, David will be taxed on his total rental income (minus running costs) which equates to £8,000, rather than just his £4,000 gross rental profit. In this scenario David would be liable to pay £1,600 tax, however he is eligible for 20% tax relief on his mortgage interest payments (£4,000) so would get £800 deducted, leaving him with a total of £800 to pay.

This would still leave David with a net profit of £3,200 and he wouldn't be affected by the changes.

CASE STUDY 2 – Single property landlord 40% tax band

Deborah is a single property landlord. She has an annual employment income of £50,000 and earns an additional £10,000 from her rental income, giving her a total income of £60,000. Deborah has to pay 40% tax as she is a higher earner. Currently Deborah's mortgage interest payments are £4,000 and her running costs are £2,000 per year, leaving her with £4,000 gross profit from her rental property.

Being a 40% tax payer Deborah will be liable to pay 40% tax on her rental income profit which means she has to pay £1,600, reducing her total profit to £2,400.

After the tax relief changes are implemented in 2020, Deborah will be expected to pay 40% tax on her rental income (minus allowable costs) which means the tax she owes will go from £1,600 to £3,200. However, Deborah will be eligible for 20% tax relief on her mortgage payment (£4,000) which will total £800. This will have a substantial effect on her overall profit, reducing it from £2,400 to £1,600.

CASE STUDY 3 – Portfolio landlord, six properties, 20% moving to 40% tax

Ian is an experienced landlord with a portfolio of six properties. Annually his rental income from all six properties totals £60,000, his running costs are £12,000 and his mortgage payments are £24,000, giving him a gross profit of £24,000. Ian also has a employment income of £15,000 per year.

Under current legislation Ian is expected to pay £4,800 tax on his rental income - 20% of his total rental income profit, £24,000. Once tax due on his rental income is deducted Ian is left with £19,200 profit.

Once the new tax relief rules are implemented Ian will be taxed on his total rental income, minus allowable costs, totalling £48,000. As a result of this he'll be pushed into the 40% tax band and the tax due on his rental income will increase from £4,800 to £13,600. However, as Ian will be eligible for 20% mortgage interest relief, which equates to £4,800, the amount of tax due on his rental income will reduce to £8,800. Leaving him with a total profit of £15,200.

Ian's tax broken down

From 2020 Ian will have to pay tax on £63,000, his total annual income (£48,000 rental income and £15,000 employment income). His tax will be calculated as follows

£0 - £11,000	0% tax	= £0
£11,000 - £43,000	20% tax	= £6,400
£43,000 - £63,000	40% tax	= £8,000
	Total	**= £14,400**

From the total £14,400 Ian can deduct £800 that he has already paid on his employment income of £15,000. He can also deduct 20% in mortgage tax relief which is equivalent to £4,800, leaving him a total of £8,800 tax to pay on his rental income.

CASE STUDY 4 – Rental Cover, 40% tax payer, high mortgage costs

Olivia is a 40% tax payer and receives a rental income of £10,000 a year. Her current mortgage payments are £5,500 and her allowable costs are £2,000 a year. Under current legislation Olivia is liable to pay tax on just her rental income profit, which is £2,500. As it stands Olivia's tax bill would be £1,000.

From 2020, under new legislation Olivia will be charged 40% tax on her total rental income, minus allowable costs, equalling £8,000, not just her profit (£2,500). This means Olivia's tax bill will increase from £1,000 to £3,200. She will be entitled to £1,100 (20%) tax relief, reducing her overall tax bill down to £2,100, however her profit will decrease substantially from what it is now, reducing from £1,500 to £400.

Points to note:

1. Examples use 2016/17 tax bands and allowances for simplicity and comparability, but the actual bands and allowances are changing with effect from 2017/18 and expected to change in future years.
2. In addition, there may also be other impacts of having taxable income increased by the new rules, such as a reduced tax-free personal allowance, a Child Benefit High Income Charge and impact on Working Tax Credits or Child Tax Credits.
3. Other finance costs may also be impacted – for example mortgage product arrangement fees.

Tax relief changes calculator

We've developed a calculator that you can download. This will help you understand how your profits could be affected over the next few years as the changes are phased in.