

WELCOME relief

Recent press reports have indicated that the buy-to-let market is due something of a renaissance, fuelled by a surge in the private-rented market.

For property landlords, this can only be good news. Some of the UK's biggest banks are even re-evaluating their buy-to-let packages, having previously considered it a risky area of lending.

Also seen as a grounds for optimism is the change in rules governing self-invested personal pensions that from April 1 next year will allow landlords to put residential property into their pension funds. The Council of Mortgage Lenders (CML), which follows the mortgage market, has put the amount of money lent in the buy-to-let market in the first half of the year at nearly £10 billion pounds.

And yet, while the figures show a booming market, landlords could be missing out on thousands of pounds of mortgage interest relief.

This is the warning from Kent accountants Burgess Hodgson. Partner Ken Jones anticipates that, as more and more people buy (and let) property as part of their pension funds, this mortgage interest relief will become increasingly relevant.

It's certainly a situation that the tax team at Burgess Hodgson see every day, particularly being based in Canterbury, which boasts in the region of 30,000 students. Like many university towns, Canterbury contains virtually whole streets of rented student accommodation – and landlords that could be missing out.

It's a simple principle – and one that now seems to be accepted by the Inland Revenue. In essence, it allows the interest relief on loans on let property to be claimed on borrowings up to the original cost of the property.

While it's not new as such, it does mark a change in the Inland Revenue's thinking, as partner Mike Horne explains: "Lots of practices grew up over the years with taxation of property, with differences between property that was furnished or unfurnished, or that was let to relatives.

"It was all very complex. But with the advent of self-assessment, the Inland Revenue had to sweep it away and come up with a more straightforward system that could deal with it."

This new system is the revised Schedule A, which came into force in 1995/6. This now works on normal accounting principles like any business and 'proprietors' can withdraw capital from the 'business' and replace it with borrowed funds.

"This is a more business-like calculation of what is profit," explains Mike. "Although the change happened nearly ten years ago, it is only recently that the IR has started to relax the rules for claiming repairs."

For example, previously it was only possible to replace a window with the exact same window, whereas it is often cheaper to put more modern windows in – such as replacing a Victorian sash with a modern, double-glazed alternative. This is now allowed under the IR's new 'relaxed' rules – even a designer kitchen can be classed as a 'repair' – and all allowable for tax relief.

The latest change concerns the interest paid, and specifically, whether an individual can claim tax relief. "There are nearly a dozen reasons to claim specific interest relief," says Mike, such as purchase of a share in a partnership or, as in this case, the purchase of a property for letting. "If that loan qualifies for the purchase of a property for letting, it would always qualify for interest relief.

"But, if you used your own money, previously, and then replaced it with a loan, that would simply be raising finance, and therefore never qualify. With the advent of the change of basis to business, as long as it's goods for business purposes, then the loan will qualify for full tax relief – a fact that not everyone realises!"

The working capital of a business includes the amount of money an individual puts in to finance the capital assets, such as the purchase of a property. If he then buys a property, he can put it into this 'notional' business; subsequently, if he then wants to take out the value of the property he put in, he can raise a loan with a bank of building society, take the money out (so it is now financed by the bank rather than the individual) and then qualify for full interest relief for tax purposes – up to 40% of the interest.

"It's really a change in the understanding of how the Revenue practice works," says Ken. "It's important because nowadays, lenders are doing interest-only mortgages on let property for very long periods. In the example below, the individual will get interest relief on £75,000 of the £100,000 he's remortgaging to, because he effectively gets interest relief up to the original amount he put in."

In effect, it means that people who have property portfolios that have gone up in price, can borrow 70% of the new value quite easily, enabling them to take out their original deposit and use that for their own use. "Also, if you are re-mortgaging up, you can do that and get the deposit on your next property," says Ken. "It could help you build a portfolio of properties and take money out in an extremely tax-efficient way."

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