Law Society (NI) Financial Advice

BUY-TO-LET INVESTORS BEWARE!

Investing in Buy-to-Let properties has been an attractive option for individuals looking to plan for their retirement or diversify their portfolio. The market has been fuelled by investors' ability to use borrowing to leverage against their existing capital and generous tax reliefs have been available on the interest part of a Buy-to-Let mortgage.

How does the leveraging work and why has it been advantageous?

Let us take the example of an individual with £25,000 to invest. If they invest that in the stock-market and the market rises by 10% they will have made £2,500.

However if they used that £25,000 as a 25% deposit on a Buy-to-Let mortgage they could buy a property for £100,000. If that property's value rose by 10% they would have made £10,000 (assuming of course that the rent covered any mortgage payments).

There are lots of downsides to be wary of as well, so Buy-to-Let should not be seen as some sort of panacea investment. Periods of un-occupancy, building repairs, negative equity, impact on wider borrowing affordability, interest rate rises etc can all prove very damaging to an individual's affairs and so it is not something to enter into lightly. I suppose the adage would be if it works it works very well but when it doesn't work it can be stressful and financially detrimental! In any event if you have a Buy-to-Let property you need to be aware of the tax changes.

So what are the changes to Buy-to-Let property taxation?

In the July Budget the Chancellor announced two major changes to taxation that will impact on the attractiveness of Buy-to-Let's going forward.

Tax relief on mortgage interest

The first applies to the tax relief on interest on any Buy-to-Let mortgages. Currently, full relief is given but going forward this in effect will be reduced to basic rate. For example a 40% tax paying individual with £20,000 of rental income and £15,000 of mortgage interest on the property would only pay tax on £5,000. Tax is therefore (£5,000 x 40%) £2,000.

Going forward however they will be assessed as having £20,000 income, which equates to an £8,000 tax liability. Against this liability they will obtain a reduction of £3,000 (£15,000 x 20%). This leaves them with a tax bill of ££5,000 which is £3,000 more than under the previous regime. The rules are to be phased in between now and 2020.

Wear and tear allowance

The second change affects wear and tear on furnished property. Under current rules the landlord can deduct 10% of the net rent even if they didn't spend any money on wear and tear in that particular year. The proposal is that relief will now only be available for actual expenditure on qualifying furnishings. This will probably result in an increased tax bill for most people.

So is there anything that can be done?

As always, it is very important not to let the tax tail wag the dog. There may be ways of structuring your affairs that are more tax efficient. Interestingly the proposed restriction on interest tax relief does not apply to companies which own Buy-to-Let properties which has led many people to consider incorporating their existing Buy-to-Let properties into a company. This is unlikely to be appropriate for the vast majority of individuals because of the complexity and potential costs but it is an example of where the specialist advice available from the Law Society's financial advice arm can benefit lawyers, their families and their clients.

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