Buy-to-lets and mortgages can be a minefield...

THE PURCHASE of buy-to-lets has for many years been a popular form of investment planning for retirement and handing on to the next generation.

The availability of mortgages to help with these purchases helped, as did the tax relief that could be claimed by offsetting the interest on the mortgage against the rental income.

This tax relief was at the taxpayer's rate of tax, so those paying tax at 40 per cent received relief on the interest at 40 per cent.

Since 2017 the availability of this relief has been phased out and since April 6, 2020 it has been possible to claim relief at only 20 per cent.

The main change was how this relief was applied, in that whereas previously the interest had been a tax-deductible expense, it is now a "below the line" tax credit.

What does this mean?

A tax credit is deducted from your tax liability after it has been calculated to work out the amount payable.

When the interest was a tax-deductible expense, it reduced the amount of rental income for tax purposes.

If the landlord had income below the 40 per cent threshold because of the mortgage interest, the removal of this expense may have the impact of taking the total income into a higher tax bracket.

Income may then be taxable at 40 per cent or even 45 per cent, with the tax credit being only 20 per cent.

Some taxpayers who prepare their own returns may not have been aware of this change and HMRC have regularly sent out letters not only to pick up additional tax from undeclared rental income, but also incorrectly-claimed mortgage interest.

Any unpaid tax assessed in this way will also be subject to interest and penalties.

If HMRC consider the errors were deliberate, these penalties can be 100 per cent of the "tax lost".

If you have a rental property and are unsure what expenses are allowable or how to claim the tax credit, please give us a call.

Butler & Co has a local and national reputation for providing excellent advice and first-class service together with a high level of client care and communication.

Please do not hesitate to contact us on 01962 735544 or by email at infobutler@butler-co.co.uk

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