

Changes to tax relief for residential landlords – worked examples

Example 1: impact before and after the restriction where there's no increase in tax

Sophia is an individual with a yearly rental income from residential property of £52,000 as her only source of income.

Her mortgage interest is £20,000 per year.

Before restriction (2016 to 2017)

Property income calculation:

Rental income =	£52,000
Finance costs =	£20,000
Other allowable expenses =	- £9,000

Property profits =	<u>£23,000</u>
Total income =	<u>£23,000</u>

Income Tax calculation:

£11,000 x 0% =	£0
£12,000 x 20% =	£2,400
£0 x 40% =	£0

Final Income Tax =	<u>£2,400</u>
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After restriction (2020 to 2021)

Property income calculation:

Rental income =	£52,000
Finance costs (£20,000) =	Nil deduction
Other allowable expenses =	- £9,000

Property profits =	<u>£43,000</u>
Total income =	<u>£43,000</u>

Income Tax calculation:

£11,000 x 0% =	£0
£32,000 x 20% =	£6,400
£0 x 40% =	£0

Less 20% tax reduction for finance costs (£20,000 x 20%)	-£4,000
Final Income Tax =	<u>£2,400</u>

The tax reduction is calculated as 20% of the lower of:

- finance costs (100% of £20,000) = £20,000
- property profits = £43,000
- adjusted total income (exceeding Personal Allowance) = £32,000

The lowest amount is finance costs, so £20,000 x 20% = £4,000 tax reduction.

Sophia is one of the estimated 82% of landlords that don't have any additional tax to pay because her total income, without a deduction for finance costs, doesn't exceed the higher rate threshold.

Example 2: impact before and after the restriction where there's an increase in tax

John's an individual with self-employment income of £35,000 and rental income from residential property of £18,000 per annum.
His mortgage interest is £8,000 per year.

Before restriction (2016 to 2017)

Self-employment income =	£35,000
Property income calculation:	
Rental income =	£18,000
Finance costs =	- £8,000
Other allowable expenses =	- £2,000
Property profits =	<u>£8,000</u>
Total income =	<u>£43,000</u>

Income Tax calculation:

£11,000 x 0% =	£0
£32,000 x 20% =	£6,400
£0 x 40% =	£0
Final Income Tax =	<u>£6,400</u>

After restriction (2020 to 2021)

Self-employment income =	£35,000
Property income calculation:	
Rental income =	£18,000
Finance costs (£8,000) =	nil deduction
Other allowable expenses =	- £2,000
Property profits =	<u>£16,000</u>
Total income =	<u>£51,000</u>

Income Tax calculation:

£11,000 x 0% =	£0
£32,000 x 20% =	£6,400
£8,000 x 40% =	£3,200
Less 20% tax reduction for finance costs (£8,000 x 20%)	-£1,600
Final Income Tax =	<u>£8,000</u>

The tax reduction is calculated as 20% of the lower of:

- finance costs (100% of £8,000) = £8,000
- property profits = £16,000
- adjusted total income (exceeding Personal Allowance) = £40,000

The lowest amount is finance costs, so $£8,000 \times 20\% = £1,600$ tax reduction.

John becomes a higher rate taxpayer because of the change as his total income is more than the higher rate threshold of £43,000. John has an additional £1,600 tax to pay.

If John or his partner is claiming child benefit, he may have to pay a [High Income Child Benefit Charge](#) because his total income is now over £50,000.

Example 3: impact of first year of phased reduction of finance cost

The first tax year that finance cost will be reduced is 2017 to 2018. This example shows the withdrawal of 25% of finance cost deduction and given as a basic rate tax reduction.

Jennifer has employment income of £25,000 and rental income from residential property of £11,000 per year. Her mortgage interest is £8,000 per year.

Salary before tax = £25,000

Property income calculation:

Rental income = £11,000
 Finance costs (£8,000 x 75%) = - £6,000
 Other allowable expenses = - £500

Property profits = £4,500
 Total income = £29,500

Income Tax calculation:

£11,000 x 0% = £0
 £18,500 x 20% = £3,700
 £0 x 40% = £0

Less 20% tax reduction for remaining finance costs calculated on 25% of finance costs (£8,000 x 25% = £2,000) x 20% -£400
 Final Income Tax = £3,300

The tax reduction is calculated as 20% of the lower of:

- finance costs not deducted (25% of £8,000) = £2,000
- property profits = £4,500
- adjusted total income (exceeding Personal Allowance) = £18,500

The lowest amount is finance costs, so $£2,000 \times 20\% = £400$ tax reduction.

Example 4: carrying forward unused finance costs

In the tax year 2020 to 2021 Brian's annual salary before tax is £36,000 and his rental income is £20,000. The property was empty for 2 months while he found a new tenant, during that time he carried out some repairs on the property. Brian's mortgage interest was £15,000 and he had other allowable expenses of £7,000 due to the repairs he carried out.

Tax year 2020 to 2021

Salary before tax = £36,000

Property income calculation:

Rental income = £20,000

Allowable non-finance costs = - £7,000

Property profits = £13,000

Total income = £49,000

Income Tax calculation:

£11,000 x 0% = £0

£32,000 x 20% = £6,400

£6,000 x 40% = £2,400

Finance cost tax reduction calculated
on property profits (£13,000 x 20%) -£2,600

Final Income Tax = £6,200

Brian's tax reduction is calculated as 20% of the lower of:

- finance costs = £15,000
- property profits = £13,000
- adjusted total income (exceeding personal allowance) = £38,000

The lowest figure is property profits, so £13,000 x 20% = £2,600 tax reduction. The £2,000 finance costs (£15,000 - £13,000) that haven't been used to calculate his basic rate tax reduction are carried forward to calculate his basic rate tax reduction in the following year.

In the tax year 2021 to 2022, Brian's salary is £36,000 and his rental income is £24,000. His mortgage interest is still £15,000 and he has other allowable expenses of £2,000.

Tax year 2021 to 2022

Salary before tax = £36,000

Property income calculation:

Rental income = £24,000

Allowable non-finance costs = - £2,000

Property profits = £22,000

Total income = £58,000

Income Tax calculation:

£11,000 x 0% =	£0
£32,000 x 20% =	£6,400
£15,000 x 40% =	£6,000

Finance cost tax reduction calculated on finance costs (£17,000 x 20%)	<u>-£3,400</u>
Final Income Tax =	<u>£9,000</u>

Brian's tax reduction is calculated as 20% of the lower of:

- finance costs (£15,000 of the current year and £2,000 brought forward) = £17,000
- property profits = £22,000
- adjusted total income (exceeding personal allowance) = £47,000

The lowest amount this year is finance costs, so £17,000 x 20% = £3,400 tax reduction.