The chancellor’s plan to remove mortgage interest tax relief, announced in the Budget and effective from 2017, will hit hundreds of thousands of property investors. George Osborne at a stroke wiped almost 11% off the gross returns from buy-to-let properties, leaving many landlords facing the prospect of a future with increasing year on year losses, when he slashed higher-rate relief on mortgages in the Budget.

These losses could compound further should interest rates rise. This tax change, which begins in 2017, will see landlords lose a quarter of their higher-rate relief each year until 2020, when it will be restricted to 20% on all mortgage interest.

**How to beat the tax changes**

If landlords remortgage now, they will protect themselves against rising borrowing costs and they may be able to claw back the shortfalls from the new tax changes. With tax relief available to higher-rate taxpayers being phased out, it will become more important for landlords to reduce their borrowing costs.

**Remortgage**

As an example, if a buy-to-let landlord is paying 5% on a typical £120,000 mortgage, which has a rental income of £750 per month or £9,000 annually. After allowing for expenses, agents’ fees and mortgage interest he could be left with a £612 annual profit after tax.

However, when tax relief is reduced to 20% this £612 profit turns into an annual loss of £588. By remortgaging typically at, 3.79% with a five-year fixed-rate loan, he could save £1,452 annually on his interest bill, turning that annual loss back into a profit of £574.

By taking no action and if interest rates rise to say 7% by the time that higher rate tax relief has completely disappeared in 2020, you could be looking at an annual loss of £2,784.

**Utilise your spouse’s personal allowance**

When a profit is made, if your spouse is not working, you may be able to assign part or all of the rental income to them, allowing them to exploit their personal tax allowance.

**Form a company**

The Government is cutting corporation tax to 19% in 2017 and 18% in 2020. One way for higher-rate taxpayers to cut their tax bills might be to invest via a company, but proceed with caution, as there can be complications. By being a business, all costs can be offset against rental income, so in theory profits may be further improved. Within a business, income can only be paid out to the directors as a dividend. From next April they can each receive £5,000 annually tax free. After that, dividends paid to higher rate taxpayers are reduced by 32.5%, while basic-rate taxpayers pay a 7.5% dividend tax.

**Reduce borrowings by selling**

Some landlords, as a consequence of this new tax law, may review selling up or paying off some of the loan, while others will wish to reorganise their arrangements. Where a landlord has a portfolio, it may make sense to sell one property and reduce the borrowings on the others.

**Rent increases**

Many professionals believe rents will have to rise, due to the chancellor’s tax change. There has been a substantial shift, with rents climbing faster than property prices, but now there is still further to go, particularly given that landlords have been targeted in the Budget.

**Where do I get more help?**

This article aims to give some informal hints and tips. We recommend that you always seek professional financial advice. Our financial services company, McPhersons Financial Solutions are offering free advice so please get in touch to arrange a meeting 01424 730000 or info@mcphersonsf.com.co.uk.

The value of your investment and the income from it can go down as well as up and you may not get back the original amount invested. Past performance is not a reliable indicator for future results. Levels, bases and reliefs from taxation are subject to change and their value depends on the individual circumstances of the investor. Please contact us for further information or if you are in any doubt as to the suitability of an investment.