

## Deduction for Mortgage Interest on Buy-To-Let Properties

Interest charged on loans and mortgages that are used to purchase property for a rental business or to pay for repairs and maintenance is an allowable expense when calculating the rental business profits or losses.

However, following an addition to the HM Revenue & Customs (HMRC) internal guidance manuals, the way in which they approach this subject has been relaxed, and now follows accounting principles more commonly associated with sole trader and partnership accounts preparation. This is good news for people with buy-to-let properties.

Up until now, loan interest was not allowable if the loan was used to extract personal funds from the rental business. However, now it would seem that as long as any withdrawal does not make the capital account overdrawn (i.e. that the amount withdrawn is not more than the difference between the cost of the property, plus any improvements and any charges against it such as the mortgage) then the interest would still be allowable. The best way of showing this is by using the HMRC's own example: -

Mr A owns a flat in central London, which he bought ten years ago for £125,000. He has a mortgage of £80,000 in the property. He has been offered a job in Holland and is moving there to live and work. He intends to come back to the UK at some time. He decides to keep his flat and rent it out while he is away. His London flat now has a market value of £375,000.

The opening balance sheet of his rental business shows:

|                 |          |                          |          |
|-----------------|----------|--------------------------|----------|
| Mortgage        | £ 80,000 | Property at market value | £375,000 |
| Capital account | £295,000 |                          |          |

He renegotiates his mortgage on the flat to convert it to a buy to let mortgage and borrows a further £125,000, which he then uses to buy a flat in Rotterdam.

The balance sheet at the end of year one shows:

|                 |            |                          |          |
|-----------------|------------|--------------------------|----------|
| Mortgage        | £205,000   | Property at market value | £375,000 |
| Capital account | £295,000   |                          |          |
| Less: Drawings  | (£125,000) |                          |          |
| Carried forward | £170,000   |                          |          |

Although he has withdrawn capital from the business the interest on the mortgage loan is allowable in full because it is funding the transfer of the property to the business at its open market value at the time the business started. The capital account is not overdrawn (HMRC Manuals BIM45700).

It would also seem that Mr A could also withdraw another £170,000 and the interest on this additional amount would still be allowable against the rental income.

Going forward with this example if Mr A did have another mortgage to fund the purchase of his own new main residence, it would be worthwhile withdrawing the £170,000 and using this to reduce his own mortgage. This way, the actual amount that Mr A borrows from the bank remains the same, (i.e. the buy to let mortgage increases by £170,000 but his own home mortgage decreases by £170,000) but now more of the interest is allowable for tax purposes. Although, buy to let mortgages may have a higher interest rate than other mortgages, for much of the time, the higher rate tax relief available on the additional interest more than levels out this inconsistency.

### **Using a loan against your own home**

Where equity in the main home is used to fund or partly fund the purchase of a buy to let property, the interest charged on this will be an allowable deduction, as long as the equity funds are used entirely for the rental business. It is recommended that there is proof that the funds have been used in the business. For example it should be shown that the date of the equity release ties in with the date of completion of the buy to let property. The mortgage statement and the completion statement should confirm this.


In many instances, the main home will be in joint names but the purchase of the buy to let will be in one spouse's / civil partner's name only. As long as the rental business actually pays the interest due from the increase in the mortgage, then HMRC will allow it as a deduction.

### **Conclusion**

The HMRC guidance is a welcome relaxation on the rules governing allowable mortgage interest. Many buy to let investors have seen growth in their property portfolios and now by re-mortgaging, some of the original equity can now be released. Even if the released funds are used for personal purposes, any loan interest from the increased mortgage can be set against the rental income.

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