Will the next two years see the death of the accidental landlord?

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In August 2017, Simon Lambert wrote in the Mail Online that "The death of buy-to-let has been greatly exaggerated, however it still remains attractive enough for investors to keep buying, even if the great British property dream is now skewed further towards the wealthy who can buy in cash"

Only one of his conclusions was right; being that BTL still remains attractive for landlords to keep on buying, but only if they're prepared to treat it like any other business, on which more later.

The fact that landlords in general are an easy, visible, and politically convenient target to one side, governments of any hue don't typically bother to regulate (licence) or tax failing industries. The one exception being if we end up with a Corbyn/Labour led administration who tax the 'rich' in order to support their union paymasters, in which case being an accidental landlord or otherwise will be the least of our worries.

In a similar vein, whatever kind of 'Brexit' we get, demand exceeding supply will continue for the foreseeable future (especially when it comes to social housing). Likewise, flexible housing solutions, Generation Rent, Rentvesters, and Donut Economics, all contribute to that opportunity continuing.

Once you strip out the hyperbole (mine included), what has actually happened is that the PRS (Private Rental Sector) now has the opportunity to transform itself from an accidental industry into a professional one, and in the process gain all the advantages that any other business sector would – and that means equal tax treatment.

First things first though – what do the George Osborne tax changes mean in practice.

1. 3% Stamp Duty (SDLT) uplift

This is a transactional tax i.e. it's just the cost of doing business – in other words, what comes around goes around, but it's a lot better than its 18th century predecessors, Window Tax and Georgian Clock Tax. Government justified the clock tax by arguing that people wealthy enough to afford a clock or watch would be able to pay the tax, just like today's landlords!

2. Expenses etc. now only allowable in the tax year in which the money was spent regardless of whether that was a loss-making one or not

Being able to carry losses forward was always an anachronistic contradiction, as it's more applicable to capital gains rather than income. That said, a business only exists to make a profit, so making a loss, even if it's just for tax purposes, is counter-intuitive.

3. 10% CGT surcharge for investment assets

That measure alone can often make basic rate taxpayers higher rate ones by the stroke of a pen and can have a huge knock-on effect thanks to S24. CGT really is a voluntary tax; after all, why would you sell an income producing asset simply to spend it all over again unless the expected return on that new investment is more than sufficient to cover the sunk costs and taxes.

4. S24 - the amount of mortgage interest higher-rate taxpayers are able to offset

This measure alone will kill off not just the accidental landlord, but even those who have dedicated their working lives to providing long-term quality housing as if they were a social landlord.

We know of landlords who despite housing hundreds of families, employing numerous staff, and paying tax like everybody else, are being forced out of business simply by the tax escalator effect. In other words, as their tax bills rise, the more tax they have to pay in advance, to the point where in 2020/21 the tax due will exceed their profit, and that's without taking into account their ability to borrow less because of the PRA rules on BTL mortgages.

The graphics below illustrate what S24 alone will do to your tax bill and growth plans. Based on the numbers shown, the higher rate taxpayers will see their tax bills over double, (Figures 1, 2 + 3).

Here are three example scenarios	1) Basic Rate Tax Payer becomes Higher Tax Payer	2) Higher Rate Tax Payer loses their personal allowance	3) Higher Rate Tax Payer becomes Advanced Rate
Rental Income	£80,000	£160,000	£250,000
Allowable Expenses	£20,000	£30,000	£50,000
Mortgage Interest	£40,000	£70,000	£120,000
PAYE Salary	£20,000	NIL	NIL
THE IMPACT OF S24 IF NOTHING IS DONE:			
Pre S24 - 2016 - 17 Tax Bill	£5,800	£13,200	£21,200
2018 - 19 Tax Bill	£8,360	£19,360	£37,100
Post S24 – 2020 Tax Bill	£11,500	£30,500	£51,000

Figure 1

"The real accidental landlord will have no choice but to leave the market and employ their capital elsewhere"

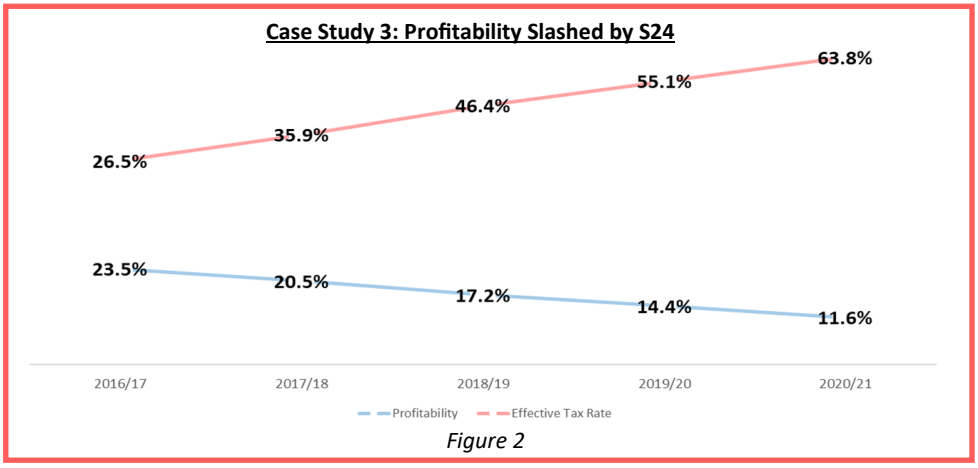

Figure 2

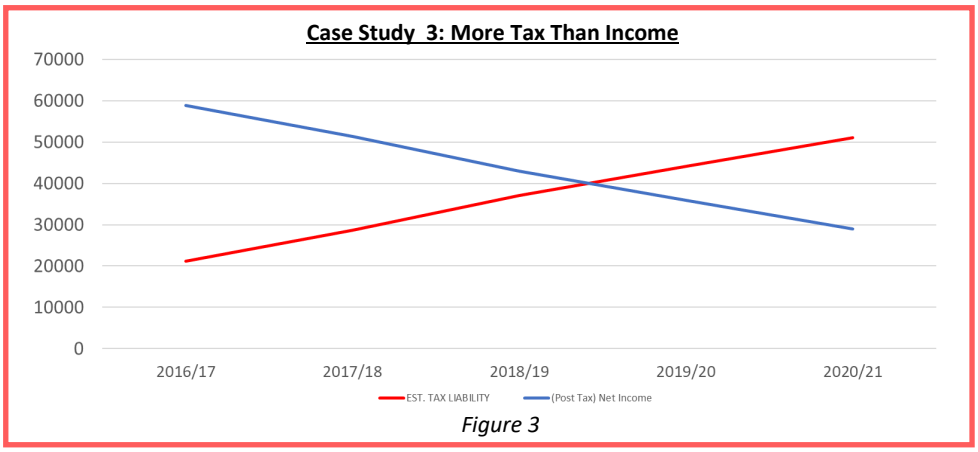

Figure 3

This means that as an otherwise successful professional landlord facing the removal of financing costs and the like as a legitimate business expense; apart from putting up rents and further compounding the tax problem, you have four main options: -

Option 1 - Sell up

Take the CGT hit and mortgage penalties (if any), and either spend the lot or invest the money elsewhere. Being a landlord is not as easy as it seems, and for some the changes are simply a bridge too far.

Option 2 - Make a positive decision to do nothing

Investigate the options as best you can and decide to stay as you are, even though that may raise how much tax you pay, lower your disposable income, and leave your eventual heirs a wholly unnecessary IHT bill. That said, don't expect to get the kind of advice you'll need for free – any properly indemnified and sector specialist tax professional will charge to establish the facts and for their time in advising you.

After all, you're buying what they know, and what you don't; and it's how their business makes its profits.

Option 3 – Incorporate

Transfer your personally held BTLs to a limited company which you own. Much trumpeted elsewhere as the obvious choice, almost without exception it's an expensive one-way street, that leaves you vulnerable to a hike in corporation tax for property companies, which yours would then be. Moreover, with the ability to get advance clearance for S162 incorporation relief (no CGT or Stamp Duty) no longer available, it could be two years before you know the true cost.

Add to that the need to remortgage every single property plus all the time, cost, restriction of choice, the potential breach of your mortgage terms and conditions if you're using Beneficial Interest Company Trusts, patently artificial bridging loans, and the seven ways in which limited companies and the individuals within them are taxed, and you'll find that it's even more expensive than S24.

Option 4 – Maximise the commercial benefits of building, running, and growing a professional property business using hybrid arrangements

This is the generally the only way by which you can successfully counter the punitive tax changes, legitimately reduce your property income tax to basic rate without negatively affecting what you can spend, create a trading business capable of being passed on intact as a going concern, whilst at the same time helping to stop the wealth you create from falling into the wrong hands.

So, will the next two years see the death of the private landlord? I think not.

What it will mean though is that now that S24 is making its presence felt all red in tooth and claw, and the PRA BTL mortgage changes are too having their intended impact, then the real accidental landlord will have no choice but to leave the market and employ their capital elsewhere.

Those landlords who are capable of embracing the changes, especially by showing BTL mortgage lenders what they need to know, i.e.

- your property investment experience
- the total amount of your mortgage borrowing across all properties
- your assets and liabilities, including tax liability
- the merits of any new lending in context of your existing buy to let portfolio together with your business plan
- historical and future expected cash flow from your portfolio
- your income both from property and elsewhere

will be demonstrably running a professional property business and for sure you'll be making a valuable contribution not only to your and your family's future, but to the wider economy and society at large.

Confused about the Tax changes?

Unsure of what to do?

With a free initial assessment we can help you to understand whether becoming a professional property business could be the right option for you.

Fill out the form at the stand or visit lt4l.uk/assessment

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