

## Interest relief on residential property (Lecture P1368 – 13.53 minutes)

Since the start of 2020/21, residential property landlords have been unable to deduct finance costs (including interest) from their property rental profits for income tax purposes. Tax relief is instead granted as a basic rate tax credit which is set against the individual's total income tax liability for the tax year in question.

The amount of this tax credit is calculated as 20% of the lowest of three alternative figures:

1. Individual's interest and other finance costs;
2. Profits of the property letting business (after deducting any losses brought forward);
3. Individual's 'adjusted total income' defined by S274AA(6) ITTOIA 2005 as total income minus any savings and dividend income and after deducting the personal allowance.

Any unrelieved amount can be carried forward to the next following tax year (and so on).

### *Example*

For 2021/22, Thomas had trading profits of £22,600 and gross rental income of £6,100. His allowable property expenses were £8,700, which included a large repair bill, and his interest charges amounted to £5,500. Thomas therefore suffered a property loss for 2021/22:

	£
Gross rental income	6,100
Less: Allowable expenses	<u>8,700</u>
	<u>£(2,600)</u>

Thomas claims this in Box 41 of SA105. The loss of £2,600 can only be carried forward to 2022/23 (see Box 43) – it cannot be offset against his trading profits.

Thomas' tax credit for his interest charges is calculated as 20% of the lowest of:

1. his interest charges (£5,500);
2. his property profits (£nil); or
3. his adjusted total income (£22,600 – £12,570 = £10,030).

Given that Thomas' property profits are nil, he has no tax credit available to set against his 2021/22 income tax liability. The unrelieved amount of Thomas' interest payments can be carried forward to 2022/23 – this must be reflected in his SA105. Note that there is no time limit on the number of years for which unrelieved interest charges can be carried forward.

For 2022/23, Thomas' trading profits are £30,500 and his gross rental income has improved to £8,950. His deductible property expenses are £1,750 and his interest payments are £5,800. He has also received dividends for the first time totalling £1,200.

Thomas' property profits for 2022/23 (after deduction of his loss for the previous year) are:

	£
Gross rental income	8,950
Less: Allowable expenses	<u>1,750</u>
	7,200
Less: Loss b/f	<u>2,600</u>
	<u>£4,600</u>

The amount of Thomas' tax credit for his interest charges is calculated as 20% of the lowest of:

1. his interest charges (£5,500 + £5,800 = £11,300);
2. his property profits (£4,600); or
3. his adjusted total income (£30,500 + £4,600 – £12,570 = £22,530).

Thomas' tax credit for 2022/23 is 20% x £4,600 = £920. The unrelieved amounts of Thomas' interest payments are carried forward to 2023/24. Thus:

	£
Interest charges for 2022/23	11,300
Less: Used in 2022/23	<u>4,600</u>
	<u>£6,700</u>

Thomas' income tax liability for 2022/23 is:

	£
Trading profits	30,500
Property profits	<u>4,600</u>
Dividends (covered by dividend allowance)	<u>—</u>
35,100	
Less: PA	<u>(12,570)</u>
Taxable income	<u>£22,530</u>
Income tax @ 20%	4,506
Less: Tax credit for interest charges (20% x 4,600)	<u>(920)</u>
	<u>£3,586</u>

*Contributed by Robert Jamieson*