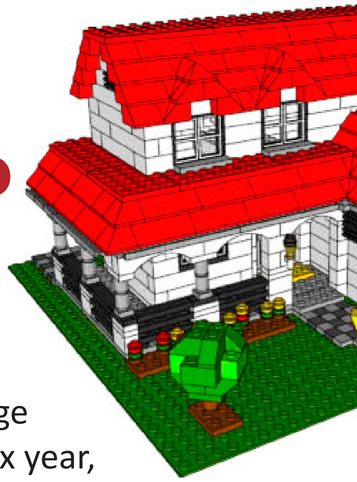
Thinking of selling an additional property soon?

Delaying could cost you!



The change in legislation that has lead to a restriction on allowable mortgage interest relief for landlords is now really starting to be felt. In the current tax year, only 50% of the mortgage interest payable is allowed when calculating your taxable rental profits. Just two years ago, this was 100% allowable.

With profit margins tightening, many landlords are now considering disposing of their additional properties, something the government appears to be actively encouraging.

In what seems to be a recurring theme with HMRC over the past 10 years, we are soon to be in a position where, “You’re damned if you do, and you’re damned if you don’t”.

Budget Announcements & Consultations

Following the Autumn 2018 Budget, the government has put out two consultation papers regarding possible changes to Capital Gains Tax (CGT) in relation to Principle Private Residence Relief(PPR). Whilst these are in the consultation phase, inviting commentary and proposed reforms, the two pieces of legislation are almost certain to be passed and come in to effect from 6 April 2020.

The two main changes are:-

- The final period exemption will be reduced from 18 months to 9 months, having already been reduced from 36 months in April 2014.
- Lettings relief will be amended so that it only applies where an owner is in shared occupancy with a tenant.

As such, anybody with a second property that used to be their own home, that is now rented could face a significant increase on any CGT payable when they come to dispose of it.

How the numbers work:-

John purchased a house in March 2000 for £150,000. He lived in this for 14 years until he purchased a new home to live in with his wife and family. As opposed to selling his old home, he decided to keep the property and rent it out.

Following the changes to the mortgage relief, John did not feel it viable to keep the second property and so sold the property in March 2020 for £310,000.

John realised a gain in the sum of £160,000. He is entitled to PPR relief in the sum of £112,000 (168/240 months). He is also entitled to another 18 months relief under the final period exemption, amounting to a further £12,000. This leaves a taxable gain of £46,000.

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As the property was previously John's main residence and it has been rented, he qualifies for Lettings Relief. In this instance, the maximum £40,000.

This leaves John with a taxable gain in the sum of £6,000. If we ignore any allowances, this will be taxable at 28%, a total tax charge of £1,680.

Now let us move the whole scenario forward 2 months. John purchased the property in May 2000 and is now selling it in May 2020, under the same circumstances.

John still realises a gain of £160,000, and he still qualifies for PPR relief in the sum of £112,000. The final exemption period is now reduced to 9 months, as opposed to 18, so the relief now drops to £6,000.

Finally, as John lived in his own home, not under shared occupancy, he no longer qualifies for the Lettings Relief.

John now has a gain of £52,000. Assuming again that there are no allowances, and this is taxable at 28%, John now has a tax charge of £14,560, an extra £12,880 in tax.

As you can see, this is a huge increase in tax.

Rather more alarmingly, the Lettings Relief is applied per owner of the property on their share of the gain. If a husband and wife jointly, own a property that used to be their only or main residence, they now stand to lose relief of up to £80,000.

If this position could apply to you, and you are contemplating the disposal of an additional property, please contact us on 01277 314000 for a review of your CGT position.