HOUSE OF COMMONS LIBRARY

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Tax relief on landlords' finance costs: s24 of Finance (No.2) Act 2015

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Summary

In the Summer 2015 Budget the then Chancellor George Osborne announced proposals to restrict the tax relief that buy to let landlords are entitled to claim on their mortgage interest, to be phased in from April 2017. In his Budget speech Mr Osborne argued that measure would "create a more level playing field between those buying a home to let and those buying a home to live in" although he took the view that the way that this change was being implemented was "proportionate and gradual … because I know that many hard-working people who have saved and invested in property depend on the rental income they get."[1]

Provision for this measure was included in the Finance Bill introduced after the Budget – specifically, clause 24 of the Bill. It now forms section 24 of the *Finance (No2) Act 2015*.[2] At the time of the Spring 2017 Budget it was estimated this measure would raise £225m in 2018/19 rising to £940m by 2021/22.[3]

Many stakeholders raised concerns at the time that this change might have a significant impact on the supply of rental property, or the level of rents, although the Government did not share these concerns – and since this measure was introduced there has not been any indication that Ministers have any plans to revisit this issue.[4]

In answer to a PQ on the impact of this reform in July 2018 Financial Secretary Mel Stride said, "it is too early to properly assess the wider impacts of the restrictions to finance cost relief for landlords introduced in April 2017 as these are still being phased in. But given that only a small proportion of the housing market is affected by these changes, the government does not expect them to have a large impact on either house prices or rent levels."[5] In answer to a second PQ in November 2018, Treasury Minister John Glen said, "The Government estimates that only 1 in 5 landlords would pay more tax as a result of the restrictions to landlords' finance cost relief, once it is fully implemented … The most recent Office for National Statistics (ONS) index of private housing rental prices shows that rental prices increased by 0.9% in the 12 months to September 2018. A year ago (the 12 months to September 2017) the annual rate of growth was 1.6%."[6]

This note looks at the way that landlords have been able to offset their finance costs against tax, the changes made to these rules by s24 of *Finance (No.2) Act 2015*, and the debate there has been over their likely impact. It looks briefly at the introduction from April 2016 of higher rates of stamp duty on the purchase of additional residential properties, as the Government has explicitly linked these two measures as being targeted to help first time buyers.

1 HC Deb 8 July 2015 c330. See also, HM Revenue & Customs, *Restricting finance cost relief for individual landlords – tax information & impact note*, 8 July 2015
2 This provision was debated and agreed, with certain technical amendments, at the Committee stage of the Bill on 13 October, without a division (Public Bill Committee, Third Sitting, 13 October 2015 cc86-91).
3 *Spring Budget 2017*, HC 1025, March 2017 p30 (Table 2.2 – item bi)
4 Ministers have reiterated the Government's position on this issue in answer to several PQs: for example, PQ44101, 12 September 2016; PQ2006, 4 July 2017
5 PQ165446, 23 July 2018
6 PQ188265, 12 November 2018

1. The tax treatment of landlords' finance costs

1.1 Introduction

In general the profits (or losses) of a property business are computed in the same way as those of a trade. So, as with the calculation of taxable business profits generally, individuals who let out property may offset certain expenses against their rental income – principally, those that are incurred 'wholly and exclusively' for the purposes of that business and are not of a capital nature. As a standard guide to the law has noted, these are "arguably the most fundamental rules on the calculation of business profits", and are of long-standing.[7]

HM Revenue & Customs *Business Income Manual* comments "the statute has, from the earliest days, included a rule restricting deductions to those incurred wholly and exclusively for the purposes of the trade. The words used have been subject to very little alteration over the years."[8]

These rules are consolidated in the *Income Tax (Trading and Other Income) Act (ITTOIA) 2005*. Under s33 of *ITTOIA 2005*, in computing trading profits no deduction is allowed for items of a capital nature. For an expense to be deductible, it must, inter alia, have been incurred "wholly and exclusively for the purposes of the trade" (under s34 of the Act.) In addition, for the purposes of computing the taxable profits of a trade, interest payable is revenue expenditure, as opposed to capital (under s29 of *ITTOIA 2005*).

The implications of these general rules for buy-to-let landlords has been that interest on a buy-to-let mortgage may be an allowable expense but *not* any capital repayment on that mortgage. HMRC's *Property Income Manual* gives details of the tax treatment of interest costs both before and after 2017/18.[9]

Prior to the changes announced in the Summer 2015 Budget, HMRC did not publish estimates of the Exchequer cost of landlords offsetting interest costs against their taxable income in this way, as noted in the answer to several PQs; for example:

> **Mr Hanson:** To ask the Chancellor of the Exchequer how much tax relief was provided for mortgage interest payments by buy-to-let residential property investors at the (a) basic income tax marginal rate, (b) higher income tax marginal rate and (c) additional income tax marginal rate in (i) 2010-11, (ii) 2011-12 and (iii) 2012-13.
>
> **Mr Gauke:** The information is not available. HMRC's administrative systems do not separately identify mortgage interest payments against residential property from other financial

7 *Tolley's Income Tax 2015/16* ed para 75.37
8 *Business Income Manual* para 37035 (Wholly and exclusively: statutory background: what the guidance covers: the statutory prohibition), ret'd March 2019
9 In particular see, *Property Income Manual* para 2052 (Deductions: interest: overview), ret'd March 2019

> costs incurred across all types of property businesses (both residential and non-residential). Moreover, property income is grouped with other income in the calculation of tax liabilities, and consequently the amounts of specific deductions effective against each rate of tax is not precisely defined.[10]

1.2 The Summer 2015 Budget

In his Budget speech on 8 July 2015 the then Chancellor, George Osborne, announced a change in the tax deductibility of finance costs to, as he put it, "create a more level playing field between those buying a home to let and those buying a home to live in":

> Buy-to-let landlords have a huge advantage in the market as they can offset their mortgage interest payments against their income whereas homebuyers cannot, and the better off the landlord, the more tax relief they get. For the wealthiest, for every pound of mortgage interest costs they incur, they get 45p back from the taxpayer. All this has contributed to the rapid growth in buy-to-let properties, which now account for over 15% of new mortgages, something the Bank of England warned us last week could pose a risk to our financial stability.
>
> So we will act, but we will act in a proportionate and gradual way, because I know that many hard-working people who have saved and invested in property depend on the rental income they get. We will retain mortgage interest relief on residential property, but we will now restrict it to the basic rate of income tax. To help people to adjust, we will phase in the withdrawal of the higher rate reliefs over a four-year period, and only start withdrawal in April 2017.[11]

The Budget report set out the context for this measure as follows:

> Landlords can deduct costs they incur when calculating the tax they pay on their rental income. A large portion of those costs are interest payments on the mortgage. Mortgage Interest Relief was withdrawn from homeowners 15 years ago. However, landlords still receive the relief. The ability to deduct these costs puts investing in a rental property at an advantage. Tax relief for finance costs is particularly beneficial for wealthier landlords with larger incomes, as every £1 of finance cost they incur allows them to pay 40p or 45p less tax …
>
> The government will restrict the relief on finance costs that landlords of residential property can get to the basic rate of income tax. The restriction will be phased in over 4 years, starting from April 2017. This will reduce the distorting effect the tax treatment of property has on investment and mean individual landlords are not treated differently based on the rate of income tax that they pay. It will also shift the balance between landlords and homeowners.[12]

Details on how this would work were given in HMRC's tax information & impact note, published alongside the Budget:

> Legislation will be published in Summer Finance Bill 2015 to restrict deductions from property income for finance costs for

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10 HC Deb 6 May 2014 cc111-2W. see also, PQ 225085, 17 March 2015 & PQ 225830 19 March 2015
11 HC Deb 8 July 2015 c330
12 *Budget 2015*, HC 264, July 2015 para 1.190-1

> residential properties for individuals and to introduce a tax reduction at the basic rate of Income Tax.
>
> Deductions from property income will be restricted to:
>
> - 75% for 2017 to 2018
> - 50% for 2018 to 2019
> - 25% for 2019 to 2020
> - 0% for 2020 to 2021 and beyond.
>
> Individuals will be able to claim a basic rate tax reduction from their Income Tax liability on the portion of finance costs not deducted in calculating the profit. In practice this tax reduction will be calculated as 20% of the lower of the:
>
> - finance costs not deducted from income in the tax year (25% for 2017 to 2018, 50% for 2018 to 2019, 75% for 2019 to 2020 and 100% thereafter)
> - profits of the property business in the tax year
> - total income (excluding savings income and dividend income) that exceeds the personal allowance and blind person's allowance in the tax year.
>
> Any excess finance costs may be carried forward to following years if the tax reduction has been limited to 20% of the profits of the property business in the tax year.[13]

It is forecast that this measure will raise £225m in 2018/19 rising to £940m by 2021/22.[14] Projected receipts have not been amended significantly since the Summer 2015 Budget.[15]

Alongside this change the Government also announced it would reform how landlords of residential property may account for the costs they incur in improving and maintaining rental property:

> Currently, landlords of furnished properties can deduct 10% of their rent from their profit to account for wear and tear, irrespective of their expenditure. This means landlords can reduce their tax liability even when they have not improved the property. From April 2016, the government will replace this allowance with a new system that enables all landlords of residential property to only deduct costs they actually incur.[16]

This measure was forecast to raise £205m in 2017/18, falling slightly to £170m in 2020/21.[17]

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[13] *Restricting finance cost relief for individual landlords*, 8 July 2015
[14] *Spring Budget 2017*, HC 1025, March 2017 p30, Table 2.2 – item bi
[15] For earlier estimates see, *Budget 2016*, HC901, March 2016 (Table 2.2 – item af) & HM Treasury, *Summer 2015 Budget Policy Costings*, July 2015 p21
[16] *Budget 2015*, HC 264, July 2015 para 1.192 & *Summer 2015 Budget Policy Costings*, July 2015 p22
[17] *Budget 2016*, HC901, March 2016 (Table 2.2 – item ag).

2. Debate over the impact of restricting tax relief

Following the Chancellor's announcement, there was considerable concern about the financial impact of this this measure for individual landlords - although commentators generally did not provide any precise numbers - as well as the potential impact on the rental market as a whole.[18]

HMRC's assessment of the impact of this measure was set out in its tax information & impact note published alongside the Budget, both in respect to individuals …

> It is expected that 1 in 5 individual landlords will receive less relief as a result of this measure.
>
> Administratively this measure will affect individuals (including partners in partnerships) with income from residential property that incur finance costs. It is also expected that both the one-off and on-going administrative burdens for these individuals will be negligible as the majority will still only need to complete one box for finance costs on the self-assessment return and the new tax calculation will be automated for those filing online. For those filing a paper return, we expect a tax calculator to be available.
>
> There will be an additional administrative burden for individuals with rental income from both commercial and residential properties as they will need to complete an additional box as a result of the measure.
>
> The measure is not expected to impact on family formation, stability or breakdown.

… and the wider economic impact:

> This measure could marginally reduce demand for housing but it is not expected to have a significant impact on either house prices or rent levels due to the small overall proportion of the housing market affected and the offsetting impact of wider budget measures.[19]

In answer to a subsequent PQ on the impact of this measure, Treasury Minister Mel Stride noted, "no estimate has been made specifically about the number of properties that will be affected by this change. This is because taxpayers currently do not inform HMRC how many properties their finance costs relate to."[20]

In their *Economic & Fiscal Outlook*, published alongside the Budget, the Office for Budget Responsibility (OBR) mentioned the potential impact of this measure, as well as the introduction of the 'main residence nil rate band' - a new £175,000 allowance for someone's home when they leave it to their children or grandchildren:

> There are a number of measures [in the Budget] that could affect the **housing market**. The introduction of a 'main residence nil rate band' in the inheritance tax regime is likely to increase the

[18] "Summer Budget: Tax changes aim to subdue buy to let boom", 9 July 2015
[19] *Restricting finance cost relief for individual landlords*, 8 July 2015
[20] PQ2007, 4 July 2017

> incentives for housing purchases and to discourage individuals from selling their homes. On the other hand, the restriction in mortgage interest rate relief to the basic rate is likely to reduce returns to buy-to-let property. Overall, we estimate that these measures will have small and offsetting effects, and so we have not adjusted our forecast for house prices.
>
> Changes to the inheritance tax regime could make it more likely that the co-existence of under-occupation among older owners and over-crowding among younger renters will become even more prevalent. It is not clear to what extent that might affect regional labour mobility or other issues relevant to our macroeconomic forecast, so we have not made any adjustments on account of this.[21]

In a long article on this reform the *Financial Times* quoted Stephen Johnson, managing director of commercial lending at Shawbrook Bank, as saying, "it's quite impactful for personal landlords, especially if they're higher rate taxpayers. All things being equal it can turn profitable investments into loss making ones. That has got people focused." The paper also noted that "even basic rate payers need to make their calculations carefully, as the changes may push them into the higher bracket and land them with a higher tax bill, advisers warned."[22] It is worth emphasizing that the Budget change restricts the deductibility of finance costs for individuals with regard to their income tax liabilities on rental income; as HMRC's impact note underlined, "there is no additional impact on business." At the time it was noted that it was likely that some landlords would respond to these changes by incorporating their businesses.[23]

Following the Budget the Institute for Fiscal Studies published some analysis modelling the impact of Budget changes for individuals and households.[24] This particular measure was considered by Stuart Adam in his presentation on the tax measures in the Budget. Mr Adam's commentary did not offer any illustrative figures for how much worse off individual landlords might be. Rather, both Mr Adam and Paul Johnson, director of the IFS, took issue with the Government's rationale for reforming these rules – that, as the Chancellor suggested, the tax system gave buy to let landlords a large tax advantage.

In his summary of the Budget, Mr Johnson said, "this line of argument is plain wrong. Rental property is taxed more heavily than owner occupied property. There is a big problem in the property market making it difficult for young people to buy, and pushing up rents. The problem is a lack of supply. This change will not solve that problem."[25]

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21 OBR, *Economic & Fiscal Outlook*, Cm 9088, July 2015 p42. For details of the new tax relief see, HMRC, *IHT: main residence nil-rate band and the existing nil-rate band*, 12 June 2017.

22 "Osborne shakes buy-to-let to its foundations, *Financial Times*, 16 October 2015. See also, "Squeeze on buy to let", *Taxation*, 3 September 2015

23 "Mortgage brokers point to loophole in buy-to-let reforms", 9 July 2015. There has been some evidence that this has happened: "Limited companies 'the norm' for buy-to-let landlords", *Financial Times*, 8 December 2017.

24 *Summer Budget 2015: IFS post-Budget analysis*, 17 June 2015

25 "Paul Johnson's opening remarks", *IFS Summer post-Budget briefing*, 9 July 2015

Similarly Mr Adam suggested that the Government's argument was 'nonsense', given that,

- Landlords are taxed on rental income and capital gains
- Owner-occupiers are not taxed on their (implicit) rental income and capital gains
- Deduction of costs is an appropriate counterpart to tax on returns.[26]

While it is quite hard to give representative figures, one approach would be to start with the fact the tax treatment of interest costs is worth more for additional rate taxpayers. This is because, in the absence of that relief, all other things being equal, they would pay tax on any increase in their rental profit at 45%. Assume someone has a rental income of £300k. To ascertain their taxable profit they may offset interest costs of £50k. They are then taxed on their profit of £250k. If interest was not tax deductible, then they would be paying an extra £22,500 in tax (£50k*0.45). Once fully implemented, this measure will restrict relief to the basic rate of tax, so that in this example, the tax saving would only be £10,000 (£50k*0.2).

At this time some landlords argued that the restriction in tax relief would *definitely* feed through into increased rents for tenants, and that, on these grounds, the Government should amend its proposals. All other things being equal, for one to be certain about this, it would have to be the case that, prior to the Budget, landlords were currently charging too low a rent, and that landlords were not fixing rents according to what the market will stand but according to some fixed income idea. The thinking would be: I need a post-tax income of £x so this rent will achieve that; now that the tax is going to go up, the rent must too. However, it seems unlikely that all landlords are ignoring the 'market' rent as a pricing policy.

There is a second question as to whether one can assume that all renters would be willing and/or able to pay higher rents. Clearly some renters might decide to buy a property if the differential between buying and renting widened, or, alternatively, move to a cheaper area to rent or delay household formation. Again, if renters had no other options, one would ask why landlords had not already factored that in to their rent-setting.

In its analysis of this reform, cited above, the *Financial Times* suggested that "the scope for big rent rises should not be taken for granted." The paper quoted Sandra Jones, a consultant at Dataloft, a research consultancy, who argued the pattern is for rents to grow modestly in most locations, most of the time, "because the annual reassessment of rent and the ability of tenants to walk away from a higher price means it adjusts quickly to supply and demand. "It's a myth to think the rental market is not competitive. Most people who rent are quite footloose — it's not their long-term home," [Ms Jones] says."[27] In an opinion piece

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[26] See, Stuart Adam, Tax Measures, *IFS Summer post-Budget briefing*, 9 July 2015 (slide 16)

[27] "Osborne shakes buy-to-let to its foundations, *Financial Times*, 16 October 2015

on this issue, the paper's personal finance editor, Merryn Somerset Webb, argued, "the buy-to-let optimists say that landlords will simply put their rents up. I think this unlikely. More landlords, being capitalists, will be charging what their market can bear already. I suspect that if they can't carry the cost they will end up selling, and — as all prices are set at the margin — pulling prices down as they go. That might help out the bottom end of the market a bit."[28]

Of course there are many other factors at play that will affect the rental market over the 4 year period that this reform is to be implemented: say, changes in interest rates, or the modifications in the planning system that would, in turn, affect the supply of housing.

Further to this, it would appear that many landlords have found that they can make money from rental property even when they are very highly leveraged, taking out large loans to buy new houses, because their mortgage costs are fully tax-deductible. From the perspective of the first-time buyer this could well seem unfair, especially if it has resulted in their being priced out of the market.

Following the Budget Members tabled a significant number of PQs on the Government's assessment of the impact of this reform, although Ministers' answers added relatively little to the analysis provided in HMRC's impact note, cited above; for example:

> **Asked by Ian Murray :** To ask Mr Chancellor of the Exchequer, what assessment he has made of the effect of the recent changes to mortgage interest relief on the private-rented sector in relation to (a) average rents, (b) availability of private sector accommodation, (c) housing benefit levels and (d) quality of rental properties.
>
> **Answered by: Jane Ellison** : HMRC estimate that 1 in 5 landlords will pay more tax as a result of this measure.
>
> Given that only a small proportion of the housing market is affected by this change, the Government does not expect these changes to have a large impact on rent levels or house prices. The Office of Budget Responsibility (OBR) also expects the impact on the housing market will be small.
>
> The Government will double the housing budget from 2018-19 and has set out the most ambitious affordable housing plan since the 1970s to support working people in their aim to own their own home, together the measures in the plan amount to over £20 billion of investment in housing between 2016-17 and 202-21.
>
> The level of housing benefits is dependent on a number of factors such as, household and individual circumstances in regards to employment and household income, inflation and rents. The Government does not expect a large impact on rent levels from this policy, and any impact would be dampened in the short term due to other policy decisions. Therefore, the government does not anticipate changes to the overall level of housing benefits as a result. Nevertheless, the government will continue to monitor rental levels charged in the private rented sector.

28 "Osborne chips away at two Tory shibboleths", *Financial Times*, 11 July 2015

> Landlords are required to maintain their properties to a legal minimum standard. The reform to the wear and tear allowance means that all landlords will now be able to offset the costs of replacing furnishings in their properties removing the previous disincentive to do so. The Government therefore does not think that the changes to the tax rules will reduce standards for tenants.
>
> Some landlords may face difficult decisions regarding their properties. This is why the Government has chosen to act in a proportionate and gradual way. Basic rate income tax relief will still be available on a landlord's finance costs, the restriction will not be introduced until April 2017 and then it will be phased in over 4 years. This gives landlords time to plan ahead of the changes.[29]

Provision for this measure was included in the *Finance Bill 2015* published after the Budget – specifically, clause 24 of the Bill. The clause was debated and agreed, with certain technical amendments, at the Committee stage of the Bill, on 13 October 2015.[30] On this occasion the Treasury Minister, David Gauke, reiterated the Government's case for this change as follows:

> Landlords are able to offset their finance costs, such as mortgage interest, from property income when calculating their taxable income, reducing their tax liability. At present, the relief they receive from this is at the marginal rate of tax. That means that landlords with the largest incomes benefit the most from the relief, receiving relief at the higher or additional rates of income tax—40% or 45%—whereas landlords with lower incomes are able to benefit from relief only at the basic rate of income tax, which is 20%. In contrast, owner-occupiers of properties do not get any tax relief on their mortgage costs, and finance cost relief is also not available to individuals investing in other assets, such as shares in public companies. That creates a distortion between property investment and investment in other assets.
>
> Clause 24 will reduce the inequity by restricting finance cost relief to the basic rate of income tax—20%—for all individual landlords of residential property. It will unify the tax treatment of finance costs for such landlords, including individual partners of partnerships and trusts. The change will ensure that landlords with the largest incomes no longer benefit from more generous rates of relief.
>
> The Government recognise that many hard-working people who have saved and invested in property depend on the rental income they get, so the clause is being introduced in a proportionate and gradual way. The restriction will be phased in over four years from April 2017, ensuring landlords have time to plan for the change…
>
> Only one in five individual landlords are expected to pay more tax as a result of this measure. The Government do not expect the change to have a large impact on either house prices or rent levels due to the small overall proportion of the housing market affected. The Office of Budget Responsibility has endorsed this assessment. It believes that the impact on the housing market will

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29 PQ44101, 12 September 2016 See also, PQ63153, 9 February 2017; PQ33114, 13 April 2016; PQ32542, 11 April 2016; PQ10113, 22 September 2015; PQ9736, 18 September 2015; PQ9772, 14 September 2015.

30 Public Bill Committee, *Third Sitting*, 13 October 2015 cc86-91. The Government published notes on these amendments at the time (*Clause 24: Relief for finance costs related to residential property businesses*, October 2015).

> be small and, taking account of the other measures in the Budget, has not adjusted its forecast for house prices. By April 2020, only 10% of individual landlords will see a tax bill increase greater than £500.[31]

Speaking for the Labour Party, Rob Marris asked the Minister about the Government's assessment of the impact the measure would have on house prices, and on the position of basic rate taxpayers who found that the change resulted in them starting to pay the higher rate of tax on part of their income:

> I appreciate that any landlord among the one in five paying more tax under the provision has almost two years from 8 July to April 2017 to sell the property if they wish to do so, so that they are not boxed in with de facto retrospective action, which can happen if there is only three months in which to sell. I salute the Government for giving that transition time.
>
> I am surprised to hear that only one in five landlords will be affected, but the Government and the OBR have done their research. I am concerned that the measure will do nothing for house prices, which is perhaps a debate for another day … I believe the buy-to-let income accruing to the landlord is counted as income for income tax purposes. There will therefore be some landlords … who, before this change, when their non-buy-to-let income, perhaps from a job, was added to their buy-to-let income were standard rate taxpayers, but who will become higher rate taxpayers after the change is made. Therefore, that group may end up paying considerably more tax.[32]

In response Mr Gauke said:

> We are not making any claims about the effect on house prices. The OBR's assessment is that the impact on the housing market will be small and it has not adjusted its forecast for house prices. The answer to the issue of house prices is improvement in supply … so it is worth pointing out that housing starts are at a seven-year high …
>
> On the impact of the changes, there was a question about whether the measures might move a basic rate taxpayer into the higher tax band. We expect that around 94% of landlords who will have to pay more tax will have a total taxable income of over £35,000. On average, landlords own 2.7 properties. Those currently with taxable income under £35,000 who will have to pay more tax have, on average, larger rental incomes and larger property portfolios; they have an average pre-tax rental income of more than £64,000, and own six properties.
>
> It is true that basic rate taxpayers could be affected by the measures, but often—not in every case, but overwhelmingly—those people will have quite large portfolios and may have leveraged up to a greater extent than the typical buy-to-let landlord.[33]

The Committee approved the clause, and the Government's amendments, without a division.

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31 Public Bill Committee, 13 October 2015 cc86-7
32 *op.cit.* cc87-88
33 *op.cit.* c89

3. Stamp Duty Land Tax (SDLT) on additional properties

On 25 November 2015 the then Chancellor George Osborne presented the Government's Spending Review and Autumn Statement.

In his speech Mr Osborne set out several measures to boost home ownership, saying, "spending reviews like this come down to choices about what your priorities are. I am clear: in this spending review, we choose … to build the homes that people can buy, for there is a growing crisis of home ownership in our country." One of these measures was the introduction of new higher rates of stamp duty land tax (SDLT) on the sale of additional residential properties, such as buy to let properties and second homes:

> The fifth part of our housing plan addresses the fact that more and more homes are being bought as buy-to-lets or second homes. Many of them are cash purchases that are not affected by the restrictions I introduced in the Budget on mortgage interest relief, and many of them are bought by those who are not resident in this country. Frankly, people buying a home to let should not squeeze out families who cannot afford a home to buy. So I am introducing new rates of stamp duty that will be 3% higher on the purchase of additional properties, such as buy-to-lets and second homes.
>
> It will be introduced from April next year and we will consult on the details so that corporate property development is not affected. This extra stamp duty raises almost £1 billion by 2021, and we will reinvest some of that money in local communities in London and places like Cornwall, which are being priced out of home ownership. The funds we raise will help build the new homes.[34]

The Chancellor's plans were confirmed in the Autumn Statement:

> **3.70 Stamp duty land tax: additional properties** – Higher rates of SDLT will be charged on purchases of additional residential properties (above £40,000), such as buy to let properties and second homes, from 1 April 2016. The higher rates will be 3 percentage points above the current SDLT rates. The higher rates will not apply to purchases of caravans, mobile homes or houseboats, or to corporates or funds making significant investments in residential property given the role of this investment in supporting the government's housing agenda.
>
> The government will consult on the policy detail, including on whether an exemption for corporates and funds owning more than 15 residential properties is appropriate.[35]

The Government's consultation was launched in December, and it set out how the new higher rates of stamp duty would apply:

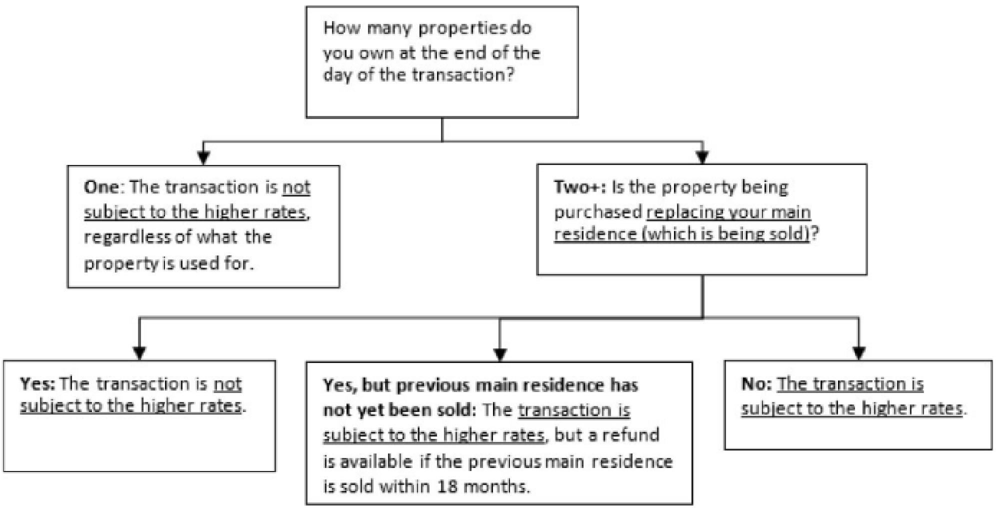
> **2.2 When the higher rates will apply**
>
> The higher rates will not apply if at the end of the day of the transaction an individual owns only one residential property,

34 HC Deb 25 November 2015 cc1371-2
35 *Spending Review & Autumn Statement*, Cm 9162, November 2015 p121

irrespective of the intended use of the property ... If the purchaser has sold a previous main residence within 18 months before the day of the transaction and the transaction is a purchase of a new main residence, the purchaser will be considered to be replacing a main residence. Where an individual is replacing a main residence the higher rates of SDLT will not apply.

However, if the purchaser is not replacing a main residence (either because they have not sold a previous main residence within the last 18 months or the property being acquired is not a new main residence), the higher rates will apply. Recognising that there may be certain circumstances where purchasers may end up in difficult circumstances, some purchasers will be eligible for a refund of the additional SDLT paid …

Figure 1: How to check if a purchase of a property by an individual is liable for the higher rates



The paper gave a number of examples of how the higher rates would, or would not apply, in certain circumstances – two examples are reproduced below:

Example 7: A owns both a main residence and a second home. She sells her main residence and purchases a new one. Although she has two properties at the end of the day of the transaction, she has replaced her main residence so the higher rates will not apply ...

Example 10: O is a buy-to-let investor with 10 residential properties in his portfolio. He also owns one residential property which he uses as his main residence. He decides to sell his previous main residence and purchase a new main residence. At the end of the day of the transaction, he owns 11 properties – his new main residence and his 10 buy-to-let properties. However, as he has replaced his main residence he will not pay the higher rates of SDLT.

It went on to discuss how the higher rates would apply where there is a gap between the original sale of a main residence, and the purchase of its replacement:

2.9 Delay between sale of a previous main residence and purchase of a new one

The government appreciates there may be circumstances where an individual sells a property which was their only or main

> residence, but there is then a period before they purchase their new main residence. The government does not want to disadvantage people in those circumstances. The government believes that there should be a maximum 18 month period between sale of a previous main residence and purchase of a new main residence for the purpose of determining whether the higher rates apply. The government is of the view that this is a sufficient period in the vast majority of cases.[36]

As noted, the Government proposed a tax refund scheme; individuals who buy a new home but do not sell their existing one would be able to reclaim the extra tax charged if they sold that first home within 18 months. In the consultation document the Government also asked for views on how 'large scale investors' might be exempted from the new rates of duty.[37]

In the 2016 Budget the Chancellor confirmed that the new higher rates of duty on purchases of additional residential property would come in from 1 April, although no exemption would be granted larger investors. In addition the time period for refunds would be 36 months rather than 18 months.[38] Legislation to set the new higher rates was included in the *Finance Bill 2016*; it now forms s128 of *FA2016*.

In general commentators focused on other elements of the 2016 Budget statement. That said, the Government's decision not to have an exemption for large scale investors was criticised by the rented property sector. In its coverage the *Financial Times* also quoted David Cox, managing director of the Association of Residential Letting Agents, suggested that tenants would see rents rise to subsidise this tax increase.[39] The next month the *Times* reported that a survey by the Residential Landlords Association (RLA) found a large majority of landlords anticipated putting up rents as a consequence of these policy changes, and that more than half were considering selling some or all of their property portfolio.[40]

Prior to the Budget the Treasury Committee published its report on the Autumn Statement, and as part of this, raised concerns as to the likely impact on the private rented sector of both the restriction to the deductibility of finance costs, as well as the new higher rates of SDLT:

> The stamp duty surcharge is likely to reduce the supply of privately rented properties, and hence result in higher rents. Were it not to do so, it could not be claimed to support home ownership. Combined with other measures in the Summer Budget and Autumn Statement, particularly the reduction in tax reliefs available on mortgage interest payments, the profitability of buy-to-let investments will be sharply reduced. The uncertainty about how far the Government is prepared to go to discourage buy-to-

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36 HM Treasury, *Higher rates of SDLT on purchases of additional residential properties*, December 2015 para 2.2, para 2.9. The consultation was launched on 28 December, and closed on 1 February 2016; details are on Gov.uk.

37 *op.cit.* para 2.11, para 2.19

38 *Budget 2016*, HC901, March 2016 pp38-9 see also, HMRC, *SDLT: higher rates on purchases of additional residential properties: tax information & impact note*, 16 March 2016.

39 "Bigger landlords denied release from stamp duty surcharge", *Financial Times*, 17 March 2016

40 "Crackdown on buy-to-let will push up rents", *Times*, 11 April 2016

> let may act as a further deterrent to investment in this sector, and with it, act as an enduring constraint on the supply of privately rented properties.
>
> Were the measures taken to curb buy-to-let to have a substantial effect, they would come at a cost to the wider economy. Access to a well-functioning, affordable housing market, including for private rented properties, has been widely recognised to be crucial to labour mobility, and hence the overall efficiency of the labour market. Labour, Conservative and Coalition governments have for decades recognised the crucial importance of maintaining confidence in the buy-to-let sector, perhaps aware of the damaging, unintended consequences of the heavy-handed regulatory interventions by both Labour and Conservative governments of the 1950s and 60s. Any impediment to labour mobility will reduce employment, economic activity, and the economy's long-run productive potential.[41]

The Government published its response in October 2016, and on this question, said the following:

> The Government has taken steps to attract billions of pounds of investment to build homes specifically for private rent. This includes a £3.5 billion debt guarantee scheme to support the delivery of new homes purpose built for private rent, and the Build to Rent fund. The Spending Review announced funding to deliver 400,000 affordable housing starts by 2021, including 50,000 affordable homes for rent and 10,000 Rent to Buy properties. Planning permission for over 250,000 homes was granted last year alone.
>
> However, given a free choice, almost 90% of people say they want to own their home rather than rent [British Social Attitudes 2014]. Despite this, only 63% [English Housing Survey, 2013-14] of people in England owned their own home in 2013-14, and this figure has been falling since 2003. The government reforms of SDLT on additional properties, together with policies such as Starter Homes and Help to Buy Shared Ownership, are intended to support home ownership and first-time buyers. The new higher rates of SDLT are expected to apply to less than 15% of property transactions per year, and are not expected to have an effect on rent levels.[42]

As with the restriction to the tax deductibility of finance costs, landlords have continued to lobby for the Government to reverse this change, but without success. Notably in the 2017 Autumn Budget the Chancellor Philip Hammond announced a new tax relief for first-time buyers, as one of a series of measures to boost homeownership. In brief, for this cohort of homebuyers, any purchase under £300,000 is tax-exempt, and relief is also given on the first £300,000 of the purchase price of properties up to £500,000.[43]

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[41] Treasury Committee, *Spending Review and Autumn Statement 2015*, HC 638, 12 February 2016, para 120, paras 122-3

[42] *The Government's response to the conclusions and recommendations of the Treasury Select Committee on the Spending Review and Autumn Statement 2015*, 13 October 2016 p15

[43] For more details see, *Stamp duty land tax on residential property*, Commons Briefing paper CBP7050, 9 November 2018.

4. Recent developments

Turning back to the issue of landlords' finance costs, in the 2016 Budget the Government announced minor changes to the changes made by *Finance (No.2) Act 2015* to ensure that the restriction on finance works operated in the way that was intended.[44] In Committee this provision was agreed, unamended, without debate.[45]

As noted, in the Summer 2015 Budget the Government had also proposed replacing the 'wear-and-tear allowance' – which allows landlords of fully furnished residential properties to claim an annual allowance of 10 per cent of the rent received in the property business, to cover wear and tear on furnishings, irrespective of any expenditure they have made for this purpose. At this time HMRC launched a technical consultation,[46] and in December 2015 the Government confirmed that legislation to introduce a replacement relief would be included in the *Finance Bill 2016*.[47]

These provisions were debated and agreed at the Committee stage of the Bill on 28 June 2016. On this occasion Treasury Minister David Gauke gave a short summary of these provisions as follows:

> The changes made by clauses 69 and 70 will replace [the wear-and-tear allowance] with a new allowance, permitting all landlords to deduct the actual costs they incur on replacing domestic items such as furniture and appliances …
>
> [This] will create a fairer system for landlords and for tenants where the genuine costs of replacement can be reclaimed against income tax.[48]

Speaking for the Opposition Rob Marris was broadly supportive but raised concerns about the potential administrative costs that landlords might incur:

> Clause 70 gets rid of [the existing regime] … and clause 69 introduces a new regime specifying actual expenditure. It sounds fairer that someone cannot claim 10% across the board if they have not spent the money, and that they have to demonstrate what they have spent. Clause 70 gets rid of the 10% allowance, and clause 69 requires records to be produced to prove that money has been spent. The difficulty is that we are talking about small businesses, and the dilemma for any Government is the trade-off between accurate, fair accounting and taxation, and something that is a bit rough and ready but much less onerous for small businesses.[49]

In response the Minister said:

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44 *Budget 2016*, HC901, March 2016 para 2.27; see also, HMRC, *Clarification to finance costs restriction for landlords*, 16 March 2016

45 PBC, Second Sitting, 30 June 2016 c36. This now forms s26 of *FA2016*.

46 HMRC, *Replacing Wear and Tear Allowance with Tax Relief for Replacing Furnishings in Let Residential Dwelling-Houses*, July 2015

47 HMRC, *Reform of the wear and tear allowance: tax information & impact note*, 9 December 2015. Provision is now made by ss73-4 of *FA2016*.

48 HC Deb 28 June 2016 c215

49 HC Deb 28 June 2016 c219

> It is interesting that, despite its simplicity, a significant number of interested parties agreed with the Government that the wear-and-tear allowance was not fair. It applies only to landlords of fully furnished properties, and provides relief even where landlords have not had to meet any actual expense. We have carefully considered the different ways in which a relief based on actual expenditure could be designed and implemented, and we have legislated for the simplest possible basis.[50]

Subsequently HMRC published guidance for landlords on the changes to the tax treatment of their interest costs,[51] and HMRC's site has a number of online tools/videos for landlords.

Following the passage of section 24 of *Finance (No.2) Act 2015*, there was some anecdotal evidence that landlords were considering whether to increase rents, sell part of their property portfolio, or leave the market entirely,[52] and that others had, as predicted, incorporated their businesses.[53] Over summer 2016 several landlords mounted a legal challenge to this legislation, but in October the High Court refused permission for a Judicial Review of section 24.[54] Over this time there was no indication that Ministers considered amending or withdrawing section 24, prior to its taking effect.

In December 2016 the Council of Mortgage Lenders published its forecast for the market in 2017 and beyond; in this it said, "There is a large degree of uncertainty in how landlords react to the income tax changes; research commissioned by the CML shows only half of buy-to-let landlords surveyed felt they had at least a fairly good understanding of these changes. We expect limited or slower growth in landlord's portfolios but will ultimately need to wait until the changes are in place to get a better idea of the cumulative impact on the sector."[55]

Subsequently in March 2017, just before the start of the new tax year, the Chartered Institute of Taxation issued a press notice, alerting landlords to the phased introduction of this change, while advising landlords from making any "any knee-jerk moves in response to the changes":

> Brian Slater, Chair of CIOT's Property Taxes Sub-Committee, said: "This is one of the most significant changes to the buy-to-let market in decades and will particularly affect heavily geared buy-to-let landlords. However, it is sensible for landlords to be cautious about making any knee-jerk moves in response to the changes.
>
> "A decision to sell properties may be tempting for those that are highly geared, meaning they are carrying a lot of debt from perhaps buying many properties or a couple of expensive ones and can no longer benefit from the relief.

50 HC Deb 28 June 2016 c228
51 *Changes to tax relief for residential landlords: how it's worked out, including case studies*, July 2016
52 eg, National Landlords Association (NLA) press notice, 10 March 2016; Council of Mortgage Lenders, *Is the private rented sector really in decline?*, 30 March 2016
53 eg, NLA press notice, *Landlords look to commercial loans to sidestep buy-to-let changes*, 24 February 2017
54 NLA press notice, *No judicial review of section 24 for landlords*, 6 October 2016
55 CML, *Market commentary: 2017 and 2018 forecasts*, December 2016

> "Helpfully the change is being phased in over four tax years, so that the full effect of the restriction will not be felt until tax year 2020/21. This will give landlords extra time to consider their options.
>
> "Taxpayers may have to decide whether to continue in buy-to-lets with reduced profits or simply sell their properties, which may impact on the number of houses and flats available to buy. Or such people could move into commercial property renting, but they will find that to be a more specialised field.
>
> "The restrictions apply to individual landlords and not to companies, which will continue to receive relief for mortgage interest and other finance costs in the usual way. This means that the change may impact on the look of the rental landscape in the future if many individual landlords choose to incorporate and become companies, although this is not without difficulty and incorporation itself can involve tax charges; these may be stamp duty land tax on the market value of properties and possible capital gains tax on properties transferred into a company."[56]

Since then the issue has been raised far less often in the House or in the general press – although there has been some analysis published on landlords' reactions to these tax changes, as well as data on wider trends in the housing market.

In March 2018 the Residential Landlords Association (RLA), which has consistently campaigned against this tax reform, published the results of a survey of RLA members it had undertaken in autumn 2017. This found that "a majority of landlords (70%) reported that the changes to mortgage interest relief would reduce their profitability as a business" and that a similar majority "reported they would increase the rents."[57]

In July UK Finance, the successor to the Council of Mortgage Lenders, published a blog post on how landlords were dealing with the tax reforms of the last three years, by John Heron (Managing director of mortgages, Paragon). Mr Heron noted a number of trends – a decline in the numbers of new buy-to-let mortgages, evidence to suggest a reduction in gearing, a shift to fixed-rate mortgages, and a rise in incorporations – but went on to conclude that "what the changes haven't done, however, is alter the fundamentals underpinning the rental market":

> So far, one thing that landlords haven't done in any number is impose above inflation rent rises to absorb higher costs. However, if fewer landlords invest in rental property, tenant demand continues to rise and strategies already adopted to meet rising costs stop being effective, upward pressure on rents may build. While landlords, at least, have a range of strategies to help them adapt to the tax changes, this is not necessarily the case for tenants. In order to ensure a steady flow of new property into the PRS we hope the government will guard against introducing any additional changes that could further dampen landlords' propensity to invest.[58]

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56 CIOT press notice, *Major change to taxation of landlords ahead*, 29 March 2017
57 RLA, *The impact of taxation reform on private sector landlords*, March 2018 p4
58 "Landlord strategies to cope with higher taxes", UK Finance blog, 30 July 2018

In October the Cambridge Centre for Housing & Planning Research published a report based on a second survey of RLA members, conducted in March-April of that year.[59] Using data provided by respondents on their 2016/17 returns, the authors estimated that about half of respondents would not lose out at all, although the reduction in tax relief by 2020/21 would cost over a fifth of the sample group £3,000 a year or more.[60] The survey also asked respondents as to whether they planned to sell any of their residential property in the future:

> The survey suggests that landlords with one property are unlikely to sell but those more affected by the changes to tax relief are more likely to sell a property in the next year. The landlords in the survey who indicated that they would sell at least one property in the next year indicated that the change in mortgage interest tax relief was the most important reason. Longer term analysis would be needed to measure the actual impact of the tax change on the sale of letting properties.[61]

Respondents were also asked about the pattern of their property purchases over the past five years. Results indicated a spike in purchases after the announcement of new higher SDLT rates in November 2015, followed by a fall in both the numbers of landlords buying houses, and the number of houses purchased, in the next two years:

> The introduction of the additional rate of Stamp Duty Land Tax (SDLT) at 3% for the purchase of additional residential properties meant that landlords brought forward their buying activities in anticipation of the increase in SDLT, with a significant increase in the number of landlords buying properties, and in the number of properties bought in 2015/16.
>
> However, the analysis showed that the number of properties purchased and the number of landlords buying properties fell in 2016/17 and 2017/18 after the introduction of the additional 3% rate of SDLT. The direct impact appears to be that landlords became less likely to buy a rental property. This may have an indirect impact on tenants as prospective tenants might see a reduction in the supply of properties to rent.
>
> However, the long-term impact is unclear. Stamp Duty revenues have been higher than expected by government and HM Treasury has raised forecasts of how much the tax increase will generate: even with rising house prices, this suggests that the higher tax rates have not deterred purchases overall. Further analysis would be needed to assess the longer term impact on landlords' property purchases.[62]

Finally, in January 2019 the RLA noted that, in their most recent survey of the UK residential market, the Royal Institution of Chartered

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[59] CCHPR press notice, *The impact of taxation reform on the private rented sector: Final report*, 29 October 2018

[60] The authors note that in making these calculations, "Future inflation was held at zero, and no adjustments were made for any behavioural change such as re-mortgaging, pre-payment, changing from fixed to floating rates or vice versa, or changes in employment income among higher rate taxpayers." (*The impact of taxation reform on the private rented sector*, July 2018 p15).

[61] *op.cit.* p23

[62] *op.cit.* p22

Surveyors (RICS), had reported a decline in landlord instructions over the past year[63], one that the RLA attributed to these tax reforms.[64]

The last time Ministers appear to have been asked about this issue in the House appears to have been in November 2018, when Treasury Minister John Glen referred to HMRC's initial assessment, before going on to note that recent ONS data on rental prices had not shown any spike in rents, as initially feared:

> **Asked by Alex Norris :** To ask the Mr Chancellor of the Exchequer, whether his Department has made an assessment of the effect on low-income tenants of landlords adjust their rental prices in relation to section 24 of the Finance (No. 2) Act 2015.
>
> **Answered by: John Glen :** The Government estimates that only 1 in 5 landlords would pay more tax as a result of the restrictions to landlords' finance cost relief, once it is fully implemented. When introduced, the government did not expect this measure to have a significant impact on either house prices or rent levels.
>
> The restrictions came in to effect in April 2017. The most recent Office for National Statistics (ONS) index of private housing rental prices shows that rental prices increased by 0.9% in the 12 months to September 2018. A year ago (the 12 months to September 2017) the annual rate of growth was 1.6%.[65]

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63 RICS press notice, *Housing market on hold for now*, 19 January 2019. RICS reported a continued decline in its updated survey published in March (*Prolonged Brexit uncertainty will damage the UK housing market*, 14 March 2019).

64 RLA press notice, *Tax rises hitting tenants in rented housing*, 17 January 2019

65 PQ188265, 12 November 2018