Broadcast

FACTSHEET: FUNDING INVESTMENT PROPERTY

SPECIAL ISSUE

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This alert will be useful for landlords considering funding options when purchasing an additional, or first, investment property.

It will often be necessary to borrow money to fund the purchase of an investment property.

Consequently, the purchaser is likely to incur interest and finance costs. The extent to which tax relief is available for these costs depends on whether the property is let, the type of let and whether the property is let through an unincorporated property business or by a company.

Key dates
Individuals who are eligible for tax relief for interest and finance costs should claim this through their Self-Assessment tax return, which must be filed online by midnight on 31 January after the end of the tax year to which the relates. For companies, the claim is made on their Company Tax Return, which must be filed within 12 months of the end of the accounting period.

This note explains when tax relief for interest and finance costs is available and how it is given.

Funding the property
Where a purchaser needs to borrow funds in order to buy an investment property, this may be done in various ways. The purchaser may choose to take out a buy-to-let or holiday let mortgage secured on the investment property. Alternatively, if they have sufficient equity in their own home or another investment property, they may wish to release some of that equity to provide the necessary funds.

If the property is a residential or holiday let or a commercial let, the landlord will be able to claim tax relief for the associated interest and finance costs. To do this, it is not necessary for the loan to be secured on the let property; relief is also available for other borrowings, such as equity released from the main home or a commercial loan where this provides the funds to purchase the property.

However, relief is capped at the value of the property when first let out. Any subsequently borrowings will attract relief until this limit is reached.

Where a company borrows money to purchase an investment property, relief is available on the associated investment and finance costs.

No tax relief is available for capital repayments.

Unincorporated landlords – interest relief for residential lets
Relief for interest and finance costs incurred by landlords in respect of residential lets is given in the form of a basic rate tax reduction. This means that instead of deducting the interest and finance costs in calculating the taxable profits of the unincorporated property business, the reduction is deducted from the tax due on the profits of the property business. Further, relief is only given at 20% regardless of whether the landlord pays tax at the higher or additional rate.

The tax reduction is 20% of the lower of:

- the interest and finance costs;
- the profits of the property business before deducting interest and finance costs; and
- the landlords adjusted net income (i.e., their income after losses and relief but excluding savings and dividend income that exceeds their personal allowance).

The tax reduction cannot create a repayment, and where income and finance costs are not fully relieved in the year in which they are incurred, they can be carried forward for relief (as a basic rate tax reduction) in future years.

Example
Paul is a landlord letting out a flat in respect of which he makes a rental profit of £20,000 before interest and finance costs. His annual interest costs are £8,000. He has no other income.

Before applying the tax reduction, Paul is liable to pay tax of £1,486 (20% (£20,000 - £12,570) on his property income.

He is entitled to a tax reduction equal to the lower of:

- *£1,600 (being 20% of the interest and finance costs of £8,000);*
- *£4,000 (being 20% of the profits of the property business of £20,000); and*
- *£1,486 (being 20% of his adjusted net income of £7,430 (20,000 - £12,570).*

Therefore, Paul is able to claim a tax reduction of £1,486, reducing his tax bill to nil. The unrelieved interest and finance costs of £570 (£8,000 - £7.430) are carried forward for relief in a later tax year.

Unincorporated landlords – interest relief for furnished holiday lets

Currently, furnished holiday lets enjoy a favourable tax regime. One of the advantages of the regime is the ability to deduct interest and finance costs in full in calculating the taxable profits of the business. This allows the landlord to receive relief at their marginal rate of tax; the relief is not capped at 20% as is the case for residential landlords.

However, the favourable tax regime for holiday lets is to come to an end on 5 April 2025. For 2025/26 and later tax years, furnished holiday lets will be treated in the same way as other residential lets with relief for interest and finance costs being given as a basic rate tax reduction rather than as a deduction in computing profits.

Unincorporated landlords – interest relief for commercial lets

The interest relief restriction applying to residential lets does not apply to commercial lets, and where an unincorporated landlord lets a business property, they can deduct the associated interest and finance costs in full in calculating the profits of their property rental business.

Property companies – interest relief

A property company can deduct the associated interest and finance costs in full in calculating their taxable profit. The restrictions on relief for interest relating to residential lets incurred by unincorporated landlords do not apply to residential property let by a company. Regardless of the type of let, the interest and finance costs can be deducted in full, even if this gives rise to a loss, which can be relieved in the usual way. The effective rate of relief will depend on the rate at which the company pays corporation tax, which in turn will depend on the level of its profits.

We can help

Please call us on **01753 888 211** or email **info@nhllp.com** if you need guidance with any of the issues raised in this Broadcast. We would be happy to help.