Student loan repayments and finance cost relief for residential landlords

General Features | Personal tax

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Changes to tax relief for residential landlords will affect student loan repayments whatever rate of tax is paid.

While the changes to tax relief for residential landlords on interest and other finance costs were first introduced in F(2)A 2015, the first phasing-in of these changes started during 2017 /18 and will continue over the next few years to be fully in place by 2020 /21. The changes will eventually result in individual residential landlords having restricted tax relief on interest and finance costs if they pay tax at a rate higher than UK basic rate on their property income. HMRC estimate that only one in five residential property landlords will pay additional tax due to this change.

Tax relief is still available on finance costs but by 2020 /21 will be fully restricted to the UK basic rate of tax and uses a different method than previously. Before the new rules, finance costs for a residential rental property, such as mortgage interest, could be deducted directly from the rental income to reduce the rental profits subject to income tax. The changes in the rules mean that the restricted element of the finance cost, for example during the 2018 /19 tax year the restricted element is 50% of the total finance cost, is not allowed as an expense deductible from rental profits; instead tax relief is given as a UK basic tax rate deduction from the actual tax calculated.

On the face of it, it would seem that basic rate taxpayers would not lose out on any tax relief and so there would be no overall consequences with the introduction of the new rules. However, that is not the case in relation to student loan repayments which are affected whatever rate of tax is paid. This is best shown through an example.

Let’s say in 2020 /21 a basic rate taxpaying graduate rents out a flat and earns above the student loan repayment threshold (the repayment thresholds for 2019 /20 are £18,935 on earned income for Plan 1 loans, £25,725 on earned income for Plan 2 loans and £2,000 for unearned income) and the mortgage interest for the rental property is £4,000. Under the old rules the mortgage interest would have been deducted from the rental profits and this would have reduced the income by £4,000 when calculating any student loan repayments.

Under the new rules, although the graduate’s overall tax position should be the same because of the tax relief given through the tax calculation, there will be an increase in the student loan repayments by £360 per year (£4,000 at 9% loan deduction rate). If the landlord is repaying both a graduate and a postgraduate loan, using a loan deduction rate of 15% (9% for Plan 1 and Plan 2 loans and 6% postgraduate loan deductions) the loan repayments would increase by £600 per year.

The Low Incomes Tax Reform Group (LITRG) have contacted HMRC to see if this policy could be amended for this consequence of the new tax relief rules, however, we were informed that this would not be possible. We understand that there have been no queries raised by borrowers contacting either the HMRC student finance team or the Student Loan Company regarding this issue for the 2017 /18 tax year.

We would be interested in hearing feedback from any members who have encountered this issue in practice, particularly if it appears that it will cause hardship as the phased introduction of these new rules progresses.