

Are Lender Arrangement Fees Tax Deductible For Landlords? ... The Definitive Answer

By specialist property accountant **Stephen Fay**

Most property investors use mortgage finance to buy their properties, and so have to pay a range of lender fees - as well as interest - in order to do so.

This article looks at whether finance fees (NOT interest - this is covered next month) are tax deductible and how relief can be obtained.

Which lender fees are you referring to?

In the post-credit crunch finance world mortgage lenders make their profits from a combination of interest charged on a loan, plus the various fees that are charged in connection with a loan. (Prior to the credit crunch fees were almost an afterthought for lenders and were often fairly nominal - hence the tax treatment was less of an issue).

Typical fees charged by lenders include: arrangement fees, application / product fees, valuation / survey fees (etc), plus mortgage broker fees.

By far the largest of these are the arrangement fees, which is the main focus of this article. Generally all other fees are paid upfront or immediately on drawdown of the loan and are fully allowable against rental profits.

Arrangement fees ... the lender's favourite profit centre!

These days lender's finance their mortgage products using arrangement fees of between 1-3% of the loan as well as interest charged on the loan after drawdown. By charging a large arrangement fee and allowing this to be added to the loan lenders can therefore promote a much lower headline interest rate. Whereas without the arrangement fee the lender would have to charge a much higher interest rate to achieve their overall profit - which might make the loan cost unattractive to landlords, meaning fewer loans and lower profits.



OK - so are arrangement fees tax deductible or not?

Arrangement fees are fully tax-deductible against rental profits - finance fees are NOT capital costs. This is the case for any business, not just landlords. For example, recently Manchester United re-financed a £500m loan and paid an £8m arrangement fee - the tax treatment is the same for them as for you! For the tax boffins, HMRC even (for the avoidance of doubt) refer to this in their 'Property Income Manual', section PIM2066, and the relevant legislation is the Income and Corporation Taxes Act 1988 Section 77, and 'Income Tax (Trading and Other Income) Act 2005 section 272.

Finance fees are almost always added to the loan by landlords (though they can be paid upfront - not good for cashflow!). It makes no difference to the tax deductibility of the finance fee expense whether the fee is paid or added to the loan as the tax deduction is allowed when the expense is incurred, NOT paid. You know that the

expense has been incurred because the lender won't give you a refund and charges you interest on the fee! This is the same principle as paying an expense by credit card (i.e. deferring the actual payment of the expense) - the tax deduction is allowed when the expense is incurred.

But my accountant told me that I have to spread the cost of the arrangement fee over the length of the mortgage ... is that right?

No! Your accountant might need a lesson in basic 'GAAP' ... accountant-speak for 'Generally Accepted Accounting Practice'. Profits of a business - any business, including a property rental business - must be calculated using GAAP. This isn't optional, however, for a small property rental business the FRSSE (Financial Reporting Standard for Smaller Entities) should also be applied.

The FRSSE states at paragraph 12.4: "Where an arrangement fee is such as to represent a significant additional cost of

finance when compared with the interest payable over the life of the instrument, the treatment set out in paragraph 12.2 [similar to FRS 4] shall be followed. Where this is not the case it shall be charged in the profit and loss account immediately it is incurred."

In the circumstances of a typical Buy to Let mortgage, an arrangement fee is not 'significant' compared to the interest payable over the life of the mortgage. Therefore, the correct accounting treatment under FRSSE for arrangement fee is to include the fee in the rental accounts when incurred, and in full.

Have HMRC actually agreed this?

We recently (2015) successfully defended a client against a HMRC investigation regarding the immediate tax deductibility of £60,000 of arrangement fees in a single tax year. We literally had to explain the points made in this article to the HMRC Officer dealing with the investigation - who of course had no choice to but to agree with us!

This is not just a case of professional 'one-upmanship' - there is a serious point to be made ... HMRC are there to be challenged - politely, yet robustly! - As we often find that the technical competence of the HMRC

Officer dealing with an investigation isn't at a level we might expect ...

BUT, watch out for the 'Wholly and exclusively let on a commercial basis' test ...

As you might expect, there is no tax relief for finance fees that are not incurred for business purposes. This also means properties let on a cheap (i.e. non-commercial) basis to friends and family - although it's fine to let property cheaply for some legitimate business reason and still claim all costs as normal. This is really a 'catch-all' test to ensure only finance costs in relation to genuine rental properties - rather than the home of a landlord or his/her friends/relatives - are allowable for tax purposes.

Your solicitor's bill when INITIALLY BUYING a property with a mortgage

When an investor buys a property initially with a mortgage (i.e. not for cash), part of the solicitor's bill relates to dealing with the purchase itself and part relates to dealing with the lender and mortgage - BUT, it is only this latter element that is an allowable expense against rental profits and solicitors don't usually split out their own fees in this way.

So, in order to claim a tax deduction against rental profits ask your solicitor to

split their bill between time spent on the purchase and time spent in dealing with the lender and mortgage - this element can then be claimed against rental profits and the remainder is claimed against the capital gain on sale of the property.

And finally ... your solicitors bill when REMORTGAGING a property

Legal fees to remortgage a property are tax deductible against rental profits and are not capital expenses at all - so, be sure to claim these costs (along with lender fees) in your rental accounts and beware that if you don't these can't be claimed against any future capital gain (only the legal fees to initially buy the property are allowable capital costs).

Summary ...

Lender's fees - as well as interest - are allowable expenses against rental profits in almost all cases. Be careful to include all the expenses you have incurred (check your mortgage statements) in your rental accounts as finance fees are NOT deductible against capital gains - even if you didn't initially claim the expenses against rental profits!

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The author: Stephen Fay FCA can be contacted at: www.fyldetaxaccountants.co.uk