

REGULATORY IMPACT ASSESSMENT (RIA)

WITHDRAWAL OF MORTGAGE INTEREST RELIEF AND MIRAS. (Final Version)

1. Under the provisions of the 1999 Finance Act, mortgage interest relief (MIR) and the Mortgage Interest Relief At Source (MIRAS) scheme will be withdrawn from 6 April 2000. Relief for new loans to an elderly person to purchase a life annuity (normally referred to as home income plans) was withdrawn from 9 March 1999. Existing plans will continue to qualify for relief.
2. This Regulatory Impact Assessment assesses the main deregulatory effects of the measure, and estimates the size of the compliance cost savings that will arise. The Council of Mortgage Lenders (CML) and a number of mortgage lenders helped the Inland Revenue in this assessment.

Mortgage interest relief and MIRAS

3. Mortgage interest relief is currently available on loans used to buy a borrower's home, subject to a limit on the size of the loan of £30,000. Just under 11 million loans (19 million borrowers including joint loans) qualify for relief.
4. Around 10½ million loans are in the MIRAS scheme, which is operated by the mortgage lenders. Under this, borrowers pay a reduced amount of interest, reflecting the gross interest that they are liable to pay less the tax relief due, and lenders recover the tax relief from the Inland Revenue. The remaining 400,000 loans receive relief through a PAYE code or in an assessment.
5. There are also just under 15,000 existing loans to elderly people for home income plans that will continue to qualify for interest relief.
6. There are about 50 pages of primary legislation and 100 pages of Inland Revenue regulations covering mortgage interest relief and the MIRAS scheme.

Purpose and intended effect of the measure

7. Mortgage interest relief has been progressively reduced over recent years. This started in 1988 when restrictions on loans that qualified for relief were introduced and continued through the 1990s when the rate of relief was reduced from the borrower's marginal rate of tax down to 10 per cent. The Government has decided that now is the right time to complete the phasing out of the relief.

REGULATORY IMPACT ASSESSMENT (RIA)

8. Withdrawal is intended to contribute to the long-term stability of the economy and to help improve the functioning of the housing market.

9. Withdrawal should also yield important deregulatory benefits for mortgage lenders.

Compliance cost savings

Lenders

10. There are approximately 1200 mortgage lenders who provide loans under MIRAS. These range from large banks and building societies to local authorities and Friendly Societies with very small lending books. The 119 lenders that are members of the CML account for over 98 per cent of current mortgage lending.

11. In operating the MIRAS scheme, the lenders are responsible for ensuring that borrowers complete the appropriate forms to qualify for mortgage interest relief. Lenders also have to put in place accounting systems to calculate and apply the amount of tax relief to individuals. They have to claim the tax relief due from the Inland Revenue, and keep records to provide proof to Revenue auditors that the tax relief claims are correct and proper for payment. Such monthly claims range between around £20 million and a few hundred pounds or less. Some small lenders sub-contract the appropriate back office services from other banks or building societies to minimise their own costs.

12. Prior to the Budget the CML estimated that the cost to lenders of operating MIRAS was £50 to £80 million a year.

13. Since then the Revenue and CML have reviewed these figures. This review has attempted to quantify time and resource savings for the lenders in the following areas:

- maintenance of computer systems (apportionment for the MIRAS element) and savings on related technology for document reading and storage;
- staff training time for learning and understanding the MIRAS rules – that part of interviewer training that can now be dropped;

REGULATORY IMPACT ASSESSMENT (RIA)

- time savings on mortgage interviews with customers, for example the time that would have been spent on explaining about tax relief and completing the MIRAS documentation;

REGULATORY IMPACT ASSESSMENT (RIA)

- satisfying Revenue audits, other time spent in contact with the Revenue, time savings on preparing the annual and intermediate claims, and the removal of one area for the lenders external auditors to examine;
- simplification of literature that no longer needs to mention tax relief.

14. A number of lenders were able to supply estimates of their individual savings under these headings. These were then grossed up by their share of the total mortgage market, and adjusted for any special factors of the respondents.

15. On the basis of this further work, our best estimate is that the savings will be around £50 million. But considerable uncertainty remains as the number of respondents was insufficient for a detailed analysis, and the figure could be as high as £80 million.

16. The majority of the savings will arise soon after April 2000 with the remainder arising after 2002 when most Inland Revenue audits will have been completed.

17. Some lenders with existing loans for home income plans will need to keep their MIRAS systems to deal with these loans. For them the full benefits will not arise until the last plan ends, but with under 15,000 such loans the total costs here will be small.

18. Some transitional costs may arise in 2000-2001 since it is expected that lenders will face some relatively small increased costs as a result of the need to manage the withdrawal of MIRAS from their computer systems.

Distribution of compliance savings

19. All lenders operating MIRAS should see compliance savings as a result of the withdrawal of relief. About 100 lenders account for the bulk of the compliance savings, but there are about one thousand other lenders (many of whom are local authorities or other big organisations as well as small organisations such as Friendly Societies) with relatively small amounts of tax relief to be claimed. These one thousand lenders will share compliance savings that are large relative to the small amounts of tax relief that they are reclaiming.

REGULATORY IMPACT ASSESSMENT (RIA)

Borrowers

20. For the vast majority of borrowers, claiming mortgage interest relief is easy and only involves completing a declaration certifying that the loan qualifies for relief. But for about 40,000 borrowers a year the loan cannot go *straight* into MIRAS. These borrowers normally have more complex affairs and may need to discuss with the Inland Revenue the details of their loan. We estimate they will make savings from withdrawal in the region of £1 million per annum.

21. There will also be savings for some 400,000 people whose loan cannot *ever* go into MIRAS, and who receive their relief each year through a PAYE code or in an assessment. To claim the relief they have to obtain details from their lender of interest paid and then claim the relief due from their Tax Office. We estimate the total savings here will be in the region of £1 million per annum.

Employers

22. Employers who provide their employees with beneficial (interest free or low interest) loans will in some cases need to keep more records following withdrawal of mortgage interest relief. But the cost of this additional work should generally be outweighed by the fact that they will not need to carry out complex calculations of the tax relief due on mortgages. The Inland Revenue is consulting with employers' representatives, the CML, the British Bankers Association, etc. about setting the official rate of interest for beneficial loans for the whole of a tax year in advance. This should reduce the compliance costs of valuing beneficial loans.

Other Benefits

Flexibility in new loans

23. The mortgage lenders believe that the regulations surrounding MIRAS have inhibited the development of more flexible mortgages, and that their withdrawal will have a positive impact upon the range of mortgage products available. They anticipate that products providing payment holidays, flexible payment options, foreign currency options etc. will become more common after April 2000. It is not possible to quantify these benefits.

REGULATORY IMPACT ASSESSMENT (RIA)

Existing home income plans

24. The rules for relief for existing home income plans have also been changed. These make it possible for existing plan holders to move home, re-mortgage or increase their loan up to the £30,000 limit without losing tax relief. These changes will help to make the administration of these existing loans easier and plan holders will be able to shop around for the best deals.

Benefits to the Inland Revenue

25. Withdrawal of mortgage interest relief will produce cost savings for the Inland Revenue. We estimate that these will eventually be about £700,000 per year in staff costs and £50,000 per year in other costs such as leaflets and forms.

Consultations

26. Some twelve months notice of the main changes to MIRAS was given which gave lenders time to implement them with a minimum of disruption. Since the changes were announced, the Inland Revenue has discussed with lenders and the CML various operational and administrative issues arising.

27. The issues discussed have included a framework for ending the audit and compliance regime and how interest paid around the 5 April 2000 will be treated. Guidance has been issued to lenders on these and other issues. Agreement has also been reached with lenders to continue giving relief for home income plans through the MIRAS arrangements. This will help to keep the lenders' compliance costs to a minimum, although it does mean that not all of the 150 pages of legislation can be repealed until the last home income plan that qualifies for relief has ended.

28. The CML and a number of mortgage lenders also provided advice and information to help us produce an updated estimate of the compliance cost savings arising from withdrawal of MIRAS.

Summary

29. The withdrawal of mortgage interest relief is intended to contribute to the long-term stability of the economy and to help improve the functioning of the housing market.

REGULATORY IMPACT ASSESSMENT (RIA)

30. Borrowers, the Inland Revenue and, in particular, mortgage lenders should benefit from the resulting deregulation:

- it will enable lenders to simplify their processes and reduce costs that should feed through to lower charges for borrowers;
- about 150 pages of legislation and regulations will eventually be repealed thus lifting significant burdens from lenders;
- we estimate that:
 - lenders will save around £50 million a year, though considerable uncertainty remains and the figure could be as high as £80 million;
 - borrowers will save about £2 million a year in professional fees and administration costs, plus substantial personal time savings, because they no longer have to claim the relief;
 - the Inland Revenue will save about £750,000 a year.
- in the medium to long term both borrowers and lenders should benefit from the increased flexibility in the mortgage loans market as lenders bring forward innovative schemes.

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