101 Property Tax Secrets Revealed

By

Jennifer Adams

This is an excerpt from Tax Insider's guide *101 Property Tax Secrets Revealed 2012/13*.

To get more tax-saving tips for landlords and property investors, **click here**.

Publisher Details

This guide is published by Tax Insider Ltd, 3 Sanderson Close, Great Sankey, Warrington WA5 3LN.

'101 Property Tax Secrets Revealed' first published in November 2012.

Copyright

The right of Tax Insider Ltd and Jennifer Adams to be identified as the authors of this guide has been asserted in accordance with the Copyright, Designs and Patents Act 1988, England.

© 2012 Tax Insider Ltd and Jennifer Adams.

All rights reserved

All rights reserved. No part of this guide may be reproduced or transmitted in any form or by any means, electronically or mechanically, including photocopying, recording or any information storage or retrieval system, without prior permission in writing from the publisher.

Trademarks

Tax Insider Ltd and other Tax Insider Ltd services/ products referenced in this guide are registered trademarks or trademarks of Tax Insider Ltd in the UK and/or other countries.

Disclaimer

1. This guide is produced for general guidance only, and professional advice should be sought before any decision is made. Individual circumstances can vary and therefore no responsibility can be accepted by Tax Insider, the co-author Jennifer Adams, or the publisher Tax Insider Ltd for any action taken or any decision made to refrain from action by any readers of this guide.

2. Tax rules and legislation are constantly changing and therefore the information printed in this guide is correct at the time of writing — November 2012.

3. Neither the authors nor Tax Insider Ltd offer financial, legal or investment advice. If you require such advice then we urge you to seek the opinion of an appropriate professional in the relevant field. We care about your success and therefore encourage you to take appropriate advice before you put any of your financial or other resources at risk. Don't forget, investment values can decrease as well as increase.

4. The content of this guide is for information only and all examples and numbers are for illustration. Professional advice should always be sought before undertaking any tax planning of any sort as individual circumstances vary and other considerations may have to be taken into account before acting.

5. To the fullest extent permitted by law Tax Insider Ltd and Jennifer Adams do not accept liability for any direct, indirect, special, consequential or other losses or damages of whatsoever kind arising from using this guide.

The guide itself is provided 'as is' without express or implied warranty.

Contents

About This Guide xi

Chapter 1. Business Structure

1. Sole Trader 2
2. Partnership 3
3. Limited Liability Partnerships 5
4. Profit Allocation 6
5. Company 8
6. Dealer Or Investor? 9
7. Record Keeping 10

Chapter 2. Property Ownership

8. Ownership 12
9. Joint Spouse Ownership (1) 13
10. Joint Spouse Ownership (2) 15
11. Joint Non - Spouse Ownership 16
12. Agreements On Transfer 17

Chapter 3. Finance And Investment

13. Allowable Interest 20
14. Equity Release 21
15. Portfolio Mortgages 22
16. Personal Loans 23
17. Cash Then Mortgage 24

18. Property Income – Accruals Basis 25

Chapter 4. Income Expenses

19. Revenue v Capital Expenditure 28

20. 'Duality of Purpose' 29

21. Foreign Travel Expenses 30

22. Car Expenses 31

23. Legal Fees 32

24. 'Wear And Tear' Allowance 33

25. 'Renewals' Basis 34

26. Tenant Repairing 35

27. Pre-Letting Expenses 36

28. Pre-Letting Repairs 37

29. Post-Letting Expenses 38

30. Pre-Sale Expenses 39

31. Property Let 'Rent Free' 40

32. 'Rent-A-Room' Relief (1) - Calculation 41

33. 'Rent-A-Room' Relief (2) – Choice Of Method Of Calculation 42

34. 'Rent-a-Room' Relief (3) – Rules 43

35. Furnished Holiday Lettings 44

Chapter 5. Capital Allowances

36. Annual Investment Allowance 46

37. Landlord's Energy Savings Allowance 47

38. Writing Down Allowance (1) – Sale Of 'Pool' Assets 48

39. Writing Down Allowance (2) – Excess Expenditure 49
40. Restricted Claim 50
41. Claim WDA In Preference To AIA 51
42. ‘Special Rate’ Allowance 52
43. Vehicles 54
44. Business Premises Renovation Allowance 55
45. FOTS Allowance 57
46. Ancillary Costs 58
47. Sale Of Commercial Property – s198 Claim 59

Chapter 6. Using Losses

48. Losses 62
49. Losses Carried Forward 63
50. Offsetting Losses 64
51. Dormant Periods 65
52. Cessation Of Business 66
53. Capital – Negligible Value 67
54. Capital – Negligible Value – Spouses 69

Chapter 7. Foreign Matters

55. Non-Resident Landlord Scheme – Tax Planning 72
56. NRLS – Agents 74
57. NRLS – Repayments – Agents 75
58. NRLS – Repayments – Tenants 77

Chapter 8. Selling Your Property

59.	Capital Gains Tax	80
60.	Consideration – ‘Arm’s Length’ Rule	81
61.	Valuing Land	82
62.	PPR Relief – Conditions	83
63.	Definition Of ‘Residence’	84
64.	Choosing Your PPR – ‘Flipping’	85
65.	‘Trigger’ Events	86
66.	Delay In Occupation	88
67.	Deemed Occupation	89
68.	Proving PPR Status (1)	91
69.	Proving PPR Status (2)	92
70.	Proving PPR Status (3)	94
71.	Conversion Of Property	95
72.	PPR And Dependent Relative Relief	96
73.	Job-Related Accommodation	98
74.	Selling Sequence	99
75.	Lodgers	100
76.	Working From Home	101
77.	Lettings Relief	102
78.	Entrepreneurs’ Relief	104

Chapter 9. Gifting Your Property

79.	Capital Gains Tax	106
80.	Exchange Of Interests	107
81.	Exchange Of Interests – Main Residence Problem	109

82. 'Hold-Over' Relief 110
83. Gifting To Charity 111

Chapter 10. Minimising Inheritance Tax And The Use Of Trusts

84. Lifetime Planning - Any Property 114
85. Gift With Reservation Of Benefit 115
86. Pre-Owned Asset Tax 116
87. Lifetime Planning – Selling the Main Residence 118
88. Lifetime Planning - Gifting The Main Residence 119
89. Lifetime Planning - Retaining The Main Residence 120
90. IHT Planning - Use Of Trusts 121
91. 'Nil Rate Band' Trust 122
92. 'Charge' Trust 123
93. 'Interest In Possession' Trust 124
94. Sales After Death 125
95. CGT 'Hold-Over' Relief and Trusts 126
96. CGT 'Hold-Over' Relief, Trusts And PPR Problem 127
97. Furnished Holiday Lets – Business Property Relief 128

Chapter 11. Minimising Stamp Duty Land Tax

98. Multiple Dwellings Relief 130
99. Gifting Property 131
100. Transfer Of Connected Property 132
101. Tax Evasion v Tax Avoidance 133
Finally – Property 'Toolkit' 134

About This Guide

Anyone owning a property will, at some time or other, find themselves subject to tax on that property. If the property is rented out income tax may be payable, on sale possibly capital gains tax and/or stamp duty land tax charged, whilst on death inheritance tax may be levied.

However, there is much that can be done to save or at least reduce the actual amount of tax payable. This guide contains 101 tax savings tips relating specifically to property.

The tips follow the lifecycle of the ownership of a property starting with the different ways a property can be owned and financed, and continuing with any tax saving possibilities whilst renting, including how losses can be utilised effectively. There are chapters suggesting ways of minimising the capital gains tax and stamp duty land tax chargeable on sale, and a chapter giving tax planning tips on inheritance tax, including the use of trusts.

It should be noted that the tips in this guide are for illustration purposes only and are intended to demonstrate where tax savings may be made. Any tax savings that are made will be dependent upon the precise circumstances of the situation and the examples are included as a guide only.

It must be stressed that professional advice should always be sought when undertaking any form of tax planning.

Chapter 1.
Business Structure

1. Sole Trader
2. Partnership
3. Limited Liability Partnerships
4. Profit Allocation
5. Company
6. Dealer Or Investor?
7. Record Keeping

1. Sole Trader

A 'sole trader' is an individual who buys properties in his own name. The sole trader is taxed on any profits made on letting income received and any capital gain made on sale.

Non-tax reasons for buying property as a sole trader:

- You have no partner with whom to share the investment.
- You wish to keep control of your investment, making your own decisions without having to consult another.

Tax reasons for buying property as a sole trader:

- If you have no other income the annual personal allowance can be deducted from any profit made on the letting income.
- The property is purchased jointly and you are a non or basic rate taxpayer. If your partner is a 'higher' or 'additional' rate taxpayer then their share of the profit will be taxed at the higher rates.

Sole Trader

Joanne and Robert own a rental property 50:50. Joanne has no other income but Robert is a 50% ('additional') rate taxpayer. Net rental profit is £600 per month – £7,200 per tax year.

Joanne: No tax £7,200 x 50% = £3,600 (less than the personal allowance of £8,105).

Robert: Tax liability of £1,800 (£3,600 @ 50%).

If Joanne owned the property as a sole trader there would be no tax liability on the full profit (£7,200 is less than the personal allowance).

2. Partnership

A partnership exists when two or more persons let out more than one property. The difference between owners who let out jointly owned property and a partnership is that in a partnership there needs to be a degree of organisation similar to that required for an ordinary commercial business with a view to making a profit. A partnership agreement is therefore required. The individual partners are taxed on their share of the annual profits or gains made – not on their drawings.

Non-tax reasons for buying as a partnership:

- You wish to share the investment.
- On death you wish the property to be transferred automatically to the partner who may not be your next of kin.
- You wish to share the control and running of the properties.
- You are not able to fund the investment on your own.

Tax reasons for buying as a partnership:

- You are a ‘higher’ or ‘additional’ rate taxpayer and your partner is a basic rate or a non-taxpayer. Correct tax planning can enable a reduction of the total tax bill.

Partnership

Joanne and Robert own a portfolio of rental properties 50:50.

Joanne is a basic rate taxpayer but Robert is a 50% 'additional' rate taxpayer. Net rental profit is £600 per month i.e. £7,200 per year = £3,600 each

Joanne: Tax liability of £720 (£3,600 @20%).

Robert: Tax liability of £1,800 (£3,600 @ 50%).

If Robert owned the properties as a sole trader the tax liability would be £3,600; by owning the properties in partnership there is a tax saving of £1,080.

3. Limited Liability Partnerships

A Limited Liability Partnership (LLP) is a corporate body with its own legal personality.

It must be registered at Companies House and have a minimum of two 'members'. Each partnership member is taxable on the income they derive from the LLP. A company can be a member of a LLP.

Non-tax reasons for buying as a LLP:

- It is a legal body separate from its members.
- The partners are protected from the acts of other partners, not having joint liability as for a general partnership.

Tax reasons for buying as a LLP:

- Different tax rates between partners.
- Using an LLP combined with a company enables each individual partner to be allocated a sufficient share of profit to cover his drawings; the balance can then be allocated to the company which pays tax thereon at only 20% (provided the share is less than £300,000).

4. Profit Allocation

A property owned jointly or in partnership does not necessarily mean that the rental profit or loss must be allocated in the same proportion as the underlying ownership of the property.

The owners can agree a different split, the proportion referring to profits and losses only and not to the capital received should the property be sold.

It would be advisable for there to be an agreement quite separate from the property purchase deed that confirms the proportion.

The agreement could accommodate any change in the owners' circumstances on an annual basis and thus ensure that the personal allowance and different tax rates are used to the best advantage each year.

Profit Allocation

The purchase deed of 54 Dorchester Place shows that the property ownership is split 90:10 between John and his partner, Jane. The net rental profit is £7,200 per year. John is a 'higher' rate taxpayer whilst Jane is a student with no income other than her share of the profit.

John's annual tax bill is £2,592 on his 90% share (£7,200 x 90% @ 40% = £2,592); Jane has no tax to pay on her 10% share (£7,200 x 10% = £720 – less than the personal allowance).

Joint net amount remaining after tax = £7,200 – £2,592 = £4,608.

It would be more beneficial for the 90:10 split to be in Jane's favour as this would mean a tax bill for John of £288 and nil for Jane.

Joint net amount remaining after tax = £7,200 – £288 = £6,912.

There would be a tax saving of £2,304.

5. Company

There are different types of company but the one most commonly used for property tax planning is the private company limited by shares. Shareholders are the owners of the company which is administered by directors. Property can be owned by a limited company which can have just one shareholder/director.

Non-tax reasons for buying as a company:

- a limited company is a separate legal entity from the shareholders;
- profits and losses belong to the company;
- the company can continue regardless of the death, resignation or bankruptcy of the shareholders or directors;
- the liability of shareholders is limited to the amount unpaid (if any) on the shares held;
- if the company fails, the shareholders are not normally required to make good the deficit (unless personal guarantees have been given);
- suppliers may be more ready to give credit to a company than to a sole trader or partnership;
- a company may find it easier to raise finance.

Tax reasons for buying as a company:

The 'small profits rate' for a company is 20% on profits up to £300,000. Although companies do not have a personal allowance, if the net rental profits from a property business are taxed at the higher rate tax as an individual, it would potentially be more beneficial for the properties to be held inside a company.

6. Dealer Or Investor?

Difference

Someone buying property to let out on a long-term basis is deemed to be an investor, whereas someone buying property to refurbish then sell, whether resulting in a gain or not, will most likely be deemed to be trading in properties – the main factor being *intention.*

Capital/investment transaction

Unless losses are incurred on sale it is usually preferable for a transaction to be of a capital/investment nature and for the property to be held personally or via a partnership/joint investment, rather than held within a company. This is because individuals are allowed an annual exempt amount and invariably are charged a lower rate of capital gains tax than the tax rates charged on company profits.

Property dealing/trading transaction

If the transaction is in a property dealing/trading situation and the property owner is a 'higher' or 'additional' rate taxpayer, it is preferable for the property to be owned within a company because the corporation tax rates charged will be lower than the income tax rates charged.

Dealer Or Investor

Investment property does not qualify for Business Property Relief (BPR) when considering inheritance tax.

Note: 'Furnished holiday lettings' are a business, not a property income investment, thus a BPR claim is potentially available.

7. Record Keeping

UK-resident landlords are taxed on rental profits made wherever the properties are situated in the world.

A record of the rental income, expenses incurred and capital items purchased must be kept. Separate sets of records are needed if the properties are let as furnished holiday lets.

Keep:

- invoices, expense and capital item receipts, rental statements;
- past years' income and expenditure accounts and Tax Returns submitted;
- bank statements;
- details of purchase of property – date of acquisition, purchase price including costs; and
- if the property was previously the landlord's main residence, details of periods when the landlord lived in the property and of periods let – to ensure PPR and letting relief are claimed.

Record Keeping

Keep records manually, using spreadsheets, or use software packages, for example 'Landlords Property Manager'.

HMRC have an index of the record-keeping requirements for a business at
www.hmrc.gov.uk/recordkeeping/index.htm

A penalty of up to £3,000 can be imposed by HMRC for failure to maintain adequate records for self-assessment purposes.

Chapter 2.
Property Ownership

8. Ownership
9. Joint Spouse Ownership (1)
10. Joint Spouse Ownership (2)
11. Joint Non - Spouse Ownership
12. Agreements On Transfer

8. Ownership

Persons who own property on their own do so in their sole name with sole rights.

Spouses/civil partners can own property in their own names or joint names.

The two legal ways in which property can be held jointly are:

- Joint tenants – each has equal rights over the property; when one dies the property is automatically transferred into the other owner's name.
- Tenants in common – the share of each is separate, may be unequal and may be disposed of in lifetime or on death as the respective owner wishes.

9. Joint Spouse Ownership (1)

By default, rental profit from property jointly owned by spouses/civil partners is taxed 50:50 irrespective of the underlying respective proportion of actual ownership.

However, if it would be more income tax efficient for the split of profit to be different, the underlying ownership also needs to be changed to the same percentage. Plus, most importantly, a form 17 *'Declaration of beneficial interest in joint property and income'* must be filed with HMRC within 60 days of the change of ownership (this restriction is strictly applied).

The declaration comes into effect from the date of signature and remains in place until either the date on which the interests in the property or income change, or the owners stop living together as a married couple/civil partners.

Joint Spouse Ownership (1)

Andrew and Anne are married and jointly own a rented property. Andrew is a 50% ‘additional’ rate taxpayer and Anne is a 20% ‘basic’ rate taxpayer. Their accountant has calculated that it would be more beneficial for the profit to be split 80:20 to ensure that the least income tax is paid.

The ownership is therefore changed to 80:20 and the declaration form 17 signed, but unfortunately it was not submitted within the 60-days’ time limit.

The income tax split therefore remains at 50:50 but legally the underlying ownership has changed to 80:20.

To take advantage of the income tax benefit a new declaration form 17 must be signed and resubmitted within a fresh 60-day time limit.

10. Joint Spouse Ownership (2)

If one spouse owns rented properties in their own name but is a 'higher' or 'additional' rate taxpayer and the other spouse is not, it would be beneficial for at least some of the rental profit to be taxed on the spouse.

To alter the income tax percentage charged, ownership of part of the property must be transferred into the spouse's name.

Should the owning spouse not wish to transfer any material percentage ownership but still wishes to reduce their tax bill, a nominal amount of, say, 1% could be transferred.

In this instance the HMRC form 17 *'Declaration of beneficial interest in joint property and income'* must **not** be signed because not signing will ensure that the underlying property ownership is 99:1 but the income split is 50:50.

Joint Spouse Ownership (2)

Andrew and Anne are married. Andrew owns a property yielding £8,000 annually. Andrew is a 50% 'additional' rate taxpayer and Anne a non-taxpayer.

Andrew transfers 1% of the property ownership to Anne, retaining 99%. Each will be taxed on 50% of the income. As Anne is a non-taxpayer this will produce a tax saving of £2,000.