Property Tax Secrets

How to cut your tax bill and sleep soundly at night

Fully updated for the 2010/11 Tax Year

Written by Colin Davison

The Property Tax Specialists

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As authors we have endeavoured to deliver information and advice of the highest quality; however you are advised not to rely on this book as your sole source of advice.

The basic principles in this book are founded on substantial experience and backed up by statistical evidence. However, please take care - not every property behaves as the 'average' - there are always lots of risky options around and we encourage you to take full and good advice on any investments or purchases that you intend to make. Equally, the nature of markets is that they are unpredictable.

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1 GETTING IT RIGHT FROM THE START

Before you begin investing in property, it is vital to have a joined up tax strategy.

Before you begin with the tax strategy, it is vital to first think of your business strategy!

Too many people jump into the property market without thinking it through and end up incurring unnecessary expense to sort out their affairs later on.

It is also essential to understand that successful property investment is NOT about avoiding tax but about formulating an effective tax minimising strategy.

Forward planning is the key here – you can plan for pretty much any eventuality. What is not sensible is trying to deal with tax issues after the event.

As you progress through this book after developing the business plan, remember it is about two things:

1. Formulating your property tax minimising strategy (NOT evasion).
2. Helping you to understand the taxes due so that you can plan ahead to pay them AND sleep at night.

1.1 First of all, who are you?

First and foremost you need to establish WHO you are so you can establish what your tax liabilities are.

1.2 Property Investor or Property Dealer?

Everybody who invests in properties will either be classed as a **'property investor'**, a **'property dealer'** or both.

1.2.1 Property Investor

A property investor will invest in property long-term.

Generally speaking, you are likely to be investing in property to generate rental income.

Adopting this strategy, you are likely to hold on to your investment for a number of years before you dispose of it.

The longer you hold on to your property, the more likely it is to be classed as an investment. It is safe to say that if you hold your property for at least 5 years, you are unlikely to be open to 'attack' from the Inland Revenue.

1.2.2 Property Dealer

A property dealer will invest in property short-term.

You are likely to be a property dealer (also known as a trader) if you are purchasing a property with the intention of selling it to produce a dealing profit.

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Adopting this approach is likely to mean that you will not be renting your property to generate income, but instead will be looking to sell it quickly so that you can realise your trading profit.

A property dealer is only subject to Income Tax. You will **not** be liable to pay CGT.

1.2.3 How to know if you are investing or dealing?

The Inland Revenue will apply some basic rules to determine if you are acting as a dealer or an investor. The fundamental and most significant test is as follows:

Motive for acquiring the property
If you acquired the property to generate income, then it is investing. However, if you acquired the property to generate a profit by quickly selling it on, then it is classed as dealing.

If the motive for acquiring the property is clear, then no further tests need to be applied. However, if it is not clear then you may need to provide proof for the following tests:

Length of ownership
If you have property that you own and have let out for only a short period of time i.e. one or two years, then the Inland Revenue could class you as a dealer. However, if you have held your property and let it out for five years or more, then the Inland Revenue is likely to be satisfied that you are investing.

Rental income
If you are an investor and are letting your property, then you will need to prove that rental income has indeed been received. The best way to do this is through bank statements and/or receipts.

Failure to provide proof of rental income could lead to you being classed as a dealer, even though you believe you are investing!

Method of finance
If you are a property investor then your loan for the property is likely to be financed over a long term i.e. 25 years. If you are dealing, then your finance is likely to be over a much shorter period i.e. one or two years.

Key Tip

Remember knowledge is power – make sure you know whether you are investing or dealing. If you know, then Mr Taxman is more likely to believe you!

1.3 Next - what are you?

1.3.1 Sole Trader & Partnerships

It is likely that you will buy your first property either in your own name or in joint names with your partner. It is very common for people to buy their first property in their sole name, without even considering any other options that may be available.

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1.3.2 Sole Trader

A **Sole Trader** refers to an individual person who purchases a property in his/her own name.

You are more likely to purchase a property in your own name if you are a lower rate taxpayer, do not have a partner you can invest with, or you do not want to invest with anyone else.

The consequence of buying a property in your own name is that you will be solely responsible for all aspects and dealings of your property. This means that all outgoing costs and generated income will be attributed to you.

1.3.3 When to buy a property in a sole name

If you are employed and pay tax at the higher rate but your partner is not employed, then the most tax efficient method is to buy the property in your partner's sole name. If this strategy is used then he/she will be able to use the personal allowance before any Income Tax is paid at all.

Similarly, if your child is at least 18 years of age and does not earn an income then you could buy the property in his/her sole name.

Key Tip

Only consider buying a property in another individual's name if they are somebody who you trust implicitly. Don't forget, the property is theirs as it is in their name!

1.3.4 When not to buy a property in a sole name

As a rule of thumb, try not to buy a property in your sole name if you are a higher rate taxpayer. If you do this then you will be liable to pay both Income Tax and CGT at the higher rate. However, this may be unavoidable; especially if you do not have a partner you could or would invest with.

1.3.5 Using Partnerships to buy property

There is nothing wrong with buying property in your own name, especially if you do not want to involve anybody else in your property business.

However, it may be advisable to reconsider if you are a higher rate taxpayer and you have a partner who either does not work, or pays tax at a lower rate.

A partnership always exists if the property is not in a sole name.

If you buy a property with a partner, then by default it will be a 50:50 split. This means that you will be taxed on 50% of the net profits at your existing tax rate, and your partner will also be taxed on 50% of the net profits at their tax rate.

Now, if your partner does not work then this is a great tax saving strategy, as they will be able to also make use of their individual tax allowance of £6,475 before they are even liable to pay any tax at all.

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1.3.6 Types of Partnership

When you decide to buy a property as a partnership, your solicitor will ask you to decide on the 'type' of partnership you wish to set up. The two available methods are explained below:

Joint Tenancy

The joint owners are regarded by the Law as owning the whole of the property without any form of separate share or distinction between them.

In consequence, on the death of one of the 'joint tenants', the whole of the property passes to the survivor or survivors.

This is a very common and convenient form of ownership between husband and wife where the parties are content for the survivor to be the absolute owner.

Please note that where property is owned as 'joint tenants' - on death the asset will automatically pass to the surviving partner.

The ownership of the land held as Joint Tenants cannot be altered by a will. A will by the first joint-tenant to die, which leaves the land to another party, would be ineffective.

Where co-owners are not married, or have made different contributions to the price, the preferred form of joint ownership will usually be as Tenants in Common.

Tenants in Common

This means that the co-owners are regarded in law as having separate and distinct shares.

You can decide between yourselves what share of the property belongs to each owner.

For example, if two friends were buying a property together and one contributed more to the purchase price than the other, this could be reflected in the respective shares of the property, say 75% and 25%.

The important point is that each of the tenants in common always owns their share of the property, and is only entitled to that percentage of the sale proceeds, if sold during their lifetime.

If they die, then their share of the property forms part of their estate. It does not automatically pass to the other owner(s).

This method is particularly advisable in a number of situations, such as:

- where purchase monies have been contributed in unequal share
- where either party has a family from a previous marriage or relationship
- where the combined value of the husband and wife's property is sufficient to attract Inheritance Tax
- where the parties are not married (co-habitees, parents and children, brothers and sisters, friends)

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Key Tip
If you are purchasing a property within a partnership then make sure you take legal advice before deciding on the type of partnership.

1.3.7 Other partnership methods

It is not necessary that a property must be in a 50:50 partnership and that a partnership only exists when two and only two people are involved.

Below, we will briefly examine some of the other tax saving partnership methods.

Non 50:50 Partnership

As mentioned in the previous section, all partnerships are a 50:50 split by default. It is possible to have a partnership that is split in a different way i.e. 90:10 or 25:75.

The important point here is that if the partnership is a non 50:50 split, then you must declare the split to the Inland Revenue, and it must be proved and based on fact.

What we are basically saying here is that each partner must pay their percentage of the deposit and source the ongoing costs from their own income.

For example, where there is a 70:30 split, one partner must be able to prove their income has provided 70% of the deposit and the partner's income has provided 30% of the deposit.

If you are able to prove this, then the profits will also be split accordingly. **If you cannot prove this then you will have to settle for a 50:50 split.**

Key Tip
You will not be able to have a non 50:50 split if your partner does not work.

If you buy a second property then you may be able have a greater split in her name. This is if her share of profit from the first property can provide her majority share of the deposit for the second property.

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The example below shows when a non 50:50-split buying strategy would save you tax:

Example 1: Income Tax implication of buying a property in a non 50-50 partnership
Mr Investor earns a salary of £50,000 annually and Mrs Investor earns £15,000 annually. They decide to purchase a buy-to-let property for £50,000 and pay a deposit of £10,000. They also decide that they want the property to be an 80:20 split in favour of Mrs Investor. Therefore Mrs Investor provides £8,000 towards the deposit and Mr Investor provides £2,000 towards the deposit. They receive an annual net rental income of £5,000. Using the 80:20 split Mrs Investor will pay Income Tax at 20% on £4,000 and Mr Investor will pay 40% on £1,000.

As you can see from the example, had Mr & Mrs Investor not declared this split then they would have used the default 50:50 split.

This means that their tax liability would have been greater, as Mr Investor would have paid more at 40% and Mrs Investor would have paid less at 20%. In fact they save £300 in tax every year from doing this.

1.3.8 Buying a property with more than one partner

If you decide to have a partner, then you are not necessarily confined to having just the one partner. You could in fact have 2 or 3 partners or even purchase a property as part of a property syndicate.

Again, the profits and costs will be equally shared unless the Inland Revenue is notified otherwise.

However, the more partners you have, then the greater trust you must also have in them!

1.3.9 Limited Company

The use of a limited company will avoid some of the higher rates suffered by using own names where you do not have a non-working partner or where you will be seriously expanding your portfolio.

It is unlikely that you will purchase your first property through a limited company. The reason for this is primarily because, as with everything else, you will want to make sure that your investment/dealing strategy works before you consider expanding.

1.4 What do you do?

Knowing Your Property Investment Tax Strategy
Having decided whether you want to be classed as an 'Investor' or a 'Dealer', or indeed both, you will now start to think about your actual strategy. Your strategy will probably consist of one or more of the seven listed below.

Please note: At this stage we are only interested in identifying what taxes we will be liable to pay. You will discover in-depth in the following chapters how we can legitimately lower our various tax liabilities.

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Let's have a look at each one of these strategies in more detail to understand the real tax implications.

1.4.1 Buy-to-Let

Following this investment strategy you will be buying either newly built properties, or you will be looking for properties that are in an excellent condition and that do not require any improvements. Once a property has been purchased, your intention will be to let it out as soon as possible.

The people who tend to follow this strategy are those who currently have their own home and want a second or third property purely for investment purposes, to supplement their pension when they retire.

Such a strategy will incur both Income Tax on rental income received and CGT when you decide to sell the property.

Example 2: Buy to Let
Mr Investor buys an investment property for £50,000. Without carrying out any development work, he rents out his property for £450 pcm. His expenses for the property are £150 pcm. Therefore, he is earning an additional £300 pcm as income, upon which he is liable to pay Income Tax. If Mr Investor then sells his property for £60,000, he will also be liable to pay CGT on £10,000.

1.4.2 Buy-Develop-Let

This strategy is likely to be followed by the budding enthusiast who not only wants to develop properties but wants to let them out as well.

Those who venture down this path, and decide to purchase a property so that it can be developed before it is let, will also be liable to pay both Income Tax and CGT.

Example 3: Buy, Develop, Let
Mr Investor buys an investment property for £25,000. He spends £15,000 on developing the property before he rents it out for £450 pcm. His expenses for the property are £150 pcm. Therefore, he is earning an additional £300 pcm as income for which he is liable to pay Income Tax. If Mr Investor then sells his property for £60,000, he will be liable to pay CGT on £20,000 only. This is because the initial purchase cost of the property and the development costs are deducted when calculating the gain.

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1.4.3 Buy-Develop-Sell

This strategy is likely to be followed if you have no interest in getting involved in the letting markets. If you have mastered the art of buying run-down properties or even building new properties, then you will only be liable to pay Income Tax. CGT will not apply to you.

You will not be required to pay CGT as you are classed as a 'dealer', where buying and developing properties is regarded as being your trade or profession. This rule is similar to that of a regular stock market investor. If you are trading shares on a regular basis, i.e. for regular income, then this is classed as your profession and you are taxed on any income you make. Again, you do not have to pay CGT.

Example 4: Buy, Develop, Sell
Mr Investor buys a run down property for £10,000. He spends £25,000 on developing the property before he decides to sell it for £60,000. Therefore, the total cost of the property was £35,000. Mr Investor will be liable to pay tax on the £25,000 profit that he makes.

1.4.4 Buy-Sell

If you buy a property and then either hold on to it for a period of time before selling it, or sell it immediately at a reasonable profit, then you will use this dealing strategy.

This is probably one of the most difficult strategies to use and probably the most risky of the strategies available.

The most common use of this strategy is with new developments, where you will reserve your property early i.e. off plan. As the development progresses, you will see the purchase price of your property increase. When the development has completed you will then sell your property at a tidy profit.

Not a bad strategy if you do your homework and pick the right market.

1.4.5 Buy-Live-Develop-Sell

This is probably the most efficient tax saving method for property investors.

If you buy a property to develop and also use it as your **main residence**, then when you decide to sell the property you will not be liable to pay Income Tax or CGT.

Income Tax is not payable, as you will receive no income from the property, and CGT is not payable as your **Principal Private Residence**, the technical name for main residence, is exempt from this tax.

Example 5: Buy, Live, Develop, Sell
Mr Investor buys a run down property for £100,000. He moves into the property and uses it as his 'main residence'. Whilst living there he develops the property spending £30,000. He then decides to sell it and move onto another property that needs developing. He sells the property for £200,000. This gives him a profit of £70,000, which is totally exempt from any form of tax.

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Now this really does sound like by far the best Tax Saving Strategy, as you pay no tax at all!

This strategy is more suited to single people or couples without children, as they are more likely to sacrifice the furnished and tidy property for the potential income and tax savings.

1.4.6 Buy-Live-Sell

You could also benefit from the PPR exemptions if you never developed a property. If you bought a property, lived in it and then sold it at a profit, you would also have a nice tax-free sum.

Example 6: Buy, Live, Sell
Mr Investor decides to relocate to Wales and buys a 3-bedroom property for £60,000. He lives there with his family for 3 years after which he decides to sell his property, as he needs to relocate again. He sells his property for £100,000. There is no CGT to pay as the property was his main residence.

The important point to note about this type of investment is that it is likely to be a much longer-term investment than the 'Buy-Live-Develop-Sell' strategy. It is more likely that you will spend years in a property, if you follow this strategy, as opposed to months. This is primarily because the investment is unlikely to give you high returns in a short time period without carrying out significant developments.

Also, this is without any doubt the most popular tax saving strategy there is, as every homeowner is knowingly or unknowingly using it!

1.4.7 Let-to-Buy

Rather than looking for a brand new investment property to let out, many investors have decided to let out their existing residence when looking to move to a new family home. This strategy is called let-to-buy.

This strategy has become more and more popular over the past 6-7 years and it must be stressed that this strategy is an excellent tax saving strategy. This is primarily because you are letting out a previous main residence and the Inland Revenue gives some very generous tax reliefs for those who decide to follow this strategy.

These generous tax-breaks include:

- Principal Private Residence Relief
- Private Letting Relief

1.4.8 Buy-Let-Live

This is probably a strategy that most investors are unaware of. This strategy has the same tax implications as the let-to-buy strategy. However, the only difference is that you will live in this property after you have let it out.

This strategy can be used as your **'get out of TAX'** free card. If you are sitting on large capital gains with a potentially large tax liability, then you can make a property your primary residence after it has

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been let out. By doing this you will be reducing your CGT liability considerably as you will also be able to make use of generous Inland Revenue tax reliefs.

1.4.9 Rent-a-Room

This strategy is quite effective for limiting tax if you decide to rent out a fully furnished room in your PPR. If you are opting for this strategy then you may decide to take advantage of the annual Income Tax allowance of £4,250. This is known as **'Rent-a-Room'** relief. This basically means that you can receive income from the let room tax-free until you reach the threshold value of £4,250.

Once you go above this value, you will be taxed on the amount that is over. You cannot offset any expenses when you make use of the allowance, regardless of whether it is within or greater than the allowance limit. Also, you cannot use this allowance if the room is not fully furnished.

Example 7: Rent a Room using the relief
Mr Investor lives in a 3 bedroom detached property. He also lets out a fully furnished room on the 'rent-a-room' scheme. He receives £5,000 annual rental income from the tenant. His income is greater than the allowance and therefore he is liable to pay tax on £750.

This favourable allowance is halved to £2,125, if somebody else i.e. your partner, also lets out a room in the same property. On such a property, there will be no CGT liability if the property is sold as your 'main residence'.

By default, the Inland Revenue will tax you as though you are running a normal rental business. I.e. where you have to take into consideration all receipts and expenses before your tax is calculated.

If you want to make use of the allowance then you must notify them within 12 months of 31st Jan following the end of the relevant tax year (i.e. just under 22 months from the end of the tax year).

The example below shows what happens if you decide not to make use of the allowance:

Example 8: Rent a Room without using the relief (1)
Mr Investor lives in a 3 bedroom detached property. He also lets out a fully furnished room but decides not to use the 'rent-a-room' scheme. He receives £5,000 annual rental income from the tenant and also incurs £2,000 expenses towards the property. Therefore, he is liable to pay tax on £3,000.

As you can see, it would have been more favourable for Mr Investor to make use of the 'Rent-a-Room' relief scheme, as his tax liability is less when using this allowance. However, it is worth considering not using the allowance if your rental income is high, and your expenses are also high. The following example illustrates this:

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Example 9: Rent a Room without using the relief (2)
Mr Investor lives in a 3 bedroom detached property. He also lets out a fully furnished room. He receives £8,000 annual rental income from the tenant and also has expenses of £7,000. If he uses the Rent-a-Room scheme then he is liable to pay Income Tax on £3,750 (Income minus allowance). If he decides to ignore the scheme and is taxed as a normal business then he is liable to pay tax on £1,000 (income minus expenses).

Key Tip

There is no limit to the number of rooms that you can let out in your main residence. The allowance is fixed, regardless of the number of rooms that you rent out.

Now, there are probably so many landlords out there trying to avoid Mr Taxman, not knowing of this rule. They are probably thinking that if Mr Taxman found out they were receiving this additional income they would be liable to pay tax. If they knew about this rule and complied with it, then they would probably only have very little, if any, tax to pay at all!

This allowance is also available to tenants. If you are a tenant and are renting a property then you can also sub-let a fully furnished room in the property you rent, and receive the £4,250 allowance. **However, be sure to get it agreed with your landlord before you take in a tenant!**

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2 Tax Basics - What Do You Need To Know?

Having decided on who you are, your dealing/investing strategy, and accepted the taxes you are likely to pay, you will now be ready to purchase your investment property. At this point, it is important to understand what tax allowances you will have for your chosen strategy. This will help you to formulate your tax buying strategy.

2.1 Understanding Income Tax

Always remember – that regardless of whether you are a property investor or a property dealer, you will be liable to pay Income Tax if your business makes a profit.

This year has seen a number of more complex changes to the tax system, I am amazed we still have the advert running “tax does not have to be taxing”, well why introduce so many new rates and issues within each?

If your business does not make a profit then you are not liable to pay Income Tax. We will now quickly look at the Income Tax guidelines so you can understand what your potential liabilities will be.

Personal allowances

There are personal allowances available depending on your age and whether you are married. Almost gone are the days when married life brought you taxable benefits although those older generations still have some small benefit, it is only the less well off who actually benefit from this process.

2010-11 brings us no changes in the personal allowances; for the under 65s as it stays at £6,475, those between 65-74 remains unchanged with an allowance of £9,490 and those older still remains unchanged at £9,640. So, there is at least some added benefit from achieving older age.

Taxable Bands

After looking at the allowance, the next key figure is the tax rate on your specific income tier. As each rate is higher than the band below it, it means you have in fact not the 4 bands listed below but potentially 6 different effective rates of tax. So tax can certainly be taxing this year. To add to the pain, personal allowances are effectively disappearing from next year for those with incomes over £100,000 (from April 2010). Personal allowances will reduce by £1 for every £2 of income above the £100,000 limit; this reduction applies to all ages. The most notable change in 2010-11 is for those with incomes above £150,000 as you will need to pay 50% for all income earned over that threshold compared to the previous year’s 40%.

Taxable Bands	2009-2010	2010-2011
Savings starting rate (1)	£0 - £2,440	£0 - £2,440
Basic rate 20%	£0 - £37,400	£0 - £37,400
Higher rate 40%	Over £37,400	£37,400 - £150,000
Additional higher rate 50% (2)	Not applicable	Over £150,000

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(1) There is a 10p starting rate for savings income only. If an individual's non savings taxable income exceeds the starting rate limit, the 10p starting rate for savings will not be available for savings income.

(2) This will come into force from 2010, of use right now for planning your next tax year.

Higher rate tax

Many will still ask what is the level of when higher rate tax "kicks in" as this is the main focus of tax planning.

This will all result in higher rate tax of 40% affecting us from £43,875 (£6,475 + £37,400).

Marginal rate of tax?

For those on different ages and income levels this will now change making it more important to understand not what your total tax bill will be but what your effective rate which you are incurring on your next £1 you earn as this is vital for decision purposes when incurring higher costs or earning more money this year. Accountants will refer to this as the "marginal rate of tax"

Key Tip

The two golden rules for Income Tax are to make sure you use your tax free personal allowance and to minimise the amount of tax paid at the higher rate of 40%.

2.1.1 How to save income tax with a partnership

Example 1: Income Tax implication of buying a property in a partnership

Mr & Mrs Investor receive £12,000 annual rental income from their rental property. Again, the annual costs are £2,000 and this leaves them with a joint profit of £10,000. However, because the property is a 50:50 split, they are both liable to pay tax on £5,000 each.

Income Tax

Mr Investor's annual income has now effectively become £35,000 (rather than £40,000) and he will be taxed on the property income of £5,000 at the basic rate of 20%. His rental income has not led to his yearly income going into the higher tax band, and therefore his tax liability is as follows:

Taxed at 20% on £5,000 (£35,000 - £30,000) = £1,000

Mrs Investor will not be liable to pay Income Tax as this is the only income she receives and she is still within her non-taxable personal allowance of £6,475.

As you can see, by having the property in joint names, Mr and Mrs Investor have only paid £1,000 in Income Tax on an annual basis. If the property was in the sole name of Mr Investor then he would have to pay £2,499.70 in Income Tax; an annual saving of £1,499.70 (£2,499.70 - £1,000). Therefore having the partnership in joint names saves them nearly £1,500 annually.

If they kept hold of the property for ten years then they would save £15,000!

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2.2 Understanding CGT

CGT is liable whenever a gain of a capital nature is made when you sell your property.

You are only liable to pay it if you are a property investor and it is only paid when the property is sold. If you are a property dealer then you will not be liable to pay CGT, nor will you be able to make use of the CGT allowance.

2.2.1 Using your CGT allowance

The most notable allowance for CGT is that in the year 2010/2011 each individual has an annual tax exemption of £10,100 (2008/2009 - £9,600). What this basically means is that if you are a property investor, and you sell your property, then the first £10,100 gain you make will be tax-free!

Don't forget, this is only one CGT saving tip for your investment. Once you have used your CGT allowance, you will be liable to pay CGT on any other capital gains.

The amount of CGT you are liable to pay is calculated by adding your remaining capital profit (after using your CGT allowance) to your annual income.

2.2.2 CGT for individual subject to Income Tax

If you are employed and incur a capital gain when you dispose of your property, then your capital gain is added onto your salary to calculate the CGT liability.

The example below illustrates this:

Example 2: CGT Calculation
Mr Investor has an annual income from paid earnings of £20,000. He buys a property and when he comes to sell it he has made a capital gain of £40,000 after deducting all purchase and selling expenses. He uses his annual CGT allowance and this leaves him with a profit of £29,900. He then has to pay 28% CGT = £8,372. His income tax bill is 20% of £20,000 = £4,000 Therefore, his total tax bill is £4,000 + £8,372 = £12,372 which may sound like a lot but he has earned over £47,000 in total!

2.2.3 CGT for individual NOT subject to Income Tax

It is possible that you will not have any income subject to Income Tax. This could occur when your income is equal to, or less than, the available allowances (i.e. Income Tax personal allowance of £6,475 and your only taxable receipt during the year is from the capital gain. If this situation arises and, after deducting the £10,100 CGT allowance, you still have a gain, then your tax is calculated in the following manner:

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Example 3: CGT Calculation (1)
Mrs Investor is a lady of leisure and has no income. She does have a piece of land that her husband bought and gifted to her some years ago. The cost of the land was £10,000, but she is now able to sell it for £20,100. She uses her annual CGT allowance of £10,100 and this leaves her with a gain of £10,000. She is liable to pay tax at 28% on the gain. This means her total tax liability is calculated as follows: Gain on £10,000 at 28% = £2,800 Total liability = £2,800

2.2.4 How to save CGT with a partnership

Example 4: CGT implication of buying a property in a partnership
Continued from Example 2: <u>CGT</u> Mr & Mrs Investor then decide to sell the property for £140,000, giving them a gross profit of £40,000. However the purchase costs of £1,000 are again deducted and this leaves them with a net capital gain of £39,000. They are liable to pay CGT on £19,500 each. They both use their £10,100 annual CGT allowances and are therefore liable to pay CGT on £9,400 each. <u>CGT for Mr Investor</u> As in the previous example, with the rental income received from the property, Mr Investor's annual income was £20,000. Now that he has sold his property and used his CGT allowance, his annual income has become £29,400 (£9,400 of capital gains + earned income of £20,000). Therefore he will pay CGT as follows: Taxed on £9,400 all at 28% tax, £2,632. <u>CGT for Mrs Investor</u> Similarly the £9,400 made from the sale of the property is added to the £4,000 annual rental income received. This gives her a total income of £13,400 for the year. Therefore she will pay CGT as follows: Taxed on 28% = £2,632. Therefore Mr & Mrs Investor have a joint CGT liability of £5,264 (£2,632 + £2,632).

By deciding to buy the property in joint names, Mr Investor and his wife have made a small tax saving – the saving is the annual allowance of 28% of £10,100 (£2,828). In the past this was a fundamental

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tax saving but with CGT rates now very low there is little saving to be made here but something is better than nothing after all!

Reliefs to CGT

There are a number of reliefs which will discover later in how we can save paying Capital Gains Tax. See later Chapter.

2.3 Understanding Inheritance Tax

Inheritance Tax is defined as 'a tax payable on the estate of a deceased person'. Currently you only have to pay Inheritance Tax (IHT) on an estate worth more than £325,000. Any value above this amount is charged at 40%. For married couples and civil partners, the allowance is £650,000 for 2010-11.

Example 5: No IHT liability
Mr Investor has properties worth £200,000 and a cash balance of £50,000. This means that the value of his estate is £250,000. He passes away leaving the whole estate to his son Investor Junior. There will be no tax liability here for Investor Junior, as the £325,000 limit has not been breached.

Don't forget that Investor Junior will still be liable to pay CGT if he disposes of the property at a higher value than he inherited it at!

2.3.1 Why should I plan for IHT now?

If you plan your IHT strategy now, then not only can you gift properties and pay less tax yourself, but, when you die, you can also minimise the tax liabilities of the ones to whom you have transferred your properties.

When you first think about the current £325,000 IHT threshold, it appears to be a very generous concession from the government. After all, £325,000 is a lot of money! But when you sit down and *really* think about it, £325,000 is not as much money as you'd think, especially with property prices increasing each year.

According to the Government, the estimated number of tax-paying estates for 2009-10 will be 4%.

It is important to note that if tax is liable on an inheritance, then it must be paid before the estate is handed over. This can cause major problems if the inheritor does not have the money to pay the taxman!

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Example 6: Planning for IHT is essential!
Mr Investor has a property portfolio worth £425,000 that constitutes his whole estate. All the properties are let out and are generating income. Upon his death he leaves the whole estate to his son, Investor Junior. The threshold of £325,000 has been breached and therefore Investor Junior is liable to pay tax at 40% on £100,000. This means that he must pay £40,000 to the HM Revenue & Customs before he can inherit the properties. Unfortunately he does not have the money to pay the taxman so a property is sold for £150,000 to pay the bill. Not only does this mean that the estate is now only worth £160,000, but Mr Investor Junior also loses out on an annual rental income of £6,000 that he would have received from the property that was sold!

2.3.2 How can I reduce my IHT liability?

It is possible to reduce IHT liability by making use of **Exempt Transfers (ETs)** and **Potentially Exempt Transfers (PETs)**.

2.3.3 Exempt Transfers

An exempt transfer occurs when a transfer is made where the inheritor is not liable to pay IHT regardless of the amount that is transferred.

The following are some transfers that will incur no IHT:

Gifts to spouse

If both husband and wife live in the UK, then all gifts between spouses are exempt regardless of value. This means that if you die and you have an estate worth £1,000,000 and transfer it to your wife, then no IHT is liable.

If your spouse is not domiciled in the UK then an estate of £55,000 can be inherited. Any amount above this will be liable for IHT – and remember; being resident somewhere is not the same as being domiciled there!

Domicile is a complex area, but is essentially a decision based on where a person's real roots are, social and professional – traditionally, it was dependent on the nationality of the father's passport. To change domicile it is normally necessary to live in a place for 17 out of the last 20 years and to show that the person has become firmly part of the country they are in.

Gift made 7 years before death

If an **outright** gift is made at least 7 years before your death, then there will be no IHT liability. An outright gift is classed as one where you will retain no benefit i.e. a property is transferred and goes into the sole name of the inheritor.

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Example 7: **Gifting as early as possible**
Mr Investor has a property worth £350,000. He gifts the property to his son in 1994. Mr Investor passes away in 2002. There will be no tax liability here for his son as the estate was transferred 8 years before Mr Investor's death.

It is worthwhile pointing out that when the property is transferred Mr Investor is liable to pay CGT on the amount of profit made on the property. This means that if he had purchased the property for £200,000 then he would be liable to pay CGT on £150,000.

Also, if his son sells the property at a later date for a value greater than that he received it for, then he will also be liable to pay CGT on this amount.

As a general rule, if you want to give away property, other than to your wife, then you should consider setting up a trust.

Annual £3,000 exemption

It is possible for you to receive an annual gift of up to £3,000 without you having to pay any tax. If the gift is less than £3,000 then the unused amount can be carried forward into the next financial year only.

Example 8: **Using annual exemptions**
Mr Investor sells a long-term property and realises a gain of £7,000. His annual CGT allowance means that he has no CGT to pay. Of the £7,000 he gives £2,000 to his son. His son also has no tax liability as it is under the £3,000 allowance. The £1,000 is carried forward into the next financial year. The following financial year Mr Investor sells another of his properties. This time he gives his son £3,500. Again, his son has no tax liability as firstly he uses the existing year's £3,000 allowance. Then, of the £1,000 brought forward from the previous year he uses £500, which again means that he has no tax to pay. **The remaining £500 cannot be carried forward into the next financial year.**

£250 small gifts exemption

It is possible for you to give a gift of up to £250 to as many people as you want in a financial year. However, if the total to any individual exceeds £250 then they will become liable for tax.

Gifts part of normal expenditure

Any gifts that form part of your **normal** expenditure will also be exempt.

Normal expenditure corresponds to gifts that the donor had a habit of making. Such gifts will include birthday / Christmas / anniversary gifts.

There is no limit to such gifts.

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Gifts to charities

Gifts that you make to a UK established charity will be exempt from IHT. Such gifts can be made anytime during your lifetime or on your death.

Marriage

Gifts in consideration of marriage to bride and/or groom are as follows: up to £5,000 by a parent, up to £2,500 by a grandparent, or up to £1,000 by any other person.

2.3.4 Potentially Exempt Transfers (PETs)

If you are in possession of an outright gift and you have not had ownership of the gift for 7 years then it is classed as a **Potentially Exempt Gift (PET)**.

If the donor dies and you have had the gift for between 4-7 years then you will be liable to receive tapering relief if the gift is over the threshold level.

Don't forget, if you have had the gift for more than 7 years and the donor dies then there will be no IHT to pay!

Taper relief is given at the following rates:

Years between gift and death	% of IHT charged
0 to 3 years	100%
3 to 4 years	80%
4 to 5 years	60%
5 to 6 years	40%
6 to 7 years	20%
7 years and over	0%

Example 9: Lifetime gift UNDER IHT threshold level

Mr Investor gifts a £100,000 property to his son in June 2000.

In June 2009 Mr Investor dies leaving an estate of £325,000 to his son.

His IHT is calculated as follows:

Lifetime Gift		£ 100,000
Mr Investor's estate on Death		£ 325,000
	Total	£ 425,000
Less Threshold at date of death		£(325,000)
	Total	£ 100,000

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IHT charged at 40% on £100,000 = £40,000

Mr Investor's son is liable to pay £40,000 IHT on his father's death.

Remember: No taper relief is available because the lifetime gift was not over the threshold value.

Example 10: Lifetime gift OVER IHT threshold level

Mr Investor gifts a £325,000 property to his son in August 2006.

In June 2010 Mr Investor dies leaving an estate of £345,000 to his daughter.

His IHT is calculated in two steps as follows:

Step 1 – IHT on lifetime gift to son

Lifetime Gift	£ 345,000
Less threshold at death	£(325,000)
Total	**£ 20,000**

Tax at 40% on £20,000 = £8,000

Because the gift is between 4 and 5 years old, taper relief can be applied at 60%. Therefore 60% of £8,000 = £4,800. This is the amount of IHT his **son** is liable to pay on the lifetime gift.

Step 2 – IHT on remaining estate on death to daughter

Estate on death £345,000

Tax at 40% on £345,000 = £138,000. This is the amount of IHT his **daughter** is liable to pay on the remaining estate.

The daughter is likely to have to sell the property and likely at below a value to what is it worth, and will be significantly worse off than her brother.

The key point to note from the above example is that the threshold level of £325,000 can only be used once, regardless of how many people receive the inheritance.

Key Tip

The £325,000 allowance can be used again if 7 years have passed since it was last used.

2.4 Understanding Corporation Tax

If you are a registered company then you will be liable to pay corporation tax, which is a tax on your company's taxable income or profits.

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£ per year (unless stated)	2009-10	2010-11
£0-£300,000	21%	20%
£300,001 - £1,500,000	Marginal relief	Marginal relief
£1,500,001 or more	28%	27%

As soon as you form a limited company, Companies House will tell the HM Revenue & Customs of your existence so there is no point in trying to avoid paying corporation tax – you will be found out!

A computer record of your company is created at Companies House and then a form is sent out to your company address for you to fill out any relevant information.

You must keep and retain records of all transactions and make sure that you send a Company Tax Return into the Inland Revenue.

These records include details of all receipts and expenses incurred in the course of your company's activities and information on all sales and purchases made in the course of the trade as well as all other supporting documents.

Firstly, you need to correctly operate Pay As You Earn (PAYE) and National Insurance contributions (NICs) on any payments to employees. It is important to note that employees include directors.

Then, you need to work out the company's total profits by adding together any profits made during the accounting period. An accounting period is never longer than 12 months and it is up to the company to decide what its accounting periods are as long as they conform to certain criteria.

These are that the period begins as soon as the company first becomes chargeable to corporation tax or simply when the previous accounting period ends.

And the accounting period needs to end when the earliest of the following takes place:

- the company reaches its accounting date
- it is 12 months since the start of the accounting period
- the company starts or stops trading
- the company is no longer within the charge to corporation tax
- the company goes into liquidation when its accounting period will run for 12 months until winding up is completed
- the company goes into administration
- the company starts or stops being resident in the UK

Between three and seven weeks after the end of your accounting period, the Inland Revenue will send out a Company Tax Return form for you to complete. If you do not have an agent or an approved software substitute then you may be sent a supplementary form (CT600) as well.

You can now file your Company Tax Return over the internet. Visit www.hmrc.gov.uk for more details.

Avoid common corporation tax mistakes

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Making a mistake with your Company Tax Return or in the payment of your corporation tax can be both time-consuming and costly for your business.

Before submitting your tax return to the Inland Revenue, make sure you've double checked it and that you have attached any relevant supplementary pages.

If you spot a mistake after you've sent in your return then you can amend it up to a year after the filing date.

In particular check:

- If there is a repayment, make sure you have put an X in the box under 'About this return'
- Ensure that you have filled in the box headed 'Turnover of the company' on page 2 - as this is often missed out in the tax calculation
- When apportioning profits chargeable to corporation tax to financial years, make sure that they are calculated on a daily basis and not on a monthly basis
- In the same section, you need to be sure that you haven't 'tweaked' the corporation tax rate to get the right amount of chargeable corporation tax and that you have only used the rates appropriate for your company
- If you have associated companies you need to complete boxes 39 or 40 and 41
- Calculate any marginal rate of relief correctly and include this calculation with your tax computation and, most importantly, make sure that you are aware of the date on which corporation tax is due, to avoid late payment and incurring penalties.

2.4.1 How can I keep corporation tax to a minimum?

Corporation tax can be lowered in a number of ways:

Claiming for higher home office costs such as using a rent a room relief at £4,250 instead of actual household bills for calculating the home office costs.

Claiming for wages and salaries for individuals in your household who assist you in the business.

2.5 Understanding Stamp Duty / Land Tax

Stamp duty is a tax that is paid when a property is purchased over a certain threshold. It is a tax that, if applicable, is paid over and above the property value.

The current rates of stamp duty are:

Purchase Price	Stamp Duty	First Time buyers
Less than £125,000	0%	0%
125,001 to £250,000	1%	0%
£250,001 to £500,000	3%	3%
Greater than £500,000	4%	4%

This means that stamp duty can be a very costly tax, especially if your property is valued at more than the £250,000 threshold level.

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But it is possible to reduce, or even eliminate, your stamp duty liability - so you can afford that luxury bathroom or kitchen after all!

There is the benefit for first time buyers as they pay zero tax on properties up to £250,000! You can take advantage of this tax bracket if you have never owned a house or flat, and if you're buying this property with someone they must also have never owned a house or flat. This threshold is to stay in place till at least 25 March 2012.

2.5.1 Avoiding Stamp Duty

Buy property worth less than £125,000!

The old nil stamp duty band of up to £60,000 was doubled to £120,000 in 2005, then raised again to £125,000 This was then raised again to £250,000 to help first time buyers onto the property ladder. So if you buy property under £125,000, or £250,000 if you're a first time buyer then no stamp duty is paid.

Key Fact

More than £6.4 billion was charged in stamp duty in the tax year to April 2007 and is a big money spinner for the Government.

Stamp Duty (1)

Mr Investor buys three properties. The first property costs £125,000. The stamp duty rate for this is 0% and therefore he has to pay nothing extra.

The second one costs £130,000 and he has to pay £1,300 in stamp duty.

The third property is a more expensive £260,000. The stamp duty rate on this is 3% and therefore he has to pay £7,800 on this one.

Alternatively, you can buy a new property as a 'shell' for a value of less than £120,000 (thereby avoiding stamp duty) - and sign a separate contract with a builder to carry out the necessary work to make it a living space.

It is important to ensure the two contracts are entirely separate if you go down this route. If the contracts are linked in any way you will find yourself liable for stamp duty.

Buy in a stamp duty exempt area

The Inland Revenue has made some deprived areas throughout the UK exempt from stamp duty. You will not have to pay stamp duty unless the property value is over £150,000 in these places.

The Inland Revenue states that:

> 'The areas that qualify for the relief are the most deprived, as determined by the indices of deprivation in each of the four nations that comprise the United Kingdom. In England and Scotland the poorest 15% of wards and postcodes qualify. In Wales and Northern Ireland the poorest 42% of wards are designated as disadvantaged.'

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There are over 2,000 locations where stamp duty is exempt for houses priced up to £150,000.

To find a list of all the deprived areas where stamp duty is exempt please use the links in the following table:

Country	Website
England	www.hmrc.gov.uk/so/dar/england.pdf
Northern Ireland	www.hmrc.gov.uk/so/dar/nireland.pdf
Scotland	www.hmrc.gov.uk/so/dar/scotland.pdf
Wales	www.hmrc.gov.uk/so/dar/wales.pdf

The Inland Revenue has also provided a disadvantaged areas relief search tool.

This search tool allows you to enter the postcode of the property you are looking to buy. It will then tell you if the property is a deprived area.

http://www.hmrc.gov.uk/so/dar/dar-sd.htm

This means that another selling point of your property could be that you can tell the buyer that they will not have to pay stamp duty!

Be careful, as not all solicitors know that stamp duty is exempt in certain deprived areas.

It is always worthwhile checking if you have paid stamp duty in a deprived area, as the Inland Revenue will not tell you that an area is exempt from stamp duty. If you have incorrectly paid stamp duty, then you must contact the Inland Revenue to claim it back.

Buy six or more properties in a deprived area!

Investors who buy six or more properties are allowed stamp duty relief on any transaction in a disadvantaged area – even where these purchases exceed £150,000.

NOTE: The government has abolished stamp duty exemption for commercial property in deprived areas from 1 July 2005, and stamp duty land tax also joins the income tax anti-avoidance disclosure rules.

So, if you deal in commercial property over £5 million you need to talk to your advisers about stamp duty avoidance measures.

Negotiate below stamp duty thresholds to save cash

If your property is close to a threshold level, it is always worthwhile negotiating to try and reduce your stamp duty liability.

This is particularly the case if you are purchasing a property and the vendor is leaving behind certain fittings and furnishings.

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Stamp Duty (2)
Mr Investor sees a house advertised for £259,000. When he goes to view the property he realises that the vendor has numerous furnishings that she will be leaving. These include: carpets, curtains, light fittings, fitted robes in bedroom, and dining furniture. The estimated cost of these items is £5,000. Mr Investor agrees with the vendor to pay for the furnishings separately and negotiates another £5,000 off the purchase price. This means that the agreed purchase price is now £249,000 and his stamp duty liability is £2,490. Had he purchased the property at the full asking price then his liability would have been £7,770. By paying for the items separately and negotiating a further reduction, Mr Investor has saved £5,280. **This means that the furnishings are essentially for free!**

Key Tip

Always try to negotiate on any property deal. This case is made even stronger if you are close to a stamp duty threshold level.

Buy live/work units and avoid tax

If you buy a live/work unit where the ratio of the live to work area is weighted in favour of the work area you can avoid stamp duty.

That's because stamp duty is only payable on the area considered habitable. This works on the same principle as buying a shell and then negotiating a separate contract for the necessary building work to make the shell a habitable environment.

Stamp Duty (3)
Mr Investor chooses a live/work unit that costs £257,500. This unit is internally divided heavily in favour of work space – 60%. Only the habitable space is considered for stamp duty liability – 40% of £257,500 – which falls well below the stamp duty threshold of £125,000. So Mr Investor avoids stamp duty on a property where it could have been 3%. His saving is £7,725. Now he can afford that new kitchen!

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Keep transactions single if buying in bulk

If you are buying more than one unit in a building, you can reduce stamp duty significantly by keeping each transaction separate.

So, if you bought four units at say £115,000 each in a single building, you would pay no stamp duty as each individual unit comes below the £125,000 stamp duty threshold.
If the transactions are linked, the purchase price is taken as a whole at £460,000 for the four units. There would be a stamp duty liability of 3% - or £13,800.

Be very clear with developers and your solicitor that your transactions are not to be linked.

Key Tip

Make sure your solicitor knows if you are buying in a stamp duty exempt area. If you are buying a shell and then contracting out the work, ensure your solicitor keeps these transactions separate.

Buy as a company and save money

It is possible to set up a limited company to buy and hold a property and to sell the company (i.e. the property) on, thereby saving on normal purchase stamp duty rates.

Instead of the normal stamp duty thresholds applying, the rate for a company is 0.5%.

If you were in the higher price bracket of £500,000 where 4% stamp duty is applied, you would save £17,500, paying just £2,500 in company stamp duty rather than £20,000!

Buying as a company has other advantages and disadvantages, so you should seek solid professional advice before setting up a property company.

Fill in your own stamp duty land tax return and save on legal fees

The Inland Revenue requires stamp duty land tax returns to be submitted within 30 days of the completed transaction.

Most people rely on their solicitor or accountant to fill in and return the forms – after they have checked and signed them.

However, it is a simple form to fill in and you can do it yourself, thereby saving on solicitor's or accountancy fees for submitting the return on your behalf.

Ensure you meet the Revenue's deadline and file the return within 30 days of completion. If you don't, you are instantly fined £100. Fail to file within three months and this becomes £200; interest is charged on money owing too.

You can now submit your Inland Revenue information online. For full information on how to fill in and submit stamp duty land tax returns, visit the Inland Revenue website.

www.hmrc.gov.uk/so/sdlt

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2.6 Understanding Local Taxes

Basically, these are taxes collected by the local council and include council tax and non-domestic rates. It must be noted here that there is no way to avoid these taxes - they are direct property taxes which have to be paid. However, in some cases it may be possible to reduce the tax payable.

2.6.1 Council Tax

Within six months of purchasing a property you may be able to appeal against the council tax band it has been placed in. Obviously this is only a course of action to pursue if you believe the property to be in a band which is too high and not the other way round or you'll end up paying out more money than you need to!

To appeal against a council tax banding you need to lodge a challenge with the Valuation Office Agency. This can be done online through its website - www.voa.gov.uk. The agency will then undertake a review of the property's council tax band and generally will let you know within two months the outcome of this review. If you think you have a genuine case then it is definitely worth a try - it may only be a saving of £100 or so a year but every little helps!

2.6.2 Business Rates

Non-domestic rates or business rates are the way in which local businesses are made to contribute towards the costs of local authority services. There are four key organisations involved in the administration of business rates: Deputy for Communities and Local Government (DCLG), the Valuation Office Agency, valuation tribunals and local authorities.

In England, the current uniform business rate for 2010/11 is 41.4p in the pound. For small businesses this rate is 40.7p in the pound (a small business is one where the total rateable value is under £15,000 or under £21,500 in London).

Example:

A property with a rateable value of £20,000 would be:

£20,000 x 0.414p = £8,280.00 to pay in business rates less any reliefs that may be applicable.

2.6.3 What reliefs could I be entitled to?

Transitional relief

Transitional relief is a government scheme which ensures that large changes in business rates due to revaluations are phased in gradually over a number of years. Businesses can work out valuations of their premises online by visiting:

www.voa.gov.uk/business_rates/index.htm

Small Business Rate Relief

Small Business Rate Relief came into effect on 1 April 2005. Eligible businesses with rateable values of below £5,000 will get 50% rate relief on their liability. This relief will decrease on a sliding scale by an estimated 1% for every £100 of rateable value over £5,000, up to £10,000. Your local billing authority will calculate the exact decrease.

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The relief is available to ratepayers with either:

1. one property, or

2. one main property and other additional properties, providing the additional properties do not have individual rateable values of more than £2,200, and the combined rateable value of all the properties is under £15,000 (or £21,500 in London). The threshold for the combined rateable value is dependent on the location of the main property. The main property is the only one that will have the relief applied to it.

In addition to this relief on liability, eligible businesses with rateable values of between £10,000 and £14,999 (or between £10,000 and £21,499 in London) will have their liability calculated using a small business multiplier.

The Small Business Rate Relief scheme is funded by a supplement on the rate bill of those businesses not eligible for the relief. This supplement is built into the standard multiplier.

From 1 April 2007, eligible ratepayers need only apply once during the revaluation period for relief, including those with rateable values between £10,000 and £14,999 (or between £10,000 and £21,499 in London). If your business ceases to be eligible on a day during the financial year, the relief will cease on that day.

You must submit your application for the relief to your local authority within six months of the end of the financial year to which it relates - for the 2009/10 financial year, the last date for applications will be 30 September 2010.

Assuming a business meets the eligibility criteria, the relief can only be granted if the property the business occupies is on the rating list from 1 April. The date of occupation of the property is irrelevant, the key date is the effective date given to the property in the rating list. If the property has an effective date after 1 April, then the relief can only be applied for from 1 April of the following year.

Empty Property Relief

From 1 April, 2008, 100% empty property relief is available for just three months on office and retail premises and for six months on industrial and warehouse premises. After this time full rates become payable.

Empty property relief is available to the owner - in this case the owner is the person entitled to possession of the property in question.

If part of your property is not being used and is completely unoccupied for a short time then your local authority may consider giving you relief, if they decide you are entitled to it, and reduce your payment on the part of your property that is clearly unoccupied and beyond use for a short period of time.

Your local authority can choose to ask the VOA to divide the current rateable value between the parts of the property that are occupied and those which are not occupied. If your application for this rate relief is successful, you will pay full rates on the occupied part of the property and 50% in respect of the unoccupied part.

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2.7 Purchase with a Mortgage or Cash Purchase?

The way you finance your property purchase can make a significant difference to the amount of Income Tax you pay, regardless of whether you are an investor or a dealer.

The two feasible options you have to purchase your property are to either arrange a mortgage, or to buy outright with a cash lump sum.

Both methods are discussed in the following sections.

2.7.1 Tax benefits of buying with a mortgage

The most tax efficient method for acquiring a property is to purchase your property using a loan.

If you decide to use a loan then the type of loan you use is likely to be a mortgage. The reasons for this are because the interest rates are cheaper, and they can be repaid over a longer period of time than a conventional loan.

The biggest benefit of using a loan is that you can claim tax relief on the interest you are charged.

If you are an investor, you can claim tax relief against the rental income, and if you are a developer you can claim tax relief against the income you receive when you sell the property.

It is good tax planning if you have a large loan, as the larger the loan, then the more interest you pay, upon which you can claim tax relief.

At this point it is worth considering what we mean by a **large loan**. It is possible, using a number of methods, to purchase a property using a 100% loan. Although this would be the most tax efficient way, it is very risky and therefore we class a maximum 80% loan as a **large loan**.

It is safe to say that an 80% loan to value is not only a tax efficient method, but also the best non-tax related strategy for purchasing your property.

If you do opt for an 80% loan to value, then you will be expected to fund the 20% deposit from your own sources.

Example 11: Buying properties using mortgages and loans
Mr Investor is a basic rate taxpayer and he buys a property for £25,000 that requires development. He pays £5,000 deposit and gets a £20,000 mortgage. He then develops the property with a £10,000 loan and after 6 months sells it for a profit of £20,000. Over the 6 months the interest charged for the £20,000 purchase loan was £900 and the interest on the £10,000 development loan was £500. He can therefore get a tax relief of £1,400, which means he is only liable to pay Income Tax on £18,600.

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Key Tip
Any interest paid on a loan that is used exclusively for the purchase or development of a property can be offset against tax. The type of loan (i.e. mortgage) is not the critical factor - its purpose is.

The table below shows some of the methods that are typically used to source your purchase loan:

Method	Comments
Remortgage existing property	You will release equity from your own home and use this to buy your investment property. You will get the cheapest interest rate if you use this method.
Buy-to-Let mortgage	This is the most common method for purchasing your investment property. The interest rate for the loan is about 1% higher than that of a remortgage.
Conventional loan	This will give you the highest rate of interest and over a short period of time. It is only beneficial to use this for small loans i.e. for development.

Cash Purchase
Purchasing a property with cash without using a loan is not a tax efficient purchasing strategy as you do not pay interest so you cannot claim any interest relief. (This means that you will have to pay more tax.) Also the cash will have probably come from a bank/building society account where you will be losing valuable interest.

Interest Only or Repayment Mortgage
Whenever you buy any property and are sourcing part or all of it with a mortgage then you will have two ways to repay the mortgage. Either you will take an interest only mortgage or you will opt for a repayment mortgage.

2.7.2 Interest only mortgages mean less tax

If you decide to opt for an interest only mortgage, you will pay less tax than a repayment mortgage.

This is because your interest repayments will remain the same throughout the period of the mortgage.

This is without doubt the most popular mortgage option for people who either invest or deal in properties. With this method the mortgage company only charges you interest on the amount borrowed.

When the duration of a loan comes to an end, the mortgage company will expect you to repay the original amount borrowed in one lump sum.

This lump sum payment is repaid using some sort of savings vehicle. However, most investors or dealers may well decide to sell their property before the mortgage reaches the end of its term, therefore negating the need to have a savings vehicle in place to pay the original loan.

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As you are only making the interest repayments on the loan, you can claim tax relief on all these payments.

With the interest only option, it is usually one's intention to make the tax payments from the net profit made on the property.

Example 12: Paying tax when investing using an interest only mortgage

Mr Investor buys a property for £50,000 and has a £40,000 interest only loan, with annual interest repayments of £2,000. He receives annual rental income of £4,000. Other costs of £500 mean that he makes an annual net profit of £1,500. Mr Investor pays tax at 20% and therefore is liable to pay a total of £300 in income tax.

He pays the tax from his net profit and this still leaves him with a cash profit of £1,200.

2.7.3 Repayment mortgages mean MORE tax

If you decide on a repayment mortgage then you will pay more tax than an interest only mortgage.

This is because each repayment pays part of the original loan. Therefore when the next repayment is calculated, it is based on the remaining mortgage amount. This method reduces your repayments gradually on a month-by-month basis, meaning that the amount of interest on which you can claim relief also reduces.

A repayment mortgage tends to be more popular with investors or dealers if they want to see their equity building up in the property quickly. By making these regular payments, the original loan will be paid off when the period of borrowing finishes.

Key Tip

Golden Rule: With a repayment mortgage, the interest on the loan can be offset against tax, but the actual loan repayment is taxable.

The considerable difference with this method is that you are likely to have to pay the Income Tax from a different source of income. Only if you are investing and you have a very high rental yield i.e. 13% or 14%, are you likely to pay your tax from the net profit.

Example 13: Paying tax when investing using an repayment mortgage

Mr Investor buys a property for £50,000 and has a £40,000 repayment loan, with annual repayments of £4,500. Of the repayments, £2,000 is for the interest and £2,500 is paid against his loan reducing it to £37,500. He receives annual rental income of £4,000. Other costs of £500 mean that he still makes an annual net profit of £1,500. Mr Investor pays tax at 20% and therefore is liable to pay a total of £300.

Considering that Mr Investor's outgoings are greater than his income, he has to pay the £330 from his personal savings account. This is not a problem for him as he can comfortably afford this and is happier to see that his loan has reduced by £2,500.

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This method of paying tax from a different source of income is used if you want to see your mortgage actually decreasing on an annual basis and you have sufficient funds to pay the tax from a different source, therefore allowing the equity to build in your property.

2.8 Typical buying costs

The costs associated with buying a property can either be offset against Income Tax if you are a dealer or against CGT if you are an investor.

Most people forget about the above fact and end up paying more tax than they should.

You should document the typical costs associated with the purchase of your property and keep these receipts so that when you come to sell your property, these can be offset against your tax bill. These can include solicitor’s costs, survey costs, Stamp Duty, Land Registry fees, Local Authority searches, broker's fee, lender's fee.

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3 Learning More About Her Majesty's Revenue & Customs

Remember: Knowledge is power and therefore the more you know about the HM Revenue and Customs, the better it is for you.

Rather than trying to avoid the Revenue it is far better to get clued up on its workings so you can stay one step ahead - it could save you a lot of money and help you to avoid unnecessary fines in the long run.

3.1 What Tax Returns must I complete if I have land and property?

If you are an investor, then you have to declare the income you have gained from land and property by filling out a self-assessment tax return which incorporates a Land and Property supplement.

If at a later date you dispose of your investment then you must also complete the Capital Gains Tax supplement.

If you are dealer and are not part of a limited company then again you must complete the self-assessment tax return.

If earning a living from property is your only income then you must also complete a self-employment supplement.

In order to inform the Inland Revenue of your properties and request the appropriate forms visit the Inland Revenue website:

www.hmrc.gov.uk

3.2 Important dates for your tax diary

If you have received income from land or property, then you must inform the Inland Revenue of the amount received. You are obliged to inform them that you have received such income in a financial year no later than 5th October of the following year.

For example, if you have received income from land or property during the financial year 2009/2010 then you must notify the Inland Revenue no later than 5th October 2010. Failure to do this could lead to you incurring an unnecessary fine.

If you are a property dealer and are self-employed then you must inform the Inland Revenue within three months of buying your first property. The form **CWF1** is used to notify the Inland Revenue that you have become self-employed.

Remember: YOU are obliged to inform the Inland Revenue and ask for the necessary forms to declare the income received. You are also obliged to inform the Inland Revenue of your property purchase and rental intentions. If you don't, you could be liable for fines and interest payments on any money owed up to double the amount.

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There are three key dates for your diary. These are identified and explained below:

6th April
In this month you will receive your tax return form if you have notified the Inland Revenue that you are receiving income from land or property.

30th September
If you want the Inland Revenue to calculate the amount of tax that you are liable to pay then you must return your tax form for the previous financial year no later than this date.

31st January
If your tax liability has been calculated either by yourself or by your accountant then you must return your tax for the previous financial year no later than this date.

Failure to submit your tax return by 31st January will result in a non-negotiable £100 fine.

This date is not only important for informing the Inland Revenue of your tax liability, but you must also make tax payments by this day.

If you submitted your tax return by 30th September, then the Inland Revenue will tell you how much tax you must pay by 31st January. Otherwise you will have to calculate your tax liability yourself or with the help of your accountant.

Tax payments due on this date fall into two categories:

Tax liability not greater than £500
If you owe the Inland Revenue no more than £500 in Income Tax then this full amount must be paid no later than 31st January.

Example 1: Tax liability that is less than £500
Mr Investor submits his first tax return to the Inland Revenue by 30 September 2009, for the financial year 2008/2009. He receives notification from the Inland Revenue that he has a tax liability of £400 that must be paid by 31st January 2010. Mr Investor promptly pays his tax before the deadline.

Tax liability greater than £500
If you owe the Inland Revenue an amount greater than £500 for the previous financial year, then you must pay this whole balance by 31st January. On top of this payment you must also pay an additional 50% of this amount. The remaining 50% of tax liability for the current year must be paid by 31st July.

This method of paying the previous and current financial years' tax liability is only valid if it is your first year of reporting profits in excess of £500. A further condition to this is that if more than 80% of the previous year's tax liability was deducted at source (e.g. PAYE) then these payments on account do not apply.

This method of **paying on account** is designed to ensure that taxpayers are never in arrears.

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Example 2: Tax payment on account
Mr Investor submits his first tax return to the Inland Revenue by 31st January 2011 for the financial year 2009/2010. His accountant has calculated for him that his tax liability for the previous financial year is £1,000. Therefore Mr Investor pays the Inland Revenue £1,500 by 31st January 2011. He then pays the outstanding balance of £500 by 31st July 2011. This effectively means that Mr Investor has paid his tax liability for the financial year 2009/2010 and has paid on account £1,000 of his 2010/2011 tax liability.

If you fall into this category and know that your current tax year's liability will be less than the previous year's, then you must notify the Inland Revenue so that the adjustment can be refunded. Alternatively if the current tax year's liability will be greater, it will be collected in your next tax return.

3.3 How to complete your Tax Return

It is strongly recommended that for the low costs these days of using an accountant, all assisted by the use of technology; it is well worth trusting someone else to review your personal tax affairs. Low cost providers such as taxzoo.co.uk or the managed service of a firm like cranleys.co.uk will quickly save you money in the long run and avoid any of those errors which could cost you dear.

For those willing to try it themselves, this chapter is for you.

With increasing investment in technology, the Inland Revenue has set up a website to allow you to complete your tax returns online. For those who don't want to use this method, it is still possible to use the postal service.

Using the Internet

This method of completing and submitting your tax return is strongly recommended by the Inland Revenue. The number of people using this method is increasing daily.

If you decide to use this method then you will need to register at the Inland Revenue website. Once registered, you will be given a unique Personal User ID and Password. These will be used when you want to complete your tax return.

This service offers the following significant advantages over the traditional postal method:

- It is a safe and secure method that can be used 24 hours a day.
- Tax is calculated automatically as you complete the forms (therefore no need for calculators!!)
- Online returns are processed much quicker.
- If the Inland Revenue owes you money i.e. you have overpaid tax, then it is refunded sooner.
- Once you have completed and submitted your tax return you receive an electronic acknowledgement (this means no more tax returns getting lost in the post!)

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Disadvantages are the same with any computer system or software – it is garbage in, garbage out. Make sure you understand the output. Prior to submission, make sure you understand the numbers.

Using the Postal Service
It is common for tax returns submitted through the standard postal service to take up to three months to process. This method may be of benefit if you want to get your tax return in quickly, but do not want to know your tax liability until approximately three months' time.

3.4 What if I don't complete my Tax Return?

As we have stated, it is your responsibility to notify the Inland Revenue that you have received income from land and property.

Before tackling the issue of **"what happens if I don't complete my tax return?"** it is worth considering why you might find yourself asking this question in the first place. There are two common reasons why the Inland Revenue is not notified about income, and why tax returns are not completed. These are **Tax Avoidance** and **Tax Neglect**.

3.4.1 Tax avoidance

Here we present you with the tax dodger. This is the person who deliberately wants to avoid paying tax so that he can have more money for himself. He will deliberately not inform the Inland Revenue of income from property and will therefore not complete a tax return.

The penalties for deliberate tax avoidance, also known as fraud, are severe if caught. Depending upon the severity of the fraud, the tax dodger will be fined and/or even sentenced to imprisonment. If you have a single property and have not paid liable tax, then the punishment will not be as severe as somebody who has amassed a property portfolio and has never paid tax.

The tax dodger is likely to be classed in one of the following two categories:

False Accounting or Deliberate Negligence
Here the tax dodger is the average non-taxpayer who is a relatively small operator and who would have a tax liability lower than £200,000. He will either be deliberately falsifying his accounts to limit his tax liabilities or will not even notify the Inland Revenue that he is receiving income.

If caught, the **Tax Inspector** will investigate him and by default, he will be charged interest from the date when the tax was originally due. On top of this he could be fined anywhere up to 100% of the amount due for trying to avoid the payment of tax.

If the tax inspector investigates this character then he could face either an **In-depth** investigation or an **Aspect** investigation. The latter is where only one figure i.e. rental income is scrutinised.

It is unlikely that an investigation by the tax inspector will lead to a jail sentence.

Serious Fraud
Here the tax dodger will have amassed quite a substantial amount of money through properties and is likely to have a tax liability that is greater than £200,000. If the Inland Revenue catches this character then the **Self Compliance Office (SCO)** will investigate him. This section of the Inland Revenue deals with serious fraud.

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If the SCO investigates this character, then it will most definitely consist of an **in-depth** investigation. If found guilty, a jail sentence as well as a severe penalty fine could be imposed.

3.4.2 Tax neglect

If you forget to complete and submit your tax return by 31st January then you will be fined.

If the Inland Revenue knows that you are receiving income, then you will be reminded on a regular basis that your tax return is overdue.

Failure to respond will lead to fixed fines and interest being charged on the amount due. If you are still not responding then the Inland Revenue will estimate what your tax liability is. This assessment is usually far greater than your actual tax liability.

Usually when one sees the estimate, it kicks starts them into completing their tax return just to prove that the Inland Revenue assessment is incorrect!

However, if the Inland Revenue finds out that you have not been paying tax then you could well be accused of **tax fraud**.

If you want to find out more about the penalties for late tax returns then you can download the following leaflet from the Inland Revenue from:

www.hmrc.gov.uk

SA/BK6 - Self *Assessment*. Surcharges for late payment of tax.

3.5 Why could the Inland Revenue investigate me?

The Inland Revenue has a statutory power to enquire into any tax return without giving a reason.

It is not only people who do not pay taxes who are investigated. Even people who pay taxes can be investigated. Therefore it pays to make sure your tax returns are complete and in order.

Below we look at reasons why the Inland Revenue may want to investigate you.

Random Checking
On an annual basis, the Inland Revenue will randomly check approximately 10,000 tax returns. No formulae or rules are applied to determine which returns should be investigated. This means that you are just as likely to be investigated if you were the first person to return your tax form or if you were the last person to return your tax form.

Returns Filed Late
If your tax return is submitted late, then not only will you be fined but there is an increased likelihood of the Revenue investigating you.

Large Capital Gains
If you are a property investor, realising large capital gains in any financial year could also trigger an investigation.

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Formulated Checking of Suspicious and Inaccurate Returns

This is a specific formulated test that the Inland Revenue performs on tax returns. The test looks for certain trends and inaccuracies that make them suspicious that the tax return is not correct.

Information Technology

Right at the outset of this book, we advised that better integration of IT systems was leading to the Inland Revenue investigating those who were either avoiding or forgetting to pay their tax.

An excellent example of this is related to DSS landlords. The Inland Revenue has been investigating all landlords who provide accommodation to DSS people to ensure that they have been declaring the income. This is possible because the DSS pay the landlords directly, and therefore they already have this information available to them.

Informers

They are people who deliberately inform the Inland Revenue that somebody is avoiding tax. It is not uncommon for a 'best friend' to be the one who has informed the Revenue that tax is not being paid. **So be warned!**

3.6 How do I prepare for an investigation?

If a situation arises where the Inland Revenue decides that they want to investigate your tax matters, then you must be prepared. Being prepared can be the difference between overpaying taxes and being fined, or legitimately paying less and the correct amount of tax.

Key Tip

The Inland Revenue wants proof to confirm that you have paid the correct amount of tax. Lack of proof is likely to result in you overpaying tax.

Below are some pointers aimed to help you prepare and have a stress free investigation. These are worth taking on board whether you are being investigated or not - they are simply basic rules of organisation that all clued up property investors should be aware of.

Receipts

If you are investing or dealing in property then you must keep all receipts for 5 years 10 months from the end of a tax year.

This is probably the most important piece of documentation you will have to support your tax return. Receipts are only valid if it is clear where the purchase was made from and how much was paid. Therefore it is vital that the receipt can be traced back to the place of purchase. Just a piece of paper with a price and date is not a valid receipt!

Keeping Records & Accounts

Being organised, although sometimes time consuming, is vital if you want to stay on top of your property and tax affairs.

Just as you will have receipts for any purchases, you should also keep records of incomes and outgoings for your property. Such records can be kept by setting up a spreadsheet.

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Keep all records and receipts in one place. If your records are held on computer, make sure that you regularly take back-ups and periodically print off a copy of the records. Keep printouts of records and all receipts in one file.

Also, it is a good idea to have a separate bank account for all your property related transactions. Not only does this allow you to see the status of your property account, but also if an investigation should take place then you will be able to quickly match up your receipts against your account transactions.

The Revenue has provided the following publication that can be downloaded from www.hmrc.gov.uk:

SA/BK3 Self Assessment. A general guide to keeping records.

Have a rough estimate of what your tax should be
If you know yourself what your tax liability should be, then you are in a better position to question the Revenue's calculations.

If you have kept accurate receipts/records, and use this e-book, you will be in a good position to calculate your tax liabilities yourself. If you want to be extra sure that your own calculations are correct, then you could employ an accountant to check over your calculations.

However, if you have a growing property portfolio or complicated tax issues then you would be well advised to employ an accountant. The accountant would be responsible for completing your tax return and calculating your tax liabilities.

Key Tip

Once an investigation has come to a conclusion, the Inland Revenue cannot re-open it for further investigation. Therefore it is in your best interests to have the investigation closed as quickly as possible!

3.7 Tax blunders

It is surprising the number of mistakes that are made on tax returns even by people who consider themselves pros so read on for a breakdown of some of the most common bloopers – and more importantly how to avoid them!

3.7.1 Capital vs Revenue expenditure

If there is one thing that the Inland Revenue is always on the lookout for it is capital related transactions which are not meant to be tax deductible. For example, people have been known to add a mortgage redemption cost as a capital transaction but this is in fact a penalty for ending the mortgage early. If the property was then sold it could be offset against the sale proceeds but otherwise it is not permissible as a cost.

3.7.2 Checking all repairs

It is amazing the number of people who overstep the mark and put down every item they buy for their personal use as a business cost without allowing for the fact that the Inland Revenue will pick up on this.

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Think what would be reasonable in terms of the expected repairs to be completed on a property and this should be acceptable. Otherwise you are asking for trouble and will be expected to come up with evidence for every single purchase made.

3.7.3 Cash

Cash is very difficult to trace and if unreasonable amounts of cash are spent without any supporting claim of where the cash came from then you could be in trouble. Of course good accounting and keeping accurate records can help overcome these issues but it is still frowned upon to use cash too much for purchasing goods and services. It can set alarm bells off with the Inland Revenue and may create the impression you have something to hide.

3.7.4 Personal items – deliveries

Make sure that any items are delivered to the address of your trading or investment property and not to your home address. Just because you have a product delivered to your home address does not necessarily mean that you are deliberately trying to defraud the Inland Revenue but it could still cause questions to be asked so better to be safe than sorry.

3.7.5 Size does matter

Hard to imagine but often the smallest things can make all the difference. Make sure you adjust your figures for any personal use and don't push your luck. The Inland Revenue are not soft and will pick up on unreasonable costs. For example, stationery is often siphoned off for personal use so ensure that the final costs are adjusted accordingly.

3.7.6 Pre-rental costs

The inclusion of costs prior to a first let is a common blunder made on tax returns. Typically costs claimed will include mortgage interest accrued between the purchase of the property and its being let. Remember that it does not become a rental property until it has actually been rented out. Once it has been rented, then costs can reasonably be offset against the rental income but not a moment before.

3.7.7 Void costs

Most void costs are permitted against the rental income of the property unless they are costs incurred by the tenant such as gas, electricity and council tax. This is because during the void periods there is no income for these costs to be offset against. Void times are ideal for catching up on repairs which can of course be included in your costs.

Top tip – get your builder to charge you for the cost of gas and electricity needed for the duration of his work so that you can them claim these as part of the costs of the repair work.

3.7.8 Training costs

Training involving the development of a new trade or skill doesn't permit you to get the tax man to pay for it no matter which way you look at it so think again. Steer clear of high level training courses in how to be a property developer – instead take advice from your accountant whose fees can be built into your costs along as it is supporting your rental business.

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3.7.9 Forgetting to sign your tax return

Believe it or not but there are a shocking number of tax returns sent in each year without a signature! No matter how accurately you have filled your form out it is not worth the paper it is printed on without your signature. The last thing you want is a fine for late submission of your form due to it being sent back to you unsigned so let this be a warning to you!

3.8 Questions to ask when choosing an Accountant

3.8.1 Tax advisors and their qualifications

A tax advisor can be a member of the Chartered Institute of Taxation or the Association of Taxation Technicians. They will have received formal training in taxation matters and can use the letters ATII or ATT after their name. Tax advisors can also be qualified accountants who have undertaken formal training. They will be a member of one of the accounting bodies and will have the letters ACA, FCA, CA, ACCA or FCCA after their name.

However, anybody can become a tax advisor; there is no statutory authority that governs tax advice. You should always request information about a tax advisor's background and experience before instructing them to deal with your tax affairs.

Appropriately qualified people to consider include practising members of:

The Institute of Chartered Accountants in England and Wales (ICAEW, ACA, FCA);

The Association of Certified Chartered Accountants (ACCA, FCCA)

The Chartered Institute of Taxation

The Association of Taxation Technicians.

Be well aware of unqualified individuals. The HM Revenue & Customs has made a recent public statement in favour of qualified accountants due to the problems experienced with unqualified accountants. Currently there is no legislation preventing anyone calling themselves an accountant which is completely different to the legal profession.

Chartered Accountants have the higher level of examinations, have an external review body auditing their work known as Practice Assurance, and they must comply with attending Continual Professional Training throughout their careers.

A qualified accountant or tax advisor will be able to prepare your tax return, calculate your liability and deal with any HM Revenue and Customs enquiries, as well as preparing accounts for sole traders and partnerships, giving tax planning and specialist advice.

Note that tax advisors will either charge per hour or a pre-arranged flat fee.

3.8.2 Specialist or general advisors - which are better?

Sometimes more expensive advisors work out cheaper in the long run! So, don't dismiss a potential advisor on cost alone!

For instance, property tax specialists may charge more than an average accountant may. However, the specialist can often provide the answer faster than the non-specialist can.

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The difference between a specialist and a non-specialist is that the specialist tax advisor can give you an immediate answer, whereas the non-specialist may need to spend some hours researching the question (and the HM Revenue & Customs documentation) before providing an answer.

So an example of costs might be:

Specialist Advisor £270 per hour
(Including 15 minutes to clarify issues with client and 45 minutes to provide a written response)

Total 1 hour, cost £270+ VAT

Non Specialist Advisor £120 per hour
(Including 15 minutes to clarify issues with client, 1.5 hours to research topic and 45 minutes to provide written response)

Total 2.5 hours, cost £300 + VAT

For a specialist advisor with low fees attached we can recommend the author Colin Davison, **www.cranleys.co.uk** and associated **www.property-accountant.co.uk**

So, the specialist - costing over twice as much, actually costs you less! This is why it is so important to establish whether or not your advisor knows the topic in detail or whether they simply '*know of it*'.

If you find that you are asking questions that your accountant needs to research - or worse still - needs to ask a specialist, then you are considerably increasing your costs.

Try to establish two things when you set out your working relationship. First of all, find out the area of specialist knowledge that your advisor can offer and make sure that you make it clear to your advisor to tell you before '*conducting research*' or contracting with other advisors so that you can establish contact directly with appropriate experts.

Note: If your tax arrangements are simple and they are likely to remain static (i.e. you'll buy and hold just a few properties) then you may find that cheaper, more general based tax advice is sufficient.

Having an advisor who can work with you on other projects, and even assisting your business friends in other areas, is of great benefit as the personal relationship with an advisor is vital to your success with them.

Having a free hour's consultation such as that offered by Cranleys can be a way to test the water as well as using their time to understand your problem. Obtain a fixed fee for the work and then you will not receive any surprise bills or shocks later!

3.9 Finding the Right Advisor

Finding the right advisor is reliant on your ability to define the tax and accounting services that you will require.

This sounds easier than it really is! That is because you are attempting to make a choice based on your prediction of your future requirements.

And, as we all know, the future rarely turns out as we expect!

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3.9.1 Find someone you can work with

For this reason, as well as finding someone with the right skills and depths of knowledge, it is also very important to be able to establish a good working relationship with your advisor at the outset.

A good working relationship is key to being able to solve those unknown future problems.

3.9.2 Think of a professional relationship as an investment

In addition, it is often a good idea to look for an advisor who is of a similar age! Yes, that's right, age does matter - let me explain why…

If you are a budding property entrepreneur of 25, then you'll very likely be looking for an older, more experienced advisor. However, if you choose an advisor already aged 55, you'll find in 10 years (or possibly less) that one of your key advisors is about to retire!

At the age of 35, your property business will no doubt be a small empire and growing - the effort of finding a replacement advisor and the loss of knowledge and working relationship will cost you very dear.

Instead, look for advisors who are closer to your age - so that as you and your business grow, they grow too!

That means that you are setting up the relationship for the long term.

You'll also find that the interests of a 35 year old advisor will be closer to those of the 25 year old entrepreneur - i.e. they both want to develop and grow their careers/ business.

Obviously, a 55-year old accountant will be more focused on retirement and possible IHT issues. So, if these issues feature in your short to medium term goals, then you might be wise to look for someone a little older.

3.9.3 How to find a good tax advisor

This is a three-step process:

Step 1
Write down your investment / business goals.

Specifically, try to decide whether you are looking to buy one or two properties for long-term rental and eventual capital gain - or will you be highly active (i.e. buying or selling or letting or renovating lots of properties).

If your 'churn' rate of properties is relatively low, then you will probably be looking for a relatively simple tax structure - which requires less specialist knowledge.

If you will be churning lots of properties or buying units in bulk, then you are more likely to make use of trusts, companies and so forth. Hence, you'll probably want a more specialist/ knowledgeable advisor.

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Step 2
Ask anyone and everyone for recommendations and create a short list of potential advisors.

In particular, ask the following:

Local property investors/ dealers - these are the guys who have first hand experience and knowledge.

Your bank manager. High street banks will have close contacts with Chartered Accountants and Certified Accountants in your area. They will understand your needs and match them with your accountant's interests.

Your lawyer. Lawyers and accountants tend to work very closely together and often pass work between them. If you have already found a good lawyer that you enjoy working with, the chances are that your lawyer will be able to recommend a good accountant.

Remember that the lawyer will be keen (after all he'll want to keep your business) to ensure that you find the right accountant. In addition, a lawyer will be able to recommend accountants based on professional experience.

Step 3
Meet with your prospective advisor and work through these questions:

Do the long-term goals of your advisor match your own?

Are you of a similar age/aspiration?

Does the knowledge of a prospective advisor match that of your investment/ business goals?

Are you clear about your advisor's costs and charging (it is a good idea to start the relationship off on a charge per project basis - this allows you to stay in control of any potential costs).

Are you clear about how the relationship will work if you require additional advice outside the knowledge/scope of your agreement?

Key Tip

Sometimes a general advisor will '*discount*' the cost of additional research if they think the knowledge can be used to advise other clients.

The advisor who helped create, edit and shape this book also offers advice and help. If you've found this book valuable you might consider contacting Colin Davison, chartered accountant and tax advisor.

3.10 Making your Accountant pay!

A good accountant comes at a cost, but they should be worth every penny when it comes to saving on tax. If you can save your accountant's time and avoid mistakes - you'll be even better off in the end.

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3.10.1 Set parameters from the beginning

Have an engagement meeting with your accountant and share your vision. This will help decide the most efficient way to meet your property objectives. For example, whether you should be using a company structure for your dealings or not.

3.10.2 Work as a team

Treat your accountant as a team member. Keep them informed as you reach goals or change direction. That way you always maximise tax savings.

3.10.3 Keep good records

Create and maintain a system to record income and expenditure on an ongoing basis. Keep receipts orderly too. This saves your accountant time - and means you pay less. Mistakes will be made if you leave things to the last minute. Keeping records is a legal obligation if you are a sole trader or limited company.

3.10.4 Prepare for a tax return

There are 12 main areas you need to cover:

1. A P60 showing salary and tax paid as a result of employment. Or a pay slip for March.
2. A form P11D which shows benefits in kind connected with employment for the year.
3. Details of any other income for the year.
4. Rents received and expenses paid for let properties, including mortgage interest.
5. Certificates of interest paid on other loans.
6. Details of assets bought or sold.
7. Pension contribution details and/or received payments.
8. Details of interest received on money in bank or building societies.
9. Dividend counterfoils or vouchers for fixed interest stocks.
10. Certificates for bonds and life policies.
11. R185/R185E forms if you have been the beneficiary of a settlement.
12. Details of charitable covenants paid or payments under Gift Aid.

Not all of these will always apply, but you won't miss tax relief if you use this 12 point checklist.

3.10.5 Avoid fines

Give your accountant plenty of time to prepare your tax return and assess your liability before the 31 January deadline. Remember you're not the only client on their books! Failure to do so will result in fines, surcharges and interest payments - you can't blame your accountant if you are late with your returns.

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3.10.6 Do easy things yourself

There is a wealth of information and guidance available on the HM Revenue & Customs website **www.hmrc.gov.uk**. Some things can be done easily yourself.

For example, you can set up your own company on your own for just £15 - and you can submit your own stamp duty land tax forms without paying fees.

3.10.7 Offset your accountancy fees

Your accountant's fees can be offset as an expense against tax.

So the accountancy bill you get for saving yourself thousands of pounds can itself be used as a tax saving measure.

We all hate paying tax, but you can't say fairer than that!

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4 Tax Strategy For Individuals & Partnerships

Having purchased your property you will now be looking to make sure that the effort you put into reducing your buying costs have not gone to waste. This means that you need to formulate an ongoing tax minimisation strategy.

4.1 Never Sell Strategy

Never a truer word was spoken when Benjamin Franklin said, 'In this world, nothing is certain but death and taxes'.

Whilst we obviously can't avoid death and we can never completely avoid tax, there are ways to eliminate or at least reduce our long term tax liability.

Any self-respecting property owner is familiar with the 'never sell' strategy - on paper it makes perfect sense - Capital Gains Tax (CGT) is never paid because you never realise the gains and CGT is waived upon death.

And Inheritance Tax (IHT) is paid on the net value of the estate, not capital gains so if the property portfolio is 'gifted' to your children more than seven years prior to death this too will avoid tax; however, if you transfer these to your children there will be CGT to pay unless you plan to transfer a small amount every year. This amount will need to be within your tax free level.

During your lifetime, the never sell policy works and seems to make good sense but without being too morbid this only works if you know roughly when you are going to die!

Another problem with the never sell policy is that banks will only lend people money until a certain age and mortgages must be settled sooner or later.

Banks are not concerned about equity or how wealthy you are in assets; banks are concerned about solvency and the ability to repay the mortgage within the mortgage period. So, in short - you can only borrow money and draw equity from your mortgages for so long...

The other problem is a common one - too much planning revolving around tax-savings. Whilst tax-planning is essential, not every decision should be decided upon by the tax implications. Economic gain, sustained income and provision for your lifestyle and dignity in old-age should be the core of the decision-making process, and within that framework provide for direct and indirect taxes.

Certainly provide for CGT but don't over plan for it. CGT is always determined on the difference of proceeds and cost - the value of the mortgage is irrelevant for CGT purposes.

So basically the never sell policy is fine but should be carefully managed, taking all the aspects into account and making the decisions for the right economic reasons, not purely for tax reasons.

So what are the alternatives to the never sell strategy?

If like the majority of people, you are (thankfully!) not sure when you are going to die, gifting equity drawn from your property portfolio over an extended period of time is a viable alternative to the never sell principle.

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This means that you won't be liable for CGT as no transfer of an asset occurs and assuming the whole estate has been gifted by the time you die, IHT will be nil too. Of course holding a minimal deposit will prevent you from transferring everything but you can certainly aim for the ideal!

However, as is often the way with tax strategies, they can create as many problems as they try to resolve!

Gifting means that you avoid CGT and IHT but by doing this, you actually create a bigger tax burden for whoever you have gifted your portfolio to - not an ideal situation by any means.

They hold an asset which they acquired at no cost, and in effect, the full proceeds of the disposal are going to be taxed after applying taper relief.

That now means they have no choice but to adopt the 'never sell' strategy to keep the equity intact.

Don't forget that gifting requires change of ownership and that requires stamp duty and legal conveyancing costs too.

So on reflection, gifting might not be the solution after all, contrary to what many property experts claim.

4.2 Wealth plan

It is time to get back to basics and devise what is known as a 'wealth plan' - a map of your economic objectives.

The plan consists of a number of components including your wealth objectives, when the assets you have accumulated will have to be paid for, what income/equity you will need at various stages in your life, what assets and equity can be gifted, what IHT taxes will be due, etc.

Then we find the best alternatives to achieve all those plans and requirements - for each requirement we have an action plan.

An invaluable part of this wealth plan is current planning to provide for maintenance costs, letting agency fees, interest rate changes, changes to council taxes, changes in stamp duty rates, inflation, the 'what ifs' of personal cash-flow shortages, loss of income, etc.

A carefully thought out wealth plan includes provision for income for the surviving spouse while the estate is being wound up. Property-laden estates generally take much longer to resolve than those that don't.

So with careful planning you can provide for the next generation, but what about beyond that?

Don't forget about those gorgeous grandchildren you like to spoil...to really make sure that your family is provided for, for generations to come, multi-generation planning is required.

Whilst gifting ownership to your children individually is fine if you have enough to go around, it can also create problems.

The more generations that get added, the more complicated it becomes. Just ask the Rockefeller grandchildren...

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This is where a Trust comes into its own to guarantee long-term wealth sustainability, asset protection, and apportioning benefit to a number of people without apportioning ownership of the properties.

A Trust is set up by the 'Settlor' to gift assets to Trustees who now legally own the assets and which they hold on behalf of persons who the Settlor wants to benefit (the Beneficiaries).

The Trustees must always act in the best interests of the Beneficiaries and are controlled by the terms of the Trust.

There are several classes of Trust, each class being taxed differently.

Trusts offer the opportunity to reduce the potential liability to IHT and there are a number of advantages in using Trusts.

Any increase in capital within the Trust would be outside your estate for IHT purposes, provided that you (the Settlor) are specifically excluded from benefiting from the Trust.

Some Trusts allow the Settlor to enjoy an income from the Trust, and after seven years all the original investments into the Trust could be outside your estate for IHT purposes.

Through a Trust you can control who receives the capital and income, and when it is received.

Put simply, you cannot completely avoid CGT and IHT - what you gain with one hand you often lose with the other - so the best bit of free advice you're likely to get with regard to tax is 'plan for it, don't avoid it at all costs'!

4.3 Abolition of taper relief

The reduction of CGT from 40% to 18% from April 2008 was cause for celebration for many property investors but for others, it is something of a double edged sword. At the same time, the Chancellor also abolished taper relief which was used by many investors, highly effectively, to reduce their capital gains tax bill.

The amount of relief claimed depends on how long you held the property. In some cases, taper relief enabled CGT to be reduced to 10% so with the abolition of this relief and the introduction of the new flat rate of CGT, this could result in an 80% hike in the amount of CGT payable – not good news at all!

To take the sting out of the tail, the Chancellor announced the introduction of 'Entrepreneurs' Relief' in his Budget of March 2008. This relief effectively reduces CGT to 10% on the disposal of up to £1m of assets. Over £1m and the flat rate of 28% applies.

However reading the small print, unless your business involves furnished holiday lettings, landlords are not eligible for Entrepreneurs' Relief which comes as a real blow for property investors who would have been able to take advantage of the now defunct taper relief.

This is where getting expert advice is crucial – there are a number of perfectly legitimate ways to minimise the adverse effects caused by the abolition of taper relief and, depending on how you choose to define yourself (see Section 1.3 What are you? for more information), ways to take advantage of the new Entrepreneurs' Relief.

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4.4 Timing sale of property to minimise CGT

You should always consider when the best time to sell your property is. By considering the following matters you could save considerably on your CGT bill:

If you are selling more than one property then try and sell over more than one tax year so you can spread the CGT over a longer period and take advantage of your annual £9,600 allowance.

Ensure that you capitalise on the 36-month rule if you had a property as your PPR and are letting it out. If you can hold out for three complete years after you moved out of the property then you will have no CGT bill.

4.5 Personal CGT allowances

Making sure that you use your annual personal CGT allowance when you sell your investment is a must. Similarly, if you have a partnership, make sure that the CGT allowances of all partners are used.

You are not allowed to carry forward any unused personal allowance into a future tax year.

4.6 £160,000 capital gain with a CGT bill of less than £2,000. Really?

Now let's work through a very realistic example where we will apply all the reliefs that have been covered in this chapter in a realistic and life-like example.

This should help you to understand how all the reliefs can work together to your advantage.

In April 1987, the bachelor Mr Investor purchased a house for £80,000. He got married in July 1993.

Unfortunately when he decided to sell his house in July 1993, he actually only got £66,000 for it, which meant he had a £14,000 loss. (He had allowed his property to become run down and it deteriorated considerably!).

On 1st September 1993 Mr Investor and his wife purchased a house for £100,000.

The property was purchased in the sole name of Mr Investor. During their stay in the property they had a conservatory built to extend the property, which was the first piece of work that was done in September 1993. The cost of the conservatory was £10,000.

Mr and Mrs Investor decided to move to a new house after the arrival of their son, Investor Junior. Therefore on 1st March 1995 they purchased a new home, which became their new PPR.

They realised that their previous residence was located in a very sought after area and therefore decided to rent out the house instead of selling it.

Their aim was to generate a good rental income as well as good capital growth from the property! The property has been successfully let out since April 1995, with very few void periods.

In April 2002, Mr Investor thought that, given the property price increases over the past years, he would get his house valued.

His house is valued now at a whopping £260,000. A gross profit of £160,000!

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After the initial hyperactiveness and jubilant cartwheels, he realises that much of the gain could be going back to the taxman as he was a higher rate taxpayer.

He therefore hires an accountant to calculate exactly what his liability would be if he sold the property.

His liability is calculated as follows:

Action	Description
Property Costs	
Property Sells Value	The property can be sold for £260,000.
Calculate original property price & 'allowable costs'	Mr Investor and family incurred buying costs of £1,900. If they sell the property now they will also have selling costs of £600. Mr Investor incurred a capital cost of £10,000 for the conservatory. This means that their total allowable costs are £12,500.
Private Residence Relief	
Calculate and deduct private residence relief.	Mr Investor is able to claim partial residence relief. Therefore the 18 months in which he lived in the property are exempt from CGT. Also he can make use of the '36 month rule', which means that another 36 months are exempt. This means that 54 months from a total of 104 months (Sept 1993 to May 2002) are exempt from CGT. 54/104 = 52% Partial Residence relief exemption. Therefore 52% of £131,163 = £68,204 exempt.
Subtotal Gain after private residence relief.	Gain after private residence relief is: *Gain after indexation – Private residence relief* £131,163 - £68,204 = £62,959

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Private Letting Relief	
Calculate Private Letting Relief	Mr Investor is also eligible to claim private letting relief. This is because the property at some point was his PPR and since moving out he has rented it out. He is able to claim a relief of £40,000, as this is the lowest of the three relevant options.
Subtotal Gain after Private Letting Relief	Gain after private letting relief is: *Gain after private residence relief – Private letting relief* £62,959- £40,000 = £22,959
Allowable Losses	
Calculate Allowable Losses	Mr Investor did actually have a loss on his first property (the bachelor pad) that he declared to the HM Revenue & Customs. The loss that he incurred was £4,000.
Subtotal Gain after allowable losses	Gain after allowable losses is: *Gain after private residence relief – allowable losses* £22,959- £4,000 = £18,959

Personal CGT Allowance	
Determine annual CGT allowance.	The personal CGT allowance for 2010/11 is £10,100, and Mr Investor is also eligible to receive the relief.
Final Total Amount chargeable to CGT.	Amount chargeable to CGT is: *Gain – Annual CGT allowance* £18,959 - £10,100 = - £8,859 Therefore Mr Investor's CGT liability is 28% of £8,859 which is **£2,481.**

There we go! This is a very genuine and life-like example that shows how you can have a huge gain and pay very little to Mr Taxman. If you adopt a tax strategy before you invest in your next property this could be you in 7-10 years time!

Even better, this could be you now, and you have just realised it!

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4.7 Using the 'Get Out of TAX Free' card

If you have not planned your CGT strategy from the outset and have bought a property and let it out immediately, then there is a strategy which can be used to dramatically reduce your CGT liability. In fact, if you are shrewd or lucky enough then you can avoid CGT altogether.

Key Tip

Always consider (if possible) making your investment property with the biggest capital gain, your PPR at some point. If you do, then you too could have huge amounts of capital gains that are free from tax!

The tax man classes your home as your 'Principal Private Residence' (PPR) and in order to prevent people from being hit by a big CGT bill when they sell up and move on, Private Residence Relief (PRR) comes into play.

In a nutshell, if you are looking to sell an investment property, then PRR holds the key to cutting down and possibly eliminating, your CGT liability. You would have to be prepared to live in the property for a period of time but in terms of the potential tax savings to be made this could be a very shrewd move indeed.

There are two types of PRR - full residence relief which applies when you have lived in a property for the entire period of ownership - and partial residence relief which is when you sell a property that has been your principal private residence for some of the period of ownership.

The amount of partial residence relief that can be claimed is calculated by taking a fraction of the periods of occupation over the period of ownership.

For example, if you lived in a property for two years out of a 10 year period of ownership then you will be entitled to one fifth relief.

With some careful planning, investors can take advantage of full residence relief to really reap the rewards and eliminate their CGT liability altogether!

4.8 How does Full Residence Relief work?

By applying what is known as the '36 month rule', full residence relief can be applied and if used correctly and genuinely, then a property investor could continue to expand their portfolio without having to pay CGT at all.

So what is the 36 month rule? Basically if you own a property that was your PPR at some point then the last 36 months will qualify for relief.

Say you purchased a property for £50,000 five years ago, lived in it for two years and then rented it out for three years before selling it for £100,000. You would expect to be hit with a huge CGT bill right? Wrong!

Believe it or not, in this example, there would be NO CGT to pay at all. How come? Well, no tax is due for the first two years of ownership because it was your PPR so qualifies for full residence relief and under the 36 month rule, no tax is due for another three years whilst it was being rented out.

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It is worth pointing out here that taking advantage of the 36 month rule and property residence relief is all well and good but make sure that you use it wisely. There is a fine line between careful tax planning and tax evasion and the consequences of tax evasion are just not worth contemplating!

Basically as far as the tax man is concerned, you need to prove that the property in question was genuinely your private residence.

In order to do this it is worth adopting the following pointers:

- Have utility and other bills in your own name at the property address. These will include gas bills, water rates, electricity supply bills, council tax bills, TV licence etc.
- Make the property address is your voting address on the electoral register.
- Be able to demonstrate that you bought furniture and furnishings for the property. Keep receipts and prove that bulky furniture was delivered to the property address.
- Have all bank statements delivered to the property address.

How long do I need to live in a property before it can be classed as my PPR?

The Inland Revenue doesn't give any specific guidance as to how long you need to live in a property but the general rule of thumb is that you should try to make it your permanent residence for at least 12 months.

Does this mean that I can live in properties for short periods of time and claim PPR on each property?

If you intend to do this purely as a tax avoidance strategy then the answer is no. The Inland Revenue take a dim view of this being used and will class you as trading so you will be liable to pay income tax.

The more sensible way of using residence relief is to move around as infrequently as possible and not to sell the property as soon as you have moved out.

As a property developer, you can use residence relief to your advantage via the 12 month relief rule which is a powerful tax saving strategy used by many a budding developer.

So how does this work? Basically if you buy a property and don't move into it immediately then you can still claim relief for the first 12 months. This means that you have got 12 months in which to complete any renovation work on the property before it has to be occupied.

Again this should be used carefully and wisely so as not to bring about a challenge from the Inland Revenue.

A more subtle approach would be to live in properties for a longer period and either reduce the number of properties in the portfolio or be willing to pay income tax, as an alternative to CGT, on some of the properties once sold.

This way everyone is happy and it is far preferable to pay income tax on one or two properties than on ALL the properties in your portfolio.

Private Letting Relief works on the same principle and is a relief that can be used when you sell your PPR, and where part or all of it has at some time in your period of ownership been let as a residential accommodation.

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The amount of private letting relief that can be claimed cannot be greater than £40,000 and is the lowest of three values. It is best illustrated via a case study.

Example:
Mr Investor buys a three-bedroom semi-detached house for £50,000 in 1990.

He lives in the house for two years and then decides to move to a bigger four-bedroom detached house. He rents out the three-bedroom house for the next five years.

In 1997 he sells the three-bedroom house for £120,000. This means that he has made a capital gain of £70,000.

5/7ths of the profit is exempt from CGT because he is able to claim partial residence relief (two years PPR and the 36-month rule).

This means that he is only liable to pay CGT on the remaining £20,000 of chargeable gain. However, Roger is also able to claim private letting relief, and the amount he can claim is the lower of these following three values:

£40,000;

amount of private residence relief already claimed is £50,000;

amount of any chargeable gain that is made due to the letting is £20,000 (assuming that property increased by £10,000 in each of the two years that the property was let).

This means that Mr Investor is allowed to claim private letting relief of £20,000 as this is the lower of the three values.

Therefore the outstanding chargeable gain of £20,000 is cancelled out by this relief, which means that he has absolutely no CGT liability.

In other words, Mr Investor has made a tax-free capital gain of £70,000 just by having lived in a property for two years!

4.9 Transferring and gifting properties

There are basically two ways to dispose of your property. One way is to **sell** the property and the second is to **gift it away**.

The method of gifting is referred to as **lifetime transfers** or **lifetime gifts**.

The rules and guidelines surrounding transferring/gifting are very complex and you should consult a tax specialist if you find yourself in this position. In this chapter we will address in general the issues that can arise when you decide to either gift / transfer a property.

With the tax allowance being on offer for the receiver it is attractive to make a gift as well as making the other party wealthier and reducing you IHT liability.

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4.10 Strategies for gifting / transferring properties

4.10.1 Realise other capital losses

If capital losses are expected in the near future, wait to transfer the property until the tax year in which the capital losses crystallise, so as to offset one against the other.

Of course, if the capital losses have already been realised then consider transferring the same year so that you can offset both the losses and also use your CGT allowance for the same year. For example, if you wait to transfer the following year then you will have missed out on a year's worth of CGT allowance.

4.10.2 Switching ownership to maximise lower tax band

Don't forget that married couples can freely transfer ownership between each other, so consider apportioning the property ownership split so that most of the tax is paid at the lower tax rate. For example, if your wife is a lower rate taxpayer then she could have a greater split (i.e. 75:25, which means tax at a lower rate!).

Example 5: Transfer property to utilise lower rate tax band

Mr & Mrs Investor are a very successful young couple, who are working full time and are both higher rate taxpayers. They have a property in joint names, which is generating £4,500 monthly net rental income on which they both pay 40% tax on their share of profits. The property was purchased in June 2007 for £110,000.

They are planning a family, and have decided that when this happens Mrs Investor will give up work to become a full-time mother.

Eliminating Income Tax

When nature takes its course in 2011, Mr Investor transfers his half of the property into the sole name of Mrs Investor. This now means that she is the sole owner. However, more importantly, there is no 40% tax to pay on the rental income as it is absorbed by her income tax allowance.

This means that just by transferring the property they have saved £900 per annum in tax. This is because Mr Investor no longer has property related income. However, they have actually saved £1,800. This is because £900 is due to the transfer and £900 due to Mrs Investor giving up work.

They have saved nearly £2,000 in tax just by transferring and splitting the property share ownership in this fashion. This is when compared to a 50:50 split.

Key Tip

Consider switching ownership to spouse if they are not working!

Transfer a sufficient amount to the spouse to use their annual exemption by splitting the property share ownership.

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4.10.3 Utilise annual exemptions – transfer in stages

If you need to transfer ownership to anybody except your wife, then you should consider transferring in stages so that you can use your annual CGT allowance. By doing this over a number of years you could eliminate most of, or even your entire CGT bill.

Example 6: Transferring in stages

Mr & Mrs Investor buy a terraced property for £35,000 in 1997. Their plan is to gift the whole property to their son in six years time when their son reaches the age of 21.

However, in 2000 (three years later) the property is valued at £80,000 and they realise that if property prices continue to increase then they will have a large CGT liability if the whole amount is transferred. This is because they are higher rate tax-payers.

To avoid any CGT liability they decide to start transferring the capital gain in stages as soon as he turns 18 in the year 2000. By using their annual CGT allowances, they can roughly transfer £20,000 to their son on an annual basis.

By the time he turns 21, they have transferred £60,000 of capital gain on the property to their son without any CGT liability. They have the property revalued and it is now worth £80,000.

Because their profit on the property is £45,000 (£80,000 - £35,000) they can now stop transferring the property and give their son full ownership. This is because they have fully transferred their capital gain, and have no CGT liability.

Had they transferred the property in one lump sum then they would have a sizeable CGT bill!

Key Tip

If you will be gifting to your children then consider gifting in stages and as soon as they turn 18.

4.10.4 Gifting on death

If you are gifting on death, your solicitor will read through your will and disperse your estate as you have instructed. No tax considerations will be taken. The important point to note here is that if your inheritor has any tax liability outstanding, due to the inheritance, then this **must** be paid before the estate is handed over!

4.11 Don’t lose your PPR!

As we have seen in various chapters/sections throughout this book, it can be very beneficial to set up a property in joint names, or move it into joint names to save on tax.

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Key Tip

However, one golden rule to take into account is that if a property has been your previous PPR, then it may not be advantageous if you gift/transfer part of your ownership to a person who cannot claim PPR when it is sold.

4.12 Don't forget your children!

There is one common goal that every parent shares. This is to try and give their children the best possible start in life.

No parent wants to see his or her children financially struggling in life.

The good news is that by investing in property wisely and tax efficiently by using your children you can give them total financial independence and keep your savings for yourself!

Buying a property in the name of your son and/or daughter is becoming more and more popular, and people are taking this route to shield themselves from both income and capital gains tax.

Due to the fact that each unmarried individual can have a main residence, it can be excellent tax planning to purchase a property in the name of a child once they reach the age of 18.

An important point to note is that if your child is not working then it is unlikely that they will be able to get a mortgage. However, you can quite easily get round this by acting as a guarantor for the mortgage.

Here are some useful tax saving strategies where children are involved!

4.12.1 Higher/Further Education

If your child is going to university, then you might decide to buy a property instead of having them live in university accommodation.

The longer the course, the more sense this makes.

The benefit of doing this is that because your child will be living in the property, it will be their main residence, and therefore when they come to sell, the CGT liability will be reduced.

Also, if the other rooms in the property are rented out then an income is received that not only covers the mortgage but can also provide some additional cash too!

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Example 7:	**Buying properties for children in higher education**

In 1997, Miss Jenny Investor, passes her exams and gets a place at Newcastle University to study a five year course in medicine. Instead of going into rented accommodation, Mr Investor buys a four bedroom terraced property, in the name of his daughter for £50,000. He provides the £10,000 deposit and acts a guarantor on a 25-year residential mortgage for the outstanding £40,000. The monthly mortgage repayment is £150.

Because the property is located close to the university, they quickly manage to find suitable tenants to take the remaining three rooms at £175 each.

This means that she has a monthly income from rent of £525. After her mortgage is paid, she still has £375 profit. This is enough to fund her whilst she is at university.

Income tax situation

There will be no income tax liability on Jenny as she is able to make use of the rent-a-room relief.

CGT situation

After 5 years she completes her course and lands a job in a London hospital. She decides to sell her house and makes a £50,000 profit.

She has no CGT liability, as it was her main residence for the duration of her university course.

This has turned out to be a FANTASTIC investment for both Mr Investor and his daughter.

His original £10,000 investment has not only given his daughter a tax free £50,000 lump sum, but it has also provided her with a regular income during her university period! Now I can't think of many better graduation gifts than this!

If Mr Investor had not purchased the property in the name of his daughter, he would have been liable for income tax each year during the 5-year rental period, and he would have also had a CGT liability when the property was sold!

4.12.2 Getting your children on the property ladder!

We all know how difficult it is for first time buyers to get onto the property ladder.

Well, another useful strategy is to buy a property in the name of a child as soon as they turn 18. However, in this instance, your child still lives with you, but has his/her own property from where they can generate an additional income.

Later, when they decide to move out of the family home, they can either move into the existing BTL property, (taking advantage of the main residency tax benefits), or they can continue letting the property for additional income.

One thing is for sure though; they will have an appreciating asset over the long-term, which they will have acquired at a young age!

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The following example shows how this strategy can be used.

Example 8: Getting your children onto the property ladder

Junior Investor turns 18 years of age and leaves college to start working as an apprentice. His starting salary is £11,000 pa.

His father, Mr Investor, decides to buy an investment property in his son's name. He buys a two-bed terraced property for £45,000, where there is a 25-year £36,000 BTL mortgage in the name of Junior Investor. His father acts as the guarantor.

The property is rented out for £400 pa and the monthly mortgage repayments are £100. This means that Junior Investor is receiving an additional and very much welcomed £300 per month. However, he is only liable to pay tax at the rate of 20% on this income, whereas his father pays the higher rate of 40%.

Junior continues to live with his parents, until the age of 23 when he decides it is time for his independence. He also now has a salary of £30,000 having served his apprenticeship.

He moves into his BTL property for two years to make use of the residence reliefs before moving into a larger house with his girlfriend.

When moving into the larger house, he again switches his two-bed house into a BTL property. At the point of moving, his two-bed property is worth £65,000, with an outstanding mortgage of £30,000.

This means that at the young age of 25, Junior has £35,000 of equity available to him! He can of course use part of this available equity to buy another investment property and start building his own property portfolio!

This above example illustrates how Mr Investor's keenness to help his son at the age of 18, to get onto the property ladder, has given him a very sound financial standing in life at the young age of 25!

Although he will be liable for income tax, his CGT liability has been reduced due to him living in the house for a two-year period.

I am sure that Junior will be just as keen to help his father in later years!

4.12.3 Offsetting costs against income

If you are dealing in property then you will pay Income Tax only when you sell your property.

The general rule for calculating your Income Tax liability is as follows:

Property Selling Cost – (Property Purchase Price + Buying Costs + Ongoing Property Related Costs + Selling Costs) = Taxable Profit

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Example 9: Tax calculation for a property dealer
Mr Investor buys a property for £20,000. He spends £600 on buying costs (i.e. solicitors' fees etc). He then spends £15,000 refurbishing the property before he sells it for £60,000. His selling costs are £400. His taxable profit is calculated as follows: £60,000 – (£20,000 + £600 + £15,000 + £400) = **£24,000 Taxable Profit.**

4.12.4 Income for Investing

If you are investing in property then you will pay Income Tax on an annual basis.

The general rule for calculating your Income Tax is as follows:

Rental Income – Ongoing Property Related Costs

Example 10: Tax calculation for a property investor
Mr Investor buys a property for £100,000. He receives £12,000 annual rental income and has annual costs of £7,000. His annual taxable profit is calculated as follows: £12,000 – £7,000 = **£5,000 Taxable Profit.**

4.13 Costs you can offset against income

You can offset a cost against your property if it satisfies the following rules:

The cost is incurred 'wholly and exclusively' for your property.

This means that if the cost was used partly for the property and partly for another purpose, then you can only offset against income the portion that was used for your property.

Example 11: Offsetting 'Wholly and exclusive' costs
Mr Investor decides to redecorate his rental property so he buys 10 rolls of wallpaper at a total cost of £100. He uses only 7 rolls in his property. Instead of returning the remaining 3 rolls he uses them at his own home to redecorate a small room. Now Mr Investor cannot offset the total £100 cost of the rolls as all 10 rolls were not used wholly and exclusively for his investment property. Only 7 rolls were used wholly and exclusively and therefore he can only offset £70 against his property income.

The cost is not of a capital nature.

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This rule only applies to an investor. It is aimed at preventing the investor from offsetting large capital costs against the Income Tax bill. If you are investing, capital costs can be offset against your CGT bill.

Therefore as long as you incur costs wholly and exclusively for your property and they are not of a capital nature, then there are a number of costs that can be offset against income from your property to reduce your Income Tax liability.

4.14 Interest charged on finance

	Offset costs for Developer	Offset costs for Investor
Interest Charged on Finance	Yes	Yes

The vast majority of property developers and investors will be using finance to fund purchases and improvements for their properties. If finance is acquired and interest is charged, the amount of interest can be offset against the rental income.

The sections below describe the various scenarios where interest is likely to be charged and how it can be offset against the rental income. You will also be shown when it is not possible to offset interest.

4.14.1 Interest on mortgages

One of the biggest, if not the biggest, cost that you will offset against your rental income will be the interest that is charged against your mortgage. If you have a BTL mortgage, or even if you have a normal residential mortgage on an investment property, then the interest charged can be offset.

Example 12: Offsetting BTL mortgage interest

Mr Investor has an 80% interest-only BTL mortgage for £40,000 on a property that he purchased for £50,000. His annual interest charge is £3,000.

The whole £3,000 can be offset against the rental income.

More and more people are now starting to use the let-to-buy strategy. It is important to realise that you do not have to have a BTL mortgage to offset the interest. If your previous home becomes an investment property and your mortgage provider is happy for you to rent it out (without transferring you to a BTL mortgage), then the interest on your residential mortgage can be offset.

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Example 13: Offsetting residential mortgage interest
Mr Investor buys his first home for £100,000 with a 90% residential mortgage of £90,000. 5 years later he decides to buy a larger house to accommodate his growing family. Instead of selling the existing house he decides to rent it out. He informs his existing mortgage company and they are happy for him to let the property, and they make no changes to the existing residential mortgage rate. This means that once the new residential property becomes his PPR he can start offsetting the mortgage interest on his first home against any rental income received.

4.14.2 Interest on remortgages

Just as it is possible to offset interest on an initial mortgage, it is also possible to offset interest if you decide to remortgage a property.

The important point to note here is that you can only offset the interest on the outstanding amount of the mortgage.

You cannot remortgage a property for a greater amount and offset the interest, unless the additional amount you are re-mortgaging is to be used for an investment property. If you remortgage and use the additional capital sum to buy another property, the additional interest can be treated as an expense to offset against income from the new property.

If you remortgage and spend the proceeds on personal living expenses, you cannot offset the cost of the loan against a future CGT liability on the sale of the property. There are strict rules as to what expenses can be offset against CGT. The interest cost can only be offset against revenue.

The following three examples will illustrate when you can and when you cannot offset the interest on a remortgage.

Example 14: When you CAN offset remortgage interest
In 1998 Mr Investor buys an investment property for £100,000. His mortgage provider lends him £80,000 on a fixed repayment basis at 7% per annum. His monthly interest charge is £250. Interest rates slowly decrease, so he decides in 2003 to remortgage and make use of the lower rates available. The outstanding amount on the mortgage at this time is £75,000 but the house is now valued at £150,000. He remortgages the property for £100,000 as he wants to add an extension to the property at a cost of £25,000. The annual rate for the remortgage is 5%. His monthly interest rate charge is now £285 on the £100,000. Mr Investor is able to offset the whole £285 monthly interest, as the full remortgage amount of £100,000 has been used for the purpose of the investment property, i.e. £75,000 for the remortgage and £25,000 for the improvement.

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Example 15: **When you CANNOT offset remortgage interest (1)**
The same example as above where Mr Investor remortgages for £120,000. He CAN utilise £25,000 of this loan as allowable interest (£100,000 - £75,000) but not the interest on the additional £20,000 above what he first paid. Because the additional amount is above the original capital value, the interest charged on the £25,000 cannot be offset against the rental income. This is because the car is not exclusively used for the property. This means that only 10/12ths of the loan interest can be offset in the tax calculations. (i.e. the outstanding 10/12ths of the £120,000) of the interest can be offset. Therefore he can only offset £208.33 of monthly interest against his rental income.

Example 16: **When you CANNOT offset remortgage interest (2)**
Mr Investor releases equity of £10,000 from an existing property (it can be either his residence or an investment property). The equity is going to be used to fund a future property investment. The money is stored in a personal bank account. Due to various unexpected delays, Mr Investor buys the investment property six months later. During the six months that the money was in his bank account, he had to pay interest, which accumulated to £700. Mr Investor is not able to offset the £700 interest against his future rental income. This is because at the time the interest was charged, the £10,000 was not being used for his property investment purposes.

4.14.3 Interest on deposits

If you decide to obtain finance to fund the deposit of your investment property, then the interest charged on this deposit can also be offset against the rental income. The source of the finance does not matter. What matters is what the finance is used for.

This means that if you release equity out of an existing mortgage or take out a personal loan to fund the deposit, then the interest can be offset against the rental income.

The examples below illustrate both these scenarios.

Example 17: **Funding deposit by releasing equity**
Mr Investor has an 80% interest only BTL mortgage for £40,000, on a property that he originally purchased for £50,000. His annual interest charge is £3,000. After 10 years his property is now worth £75,000. He contacts his bank and they advise that he can release £10,000 equity. He wants this money to fund the deposit on another BTL property. The interest charged on both the original £40,000 BTL and the £10,000 equity release can be offset against his income from the properties.

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Example 18: Funding deposit using a personal loan
Mr Investor decides to buy an investment property. The value of the property is £100,000. He is able to get a BTL mortgage for £80,000 and therefore he needs to find a £20,000 deposit. He only has £10,000 in savings so he gets a loan for the remaining £10,000. Both the interest on the BTL mortgage and the loan can be offset against the rental income.

4.14.4 Interest charged for improvements and developments

Sometimes it is necessary to get finance to make improvements to an investment property. You may decide to add an extension to your investment project, or you might simply decide to replace a bathroom suite. Whatever the case, if you are charged interest on your finance then it can be offset against the rental income.

It is important to note that you can only offset the interest that you are actually charged. This means that if you decide to repay the loan early, then you can only offset the interest that you have paid to date.

Example 19: Using finance to make an improvement
Mr Investor decides to replace an existing bathroom suite. In order to successfully complete the project he needs to buy the bathroom suite and pay a plumber to do the work. The total cost of the project will be £2,000. He decides to get a loan for this amount over two years, where he will pay monthly interest of £20 for the duration. Mr Investor can offset the monthly £20 interest payment against his rental income. This means that if he keeps the loan for the whole period he will pay back £480 in interest alone. However, he decides to repay the loan early, after 12 months. Therefore he only pays £240 in interest. This is the amount that he can offset against his income.

4.14.5 Interest on purchase of goods

If you are letting out a fully furnished property, you might decide to take advantage of the generous (or maybe not so generous!) finance agreements you can get from the retailers. If you opt for getting finance and paying interest on furnishings, then it can be offset against the rental income.

Example 20: Using finance to purchase furniture
Mr Investor decides to replace an old and tired 3-piece suite in one of his properties. He buys a new one for £1,000 on a 'buy now pay later' scheme. Over the period of repayment he pays back £300 in interest. He can offset the £300 against the rental income received for the property. This can be offset regardless of whether he uses the **allowance** or the **renewals** method.

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4.15 Buying and selling costs

	Offset costs for Developer	Offset costs for Investor
Buying & Selling Costs	Yes	No

Buying costs are incurred when you purchase the property. These buying costs, along with the solicitors' selling costs, can only be offset against your Income Tax if you are a property dealer. However, they can be offset against your CGT if you are an investor.

Selling costs will typically include Solicitors' Costs, Agent Fees and Redemption Penalties (if you are unfortunate enough to be stung by any of these)!

Also, any costs for acquiring additional finance i.e. releasing equity, can also be offset against income.

Example 21: Offsetting buying & selling costs

Mr Investor buys a property for £50,000. His buying costs for the property are £1,600 and are made up as follows:

Solicitors' Fees: £800

Surveyor Fees: £500

Booking Fee: £300

He then spends £20,000 developing the property before he sells it for £90,000. His selling costs are £400 for the solicitors' fees and £1,000 for the agents' fees. Therefore Mr Investor is liable to pay tax on £17,000.

One of the principles in accounting is to match sales against the purchases in the same year.

By doing this you are making your business easy to manage and are keeping a good accounting record.

4.16 Rent, Rates, Insurance

	Offset costs for Developer	Offset costs for Investor
Rent	Yes	Yes
Rates	Yes	Yes
Insurance	Yes	Yes

All costs that are explained below can be offset whether you are a developer or an investor.

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4.16.1 Rent

If you are required to pay ground rent or any other form of rent under a lease agreement (i.e. if you are subletting), this can be offset against your income.

4.16.2 Rates

Any of the following rates that you pay can also be offset against your income:

Council Tax

Water Rates

Electricity Charges

Gas Charges

Service Charges (these are more common with new developments e.g. apartment blocks)

Feu duties (Scottish ground rent)

TV Licence, telephone line rental, satellite system etc

4.16.3 Insurance

If you take out buildings and contents cover for your property, you can offset this cost.

There are also other forms of insurance that can be offset. These are detailed below:

Gas & Plumbing Insurance
Efficient landlords will take out insurance against the gas/water supplies and the property's central heating system. British Gas is one such provider that offers this insurance under different levels of cover. This insurance basically means that they will come out and repair your gas central heating system and any gas/water supply breakdowns once reported.

Not only can the costs of such insurance be offset against your income, but you also have peace of mind, as the insurer is usually out to repair the problem the same day! This is an excellent sales pitch for a prospective tenant.

Further details can be found by visiting the following website:

www.house.co.uk

Electricity Insurance
Any insurance cover taken out for the electrical wiring system of the property can also be offset. Again, suppliers like British Gas provide such cover.

Appliance Cover
If you have taken out extended insurance cover on an appliance in your property then this can also be offset.

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Example 22: Offsetting product insurance policies
Mr Investor is renting out a fully furnished property. He takes out annual insurance policies for the washing machine, dishwasher and fridge freezer. These cost him £100 per annum. He can offset the cost of £100 against his rental income.

4.17 Maintenance and repairs

	Offset costs for Developer	Offset costs for Investor
Maintenance & repairs	Yes	Yes

If you are dealing in properties, then all repairs and improvement costs can be offset against your income.

For the investor, the Inland Revenue states you can offset any expenses that 'prevent the property from deteriorating'.

What this means in a nutshell is that you cannot take off the cost of making any improvements on the property.

Such improvements are likely to include extensions, loft conversions, etc. Instead these costs are offset against CGT when you come to dispose of the property so you still benefit from making improvements – just not straight away!

Typical costs you can offset against your income as a property investor are structural repairs such as to internal or external walls, repointing, interior or exterior decorating or treatment for damp or dry rot and repairs to fixtures and fittings.

Key Tip

Repairs to newly acquired property, that were necessary before the property could be brought into use, are added to the capital cost of the property.

4.18 Renewals

	Offset costs for Developer	Offset costs for Investor
Renewals	Yes	Yes

Only an investor will incur this expense. It relates to the costs associated with replacing existing furniture, fixtures and fittings.

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4.18.1 Renewal of fixtures and fittings

Fixtures and fittings are considered to be those items that a tenant is not expected to bring into a property. These form an integral part of the property and are likely to cause damage if they are removed. Such items include:

Kitchen unit fittings

Bathroom suites

Gas central heating system and gas fires

Doors & windows

Essentially there are three kinds of renewals you can have for fixtures and fittings. These can be described as:

Like-for-Like

Like-for-Like plus capital improvement

Capital improvement

Like-for-Like

If a property investor decides to replace an existing deteriorating fixture then the cost of replacing it can be offset against the rental income as long as it is similar to a **modern equivalent** and no capital improvements have been made.

The important point to note here is that the replacement must be of a similar kind i.e. 'like for like'. This means that the intention is not to deliberately replace it with a superior product where the character of the asset is improved.

Example 23: Renewing with 'Like for Like'

Alexander has a property that he has been letting out for 5 years. The kitchen is now in a poor state and is in need of replacement. The existing kitchen comprises of 3 wall units and 3 base units.

The kitchen is refurbished with a similar standard kitchen where the work done includes: the stripping out and replacement of 3 base units, 3 wall units, sink, retiling, work top replacement, repairs to floor coverings and associated re-plastering and re-wiring.

The whole cost of the project is £2,000. He is able to offset the complete cost against the rental income, as it has been a like-for-like replacement, where no capital improvements have been made.

However, sometimes it is not possible to replace with a **modern equivalent**.

An example is double-glazing.

In the past, the Inland Revenue took the view that replacing single-glazed windows with double-glazed windows was an improvement and was therefore classed as a capital expenditure. But times have changed. Building standards have improved and the types of replacement windows available

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from retailers have changed. Therefore the Inland Revenue now accept that replacing single-glazed windows by double-glazed equivalents counts as allowable expenditure on repairs.

It is not surprising that the Inland Revenue has made this ruling, as it is probably cheaper to buy double-glazed windows than it is to buy single-glazed windows!

Like-for-Like plus capital improvement

If you decide to replace with like-for-like, but also make improvements i.e. add extra fixtures/fittings, then the latter cannot be offset against the rental income. Instead it will be offset against the capital gain when you dispose of the property.

Example 24: Renewing with 'Like for Like' plus capital improvement

Using the previous example.

Alexander refurbishes with a similar standard kitchen where the work done includes: the stripping out and replacement of 3 base units, 3 wall units, sink, retiling, work top replacement, repairs to floor coverings and associated re-plastering and re-wiring. However, he also adds 2 additional base units, 2 additional wall units and additional worktops. This is classed as capital expenditure.

The total cost for the project is £3,000, where £1,000 is for the capital costs.

This means that £2,000 will be offset against the rental income (as in the previous example). However, the £1,000 of capital improvements will be added to the cost of the property and will be offset against the capital gain when the property is sold.

Capital Improvement

If you decide to replace fixtures & fittings with a totally superior product then you cannot offset any cost against rental income at all. The reason for this is because the whole improvement will be classed as a capital improvement.

Example 25: Renewing with capital improvement

Alexander refurbishes with a completely superior kitchen where the whole kitchen is substantially upgraded. This includes replacing the standard base/wall units with expensive customised items, using high quality materials and adding additional units as well. The cost of the project is £7,000.

In this instance, Alexander cannot offset any cost at all against the rental income, as the whole renewal is classed as a capital improvement. However, the £7,000 will be offset against the capital gain when the property is sold.

4.18.2 Original cost of installing fixtures and fittings

The original costs of installing fixtures and fittings cannot be offset against the rental income but they can be offset against any CGT due when the property is sold.

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Example 26: Capital improvement before letting property
Mr Investor buys an investment property. Although the property is in a good condition, he decides to change the bathroom suite before he lets the property for the first time. The cost of the bathroom suite including fitting is £800. Mr Investor is not able to offset this cost against the rental income received from the property as it has been incurred before the property has been let.

This example illustrates that it is worthwhile considering when to replace fixtures and fittings in a property. If Mr Investor had decided to replace the bathroom between tenants then he would be able to offset the cost against the rental income.

Key Tip

If you have purchased a new property that does not require any immediate work, then consider making the changes/improvements after the property has been let. This will allow you to offset the cost against any rental income.

4.18.3 Renewal of furniture

The costs of renewing furniture can only be claimed if you do not use the '10% wear and tear' allowance.

If you are providing a fully furnished property then your costs for renewing are likely to be considerably more than those for an unfurnished property. This is because you will be providing all the furniture in the property i.e. sofas, beds, cooker, etc.

Example 27: Renewals of Furniture
Mr Investor is renting out a fully furnished property. In between tenants he decides to replace the three-piece suite and the dining table & chairs. Because he does not claim the wear and tear allowance he is able to offset the full cost of replacing the furniture. The cost of the three-piece suite is £600 and the dining table and chairs cost £180. This means that Mr Investor can offset the combined cost of £780 against the rental income received from the property.

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4.18.4 Original cost of furnishings

It is not possible to claim the cost of purchasing furniture (new or second hand) against rental income, when a particular item has been acquired for the first time. The only way to offset costs is if the items of furniture are then replaced.

4.19 Capital allowances

	Offset costs for Developer	Offset costs for Investor
Capital Allowances	Yes	Yes

If you are a dealer or an investor, and you purchase any product that is used wholly and exclusively for the purpose of the properties, then you can use the capital allowances method to write down the cost of the purchase.

This method tends to be used when a purchase is in excess of £100 and has an estimated economic life of greater than one year. This method is also referred to as the **20% write down allowance**.

Typical purchases that can be offset using this method will include:

DIY tools i.e. for renovating property

Cleaning equipment i.e. vacuum cleaner, carpet washer

Computer system

Vehicles etc.

This method cannot be used for fixtures, fittings and furnishings inside a residential property i.e. for furniture replacement.

If you decide to use this allowance, the capital value of the equipment reduces by 20% on a year-by-year basis. Therefore the amount that the purchase decreases by is the amount that you offset against the income. The example below illustrates this.

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Example 28: Offsetting capital allowances

Mr Investor has three investment properties and he purchases a vacuum cleaner/washer so that he can periodically clean the carpets. The cost of the product is £250.

He can use the write down allowance in the following manner:

Year No.	Machine Value	20% Allowance
1	£250	£50
2	£200	£40
3	£160	£32
etc.	etc.	etc.

This process of writing down will continue until the property is sold.

4.19.1 Annual Investment Allowances

For small entities who will purchase capital under £50,000 each year, the current tax changes provide 100% of capital purchases to be treated as costs in the year of purchase. This is a massive change on the previous 40% first year allowances.

4.20 Legal and professional costs including tax advice

Accountant and Tax Advisor:
Hard to think it is true but the tax man is happy for you to seek professional help in the form of an accountant which will save you paying him too much tax. So a bill of £100 for an accountant will actually only cost you the net amount of £60 due to this being tax deductible (assuming 40% tax payer).

Other legal fees:

	Offset costs for Developer	Offset costs for Investor
Legal and Professional Costs	Yes	Yes

It is possible for a developer to offset all legal and professional costs that are incurred for the property. The ones listed below are exclusively for the investor:

Costs of drawing up a new rental agreement that is for not more than one year. The Inland Revenue classifies a rental agreement that is more than one year in length as being of a capital nature. Therefore this type of agreement cannot be offset as a cost against Income Tax.

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Costs incurred in evicting an unsatisfactory tenant for the purpose of re-letting the property. However, if you are evicting a tenant and do not intend re-letting the property then the costs cannot be offset.

Accountants' fees incurred in drawing up accounts.

Costs of obtaining a valuation for insurance purposes.

Subscription to associations that represent the interests of the landlord.

4.21 Costs of services provided including wages

	Offset costs for Developer	Offset costs for Investor
Costs of Services	N/A	Yes
Wages	Yes	Yes

4.22 The 10% Wear & Tear Rule

	Offset costs for Developer	Offset costs for Investor
10% Wear & Tear Rule	N/A	Yes

This rule is only valid for an investor.

The allowance amounts to 10% of the annual rental income received from the property. It is calculated after deducting charges or services that a tenant would normally bear, but are, in fact, borne by you (e.g. water supply, council tax etc.).

The allowance is used to cover the cost of renewing furniture and furnishings that would normally be purchased by the tenant in an unfurnished property.

4.22.1 Fully furnished accommodation

The 10% wear and tear rule can only be used if 'fully furnished' accommodation is provided.

In order to satisfy the criteria of a **fully furnished** property, then the property must be ready, so that tenants can simply bring their personal belongings and start to live in the accommodation.

This means that one would expect the following furniture and furnishings to be provided as part of a fully furnished property:

Suites, tables & chairs

Flooring i.e. carpets, laminate flooring

Curtains, blinds, bed linen

Televisions, microwaves, fridge, freezers and washing machines

Cutlery & crockery

Framed pictures & ornaments

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Instead of offsetting the costs of each renewal, you claim the 10% allowance.

Example 29: Using the 10% wear and tear allowance
Mr Investor has a furnished luxury apartment that he lets out to a professional working person. His annual rental income is £10,000 per annum. The income includes service charges of £1,000 per annum. He decides that he wants to make use of the 10% wear and tear allowance, which means that he can offset another £900 against his income. The allowance is calculated after the rates and services charges have been deducted from the gross income. Therefore he has £9,100 of income upon which he is liable to pay tax. However, he can also offset the cost of the service charges, which is £1,000. This means he is liable to pay tax on £8,100.

You can claim for renewing fixtures and fittings regardless of whether you use the 10% wear and tear rule.

Whatever basis is chosen i.e. renewals or wear & tear allowance, it must be followed consistently. It isn't possible to chop and change between the wear and tear allowance and the renewals allowance from year to year.

4.22.2 Part furnished accommodation

Generally speaking, you cannot use the 10% wear and tear allowance on part furnished property.

Many landlords, knowingly or unknowingly, provide **part furnished** accommodation. If you invest in a new build development then you may well get carpets and a fully fitted kitchen included in the purchase price. If this is the case then you will be providing a partly furnished property. It is extremely unlikely that the Inland Revenue will allow you to use the allowance in this scenario as, strictly speaking, you are not providing **fully furnished** accommodation.

However, the more furnishings you provide, then the greater likelihood there is of being able to use the allowance, as you are getting closer to providing a fully furnished property. This means that if you also provided a suite, beds and dining table then you are more likely to be able to claim the allowance. The reason for this is because you are genuinely attempting to provide a fully furnished property where the tenant can move into the property without the need to buy any significant furnishings.

4.23 Bad debts

	Offset costs for Developer	Offset costs for Investor
Bad Debts	N/A	Yes

This is another expense that is incurred by an investor only.

It is possible to deduct debts that are either irrecoverable, or you believe, through good justification, are irrecoverable.

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It is only possible to make such deductions if you have taken all reasonable measures to retrieve the debt.

This situation is most likely to occur if the tenant has lost employment and is unable to pay the rent. However, you cannot deduct debts if the tenant is a slow payer and pays the rent late.

Example 30: Offsetting bad debts

Mr Investor lets his property to a professionally employed individual for £650 pcm. The professional loses his job and falls into arrears. Mr Investor starts legal proceedings to get the tenant evicted. The tenant vacates the property and disappears two months later without notifying Mr Investor. This leaves him with lost rental income to the value of £1,300 (he never bothered taking a deposit off the tenant!!).

If the rental income was owed for the previous tax year, and Mr Investor has already submitted his tax return for that year, he would need to notify the Inland Revenue. His tax liability would need to be recalculated with the £1,300 of lost income and costs in retrieving the rent arrears being offset.

4.24 Travel costs

	Offset costs for Developer	Offset costs for Investor
Travel Costs	Yes	Yes

Both traders and investors will most definitely incur this cost. Any travelling costs that are incurred wholly and exclusively for your properties can be offset against the income.

There are no limits to the form of transport that can be used. Even if you are an expatriate and you travel from overseas to manage/set-up your property, you can offset the cost of the journey against your rental income.

The most common mode of transport that will be used by individuals will be vehicles i.e. cars. If such a vehicle is used then you can offset the costs of the vehicle spent for the purposes of your property. This is known as **apportioning costs**.

This method involves not only keeping a log of the miles done for the property, but you also need to know the total miles done by the vehicle in the tax year and the cost that has been incurred on petrol. Also you need to keep a record of all expenditures that have been made for running and maintaining the vehicle. Such expenditures will include:

Road tax

Motor insurance

Servicing

Repairing

Other (i.e. cleaning, washing etc)

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You will firstly calculate the percentage of miles that have been used for your property from the total miles. You will then use the percentage calculated to determine the costs incurred for the vehicle.

Example 31: Calculating and offsetting travelling costs

Mr Investor decides to calculate his travelling costs using the apportioning method. In the whole tax year he travels 10,000 miles and 1,000 of these miles are for the use of his properties. Therefore he is able to offset 10% of all costs of the vehicle against his income.

He incurs the following costs in the year:

Expense	Cost	Amount Offset
Vehicle price	£10,000	£250
Annual Mileage	£1,400	£140
Road tax	£140	£14
Motor Insurance	£900	£90
Servicing	£300	£30
Repairing	£600	£60
Other	£70	£7

Therefore the total amount that can be offset in the year is £591.

As you can see from the above example, if you take the time and effort to keep a detailed log then you can reduce your tax liability. However, you need to decide if the amount you save is worth all the receipts/records that you must keep.

Key Tip

If the property is in joint names, but the vehicle is in the name of the higher rate taxpayer, then this cost can be offset in full against the higher rate taxpayer.

4.25 Pre-trading expenditure

It is possible to offset costs against income even if they occurred before the property was purchased.

Most investors will start to incur costs once they have decided that they are going to invest in property. It is possible to offset any such expenses if they were incurred up to seven years before the property was purchased.

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Example 32: Offsetting pre-trading expenditure
In 1995 Mr Investor decides to start investing in property, as he believes that his pension fund will not provide him with a suitable retirement fund. He decides to read Colin's ebook eBooks and also takes some initial advice from Colin recommended on the forum. The combined cost of the books and accountant's fee is £250. In 1996, Mr Investor finally manages to get onto the property investment ladder. Because the previous costs were incurred less than seven years before he purchased the property, he is able to offset it against his future rental income.

4.26 Other expenses

Below are some other common costs that you can offset against your property income. This is not a comprehensive list as different costs arise for varying circumstances. However, if your cost satisfies the "wholly and exclusively" rule then you will be able to deduct it from your income.

4.26.1 Safety Certificates

These are of particular importance to the investor. Any costs incurred in obtaining safety certificates for the property, such as gas and electricity can be offset against income.

4.26.2 Cost of rent collection

Any costs incurred by an investor in collecting the rent of a tenant can also be deducted.

4.26.3 Telephone calls and line rental

Any calls that are made in connection with the property can be deducted i.e. calls to a tenant. It is important that you keep a log of calls made, especially if the bill is likely to be high. Also if you have a growing property portfolio and you have a second telephone line installed that is used for the properties then this cost can also be offset.

4.26.4 Advertisement

If you decide to advertise the property for sale or to rent yourself in a local paper or magazine, then these costs can be offset.

4.26.5 Magazines / books

Any books or magazines you purchase that are used for the purpose of your properties can be offset. Such books will include any of the books you have already bought from the www.propertysecrets.net website, magazines for home interior design, and magazines for self-build etc.

Unless you are a property trader these costs will not be allowable. We cannot be trained to be investors at the tax man's expense whatever you might see elsewhere.

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4.26.6 Training / seminars

Many people today are deciding to attend **seminars** and **boot camps**, as they believe that they will give them a fast track introduction to property development. Such training can cost between a few hundred to several thousands of pounds. If you qualify as a trading activity and the training is not for a life training skill (such as becoming a builder) but related to the updating of a skill or perhaps enabling you to find property, or if you are a builder, the cost of a course to update you with a skill such as safety, such costs can be offset against rental income.

Note: this will not be available if you are starting out as an investor as it will certainly not be an existing trading activity.

4.26.7 IT equipment and stationery

The cost of buying stationery for the purpose of communicating with tenants and other property related matters can be offset. Also, as your portfolio grows, the need may arise to buy a personal computer to store your letters of communication, keep records/accounts and communicate by email. If this is the case and it is wholly and exclusively used for your properties, the cost can also be deducted from rental income using the write down allowance.

4.26.8 Rentals

Furniture rentals are becoming more and more popular. If you rent such furniture then the cost can be offset. This also applies if you hire any other equipment for use in your property i.e. steam cleaner.

4.26.9 Using home as office

Most property dealers manage their properties from their own home. If this is the case, you can claim for additional heating and lighting expenses that you may incur.

In some instances you may have a dedicated room that is used to manage your properties. If this is the case then not only can you claim for lighting and heating, but also for other costs that are referable to that room. Such costs will include building & contents insurance, water charges and council tax charges.

If you are an investor and manage your own portfolio, and the resultant claim for expenses is reasonable (around 10-15% of the rental income) it is likely to be acceptable.

4.26.10 The Three Golden Rules to keeping your income tax bill minimal and accurate

The three golden rules to help keep your Income Tax bill accurate and to a minimum are:

1. Ensure that you and any relevant partner use the annual Income Tax allowance.

2. Try to purchase your property with your partner, especially if you are a higher rate taxpayer, and your partner is at a lower rate or does not work.

3. Ensure that you offset all costs against your income that have been incurred wholly and exclusively for your properties.

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4.27 Ongoing tax strategy - SIPPs & Pensions

Whilst Gordon Brown killed off SIPPs (Self Invested Personal Pensions) as a means of investing in residential property tax free, there is still a way that SIPPs can be used to the property investor's advantage.

So what is a SIPP? It is basically a kind of DIY personal pension where you pick the investments yourself and there is no CGT to pay on the profits.

SIPPs are subject to the same rule as pensions including the same limits on contributions, the same 25% restriction on the tax-free lump sum on retirement and the same restrictions on how you take the money out once you've retired.

Following the Government's U-turn on allowing investment in residential property, now the only way SIPPs can be used in this context is indirectly through a fund such as a REIT.

REITs are allowed to be put into a SIPP with the result that the rental income and profits from the sale of assets within the REIT are tax free (providing that 90% of the profit is distributed as dividends) and also there will be no CGT to pay on profits when the investor sells their shares.

There are downsides to SIPPs however, and the first major one is that your ability to borrow money is more limited in a SIPP than if you invest in a property directly outside a SIPP.

Costs and charges involved in setting up and running a SIPP can be very high and many collective funds charge high performance related feeds. Also if you transfer from an existing pension fund to a property friendly SIPP the charge made is typically about 4%.

Consult with a tax adviser and weigh up whether the benefits outweigh the costs before making the decision as to whether a SIPP is right for you.

4.28 Pensions

A pension is not just a way of saving for retirement - it also offers some attractive tax advantages.

There are currently three main types of pension: State, personal, and company or occupational.

4.28.1 State pension

The amount of basic State Pension you'll receive will depend on the amount of National Insurance contributions you've paid or are treated as having paid. Depending on your individual circumstances, you may also be entitled to additional State Pension.

The State Pension is payable from State Pension age – 65 for men, 60 for women born on or before 5 April 1950 but you can put off drawing it for up to five years.

4.28.2 Company pensions

Company pensions are set up by employers to provide pensions for their employees on retirement. If you are able to join one, it's worth considering as most people will be better off in retirement than if they had not joined.

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4.28.3 Personal pensions

Personal pensions are available from banks, building societies and life insurance companies, who invest your savings on your behalf.

Under HM Revenue and Customs rules you can start taking your pension from age 50 (increasing to 55 by 2010) and to take part of your pension fund as a tax-free lump sum.

4.29 Tax advantages of pensions

The pension fund doesn't pay tax on any capital gains or investment income.

Also, when your pension matures, you can take up to 25% of it as a tax-free lump sum provided your pension scheme rules allow it and your total savings are within the 'lifetime allowance' for the year in which you take your benefit.

It is worth noting that lump sums or income drawn from savings above the lifetime allowance will be subject to tax charges.

4.29.1 Pensions for the self-employed

If you're self-employed you make class 2 National Insurance contributions. These will entitle you to the basic State Pension, but not the additional State Pension.

If you want to receive more than the basic State Pension when you retire, you might want to consider starting a personal or stakeholder pension scheme. You'll then be able to make regular payments to build up savings for your retirement.

4.29.2 Pension rules from April 2006

Since April 2006, simpler rules have been applied to both personal and company (occupational) schemes. The new rules allow most people to pay more into their pension schemes – and on more flexible terms.

4.29.3 Saving more into your pension

You can now save as much as you want into any pension scheme. The rules for claiming tax relief on your pension contributions are also more flexible, though tax charges will apply if you go above certain new allowances.

4.29.4 Abolition of pension contribution limits

You can now contribute as much as you like into any number of pension schemes (personal and/or company) each year, and there is no upper limit to the total amount of pension saving you can build up.

4.29.5 Tax relief on pension contributions

Each year you will receive tax relief on your pension contributions up to 100% per cent of your earnings (salary and other earned income) subject to an 'annual allowance' above which tax will be charged.

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If you have little or no earnings and are in a 'relief at source' scheme, you will still get tax relief; for every £80 you contribute in a tax year, the government will contribute a further £20 until the total value of contributions reaches £3,600 for the year.

If you're a higher rate taxpayer, you can claim the difference through Self Assessment or, for example, by making a claim by letter to your Tax Office.

Anyone can pay into a personal pension scheme - whether they pay tax or not. If you don't pay tax, the most you can pay in with the benefit of tax relief is £2,808 a year but you'll still get basic rate (20%) tax relief added to your contribution. In other words the government will 'top up' your contribution to make it £3,600 if you pay £2,808.

4.29.6 Tax relief if you put money into someone else's personal pension

You can put money into someone else's personal pension - like your husband, wife, civil partner, child or grandchild's. They'll get tax relief added to it at the basic rate, but this won't affect your own tax bill. If they've got no income, you can pay in up to £2,808 a year (which becomes £3,600 with tax relief).

4.29.7 Annual allowance above which contributions will be taxed

Yearly pension savings above a new 'annual allowance' are taxable at 40%, whether made by you and/or your employer.

The annual allowance for the tax year 2008-9 will be £235,000 and will rise each year until it reaches £255,000 in 2010; thereafter the amount will be reviewed every five years.

If the annual allowance is exceeded, you'll need to declare the extra pension savings and pay the annual allowance charge through Self Assessment. The annual allowance charge will not apply in the year you take all your benefits.

4.29.8 'Lifetime allowance' above which a tax charge will apply

You now have a 'lifetime allowance' against which the total value of the benefits built up in your pension fund/s by you and/or your employer (including investment growth) will be tested. This applies in addition to the usual Income Tax due on pension payments.

The lifetime allowance for the tax year 2010-11 will be £1.8 million and it will be reviewed every five years.

If you take benefits above your lifetime allowance as a pension, the lifetime allowance charge on the excess amount will be 25%, and if you take benefits above your lifetime allowance as a lump sum, the lifetime allowance charge on the excess amount will be 55%.

The lifetime allowance 'test' will take place when you start drawing your benefits or when you reach age 75 (in this case tax would be payable as if you were drawing an income from the pension; you can't take a lump sum once you reach age 75).

If your pension is close to, or above, the initial lifetime allowance figure it's important to seek specialist advice about how you might protect your pension from the lifetime allowance charge. Protection can be obtained up to 5 April 2009. You can also get general advice from The Pensions Advisory Service on 0845 601 2923 or you can speak to a pensions adviser.

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4.30 Ways of taking your pension income

There are now four choices:

- take a scheme pension - a secured pension for life paid out of the scheme assets
- buy an annuity (an investment that provides a regular income for life)
- draw an income directly from your pension fund, as an 'unsecured pension' before age 75
- draw an income directly from your pension fund, as an 'alternatively secured pension' from age 75

All types of pension schemes are now allowed to pay a tax-free lump sum of up to 25% of the value of your benefits, provided there is provision in the scheme rules, to an overall maximum of 25% of the Lifetime Allowance. Tax free lump sums are not available once you reach age 75.

For more information on ways to take your pension, visit the Financial Services Authority (FSA) website at **www.fsa.gov.uk**.

4.30.1 Working and drawing your company pension

If you're a member of a company pension scheme, you no longer have to leave your job to draw a pension.

You may also be able to draw all or some of your pension while still working full or part-time for the same employer, depending on your pension scheme's rules.

You can then use the rest of the fund you have built up to buy an annuity (a regular income payable for life) from a life insurance company; this does not have to be the same company that you have your pension plan with.

Alternatively, you can take an income (taxed at your normal Income Tax rate) from the remainder of your fund while it continues to be invested – as an 'unsecured pension' up to age 75 or an 'alternatively secured pension' once you reach age 75.

From April 2006, if your total pension savings from all sources is £15,000 or less (1% of the lifetime allowance) you may be able to take the whole amount as a cash lump sum, with 25% tax-free. The limit for being able to take all cash will gradually rise to £18,000 by the 2010-2011 tax year.

4.30.2 Do you need a personal pension?

Your decision will depend on how much you can afford to save for your pension and how much you will get from other pensions when they become due.

Using a personal pension to top up a company pension

You can take out a personal pension, including a stakeholder pension, to top up an occupational pension. But first check if your employer provides a more cost-effective way of topping up contributions, through 'Additional Voluntary Contributions' (AVCs).

Is a personal pension right for you?

Personal pensions are suitable for:

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- people who are self-employed
- people who aren't working but can afford to pay for a pension
- employees whose employer doesn't offer a company pension scheme
- employees who do not pay into a company pension
- employees on a moderate income who wish to top up the money they would get from a company pension

However, if you have moderate earnings, or think you might need to stop and start payments, or vary the amount, you might want to consider a stakeholder pension.

4.31 Stakeholder pensions

Stakeholder pensions are a type of personal pension. They have to meet certain government standards to ensure they are flexible and have a limit on annual management charges. The minimum payments are also low and you can stop and re-start payments whenever you wish.

4.31.1 How stakeholder pensions work

Stakeholder pensions work in much the same way as other money purchase pensions. You pay money into your pension to build your pension fund.

The managers of the stakeholder pension scheme invest the pension fund on your behalf. The value of your pension fund will be based on how much you have contributed and how well the fund's investments have performed.

When you retire, you use the fund you have built up to buy an annuity (a regular income payable for life) from a life insurance company of your choice.

How stakeholder pensions differ from other personal pensions

By law, stakeholder pensions must meet a number of minimum standards to make sure they offer value for money, flexibility and security.

The standards include:

Limit on annual management charges:

- managers can charge fees of up to 1.5% of your pension fund each year for the first 10 years you hold the product, and thereafter up to 1%

Flexibility:

- you can switch to a different pension provider without the provider you leave charging you
- you can start contributions from as little as £20, and pay weekly, monthly or at less regular intervals
- you can stop, re-start or change your payments whenever you want – there are no penalty fees

Security:

- the scheme must be run by trustees or by an authorised stakeholder manager, whose responsibility will be to make sure that the scheme meets the various legal requirements.

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4.32 Setting off your own home mortgage

4.32.1 Why not offset your own mortgage interest?

If it possible you cry, well for many there is an option available using current tax laws. It is certainly a tax top you should not do without undertstanding fully. Getting tax relief on your own home is possible. Now, doesn't that sound like a great idea – getting tax relief on the mortgage interest that you pay on your main residence?

Well, you will be pleased to hear that it is possible by following a simple (and relatively unknown) tax relief and some creative financial planning.

4.32.2 The Basics

As most accountants would say, it is not possible to deduct or claim interest relief on your main residence as your main residence is not part of your property business.

This is due to the fact that there is no income being shown on the books, the costs cannot be deducted against this. Norental income is received from your main residence so you are completely unable to claim this, right?
There is an exception...you will also be aware that you *can* claim interest relief on properties that form part of your property business i.e. your buy-to-let portfolio. In such instances you can offset your mortgage interest on your let properties against any rental income received.

4.32.3 Tax restrictions?

Tax law on this was first introduced 5 years ago, but is does allow a claim to reduce your tax bill quite legally. It is possible for you to release equity from the investment properties and offset the interest regardless of what the equity release was used for and offset against your own home.

Yes, the restriction is that the equity withdrawn cannot be greater than the market value of the property when it is brought into the letting business. If the property had been originally bought for letting, this amount would be the purchase cost of the property. If it had however been used as your home previously, you can then it will be the value of the property when it first became a rental property.

4.32.4 So How to do it

Well there are two ways to achieve this:

Remortgaging existing buy-to-let property/portfolio

Those of you who have or are growing a buy-to-let portfolio are likely to have equity in the property. The example below shows how/when this equity can be released to give you a tax benefit.

Example

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In 2005, Carina purchases a rental property for £160,000 with a deposit of £40,000 deposit and borrows from a bank £120,000. In 2009, the property is worth £200,000 and the withdrawal using a new mortgage of £160,000, withdrawing £40,000 in the process.

She offsets the income against her own home, then saves a great deal of her own monthly mortgage payment.

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5 Tax Strategy For Companies & Trusts

5.1 Setting up a Private Ltd Company

Before outlining the best tax strategy for limited companies and trusts, it is first of all worth establishing whether setting up as a limited company or putting your assets in a trust is a good idea.

Most property related investors and dealers will at some point consider whether it will be beneficial for them to set up a private limited company to run and manage their properties. There is no simple and straightforward answer to this question, as each case needs to be examined on an individual basis.

5.1.1 What is a Limited company?

A limited company is an incorporated company in the private sector, in which the investor has limited liability and the company has a separate legal identity.

There are three main types of limited company:

Private Limited companies - as the name suggests these are companies whose shares cannot be sold to the general public. The name of the company always ends with "Limited" or "Ltd".

Public Limited companies - have shares which are listed (quoted) on, and sold to, the general public via the Stock Exchange. The name of the listed company must end with "plc".

Companies Limited by guarantee - whose shareholders promise to pay a specified sum of money if the company is wound up. These companies are usually non-profit making; for example, charities.

For the purpose of this book we will only be discussing private limited companies. The primary reason is because this is the type of company most people dealing in property are likely to consider setting up.

5.1.2 Private Limited Company

'A private limited company is a legal entity in its own right, formed by at least two people, which carries out its own transactions, separate from the people who have set it up.'

Such a company must have at least one director and one company secretary. A company's sole director cannot also be the company secretary as this would mean that the company only consisted of one person.

A private limited company will have limited liability. If the company fails, then the owners (its shareholders) will be protected with limited liability.

This means that if a company is put into liquidation, the people who own the company will only be required to pay what they have already paid or agreed to pay towards settling its debts.

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Example 1: Understanding 'limited liability'

Mr Investor sets up a limited company. The company purchases two properties for £50,000 each. He invests £20,000 of his own money which acts as a £10,000 deposit for each property. This was the minimum requirement from the bank that financed the remaining £80,000.

Through poor management and difficult market conditions the company is unable to continue operating and is therefore declared insolvent. The bank is still owed £80,000. Mr Investor is not liable to pay this as he only has limited liability, which is for the £20,000 that he has already invested.

5.1.3 Company Director(s)

The director(s) of a company can be anybody who is appointed by the members to run the company. The company director(s) will be responsible for ensuring that statutory documents are delivered to the registrar at 'Companies House'. Such documents could include a directors' report, a balance sheet, profit and loss account, an accountant's report and if appropriate, group accounts.

If you have rental profits greater than £5.6 million, you may also qualify for needing an audit. If so, an additional Auditor's Report will be needed.

5.1.4 Company Secretary

Every formed company must operate with a company secretary. There is no need for the secretary to be professionally qualified (i.e. member of the Chartered Institute of Secretaries or Institute of Chartered Accountants) for a limited company and there are no specific guidelines for the role of a secretary.

The typical duties of the company secretary will be specified in the contract of employment. Most chartered accountants will offer this service as part of your annual accounting package if you cannot call on anyone to do this.

5.2 Difference between Limited Company and Sole Trader / Partnership?

The most significant difference between trading as a limited company and trading as a sole trader or partnership is that the directors of a limited company are not personally liable for debts incurred by the company.

This is providing that they act in a correct and honest manner. In the case of a sole trader or partnership, there is no divide between ownership and the management of the business i.e. they are accountable for all aspects of the operation.

There are also differences in the way in which limited companies and sole traders or partnerships are run. A company can have an unlimited number of members where shares may be transferred without the agreement of all shareholders. Also the way that new capital is introduced is fixed by company rules, as is the method of profit sharing.

On the other hand, a partnership has a limited number of members; no change can take place unless all members agree; and any transfer of interest or assets can take place only with the consent of all the partners.

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5.3 The big myth about 'Limited Liability'

Banks do not make billions in profit year-on-year by giving away bad loans to unsuccessful landlords. Limited liability is a concept that they actively pursue, where their own liability is LIMITED, not the landlord's!

One of the biggest misconceptions that people have when wanting to manage their properties through a private limited company is that they believe literally in the phrase limited liability. More mistakenly, they believe that the phrase only refers to them i.e. where their own liability is limited.

Many property investors believe that if they purchase a property through a limited company, and the property is not a success, then they can walk away from the property and have no liabilities i.e. the banks will have to sort out their own mess.

There are a number of lenders willing to lend to Limited Companies but be aware. Those that lend to new companies will most definitely want personal guarantees. What this in effect means is that if your property does not succeed, the bank will still be safeguarded through the personal guarantees they have acquired from the individual.

Wanting to set up a limited company for the sole purpose of limiting your liability is not a good reason, and banks will be reluctant to lend you money for such a venture, especially if it is your first venture and you have limited funds.

For this reason we often advise companies to trade in property development before owning their own property. Such trading can be for your own property investment!

5.4 Taxes associated with a Company

If you set up a limited company then the primary tax you will be liable to pay is corporation tax. This is the tax that is paid on a company's taxable profit. This is the equivalent of Income Tax that is paid by a sole trader/partnership.

The corporation tax main rate is now 28% although many people reading this book will never be paying at this rate.

The smaller companies' rate is 21% for companies with taxable profits between £NIL and £300,000. (In 2006 the starting rate of zero for companies with taxable profits of £10,000 or below was removed.)

Between £300,001 and £1.5m of profits, marginal small companies' relief can be applied, which is calculated on a sliding scale where a company's profits fall between the LOWER relevant maximum amount and the UPPER relevant maximum amount.

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5.5 Corporation Tax Rates 2010/2011

The corporation tax rates for the 2010/2011 financial year are detailed in the table below:

Taxable Profit	Rate of Tax	Description
Up to £300,000	20%	If the business makes between £NIL and £300,000 then it is taxed at 20%.
£300,001 to £1,500,000	Marginal relief	If the business makes a profit between £300,001 and £1,500,000, marginal relief is applied.
Greater than £1,500,000	27%	If the business generates a profit that is greater than £1,500,000, then tax is charged at 27%.

Example 2: Paying Corporation tax – Small Company

Carina sets up a limited company called Cieran Property Limited and purchases a property through the company. Her profit after costs in the financial year is £10,000.

As her profit is £10,000, she will pay £2,000 in Corporation Tax. This is payable 9 months and a day after the year end.

5.6 CGT for properties in a Limited Company

Corporation tax replaces CGT for companies.

On selling a property, a company is not liable to pay CGT. It is only liable to pay corporation tax. This means that the profits from selling the property will be added to any other profits that the company has made in the year.

Example 3: Paying corporation tax (2) no dividend

Cieran sets up a company called Davison Investments Limited, purchases a property through his company at a cost of £40,000. Five years later he sells the property for £80,000, realising a £40,000 gain. In the same year the company also makes £5,000 profit from the rental income.

If the company has made no other profits in the year then the corporation tax liability is as follows:

Amount	Rate	Tax Payable
£0 to £45,000	20%	£9,000

The total amount of corporation tax payable by the company is **£9,000.**

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5.7 Taking money out of a Limited Company

It is possible to take money out of a company by either paying dividends or paying a salary.

5.7.1 Paying Dividends

Dividends can be a very tax efficient way to pay money out of the profits made by a company. In fact this is the most common way to realise profits from a company.

If you are a basic rate taxpayer, any dividends paid will be free from Income Tax until you become a higher rate taxpayer.

This means that if you are a basic rate taxpayer then you can receive a dividend payment free of tax until your annual taxable income exceeds £higher rate levels.

Once you become a higher rate taxpayer then you will incur an Income Tax charge at the rate of 32.5%, but taking into account the tax credit of 1/9, the effective rate is actually 25% of the marginal amount. Even at the higher rate level, it is better to have a limited company if the company is able to use the 21% tax – the combined amount of 39.9% on the marginal £1 is still lower than the 40% tax bracket. Traders will also have 1% Class 4 National Insurance Contributions to pay.

Example 4: Tax implication when paying a dividend

Colin and Carmen own Cranleys Investments which has a property portfolio that generates an annual profit of £25,000 after corporation tax.

Dividends of £5,000 are paid to each of the two shareholders, Colin and Carmen, where Colin, a hard working tax advisor with work elsewhere is a higher rate taxpayer and Carmen, a full-time mother of three pays tax at the basic rate on her £6,000 per annum salary which is earned from the company as a tax efficient drawing.

The tax liability is calculated as follows:

Carmen will pay no Income Tax as the £5,000 dividend payment is not enough to make her a higher rate taxpayer.

Colin will pay tax at 25% on £5,000 as he is already a higher rate taxpayer. This means that his total Income Tax liability is **£1,250.**

£1,250 is therefore the combined tax liability for both Colin and Carmen.

From the above example we can see that even less tax could be paid if Carmen had a greater shareholding. This could easily be achieved, as it is possible to gift shares freely in a company.

5.7.2 Salary and other benefits

The other method to release profits through a company is to pay a salary. The salary is paid before the profits of a company are calculated.

If a salary is paid then the recipient will be liable to pay Income Tax.

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It can be beneficial to pay a salary to a non-tax paying person, as this can be used to reduce the profit of a company, thus reducing the corporation tax liability.

An employee having the use of a company asset will be subject to income tax on the value of the benefit received.

There are special rules if it is living accommodation or a car, but otherwise a general rule of 20% of the market value is used as a figure to tax the individual on.

This can have an effect if you purchase an overseas property and decide to use it. It may be regarded as a taxable benefit.

Example 5: Tax implication when paying a salary

In 2009 Colin's other company Elga Trading Limited has a property portfolio that generates an annual profit of £14,000. He pays a £4,000 salary to his oldest son Craig, who is studying at university. His son does occasional work for the company. He also pays out £2,000 to Cieran who is at sixth form college and Carina £1,000 who is still at secondary school. They all of course contribute to the running of Elga Trading Limited

This means that the profit of the company is reduced to £7,000, which means that the company has £1,400 corporation tax to pay.

This is a great example of how you can ensure the help with the studies is put in a tax efficient way. Why not apply it to the nanny or Au pair as well?

5.8 How do I set up a Limited Company?

Ready-made companies are available from company formation agents whose names and addresses appear in the Yellow Pages. Alternatively contact Cranleys or your own accountant or professional advisor who will be able to set up the company for you.

It is possible to have a company set up online within 24 hours. You could have the two most important sets of documents, Certificate of Incorporation and set of Memorandum and Articles of Association, issued with 24 hours. This means that you could well start operating your company within a couple of days!

A couple of good websites that are worth looking at for setting up companies are:

www.jordans.co.uk

www.cranleys.co.uk

5.8.1 Companies House

If you decide to set up a limited company then you will need to register it with Companies House.

Companies House has three main functions:

- The incorporation, re-registration and striking-off of companies
- The registration of documents that must be filed under company, insolvency and related legislation

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The provision of company information to the public

For further information you can go directly to the website by clicking on the link below:

www.companieshouse.gov.uk

5.9 Should I set up a Limited Company?

There are no strict guidelines that dictate when a limited company should be set up. Every case must be discussed with a professional advisor and on its own merits.

However, there appears to be a general consensus amongst professional advisors that as a general rule of thumb, it is not advisable to set up a limited company for managing your investment properties.

The following two sections will give some of the merits and drawbacks of limited companies when used to acquire and manage investment properties.

5.9.1 Benefits of a Limited company

1. If the company makes a profit, tax rates are lower.
2. A company can define its own financial accounting period that does not exceed 18 months.
3. The profits made through the company can be extracted as dividends. This means that a basic rate taxpayer ends up getting the profits (after corporation tax) tax-free until the higher rate tax threshold is reached.
4. If you are successful in getting finance from a lender without any personal guarantees, then you will indeed have **limited liability**. This will mean that the limited company will provide protection against financial claims against you as an individual.
5. You will continue to get indexation relief on the property. This means that when the property is sold, you will be able to decrease the amount of tax that is liable.
6. You can make very significant stamp duty savings. You only pay stamp duty at the rate of 0.5% on shares, rather than up to 4% on property purchases.
7. There are no payments on account for a ‘small’ company so some cash flow advantages.

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5.9.2 Drawbacks of a Limited Company

1. There are very few lenders who will lend money to limited companies that are formed purely for investing in property. If they do finance the investment, then it is very likely that they will want personal guarantees. This means that you will never have **limited liability**.

   This also means that due to the lack of lenders prepared to lend money, you may find yourself having to pay commercial rates on loans used to purchase a property. Commercial rates tend to be higher than buy-to-let mortgages and will usually need to be repaid within 15 years.

2. Unlike an individual, a company must pay stamp duty if the company purchases property for under £125,000.

3. Companies do not have a personal CGT allowance.

4. Limited Companies are bound by the Companies Act Legislation, which must always be adhered to. Also the Company Secretary and Directors have legal duties. These include preparing accounts and making an annual return, and filing these accounts at Companies House. Failure to do this can lead to hefty fines i.e. £1,000 if the return is a year late. This administration cannot only be very time consuming but also costly.

   Professional costs for preparing the accounts of a limited company are usually £300 more expensive than preparing accounts for a sole-trader or partnership due to the additional work required – annual statutory accounts, payroll, Corporation tax forms and statutory administration but it is still well worth it.

5. Directors are classed as employees. This means that if they receive salary from the profits of the company then the company will have to pay PAYE on such payments. There is a lot of administration involved in setting up PAYE, which makes it very time consuming for yourself, and costly if you use a professional advisor.

6. If you decide to move a property into a limited company then it must be transferred at a market value. Therefore if a property was purchased at £50,000 and moved into a company 10 years later when it had a value of £100,000, then it must be transferred at this amount. This means that an immediate CGT liability is triggered on the transferor.

7. Operating through a company means that you will lose all rights to the following reliefs that are available for reducing CGT when you operate as a sole trader/partnership:

   Private Residence Relief

   Private Letting Relief

These two reliefs alone can give a sole trader/partnership huge savings in CGT.

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5.10 When a Limited Company is a BAD idea

It is not generally a good policy to have appreciating assets i.e. properties in a company, as you will potentially be charged double tax when you sell your property IF you need to draw this money out again personally straight away. You will suffer tax at 39.9% overall – only very marginally better off than owning personally.

This is referred to as a double whammy and occurs when the company pays tax on the profit, and you pay tax when you receive a dividend.

Example 6: Paying tax twice - Double Whammy

Mr Investor is a higher rate taxpayer and generates a profit of £200,000 when he sells his property through his Ltd company.

Corporation Tax

The amount of corporation tax is calculated as follows:

20% tax on £200,000 profit = £40,000 corporation tax

This means that the net profit after corporation tax is £160,000.

Tax on Dividend

When the £160,000 is paid as a dividend to Mr Investor he is taxed as follows:

25% tax on £160,000 gross profit = £40,000

This means that Mr Investor has a total tax liability of:

£40,000 Corporation Tax + £40,000 Income Tax = **£80,000** Total tax liability

This is the effect of double tax, i.e. **Double Whammy.**

Property not in Ltd Company

If Mr Investor had the property in his own name, and not in a Ltd Company, then tax would be calculated as follows:

£200,000 profit – £10,100 CGT allowance = £189,900

28% tax on £189,900 = **£52,920** CGT Liability

This means that Mr Investor saves **£27,080** by not setting up a Ltd Company.

5.11 When is it beneficial to use a Company?

Although it was mentioned in the previous section that 'it is not generally a good policy to have appreciating assets in a company', it is beneficial certainly for property developers and even investors to set up a company in certain situations.

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The property sales in the company, which are then followed with cash being used for purchases, lead to far more cash being retained in the company. The key here is not to draw out a dividend unless you really need to.

It is better to build up the portfolio in a limited company and then transfer shares and make dividends to family members that will not suffer further tax on these dividends. Only higher rate tax payers will pay tax on dividends.

5.11.1 The Property Investor

Using a company becomes a very viable option when you will not be extracting the money from the company, but will instead be reinvesting it. If you are able to survive and maintain your standard of living through other means, i.e. your full-time job, then using a company to acquire new properties and grow your property portfolio makes sound financial sense.

The significant benefit can be explained via the following two examples.

Example 7: Growing portfolio WITHOUT a company

Mr Investor has 5 properties in his property portfolio, which is worth £900,000. He receives a net rental income of £55,000 per annum. He is a higher rate taxpayer and therefore on this he pays tax at the rate of 40%.

This means that after tax he has £33,000 available to invest into his next property.

Example 8: Growing portfolio WITHIN a company

Mr Investor owns the same five properties in a company. However, on the £55,000 rental income he is liable to pay corporation tax at the rate of 20%, which means that his company has a net profit of £44,000.

If Mr Investor decides not to take the money out of the company, he is able to use this full amount to act as a deposit on his next property purchase.

As you can see from the two examples above, if Mr Investor uses a company then he has an additional £11,000 that he can use towards the purchase of his next property. By not extracting the money from the company Mr Investor has also avoided the double whammy situation.

If Mr Investor were to continue investing in this way using his company, then you can see how over the coming years he could quite easily buy properties through his company that were worth in excess of £100,000, without the need to use a mortgage!

However, it is still important to understand that although you can use a company to grow a property portfolio more quickly than if you do not use one, you will still want to extract your profits at some point.

This means that you will still be liable to pay both corporation tax as well as income tax on any potential dividend.

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5.11.2 The Property Developer

Most property developers who make a living by buying, developing and then selling properties, will be operating through a company.

In fact, most self-employed people take advantage of the tax benefits of a company and therefore there is no reason why a property developer should operate any differently. It is likely that the developer will be paying himself a regular dividend from the income generated by the company.

It is still more tax efficient for someone to have a company.

5.12 Setting up a property management company

A strategy that has been adopted by some property investors is to set up a property management company to reduce the income tax liability.

This is particularly useful when you are a lower rate taxpayer and you are expecting your income to be in the higher rate level.

However, it is not sufficient just to pay money into your company to reduce your tax liability. You should draw up a contract between the company and yourself, setting out services to be provided and monthly charge. This will help to prevent a challenge (as artificial transaction to reduce tax) from the Inland Revenue.

Example 9: Using management company to reduce Income Tax

Mr & Mrs Investor have a portfolio of 5 properties. They are also both employed as full-time teachers earning an annual income of £20,000.

They decide to set up a management company, called Investor Property Management Ltd.

They also draw up a contract, where Investor Property Management Ltd is responsible for providing the following services to Mr & Mrs Investor:

- Monthly property inspections
- Resolving all property queries
- Arranging for repairs to property
- Cleaning the property between tenancies
- Purchase of new furniture, fixtures and fittings etc

The cost for providing this service is £900 pcm.

This means that the company is being paid £9,600 per annum for providing the services.

This income for the company is £9,600 before any expenses. If we assume no offset expenses, the company has no corporation tax to pay on £9,600 x 21%, £2,016.

The company saves the Investor’s 20% tax on the £9,600, so £1,920.

By setting up a company Mr and Mrs Investor have saved £96 (£2,016- £1,920) in tax!

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5.13 Selling a Company

If you decide to sell your company then you will be liable to pay capital gains tax.

This is because the sale of company is classed as a capital disposal.

Most property investors who have used a company to build a successful portfolio will decide to sell the company at some point in the future.

Example 10: Selling your company

Mr Investor formed his company in 2002 with a £100,000 investment to help acquire his first property. In May 2012 he decides to retire after having grown a portfolio comprising 20 properties with a value of £1,500,000.

Mr Investor, by continuously re-investing the profits generated by the rental income, has successfully grown the company.

Mr Investor's tax liability

Because Mr Investor originally invested £100,000, this will be deducted from the company value, which means that he has made a profit of £1,400,000.

Offsetting his personal CGT allowance of £10,100, he will be taxed at 18% on £1,389,900.

This means that Mr Investor will have to pay £250,182 in CGT.

This leaves him with a total profit of £1,149,818.

5.14 Trusts

5.14.1 Why Trusts?

Trusts offer a means of holding and managing money or property and as such, are a highly lucrative method of protecting your assets for the future.

Trusts are set up in order for you to channel funds or the value of an estate, for the benefit of your family now or after your death. Your house, your savings and your property portfolio can all be placed in a Trust now, ready to be passed on with the minimum of fuss when you die.

Instead of giving your 21 year-old daughter your family fortune now, you can use a Trust that releases the money when you think she'll be ready to handle it sensibly!

For a Trust to be legal, you will need to ensure it is set up correctly, or else it will hold no power at all.

Setting up a Trust should be well thought out. Once you've appointed the Trustees (members who control the Trust) and determined the Beneficiaries (those who benefit from the Trust), there's no turning back - even if you've made yourself a Trustee. Trusts are governed by powerful, and inflexible, rules.

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There are several main Trust types available. The Trust you will choose depends upon the size of your wealth, your personal circumstances and the relationships you have with your children.

5.15 Your Will Trust

Don't think that Trust funds are only for the rich. If you want to make a Will (and of course you should), you'd do best to use a Will Trust.

A Will Trust will mean you can claim Nil Rate Band taxation up to £285,000 and give full control of your estate to your spouse, for example. You can also set up a Pilot Trust, which guarantees any pension fund or insurance policy will be paid to your surviving spouse.

5.16 Interest in Possession Trust

Interest in Possession Trusts allow you to give money or possessions to beneficiaries. You will need to identify a beneficiary who will initially enjoy the income provided by the Trust. You can change the beneficiary and even name an alternative beneficiary for the capital.

5.16.1 A set income

Mr Investor transfers £200,000 into the Investor Trust. Mr Investor had previously set the following annual incomes from any transfers:

Investor Jack Junior to get a quarter (£50,000)

Investor John Junior to always receive the first £10,000

Investor Jim Junior to receive the remaining balance (£140,000).

In the above example, each beneficiary receives a specific, pre-arranged amount - an interest in possession.

5.16.2 Changing a set income

Mr Investor transfers £200,000 into the Investor Trust. Mr Investor is a Trustee, along with his brother Mr Investor the Second. They had previously set the following annual incomes from any transfers:

Investor Jack Junior to get a quarter (£50,000); Investor John Junior to always receive the first £10,000; Investor Jim Junior to receive the remaining balance (£140,000).

However, at the time of the latest transfer, Investor John Junior has a change of status and Investor Jim Junior has died.

As Trustees, they decide to make Mr Investor the Second receive the first £10,000. The balance will stay in the Trust.

Key Tip

With an Interest in Possession Trust, the amount is predetermined and not down to the discretion of the Trustees. This Trust will suit you if you have a wider family group, or where there is a possibility of beneficiaries changing over time.

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5.16.3 Changing possession

Investor Junior is the beneficiary of his father's Trust. He receives an income of £10,000 per year from the fund. Investor Junior has the 'interest in possession'.

However, Investor Junior dies two years later. His mother, a Trustee, ensures that Investor Junior's younger brother, Investor Junior the Second, now receives the income.

With these trusts, you could also arrange for more than one person to receive an equal share of income.

If you want to avoid Agatha Christie-esque intrigue and scheming within your family, it is vital that you consider carefully the Trustees of any Interest in Possession Trust.

And remember to review your Trustees in the event of death or divorce!

5.16.4 IHT and return of capital with mini-trusts

Clever use of Interest in Possession Trusts can be found by setting up a series of them, known as Reversionary Interest Trusts.

Basically, you give a large amount of cash to the Reversionary Interest Trust. This money's then divided across a series of smaller Trusts. The transfer is a potentially exempt transfer and subject to the seven-year rule.

Depending upon how many smaller trusts are established, they operate in the following way:

Trust A) Income is paid to a beneficiary for one year, after which the remaining funds are paid back to the transferor

Trust B) Income is paid to a beneficiary for two years, after which the remaining funds are paid back to the transferor

Trust C) Income is paid to a beneficiary for three years, after which the remaining funds are paid back to the transferor

Trust D) Income is paid to a beneficiary for four years, after which the remaining funds are paid back to the transferor.

And so on...

Key Tip

In the above example, the transferor receives an income (actually it's a return of capital). This income is not part of the estate (as described earlier), so it's free from IHT. And as it's not strictly income, it's free from income tax too!

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5.17 Accumulation & Maintenance Trust

A form of Discretionary Trust, which also requires an interest in possession by the age of 25. Income from Trust assets has to stay within the Trust unless used for maintenance, education or the benefit of the beneficiaries.

For this reason, it is best suited to grandchildren being supported during school, college and university.

Transfers here are tax free - with no tenth anniversary charge. There's also no IHT when the beneficiary becomes entitled to income, say at the age of 25.

5.17.1 Paying fees, free of IHT

Papa Investor offers to pay for his grandson to attend private school. The fees are £40,000 per year. To avoid this gift being taken as part of any IHT calculations - should he die - he sets up an Accumulation and Maintenance Trust.

Papa Investor has opted for this Trust, rather than attempting to claim this as a regular gift out of his normal income. This is because he has two grand-daughters who, whilst not yet old enough, he would like to benefit once his grandson finishes his schooling.

Also, whilst the value of his estate is considerable, Papa Investor's income is now only £90,000. He may find it difficult to prove that the £40,000 is 'normal'.

5.18 Bare Trust

A Bare Trust gives full Trust rights to the beneficiary. The beneficiary can therefore decide what to do with the income and capital. As a result, tax implications are determined from the actions of the beneficiary (unless they are under 18, in which case, you the parent will pick up the tax implications).

5.19 REITs – Real Estate Investment Trusts

Gordon Brown’s 2006 Budget proposals heralded the arrival of REITs (Real Estate Investment Trusts). Property companies likely to convert to the new status warmly received the proposals.

But what are they and what do the proposals mean for investors looking to minimise tax?

5.19.1 What are Real Estate Investment Trusts?

Real Estate Investment Trusts are a UK tax efficient way of holding property assets: tax efficient for property companies that become REITs – and tax efficient for investors who buy into REITs.

They are not new and have been around a long time in places like the USA, France and Australia where they have proved useful to companies that want to raise money against property.

These tax efficient vehicles act like unit trusts or shares, and invest in commercial and residential property.

Many property companies are expected to convert to REIT status because they will pay no corporation tax if they distribute 90% of their net profits to investors.

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Three quarters of income must come from rents but the rest can come from other services and development.

Currently property companies pay corporation tax on their rents as well as on their profits when they sell.

Analysts expect many UK property companies that have gone private over the past few years will now convert to REITs, thereby expanding the number of listed property companies and increasing investor interest in the sector.

REITs have got off to a flying start since their introduction in January 2007, though it's too early to assess their long-term success.

5.19.2 Are REITs right for you?

One of the reasons REITs have been created is as an easy means for investors to get an exposure to property, other than owning properties directly.

REITs also enable small investors to get involved in commercial property as well as in residential property – and to diversify their investments across a wider geographical spread.

How attractive this proposition is depends on your view of property investment or what stage you're at.

As a younger property investor you are likely to be going after strong growth.

By far the best way to do this is by directly owning a property, gearing up your investment as much as possible with an interest-only loan and covering the loan repayments with the rent (the interest of the loan being off-set against the rent for tax purposes).

REITs will never be able to provide the substantial growth you can achieve building a property portfolio in this classic way.

Instead REITs, where you own property indirectly as part of a pool of investors, are like shares and are more about producing an income than achieving exciting growth.

As such they may suit an older person who wants some exposure to property, without the management hassle of direct ownership, and who is looking at income rather than capital growth.

In countries where REITs are common, they have paid out a steady dividend rate of around 4.5 to 5%.

But remember REITs cannot be geared – although they are safe and reliable.

You just own a share in a property company, not a tangible asset like a buy-to-let apartment.

In simple terms you are exposed to property in a broad sense but you don't own the actual bricks and mortar. It's the equivalent of a tax efficient unit trust.

5.19.3 How to minimise tax using REITs

For property companies becoming REITs, the new status means they will reduce and may even eliminate taxes on earnings that would have been levied at the corporate level; instead the income is passed through the REIT to the investor.

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In the past, the problem for shareholders in property companies is that they have been double-taxed, once as shareholders and once again as the owners of a property company.

REITs remove this two tax situation, so long as 90% of the net profit is paid to investors.

Investors in REITs will not pay tax on rental income in the way they would if they directly owned and rented out a property, or capital gains tax when properties are sold. Instead, they pay tax on dividend income paid on shares and CGT on the trust itself.

We believe most people will hold REITs in a limited company structure and will use them to roll over gains and avoid Capital Gains Tax.

This will be a major benefit for investors who have previously sheltered their investments in complicated structures off-shore that make it difficult to bring money back into the UK without big penalties.

Other people may hold REITs in a self-invested personal pension plan and trusts to further shelter the steady income stream.

5.19.4 Questions and answers about REITs

Are REITs risky?
Yes, in as much as shares can go down as well as up.

Investment trusts can also sometimes trade at a discount to their underlying asset values, so this can enhance their volatility relative to unit trusts.

However, this could also provide an opportunity to buy assets at a discount if, say, you think the discount could get smaller in the future.

They will also follow stock market sentiment much more closely than direct property holdings.

What can REITs invest in?
They can invest in commercial or residential property.

Why did share prices in some UK property companies go up after Gordon Brown's announcement?
First, existing property companies will be able to switch to REIT status on payment of a charge of two per cent of the value of their gross investment assets.

The stock market had thought that the then Chancellor would have set the conversion charge higher than this.

So this was good for some property shares.

Second, the extent to which a REITs income must cover its interest payments was set lower than many had thought.

Third, the stock market believed REITs would have to distribute 95% of their profits to investors, but Brown set the figure at 90% - also better than the market had hoped.

That is why the shares in those companies that were thought most likely to want to convert went up.

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Land Securities, the biggest property group, went up 13% on budget day.

However, Gordon Brown kept some limitations; most notably the rule saying that no individual shareholding could be bigger than 10% or else a tax charge would be applied.

Could other companies become REITs?

Yes. In particular, it's thought that some large retailers will be interested in converting to REIT status.

However, as they cannot invest in properties they also own, they would need to do a few complex transactions first - possibly selling their assets and then leasing them back.

Is it worth getting excited about REITs?

If you are a landlord, then investing directly in property REITs will probably seem a bit tame because with a share in a REIT, you'll just own a share in a property company.

So you can't drive past your asset, like you can with a property that you own directly.

You can't touch and feel it. All you can do is check its value in the FT!

Perhaps most importantly, you can't use gearing to maximize your return on investment and you cannot re-finance in the same way as you can with your own property. You also can't make the same detailed investment decisions as when you own property directly.

However, REITs can produce a decent income.

REITs will be slow and steady because their borrowing limits mean they are a lot less geared (ie. they can take on a lot less debt) than private investors in residential property can (and have) been doing.

REITs are especially attractive if you want an income, and that means REITs may be of more benefit to older people, rather than younger investors who are much more likely to be focusing on growth.

This is because REITs will need to redistribute a large portion of any profit - rather than refinance to reinvest which is the classic way of building up wealth within property.

And this is why the government likes them - they should be a safe and steady way for Joe Bloggs to invest in property assets without needing to take on lots of debt.

Will REITs push up house prices?

It is likely that the big property companies will buy up large portfolios of new build from builders.

As such, they will be buying new supply and helping to bring new supply to the market.

They may buy small chunks of existing stocks, but this is thought to be unlikely.

The net effect on house prices will very probably be neutral.

5.20 Flexible Reversionary Trusts

New to the trust regime is a Flexible Reversionary Trust. Labelled by one advisor as "the perfect inheritance tax planning solution for most people". Why? It can provide a saving compared with the IHT saving of an outright gift as the donor can still have complete access and control over their capital and income. Too good to be true I hear? Surely we cannot have what we want and HMRC not penalizing what we do?

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After seven years the entire amount of the initial transfer no longer forms part of the settlor's estate, yet the settlor retains potential access to the maturity proceeds of all 100 policies over the following ten years. In this example neither the settlor nor beneficiaries have received any payments, yet the trustees retain the flexibility to allow policies to mature and revert to the settlor, or they can appoint monies to beneficiaries if necessary.

Crucially, the deferral of any policy to a future date or the appointment of capital to beneficiaries is not deemed to be a further transfer of value on the settlor for IHT purposes.

What is the benefit of the FRT over DGTs and loan trusts?
No automatic return of capital
A paradox of a DGT is that although the discounted value of the initial transfer falls outside the settlor's estate after seven years, the annual payments to the settlor will simply accumulate in his estate unless spent. The same issue applies to loan trusts where little inheritance tax saving will be achieved until the loan starts to be repaid.

There is no requirement to take a fixed repayment of capital from the FRT as the trustees can defer any reversions without any IHT implications.

No restriction to a fixed income
A major disadvantage with DGTs is that access to capital is lost and the income level must be fixed at outset. This can present problems over long periods of time where the settlor relies on the income. An income set at 5% of the initial fund value will fall by 47% in real terms with an inflation rate of 3% over twenty years. Why commit to a fixed income when you don't have to?

The FRT allows the settlor to structure the policy maturities or reversions in line with their expected needs. Also, each reversion will include any investment growth so an element of inflation-linking is built in.

Is a discount important?
In contrast to a DGT, no discount applies to the initial investment into an FRT. However, a discount is not necessarily useful for all clients. Where the settlor does not intend to transfer more than their nil rate band into trust and they have a life expectancy far greater than seven years, then a discount will not provide any great benefit as long as the settlor does in fact survive for seven years. After seven years, the initial transfer will be exempt from IHT whether it is made via an FRT or a DGT.

Elderly clients with short life expectancies making investments above the nil rate band are the biggest beneficiaries of discounts, but paradoxically the elderly gain the lowest discounts because of their lower life expectancies.

Ease of appointing capital to beneficiaries
A unique feature of the FRT is the ability of the trustees to appoint capital to any potential beneficiary at any stage without the potential IHT complications of DGTs and loan trusts. Any appointment will not be a further transfer of value for IHT purposes on the settlor. Appointments from DGTs and loan trusts are problematic – some DGTs do not allow payments to beneficiaries during the settlor's lifetime. Furthermore, where the settlor gives up a right to income or a loan repayment this would be a further IHT transfer of value by the settlor – the FRT avoids any such issues.

Choice of investment holding structure

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Structures such as DGTs, FRTs and loan trusts have always been the preserve of life assurance companies. However, their use is not restricted to life assurance bonds. One FRT provider allows the trust to be established with unit trusts/OEICs. This can be particularly These have become favourable for long-term growth investments with the much lower CGT rate of 18%. It is now more attractive as compared with the 40% rate of an offshore bond.

5.20.1 How they work

Where the endowment policy version is utilised, the payment of any policy maturity proceeds to the settlor will trigger a chargeable event. The tax charge will be calculated in the normal manner for life assurance policies. With DGTs, if the payment to the settlor is within the 5% per annum withdrawal allowance any tax charge is deferred until a chargeable event occurs or twenty years has passed, whichever occurs sooner. This can create a favourable tax outcome depending upon the settlor's and future beneficiaries' tax positions.

It is therefore imperative that a detailed tax comparison is undertaken to see whether the life assurance policy or unit trust route provides the best investment holding structure for you and your specific circumstances.

5.20.2 HMRC treatment

The introduction of the Pre-Owned Assets charge (POAT) demonstrated the Government's intention to attack what they deem to be unacceptable tax avoidance. The FRT, which has been utilised since the early 1990s, uses tried and tested principles.

Importantly HMRC have confirmed their treatment of the FRT:

The settlor's right to receive the reversions is not a gift with reservation of benefit.
Any reversions to the settlor will not incur an exit charge or periodic charge within the trust.
The deferral of any reversions will not be a further chargeable transfer on the settlor.
The FRT will not be subject to a pre-owned assets charge.
Who will benefit from using the FRT?
The FRT is not just an alternative to a DGT and loan trust. As it avoids the inflexibility of the DGT and relative ineffectiveness of a loan trust, it is suitable for a far broader range of situations.

5.20.3 Who is it suitable for?

It is ideal for those who are highly likely to survive for seven years and who do not require an immediate income or fixed repayment of capital. Someone transferring £325,000 into an FRT will save £130,000 of IHT, as long as they survive for seven years and the value of their estate on death remains above the nil rate band. Younger clients could establish a new FRT every seven years and make further savings. Ten year periodic and exit charges can be applied to trusts, but it is often possible to reduce or even prevent these from being applied by establishing more than one trust at outset.

It is also possible to use the FRT with the normal 'expenditure out of income' exemption. This allows those with a surplus income to make gifts which are immediately exempt from IHT.

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The flexibility and IHT efficacy of the FRT hinges on the ability of the trustees to defer or defeat the reversions to the settlor. Those wanting to ensure that under no circumstances can the trustees (who are selected by the settlor) defeat the reversions/payments to the settlor, will not find the FRT suitable.

Conclusion
The FRT is not a panacea for IHT planning. You should always receive coherent estate planning advice which takes into account your overall circumstances and objectives. This often requires co-ordinated advice from your legal, tax and financial advisers. When consulting financial advisers make sure you seek independent advice as those companies providing tied or multi-tied advice do not currently provide an FRT.

The advantages of FRTs are particularly apparent in today's economic conditions. Many people will avoid outright gifts because of falling asset and capital values. The FRT can facilitate IHT mitigation whilst not giving up access to the capital. If your finances recover you can use the FRT to pass monies to your beneficiaries in later years, but if not, then the reversions can be paid to you. The FRT allows a full range of liquid asset classes to be held in trust, including cash holdings – there is no requirement to invest in equity investments.

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6 OVERSEAS TAX – THE BASICS

Many people are recognising the benefits of moving abroad, not just to take advantage of sunnier climes but for tax purposes.

If, like most people, you are investing in property to ultimately create your pension, then you may be well advised to consider a move abroad before you start to realise your capital gains.

Why? Well after five years of living abroad you will be counted as a 'non-ordinary resident' and will automatically be immune from paying any Capital Gains Tax in the UK.

Before you start packing your bags, it is worth mentioning that in his first Budget of 2008, Chancellor Alistair Darling announced plans to clamp down on people taking advantage of living abroad for tax purposes and offshore trusts and funds. It is therefore worth monitoring future Budgets to assess the ongoing viability of either living or trading abroad.

So, once you have completed five full tax years away from the UK you can then start selling your UK assets CGT free and, in theory, come back to a nice little nest egg. Bear in mind, however, that you will have become tax resident in another jurisdiction and will therefore be liable for tax in that place. You need, then, to choose where you live with care.

It is essential to understand the basics to make sure that your search for the promised land pays off.

Before you leave the UK, you need to fill out a P85 form ('Leaving the UK') and submit it to your tax office. If you are leaving employment in order to emigrate, then you will be issued with a P45 form from your employer which will show details of pay and tax to date. This should be submitted to the tax office together with the P85 form.

Assuming that you are ordinarily resident in the UK, you will cease to be a UK resident from the day after you leave the country if you are abroad for at least a complete tax year, whilst abroad you work in full time employment or your return visits to the UK total fewer than 183 days a year and average fewer than 91 days in any year.

6.1 Pensions

With regard to your employer's pension scheme, you and your employer may continue to make contributions up to the allowable limits for up to 10 years after you leave the UK.

You may not, however, make Free Standing Additional Voluntary Contributions (FSAVC) during a period of non-residence.

If you are a member of a personal pension scheme and you move overseas, but no longer have UK taxable earnings, you may still pay up to the earnings threshold to your personal pension scheme. However this is dependent on you having been resident in the UK at some point in the last five tax years.

Changes to the taxation of pensions were introduced in April 2006, specifically limiting the lifetime limit for pension savings and the annual allowance for tax-favoured contributions.

Although these changes may not affect you during your time overseas, you should take advice on the implications of these changes for you in the future.

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Will I still need to complete a UK tax return after my departure?

If all your UK taxable income is subject to UK withholding tax and you are not a higher rate (40%) tax payer, you may not have to file a tax return but unfortunately most higher rate taxpayers do have to continue to file a tax return on any UK taxable income.

6.2 Income Tax

If you are not resident in the UK, you will be liable to UK tax only on income arising in the UK (e.g. UK pensions, taxable rental income, interest income from UK banks and building societies, dividend income from UK corporations).

If you sell your home in the UK in the tax year you become non-resident, any capital gain may come within the scope of UK tax, even if the sale takes place after you have left the UK.

However, if you have - or are deemed to have - occupied the property as your main residence to within three years of the date of sale, the gain is fully exempt so it might be worth thinking ahead on this one.

6.3 Shares and savings

If you were resident in the UK for at least part of four out of seven tax years prior to your year of departure, and you will be not resident for fewer than five full tax years, any gains and losses made on share disposals during your period of absence will be counted within the tax year of your return to the UK.

One way to avoid this may be to make sure that you acquire assets after leaving the UK. If such assets are disposed of in an intervening year, any gains or losses on such assets are completely excluded from the charge upon your return to the UK.

With regard to any Individual Savings Accounts (ISAs) you may have then you must be resident in the UK for tax purposes in order to contribute to an ISA. If you start an ISA in the UK and then go abroad, you cannot continue contributing to the ISA during your period of non-residence.

You can however make the full annual allowable contribution prior to leaving the UK and you will still get tax relief on investments held in the ISAs.

When you return you can start putting money in again (subject to the normal annual limits) so basically you can pick up where you left off.

6.4 Personal Equity Plans (PEPs) and Tax Exempt Special Savings Accounts (TESSAs)

PEPs and TESSAs opened prior to 6 April 1999 will retain their tax efficient status during the time you are away and so the income and gains will continue to be exempt from UK tax.

6.5 Social Security contributions

Your requirement to pay UK or foreign social security contributions during your absence from the country will depend on how long you are leaving the UK for, what country you are going to and if you will be employed by a UK or foreign employer.

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If you are going to work in a country within the European Economic Area or to a country with which the UK has a reciprocal agreement, any contributions made whilst abroad should be included in your total contributions figure at retirement.

It is worth checking with the UK Department of Social Security before deciding what contributions to make whilst you are away.

6.6 Offshore Tax planning

More and more property investors are recognising the benefits of 'offshore' jurisdictions when it comes to tax planning - with careful consideration, considerable sums of money can be saved. But where to begin?

6.6.1 What is an offshore trust?

An offshore trust is a trust set up in another country where it will pay no or low tax. The trust is not allowed to do business in that country but can do business worldwide, open a bank account worldwide, invest and generally conduct all the legal enterprise activities it wishes.

Offshore jurisdictions are known in technical terms as International Offshore Financial Centre or IOFC for short. Most consultants recognise 42 IOFC's ranging from rather unsophisticated jurisdictions like Vanuatu to more regulated jurisdictions like the Seychelles and British Virgin Islands to Switzerland, which is one of the most regulated jurisdictions in the world. There are also another half a dozen like Israel, Dubai and certain states in America that work very well without the stigma of being a tax haven.

IOFC's typically have favourable tax rates or no forms of taxation at all, simple company and trust legislation, no exchange control and a varying extent of secrecy of the company directors, shareholders and its financial affairs. These are the typical criteria citizens of high-tax and high-regulation jurisdictions look for when going offshore.

Because IOFC's often have little or no forms of tax, they are often called tax havens, but the advantage of these jurisdictions and of going offshore is not limited to tax advantages. We'll cover all the advantages shortly.

6.6.2 Why offshore?

Individuals and companies go offshore for a number of reasons, but it would be safe to say that the majority do it for tax reasons.

The five most common reasons individuals and companies find going offshore an attractive proposition are:

1. Tax savings
2. Asset protection
3. Pre-migration planning
4. Economic anonymity
5. To escape jurisdictional regulation

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6.6.3 Tax savings

Tax savings is by far the dominant reason why individuals and companies consider going offshore. Those tax savings vary from short-term annual tax on some income to advanced planning to reduce inheritance tax.

Going offshore can relieve most, if not all, of the income tax, inheritance tax and capital gains tax payable by residents in high tax jurisdictions.

It's not uncommon for high tax jurisdictions like the UK and USA to be receiving upwards of 60% of your income once you take income tax, social taxes, stamp duty, council tax, and so on into account.

The popularity of offshore structures for holding UK property has increased significantly over the past 3-4 years. By way of example, the Jersey Financial Services Commission estimates that they now regulate over £23 billion of real estate funds. This increase in popularity is largely due to the considerable tax savings that these structures can bring.

For those who are non-domiciled in high-tax jurisdictions, the tax benefits are even greater and structuring can become simpler.

A carefully structured offshore plan can reduce or eliminate one or more of the following:

- Withholding taxes
- Trade profit taxes
- Property profits – capital gains
- Property profits – rental income using back-to-back loans and double-tax agreements
- Capital gains taxes
- Worldwide income tax regimes
- The EU savings directive disclosure and withholding tax

Three British billionaire ex-pats are retailer Philip Green or more exactly his wife Christina (though they count as one for the purposes of our list); Clive Calder, the South African born ex-record-label tycoon who discovered Britney Spears; and currency trader-turned-investor Joseph Lewis. They live in Monaco, the Cayman Islands and the Bahamas respectively.

Now here's the twist: while those three places have long had a certain tax appeal to the wealthy, many of the non-Brit billionaires based in the UK, such as Mittal, Abramovich and Rausing, are attracted by the UK's own emerging reputation as a tax haven with good schools, nice homes and (still relatively) safe streets.

And while the foreign-born take advantage of a well-known tax provision for non-domiciled residents that allows those who live in the UK for some, but not all, of the time, to be taxed only on their UK earnings, it seems that the legions of financial advisers that exist in Britain's billionaire support ecosystem can make the UK hospitable to home-grown wealth, too.

6.6.4 Tax efficient

According to a published study by accountancy firm Grant Thornton and commissioned by the Sunday Times newspaper, British billionaires paid income tax totalling £14.7 million on their £126 billion combined fortunes last year, and only a handful paid any capital gains tax.

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Grant Thornton estimated that three in five billionaires paid no personal income taxes, although they would have paid indirect taxes such as VAT and council tax. Business income would have been tucked away in offshore trusts and companies. Most of the rest who did pay taxes would have paid themselves in dividends rather than with a salary. Dividends are taxed at an effective rate of 25% rather than the 40% higher rate of income tax.

Accepting that there is a degree of guesswork in the numbers, given that neither individual tax returns nor the details of more arcane tax shelters are public documents, but taking them at their face value, we estimate that Britain's billionaires paid an effective income tax rate of barely 0.4%.

6.6.5 Asset protection

Asset protection refers to a set of legal techniques for protecting one's assets from judgements, litigation or certain forms of wealth taxes.

Asset protection is based on the basic principle that any asset that you own can be reached by a creditor. The flip side of that equation - any asset you do not own, cannot be reached by your creditor. That is the goal of asset protection planning. Various structures aim at removing you from the legal title to your assets, while you retain complete control and enjoyment of the assets.

There are literally dozens of various asset protection structures in use today.

The specific structure best suited for each person will depend on: (1) the nature of the asset being protected (i.e. different structures are used to protect rented real estate, a personal residence, a bank account, a retirement plan, etc.); (2) the timing of the claim or lawsuit; (3) the debtor's risk adversity; and (4) the aggressiveness and the intelligence of the creditor.

For example, if you are seeking to protect your house you have approximately 7 different options.

You may transfer ownership to a living trust with a generic name, you may transfer ownership to an irrevocable trust, you may encumber the residence, you may record a naked deed of trust, you may sell the residence on an instalment basis to a family member or you may sell for cash to a stranger on a “friendly” arrangement to buy it back at some point.

Simply changing legal title to a living trust with a generic name may work to defeat the claims of some creditors, but not most. For someone who wants real protection, a better option may be an irrevocable trust or an outright sale of the residence.

It is preferable to engage in asset protection planning before there is any need for it. But for most people it is never too late to plan. Even after a lawsuit is filed, many people can still engage in planning. Even if the planning is deemed to be a fraudulent transfer there is usually no downside because the planning will be simply set aside.

Consequently, you may have nothing to lose by engaging in planning, but gain the advantage of delaying the lawsuit, making it more complicated or having the creditor engage in more complex anti-trust lawsuits against you. In these situations, many creditors discover that the rewards of the lawsuit will not outweigh the cost of the lawsuit and revert to a simpler-based lawsuit or draw it to a close all together.

Another consideration is whether or not the asset is easily converted to money; if it can be then the asset can be protected by using an offshore trust and offshore bank account. This option is effective

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because the asset is outside the control of any local court and the debtor cannot be ordered to bring the asset back since he does not control it.

Asset protection does not deal with secrecy or hiding assets.

Hiding assets is an ineffective means of shielding them from creditors because a debtor would usually have to disclose his assets in a debtor exam, under penalty of perjury. A properly structured asset protection plan allows the debtor to reveal the nature and the structure of the plan without sacrificing its efficacy.

6.6.6 Pre-migration tax planning

PMTP is a specialist branch within the management of offshore tax planning. It involves the transfer of assets, income or entitlement offshore before the citizen moves to a highly regulated or taxed jurisdiction.

Quite a few jurisdictions, including England, treat residents who are domiciled differently from those who aren't domiciled. In England, for example, non-domiciled individuals only pay inheritance tax on assets they own in England and they're not taxed on dividends and interest they earn outside England.

So, there are obvious advantages of not bringing your assets to England if you move from another jurisdiction. Depending on a few factors, and where you plan to move to, other highly taxed jurisdictions have similar arrangements.

A simple and often followed route, that doesn't need a great deal of planning and expense, is for individuals moving to a high-tax country to obtain fiscal advantages in their new country by placing funds in an International Trust in Cyprus, New Zealand or the Seychelles.

6.6.7 Economic anonymity

Highly regulated societies are subjected to a constant barrage of legislation that strips away economic privacy. Governments and the justice system generally view the national interest as more important than the right for residents to maintain economic privacy.

Here are just a few examples of how UK residents have had their economic privacy stripped away by legislation:

Banks, solicitors, accountants and other professional advisers are required by law to identify you, keep a record of your identity and residential address. This is to comply with money laundering provisions and anti-avoidance legislation - and out of the 60 million people in the United Kingdom less than 1,000 crimes of money laundering, tax fraud and tax evasion were reported in 2004/5.

All UK registered companies must file an annual return and accounts, all of which can be accessed as public record. This annual return includes the personal details of the directors, company secretary and shareholders.

All land and property transactions are available for public inspection. As soon as you own any land or property in England, your name, address and details of the property including the purchase price and mortgage are recorded in a public register. Anybody can access it.

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Credit reports can be ordered on the internet for under £100 and contained in the detailed reports are, among other things: your full name, national insurance number, your current and previous addresses, list of your bank accounts, credit cards, store credits, income/wealth grouping, etc.

Anyone can get this information.

It's possible by using offshore structuring or advanced identity protection to avoid every single one of these provisions.

6.6.8 Escape jurisdictional regulation

Many of the IOFC's have little or no regulatory restraint on international business, foreign exchange control, fiscal monitoring, reporting duties, annual returns to file, etc.

Most offshore jurisdictions don't have annual returns to be filed; only basic accounts need to be kept (if any at all) and most don't have public registers of any kind.

6.7 How to go offshore

There are a few different tools we can use and applications that going offshore work best for. Experienced and qualified offshore planners develop and work within the framework we call an Offshore Structuring Plan (OSP) and within the plan is a great deal of detail, which we will cover shortly.

Before we go through the OSP, we'll cover the formation types (called "vehicles") we use and the applications that are best suited to offshore.

6.8 Offshore vehicles

6.8.1 Company / IBC

IBC's (International Business Company) are very similar to other Limited Liability companies but are formed and regulated under non-resident legislation in the jurisdiction they are incorporated in. They are exempt from any forms of tax on income they generate outside the jurisdiction.

In most jurisdictions records of the IBC's are not for public record, do not need to keep accounts or file annual records with the regulators.

Characteristics of an IBC vary by jurisdiction, but will usually include:

- Exemption from local corporate taxation and stamp duty, provided that the company engages in no local business
- Annual agent's fees and company registration taxes are paid to the jurisdiction where the company is incorporated
- Preservation of confidentiality of the beneficial owner and directors of the company,
- wide corporate powers to engage in different businesses and activities
- The ability to issue shares in either registered or bearer form
- No need to keep accounting records or subject them to annual audit

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6.8.2 LLC

Limited Liability Corporations are generally limited to the USA and are comparable to an IBC, with a few changes in terminology. Instead of having directors, LLC's have members and instead of shareholders, LLC's have members.

6.8.3 Trusts

An offshore trust is created when assets are transferred to a trustee. The trustee becomes the legal owner and is responsible for managing the assets and distributing them to the beneficiaries of the offshore trust (which could include the person or corporation that transferred the assets to the trustees) in accordance with the terms of the trust deed.

The terms on which the Trustees administer the trust assets are detailed in a trust deed, and trust legislation to govern trusts has been enacted in many common law jurisdictions.

When a trust is established in a suitable offshore jurisdiction, provided that residents of the offshore jurisdiction are excluded from receiving benefit from the offshore trust, then there will be no local taxes applicable to the assets and income of the trust.

6.8.4 Foundations

An offshore foundation is a conventional foundation that is formed under the laws of an offshore jurisdiction. Like conventional foundations they are generally a low tax entity, but with less red tape and reporting requirements.

Foundations are mainly used for altruistic or estate planning purposes. In terms of the legal structure, an offshore foundation lies somewhere between an offshore company and an offshore trust.

Best suited applications:

1. Land and building
2. Intellectual property like patents, trademarks and copyrights
3. International trading & consulting
4. High worth assets like art, collectables, yachts, aircraft, jewellery
5. Investment and finance

6.9 Offshore Structuring Plan (OSP)

The first stage is to analyse the existing tax liabilities and non-financial burdens. Where there is little money involved, be careful not to incur expenditure in structuring an offshore plan that is out of proportion with the benefits.

The design of an OSP normally involves one or more of these:

1. Selecting the form of international transaction, operation or relationship
2. Selecting the most appropriate vehicle

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3. Determining where, if any, there will be a permanent establishment for tax treatment

4. Selecting the foreign jurisdiction(s)

Rental income, dividends and capital gains frequently receive different treatment at the domestic and foreign levels. The OSP has to take this into account and factor in any double tax agreement arrangements.

International tax planning, in some cases, can be easily achieved by introducing a foreign element, such as the creation of a trust or separate company in a low-tax jurisdiction.

Any plan needs to be evaluated from time to time to consider these 3 cases:

1. If the plan is not adopted.

2. If the plan is adopted and succeeds.

3. If the plan is adopted and fails.

The final stage in the process is to identify the potential risks or disadvantages. Where there are substantial risks or disadvantages to the plan, risk management becomes an important consideration, or alternative plans need to be considered, even if it means starting again.

Often, the biggest risk is a challenge by domestic tax regulators and provided that the OSP is robust enough to withstand their scrutiny, or the OSP is sufficiently well structured to avoid detection or investigation by using non-disclosure jurisdictions and nominee structures, the plan could well go ahead despite the risks.

6.9.1 Where offshore

Where to set up your offshore structure is an important part of the planning process. There are 42 recognised IOFC's, each with their own advantages, disadvantages and costs. It takes experience and education to identify which jurisdiction is best suited to each application.

Broadly speaking, there are 5 factors to consider:

1. Desirable rates of tax

2. Disclosure of directors, shareholders and company documents

3. Ability to have non-resident directors and shareholders

4. Credibility of the jurisdiction

5. Political and economic stability

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6.10 Costs of going offshore

Going offshore is often not a cheap exercise and its cost can vary wildly - from around £1,500 to well over £100,000, depending on the complexity of the offshore structure plan (OSP), the jurisdictions involved, and the time and expertise you employ.

These costs are segmented into two cost centres: there are the initial costs to set the structure up and the ongoing jurisdictional costs.

One-off, set up costs include the following main elements:

1. Vehicle formation
2. Jurisdictional incorporation taxes
3. Registered office costs
4. Registered agent fees
5. Planning and professional fees for the offshore planner
6. Courier and postage costs

….and finally there could possibly be some legal fees if you need to obtain professional references, notarised copied of documents etc.

For an average structure in a no-tax jurisdiction these costs vary between £1,500 - £5,000.

Recurring costs pay for annual jurisdictional taxes, use of the registered office, your registered agent, the use of an office outside of England, your travel costs and possibly on-going consulting to keep your OSP current.

Remember, for any offshore structure to be affective, you have to manage and operate the structure outside of England. You will incur travel costs, the use of an office or conference room and possibly local managers and directors to help you.

Almost without exception, our OSP's include using directors and corporate managers to manage the company on a day-to-day basis for our clients. It largely achieves all those “management” requirements and it's far easier for the clients too.

Irrespective of the cost of going offshore, always compare those costs to the short-term and long-term tax savings. Then consider the non-financial benefits like: gaining economic anonymity and avoiding your local compliance requirements.

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6.10.1 Example 1: Owning property offshore in the UK

Under the current tax regime, non-resident property owners are exempt from paying capital gains tax.

So for property investors the United Kingdom is very attractive; it has:

1. high rates of return
2. a stable and well-regulated property industry
3. ample opportunity to invest
4. no capital gains tax for non-residents

A UK-based property developer and investor generated £250,000 in taxable income for the year. Their current tax bill is in the region of £100,000. He approached an accountant to reduce his annual tax payments.

The accountant decided to incorporate a Cypriot company with Cypriot directors who are accountants to manage the company from their offices. The client was appointed as the company's local manager and a director of the Cypriot company, and would be entitled to 20% of the annual profits as his remuneration (roughly £50,000 a year). Each month the manager travels to Cyprus for a company meeting at which the business decisions are made.

The shareholder of the company is a Jersey Trust of which the Trustees are a firm of Jersey registered solicitors. The Trust is rather complicated but no beneficiaries are named in the Trust Deed and it is a discretionary trust, all aimed at creating the greatest flexibility for the future tax planning.

The company generates another £250,000 in the next year on which the company pays 10% in tax in Cyprus (£25,000). The manager (the client) pays £15,000 in tax and National Insurance.

The costs of the structure cost £8,000 to set up and £4,000 annually.

The total outgoing then is: £52,000

Previous tax payments: £100,000

Total tax savings: £48,000 in the first year and £55,000 a year thereafter

6.10.2 Example 2: Owning property offshore – outside the UK

Pamela wants to invest in a holiday apartment development in Dubai but wants to do it as tax-efficiently as possible.

She has 6 properties with available equity of £120,000. Each apartment she wants to buy costs £115,000 and additional costs will be another £3,000.

Her plan is to buy 6 apartments and in 10 years time retire to live in Spain.

Pamela puts up a bank guarantee for the BVI company to take a local mortgage to buy 4 apartments and travels to Dubai to execute the agreements. She plans to return to Dubai 3 times a year to review the company performance, receive bank and mortgage statements and to update the company's accounting records.

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When she sells the properties in 10 years time, all the capital gains will be captured in the BVI company. Provided that she manages the company's affairs outside the UK and doesn't receive any of the proceeds herself, it will be tax-free.

The current plan is for the BVI company to loan its money to Pamela on a lifetime loan repayable on death, the loan to be made once she buys a house in Spain.

6.10.3 Example 3: Pre-migration tax planning

A South African entrepreneur planned to move from South Africa to the United Kingdom. As part of his investment expansion, he wanted to purchase a property in London for £1,000,000.

He incorporated a company in the BVI with a BVI Trust being the shareholder using a specialist company director in the BVI to act as the company director. The cost of the structure was £2,500. To add to his economic anonymity, a solicitor in London was granted a special power of attorney to sign documents on the company's behalf and enter into the required correspondence.

He put up a bank guarantee equivalent to the £1,000,000 for the BVI company to raise a local mortgage and acquired the property. With stamp duty and legal costs the total acquisition costs came to £1,080,000.

The property was put on the market for £1,750,000 after some cosmetic remodelling, but was finally sold for £1,600,000. The company incurred costs of £18,000 to sell the property and cancel the mortgage.

The net result of the two transactions was a capital gain of £502,000. Because the BVI company was non-resident for tax purposes the capital gain is tax-free.

The total tax saving, if the client paid capital gains tax, could have been as high as £160,000 – all for an investment of £2,500 per year.

6.10.4 Example 4: Advanced tax corporate planning

Taxes in America were draining the monetary reserves of an American software company and hindering it from expanding its operation worldwide. The value of the company at the time was $4,500,000 and it was co-owned by two individuals. Their annual tax payments were $180,000, effectively a tax rate of 28%.

The company was advised to incorporate a company in Ireland where IT expertise is available and various grants are offered to foreign employers. The company in Ireland was tasked with world wide sales, and software support for Europe and Africa. An office in Singapore offered support to Asia and Australasia. For all intents and purposes it was a stand-alone company with a permanent place of establishment in Dublin.

After implementing the plan over an 18-month period and getting the Irish company fully functional, profits from worldwide sales and support contracts reached $1,000,000 and were taxed at an effective rate of 12%.

Reducing the tax rate from 28% to 12%, and the key to it all was moving the sales division to Ireland.

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6.11 New Zealand

New Zealand might not be the first country you'd think of when investigating offshore tax planning and if you surfed the web or contacted offshore structuring consultants you'd be very fortunate to find anything on using New Zealand as part of your tax planning.

And yet New Zealand Offshore Trusts (NZOTs) are an excellent way of owning assets and increasing wealth without accruing the tax burden that normally goes with it in other high-tax jurisdictions of Europe and America.

An NZOT is simply an offshore trust set up in New Zealand to maximise the benefits of New Zealand's tax system.

New Zealand is well known as a safe, stable and secure country that offers considerable benefits to those involved in international tax planning, particularly in the realm of personal and asset protection and privacy.

The New Zealand government has implemented various changes to encourage greater investment in their country making New Zealand offshore one of the best international financial centres in the offshore banking and investment arenas.

6.11.1 Benefits of NZOTs

NZOTs have all the best points you want from an offshore vehicle without many of the drawbacks:

- It is 100% tax-free if the trustees and beneficiaries are not resident in New Zealand.
- Setting one up is reasonably straight forward and not time consuming. A NZOT can be established and functional within two weeks.
- The Trust Deed is variable and can be customised to suit your individual requirements.
- It is not expensive: a typical setup will cost £3,000 and costs in the region of £1,000 a year to maintain.
- New Zealand is a credible jurisdiction, unlike many other tax havens.
- The legal profession in New Zealand is extensive and well-regulated, so you have the comfort of receiving quality advice and services through service providers you can trust in New Zealand.
- NZOTs are recognised by local and international banks and do not attract any special attention, nor are they subject to abnormal scrutiny.
- New Zealand has a stable currency, stable economy and has good political and trade links internationally, which gives it an edge over many other tax-free jurisdictions. It's very unlikely that New Zealand would be subject to a civil war, economic collapse or international isolation, for example.

A practical example of how an NZOT could assist in your tax-planning could be having it own a rental property.

The rental profits will accumulate tax-free and there will be no New Zealand capital gains tax if the Trust disposes of the property. The profits, assets and reserves can accumulate indefinitely - totally tax-free.

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Also, an NZOT, having its management conducted outside of the UK, could acquire property in England and any disposals will be exempt from capital gains tax, saving significant amounts of tax for property developers or property portfolio owners.

When the need arises, the Trustees can then pass on a benefit in cash or the use of a Trust asset. There will be tax to pay but this can be planned to minimise tax liability.

For example, the trust could pay the university fees for a student which otherwise would have to be paid with after-tax funds. Of course the student would pay tax, but having no other income, would be entitled to £5,035 a year tax-free, and anything over that pays tax at just 10%.

New Zealand may be on the far side of the globe but should be right in the forefront of tax-planning. It's inexpensive, flexible, credible, secure and tax-free in most circumstances.

6.12 Cyprus

Cyprus has an excellent business infrastructure and many international banks have formed offshore banking units on the island and provide services to foreign and offshore companies.

There are also legal trusts set up which are established under English law – your chartered accountant or lawyer in Cyprus probably trained in England at an English university – making life a lot more straightforward for UK investors.

Another major reason for choosing Cyprus as the ideal location for setting up an offshore entity is the fact that the country has a highly favourable double tax treaty with most East European countries where many property investors looking for maximum capital gains are going to want to buy property.

A double tax treaty in a nutshell, is an agreement between two states designed to protect against the risk of being taxed twice on the same income - a common drawback to finding a location for an offshore entity.

Basically, the fact that Cyprus has double tax treaties with a number of East European countries means that the investor can take advantage of favourable tax breaks in both Cyprus and other countries it has a double tax treaty with, and establish offshore entities in more than one location without running the risk of being taxed twice.

For example, having set up an offshore trust or company in Cyprus, the investor can then set up other entities in a Central & East European country such as Poland and, after paying Polish taxes, pay 0% tax on the income earned from the trust or company.

6.12.1 Important issues

However, there are some important issues to watch out for.

The most significant issue is that Cyprus was listed by the Financial Stability Forum as being a ‘group three’ country, which means it is deemed as having ‘low quality of supervision of the financial sector’.

The Financial Stability Forum, an independent, international body, was established in 1999 to promote financial stability through exchange of information and co-operation and financial supervision and surveillance.

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As a result of being given this less than complimentary status, Cyprus signed a letter of commitment promising to implement exchange of information on ownership of property on entry to the EU in 2004.

Without going into the ins and outs of the implications of this for the investor, this simply gives them added peace of mind that Cyprus is committed to raising its status as an international financial centre.

6.12.2 Company Law and taxes

Cyprus' company law is similar to the UK – but not as advanced.

Private companies may be registered as 'exempt' or 'non-exempt' and it is recommended that investors set up an exempt private company.

The primary benefit of an exempt private company is that the company is not required to submit audited accounts, saving the expense of having to employ an auditor in Cyprus.

In July 2002, the Cyprus Parliament enacted a series of new tax reforms that took effect in January of the following year.

The aim of these new measures was to harmonise the tax laws of Cyprus with European Union directives, to simplify and modernise the tax system and also to make Cyprus a more attractive, international tax jurisdiction.

There are a number of changes in the Cyprus tax system that are relevant to the UK investor.

First and foremost, taxation is now based on residency rather than the source of income, which is highly advantageous to non-resident UK investors.

Under the amended income tax legislation, Cyprus residents are taxed on their worldwide income whilst non-residents are only taxed on their Cyprus income.

So, by establishing an offshore trust or company, the investor has set up a 'holding' entity for the purposes of storing money for the long term, which the tax man can't get his hands on for either CGT or IHT purposes.

It is then possible under certain conditions to gradually bring money back into the UK tax-free.

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7 NON-RESIDENTIAL PROPERTY INVESTING

Many property investors overlook the commercial property market as being too complicated, but with falling yields in the residential buy to let market maybe the time is right to look into commercial lettings.

On commercial lets, retail yields generally vary from 4 to 6% for a good prime or a reasonable secondary pitch. And if there was a flat above the shop providing an additional income, the yield could be slightly higher at about 6 to 6.5%.

Office yields have fallen from around 6% in 2006 to about 5% in 2007.

Both offices and shops have seen good capital growth over the last few years with total returns in the last 12 months of around 22%. The question is, of course, whether this will continue.

With commercial lets, leases are a lot longer than you see in a typical assured shorthold tenancy in the residential buy to let sector - where 6 months or 12 months are the norm, after which time you will be looking for a new tenant.

Most commercial tenants now sign a lease of about ten years, though lease length has been coming down slowly in recent years.

Average leases for retail space tend to be typically about twelve years whereas those for offices and industrial space average at about eight years. What this means of course, is that you can get more certainty of income over a much longer period than in a residential buy to let.

So, with commercial lettings there are fewer voids and holes in income to worry about, plus, if the tenant doesn't pay, you can send the bailiffs in within 14 days.

Compare this to the 3 to 5 months of no income you would face in residential if the tenant defaults and decides to go the whole way through the courts to a bailiff eviction.

You can set rent review periods, and for many commercial properties these are set at the outset and will come with the property when you buy it.

A typical rent review period would be about 5 years and with some leases you can specify at the outset how much the rent will rise during the period of the lease.

With other leases a rent review period can be set annually. This sometimes happens with leisure uses where the tenant is a gym for example. Rent reviews in commercial properties are only ever upward and never downwards.

Some leases will include a break option clause, but if you don't have one, you will of course have more certainty than if you do, because tenants often make use of them to terminate the lease.

As well as the length of the deal, another good thing about commercial is that normally the tenant is responsible for repairs to the building and for insurance too (a repairing lease) - so no calls on a Sunday to get the boiler fixed!

Tenants also have to leave the property in the condition they found it and make good any wear and tear at the end of the lease.

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Typically your work will be limited to management of the physical side of the property, collecting rent, rent reviews, re-letting, handling lease renewals and possibly arranging insurance, which can be charged back to the tenant anyway.

In most cases though, it is the tenant who must arrange insurance for the building. If they fail to do this, you can then arrange it yourself and charge it back to the tenant.

In addition, the relatively low level of default achieved in the recent (admittedly rather attractive business climate) will look good to investors.

Sometimes, in the event of tenant default, the liquidator may well opt to pay the rent to stop the lease being forfeited, though there is no guarantee you will get your money if the tenant goes bust.

7.1 The risks of commercial investing

There are, of course, risks in investing in commercial. If you are investing directly, your one-off investment will be inherently more risky than if you spread risks in a collective vehicle like a fund.

For retail property, one risk is that the shopping centre hub may move, thus leaving your property in an area that no one now wants to rent.

Experts in commercial lettings say you should look carefully to make sure that a major new shopping centre is not planned that could wipe out the value of your property.

As far as possible, try to stick to prime locations to get good tenants, though inevitably the cost of such prime investments will be that much higher.

Therefore, in order to get a more realistic price at a decent location, you may be best looking for a property that could benefit from some improvement, which would then make it more attractive to a better class of tenant.

If there is some residential property above the commercial premises that is producing an income, this can help cover the cash flow that will be strained while you carry out the improvements.

Also, don't underestimate the importance of the physical characteristics of the building. How it is laid out will have a great bearing on what can kinds of trades can use the building, and so will have an effect on tenant demand.

The needs of the modern office for under floor cabling could have a big impact too and may make the space impossible to let if it is not up to scratch.

Sometimes you may have to bite the bullet and change the property around to cater to a different retail use as markets change. A good example of this is the way that large banking halls in inner cities have been turned over to bars and clubs.

For finance, bear in mind that most lenders will only lend up to 70% of the market value, well below the 85% that is the typical maximum on buy to let.

There is no doubt that commercial properties have done well in the last few years, but the recent strong capital growth that the sector has seen may not continue for much longer.

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However, the neat thing about commercial is the fact that once you have bought the property, you don't have to do too much. The leases are for long periods and you should be able to watch the rent roll in without having to incur too much cost.

In other words, gross yield and net yield will not be too far apart.

7.2 Taxation on commercial property

There are also good tax breaks for commercial property. Unlike residential, it can be held in a SIPP so you get tax relief on your contributions and the property can be exempt from tax on income and profits.

Capital allowances are better but gearing is far less than on residential, however.

The tax situation is dependent on the status of the property owner – i.e. whether you are a trader or investor/dealer.

The distinction between the two in terms of tax issues depends on the intentions of the owner at the time he or she acquired or developed the property in question rather than their motives when and if they are selling the property.

It is worth taking into account that where an investment property is acquired or developed with a view to making a profit on its sale, the resulting profit will more than likely be assessed as income.

Commercial property owners were dealt a number of blows in recent budgets that are worth taking note of.

The Chancellor has removed tax relief on empty commercial properties after three months and also cut tax benefits from expenditure on industrial buildings after six months.

Also announced were two changes to the tax relief available on construction and improvements made to industrial premises. Relief, worth £230m a year, was abolished, available on expenditure to upgrade such property - owners could claim back depreciation on construction costs at a rate of 4% a year.

Relief available for putting in new fixtures and fittings on these buildings has also been reduced, such as lighting and air conditioning, from 25% to 10%.

The most recent move is the abolition of taper relief on CGT when properties are sold. This could effectively increase the amount of tax payable from 10% to 18% - a massive 80% hike. The only way to avoid this is through the application of Entrepreneurs' Relief but whether you are eligible to apply for this relief is the crucial question.

Landlords are not specifically entitled to the relief unless you deal with furnished holiday lettings but take some professional advice here to see if there is any possibility of taking advantage of Entrepreneurs' Relief – it could be the difference between paying 18% CGT and paying 10%!

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7.3 Tax on holiday lettings

If commercial lettings are a bridge too far then you may decide to opt for holiday lettings instead. The 2010 Emergency Budget has resulted in some changes in regards to tax on holiday lettings.

If you opt to provide furnished holiday lettings, then you will pay Income Tax as is the case with other normal lettings i.e. buy-to-let. Standard tax calculating rules, of offsetting expenses against rental income, are used. In order to qualify as a holiday letting, the property must satisfy the following three tests:

It must be available for commercial letting to the public as holiday accommodation for at least 210 days in a year (changed from 140 days).

It must be let for at least 105 days (changed from 70 days).

The same person must not occupy it for more than 31 days in a 7-month period.

It is important to note here that if you run more than one holiday letting business, then it is not necessary to let out both properties for 70 days each.

As long as both properties give an average let of 70 days then this test is satisfied.

Example 1: Holiday Lettings (1)
Mr Investor runs two furnished holiday lettings businesses. One is let out in a 12-month period for 90 days and the other is let out for only 60 days. Because the average let is 75 days, the '70 day' occupied let rule is satisfied.

There are significant tax benefits associated with furnished holiday lettings that do not apply to other lettings. These are as follows:

7.3.1 Offsetting losses

If your holiday letting business makes a loss, then these losses can only be set against income from the same FHL business.

Example 2: Holiday Lettings & Offsetting Losses (2)
Mr Investor runs a furnished holiday lettings business. He calculates that at the end of his tax year his lettings business has made a loss of £3,000. Mr Investor also works as an IT Consultant and receives an annual salary of £25,035. That loss of £3,000 cannot be offset onto his IT consultancy role but the loss can be held for use in future years for the same furnished holiday lettings company.

7.3.2 Entrepreneurs' Relief

Introduced in the 2008 Budget, Entrepreneurs' Relief entitles the investor to reduced CGT of 10% (as opposed to the flat rate of 18% CGT, also introduced in the same Budget) on the disposal of assets worth up to a million pounds.

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Residential and commercial landlords are not eligible for this relief but if you specialise in furnished holiday lettings then you can take full advantage of being eligible for Entrepreneurs' Relief.

7.4 VAT – do you need it?

A crucial issue to be considered when considering non-residential letting is whether you need to register for VAT.

First of all - what is VAT?

VAT stands for Value Added Tax and is a tax that applies to most business transactions involving the transfer of goods or services. Once your business turnover reaches £64,000 in any given year you are liable to register for VAT.

This means that whenever you buy or sell anything in the course of your business you will charge VAT on your sales, keep proper VAT records on all incoming and outgoing transactions, and pay VAT to HM Revenue and Customs.

Having established what makes you liable to register for VAT, the next stage is to ascertain whether this applies to you.

Generally speaking, for property investors in the buy to let market, VAT is not relevant at all, or for traders dealing in existing buildings. However, for traders dealing in new builds then VAT is most definitely a factor.

VAT is currently charged at 17.5% but if you are VAT registered, you will normally be able to reclaim the VAT on purchases that you make for the business, known as 'input tax', which for the purposes of VAT, are reduced on certain building items or even zero-rated.

You cannot, however, reclaim VAT on purchases that aren't for your business, or which relate to any goods or services that are exempt from VAT in the first place. For information on goods and services that are VAT exempt visit www.hmrc.gov.uk

7.5 Transfer of a business as a going concern (TOGC)

If you can obtain TOGC status on a property sale then no VAT needs be charged. This has an immediate cashflow advantage for the purchaser as they do not have to finance the VAT for up to three months.

But get it wrong and charge VAT on a transaction that qualifies as a TOGC, and this can lead to the purchaser having input tax disallowed by HM Customs & Excise and having to claim the VAT back from the vendor.

To qualify as a TOGC in the case of a property sale, the purchaser must have opted to tax the property and notified HM Customs & Excise from the date of the transfer, be registered for VAT and there must be a property rental business in existence.

This is commonly thought to mean that the whole property must be sold with existing tenants or that it must be at least partly tenanted. However this need not be the case; following a number of VAT Tribunal decisions, HM Customs & Excise now accepts that a property rental business exists in all of the following circumstances:

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7.5.1 Transfers that count as a TOGC

These are examples of where a property transfer will count as a TOGC, so if you:

- Own the freehold of a property that you let to a tenant and sell the freehold with the benefit of the existing lease, a business of property rental is transferred to the purchaser. This is a business transferred as a going concern even if the property is only partly tenanted. Similarly, if you own the lease of a property (which is subject to a sub-lease) and you assign your lease with the benefit of the sub-lease, this is a business transferred as a going concern;
- Own a building that is being let out where there is an initial rent free period, even if the building is sold during the rent free period, you are carrying on a business of property rental;
- Granted a lease in respect of a building, but the tenants are not yet in occupation, you are carrying on a property rental business;
- Own a property and have found a tenant but not actually entered into a lease agreement when you transfer the property to a third party (with the benefit of the prospective tenancy but before a lease has been signed), there is sufficient evidence of intended economic activity for there to be a property rental business capable of being transferred; and
- Are a property developer selling a site as a package (to a single buyer) that is a mixture of let and unlet, finished or unfinished properties, and the sale of the site would otherwise have been standard rated, then subject to the purchaser electing to waive exemption for the whole site, the whole site can be regarded as a business transferred as a going concern.

If you are buying a building and the purchase falls into any one of the above categories it will be a TOGC and no VAT should be charged.

Make sure the vendor is aware of this and treats the transaction correctly and you can save the costs of financing the VAT charge for up to three months, which can be substantial.

7.6 Tenanted commercial property

In addition to the above requirements, as a result of the 2007 budget, HM Customs & Excise has made an additional amendment that imposes a new condition for obtaining TOGC status when selling a tenanted commercial property on which the option to tax has been exercised.

It is quite simple to fulfil and is designed as an anti-avoidance measure that will affect few businesses. However, if you forget to do it you may lose your TOGC status and receive an assessment from HM Customs & Excise for under-declared VAT so it is important to remember.

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7.6.1 No tax effect

An option to tax does not have any effect (is 'disapplied') where the purchaser intends to use the property in one or more of a specified number of ways.

The most common of these are:

Use as a dwelling or number of dwellings;

Use for a charitable purpose, other than as an office;

Use by a housing association; or

Use by connected parties other than for mainly 'eligible purposes' (anti-avoidance).

The new condition only applies to property transactions in excess of £250,000 and requires the purchaser to notify the seller that he will have his option to tax disapplied. This notification must be made before completion of the transaction.

If you are selling a property and want TOGC status you must ensure you have a letter from the purchaser confirming that his option to tax will be disapplied. If you don't get one, you will have to charge VAT.

This requirement to notify the vendor is not particularly onerous and it is likely that the majority of transactions that qualified for TOGC treatment before the Budget will still qualify providing the purchaser is able to give this notification.

However, VAT will be charged on the sale if the purchasers fail to provide the notification, and the parties concerned will suffer the adverse cash-flow consequences, increased Stamp Duty Land Tax (SDLT) and, possibly, penalties for getting it wrong.

7.7 Construction Industry Scheme Register

Generally, credit for VAT suffered as 'input tax' (VAT incurred on the purchase of supplies to be used for business purposes) is only available to a registered person during the course of their business. Exceptionally, however, VAT may be reclaimed on goods used in the construction of a property.

It is also worth mentioning here the Construction Industry Scheme register. It may not be relevant to most readers, but for property dealers and developers it could prove costly not to know about it!

The register has been introduced by HMRC as part of its drive to stop people in the construction industry from avoiding taxes – the organisation believes some £130m is owed in extra taxes.

7.7.1 The main points of the Construction Industry Scheme Register

Contractors have to verify that any new sub-contractor in their employment is registered with HMRC. This can be done online.

Sub-contractors will still be paid net or gross of tax, but it is up to HMRC to specify which. A higher rate tax deduction of 30% can be assigned to sub-contractors if they cannot be matched to existing records on the HMRC system.

Monthly returns should be filed online with a declaration that states the contractor has checked the employment status of each sub-contractor.

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Failure to submit the monthly return on time will lead to a penalty being charged based on the number of sub-contractors listed on the late return. A late submission of nil return automatically attracts a £100 penalty.

In order to be sure that you concur with the requirements of the Construction Industry Scheme register, you first need to establish the employment status of any sub-contractors.

Can you tell the difference between a sub-contractor and one of your employees? There is no statutory definition of these terms but it is the relationship between all the involved parties that is crucial. More information can be found at **www.hmrc.gov.uk/new-cis/**

7.8 So what should I do now?

Some things to look at to prevent any unnecessary surcharges or fines:

Decide who is going to be responsible for ensuring the employment status of your sub-contractors, and make sure their assessment is correct and there is no false self-employment.

Decide who will be responsible for signing the declaration of the monthly return.

Evaluate software that can help with the management of your sub-contractors and that adheres to CIS rules.

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8 Tips For Paying Less Tax On Your Property Investment

This final chapter is designed to offer the key pointers to help you pay less tax.

Many of the items implicitly lead you back to earlier sections of the book for clarification. Our aim is to encourage you to address the vital aspects of tax planning…and to help you if you should find Her Majesty's tax inspectors taking a closer than normal interest in your affairs.

Britons will have paid £5.7 billion more tax than they needed to last year because of poor planning.

Here are 19 things you can do to make sure your money doesn't go into that over-payment pot!

1. Off-set mortgage interest

Income tax is payable on rental income, but you can beat the taxman by off-setting rent against the interest paid on mortgages. Loan interest is simply claimed as a deduction against rental income. That's why it pays to have interest-only mortgages on let properties.

Rental losses can also be carried forward and set-off against future rental profits.

Whether your interest is tax deductible or not generally depends on the use to which the money is put. It does not, as many people seem to think, depend on which property the loan is secured on.

For example, if you remortgage your own home and use the money as a deposit on a buy-to-let then you can reclaim the interest because the money has been used for business purposes.

2. Prove residency to save thousands

Principal Private Residence Exemption means that if you can prove you are living in a property then you can sell it without Capital Gains Tax.

You need to live in it for as long as it takes to prove residency...and that may mean joining local groups and associations as well as being on the electoral roll.

3. Avoid stamp duty

If you buy property under £125,000 or in a government stamp duty exempt area, you pay no stamp duty. If the price is between £125,000 and £250,000, then you pay 1%. Over £250,000 and it's 3%; and more than £500,000 the tax hit is 4% - a minimum of £20,000.

You can avoid stamp duty and save yourself thousands by using avoidance strategies.

4. Furnish let properties

By letting properties that are fully furnished you can save yourself tax in the long run by claiming a 10% wear and tear allowance on net rents. Allowance of 10% of net rents may be claimed instead. An alternative allowance to the 10% wear and tear claim is called 'renewal'. If you replace a piece of furniture, a fixture or a fitting, you can claim a deduction.

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5. Use your Capital Gains Tax allowance

Many people don't use their CGT allowances when they sell. If you use them well you will save thousands of pounds in tax.

When you sell let residential property (which has never been your main residence) the increase in value between buying and selling the property is liable to capital gains tax.

It is charged on total gains in a tax year, but less annual capital gains tax exemption (£9,600 per person) and any capital losses (**of the same or in the previous year**).

6. Claim Revenue costs instead of capital costs

If a property investor can claim substantial work expenses as revenue costs instead of capital costs, they can gain considerably by reducing their annual property income tax bill. Done carefully and calculated with precision, a landlord can achieve an annual tax liability amounting to zero.

While this strategy may not be feasible year on year, it is possible for a couple of years, when there is often the greatest need to preserve funds while creating a quality letting.

7. Claim for Rental Losses

All your UK property lettings are treated as a single UK property business. Hence, the loss on any one property is automatically set off against profits on others. Any overall loss cannot generally be set off against your other income but will be carried forward and set off against future UK rental profits. Losses arising on furnished holiday lettings may, however, be set off against other income and can sometimes lead to useful tax repayments.

8. Claim provisional expenses

Did you know that you can make provision for certain future costs that you have not yet actually incurred and still claim a tax deduction?

The key requirement is that you are legally obliged to incur the expenditure.

If you have evidence that work needs doing on a particular property and quotes from a builder, then you can make provision for these costs in the current tax year even though the work has not been started yet.

9. Motor Expenses

The cost of running one or more vehicles used in your property business can be claimed as a business expense. Generally, the vehicle will have some private non-business use, so an appropriate proportion should be claimed. The appropriate proportion will vary from investor to investor but could be in the range 25% to 50%.

10. Office Costs

Most investors do their admin at home and can therefore claim a proportion of their household bills. Generally, the proportion that can be claimed is based on the number of rooms, excluding bathrooms and kitchens. And expenses that can be claimed may include gas and electricity, council tax, general repairs and insurance.

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11. Travel & Subsistence

Travel costs incurred visiting your existing properties or scouting for new ones should be allowable. If your trip necessitates an overnight stay, you will also be able to claim accommodation costs and meals. These costs will only be allowable if your trip was purely for business purposes, and any private element of the trip must be merely incidental.

12. Training & Research

Many investors spend a lot of money on seminars, courses, books and magazines. The rule is that expenses incurred in updating or expanding existing areas of knowledge may be claimed but any costs relating to entirely new areas of knowledge are a personal capital expense. This can be a difficult distinction to draw. However, in most cases, property research expenses should be tax deductible.

13. Legal and Professional Fees

Fees incurred buying a property cannot be claimed against your income tax – they are generally only allowed as a capital gains tax deduction when you eventually sell your property. Costs incurred year in, year out in earning rental profits can be claimed, e.g. the cost of preparing leases, collecting debts and preparing your tax return.

14. Pre-Trading Expenditure

You may incur some expenses for the purposes of your property business before you even start to let any properties out. Such expenses incurred within seven years before the commencement of your business may still be allowable if they would otherwise qualify under normal principles. In such cases, the expenses may be claimed as if they were incurred on the first day of the business.

15. Involve partners and save money

Owning and renting a let property jointly can enable rental profits to be divided equally between partners. That means more than one set of personal allowances and basic rate tax bands can then be used to reduce income tax.

If a property is sold, each partner can deduct their annual capital gains tax exemption from the profit.

16. Shelter your profits in special share schemes

The government is actively encouraging people to invest in Venture Capital Trusts and Enterprise Investment Schemes. These related investment vehicles support small businesses. As this is something the government is actively promoting, there are a great tax breaks for investors.

Currently you can shelter your property profits from capital gains tax by reinvesting the money in an Enterprise Investment Scheme or a Venture Capital Trust.

17. Be organised or pay the price!

The Inland Revenue is threatening to get tougher by increasing fines in the future.

But if you file your accounts on time, keep records to minimise income tax, and pay your tax on time, you won't have to pay the already hefty fines.

If you don't get your return in by 31 January, you are fined £100 automatically. By 28 February if you have still not paid tax due on January 31, you face an automatic 5% surcharge on the bill.

If you are a limited company, you can pay up to £1,000 for late returns and interest on tax owing.

18. Set up a company and pay less tax!

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There are lots of benefits of using a company for the long term and you can potentially pay much lower tax by setting one up. For example:

A lower 21% rate of corporation tax - as against 40% for sole traders.

No national insurance to pay on the company's profits unlike purchasing in your own name.

Share structures and 'goodwill' transactions that can minimise or eradicate tax liabilities.

Taper relief, where tax is reduced over time, can be beneficial to property developers and traders.

You can turn property wealth into shares, passing them on to children to avoid inheritance tax.

Running expenses (such as wages and cars) can be off-set against tax.

19. Make a will – and avoid a dead loss!

Last year more than £1 billion of extra tax was paid by people who did not plan for inheritance tax.

Make a will, then devise a strategy to gift properties or transfer properties - or use a trust - to bring your estate's value within the current £325K threshold. You will need expert advice, so consult an accountant to avoid unnecessary inheritance tax.

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9 FIGHTING THE TAX INVESTIGATION

And, if the worst happens, and the taxman does come knocking – then you need to be prepared. **Here are the top ten nuggets of advice we would offer.**

1. Use a professional

It is a false economy to try and save money and submit complicated tax returns yourself. You'll only end up having to pay more money, and it is worth every penny for specialist advice from professionals who are dedicated to trying to save you money in the long run.

2. Keep a record of everything

Make sure that you keep records of absolutely every transaction you carry out with regard to property investments, including who, when, what and how much. It may seem arduous and time consuming but you'll be glad of it if you are ever unlucky enough to have to undergo an investigation.

3. Justify everything

As well as keeping a record of everything you need to be able to justify every transaction you carry out and ensure that it can be directly related to your business and not for personal use.

4. Measure intention

You need to be able to demonstrate your intention with each transaction and be able to prove your reasons for whatever the transaction is. This is key to justifying the nature of your business.

5. Know your deadlines

It is all too easy to get bogged down with day to day issues and forget about the bigger picture. Make sure you keep a diary of any significant deadlines throughout the year - with some careful organisation there is really no excuse for missing deadlines and incurring unnecessary fines and investigations.

6. Submit your tax return online

By submitting your tax return online, you can keep contact with the tax man to a minimum but without getting into trouble for it! Any mistakes or errors can be dealt with online quickly and efficiently thereby reducing the chances of further tax investigation.

7. Deal with things promptly

It's not rocket science - simply by reacting to enquiries or any issues which arise promptly, you will gain a good reputation and standing with the tax office, which could stand you in good stead at a later date. There's no harm in it and it's never a bad thing to be known for being reliable and efficient.

8. Check everything

Check everything – and, if in doubt, check again! Make sure that you have been accurate and honest on your tax returns - the Inland Revenue is always on the lookout for transactions that aren't meant to be tax deductible such as capital-related purchases or items that are for personal use rather than business use.

9. Be careful

Remember that everything you say can be used in evidence at a later date so be cautious when speaking to the Inland Revenue and make sure you don't inadvertently land yourself in trouble.

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10. Be honest and professional at all times

Maintain an honest and professional stature with both the Inland Revenue and your accountant and you can't go wrong - the Inland Revenue aren't looking to catch you out, so if you are above board with everything and pay for the right, professional advice then you have nothing to worry about.

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10 Bonus Chapter: 101 Allowable Expenses

Everyone knows how to spend money, but not everyone knows what they can claim money back from! Here is a chapter which will inform you on which expenses are allowable and therefore you have the right to claim money back from!

10.1 Receipts

1. Rental Income Received
2. Other Income Received

10.2 Rent, Rates & Insurance

3. Ground Rent
4. Council Tax
5. Water Rates
6. Gas Charges
7. Electricity Charges
8. Service Charges
9. Television License
10. Telephone Line Rental
11. Broadband
12. TV Satellite System
13. Buildings Insurance
14. Legal Insurance
15. Contents Insurance
16. Gas Insurance
17. Plumbing
18. Electricity Insurance
19. Appliance Cover 1
20. Appliance Cover 2

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21. Appliance Cover 3

10.3 Repairs, Maintenance & Renewals

22. Gas Safety Certificates
23. Electrical Safety Certificates
24. Internal Maintenance & Repairs
25. External Maintenance & Repairs
26. Sofas and Suites
27. Tables and Chairs
28. Wardrobes
29. Drawers
30. Flooring – Carpets, Laminate Flooring
31. Curtains
32. Blinds
33. Beds & Bedding
34. Fridge/ Freezer
35. Washing Machine
36. Dishwasher
37. Microwave
38. Oven
39. De-humidifier
40. Cutlery
41. Crockery
42. Decorations – Pictures, Ornaments
43. Kitchen Units
44. Bathroom Suite
45. Gas Fires
46. Central Heating Systems

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47. Doors

48. Windows

10.4 Legal and Professional Fees

49. Estate/ Letting agent fees

50. Inventory clerk fee

51. Accountants Fees

52. Tax advisor fees

53. Book-keeper fees

54. Marketing consultant

10.5 Loan interest and other finance costs

55. Interest charged on Mortgage

56. Interest charged on Loan

57. Bank charges

58. Overdraft interest

59. Overdraft set up fee

60. Credit card charges

61. Bounced direct debit fees

10.6 Capital Purchases & allowances

62. Electrical items

63. Plumbing items

64. Installations

65. Wear and tear allowance

66. Annual Investment Allowance

67. Business premises renovation allowance

68. Landlords energy saving allowance

10.7 Services provided to Tenant

69. Reception/ concierge

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70. Security
71. Cleaning
72. Washing
73. Ironing
74. Gardening
75. Porterage
76. Employee wages

10.8 Other allowable costs

77. Mileage to inspect property
78. Other travel charges
79. Advertisement Costs
80. Books
81. Magazines/ Newsletters subscriptions
82. Updating courses
83. Stationary
84. Tools

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Property Tax Secrets

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