PROPERTY TAX SOLUTIONS

Spring 2005 Newsletter

Taxation solutions minimising the tax paid by Landlords

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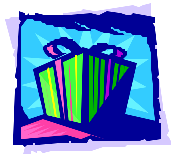
Can I give my property away?



There is nothing to prevent you from giving an investment property away, but there are four different taxes to worry about when you do so:

Capital Gains Tax (CGT)
Unless you give the property to your spouse, or to a charity, you will generally pay CGT as if you had sold the property at its full market value. There are two occasions when you can elect to pass on the capital gain (and potential tax) to the recipient of the gift:

- When the property is treated as a business asset, which would normally only apply to commercial property, but can also apply to furnished holiday lettings;
- When the gift is to the trustees of a discretionary trust.

Inheritance tax (IHT)
This tax is normally only paid after someone dies on the value of what they owned at their death, plus a percentage of the value of all gifts made within seven years of death. So if you give a property away it will still be counted as yours to some extent for IHT if you die within seven years. You must also cease to take any benefit from the property, such as rent or personal use, as the gift will not be effective for IHT until that benefit also stops.

Example:
Your father gave you his house worth £700,000 when he moved into a nursing home. He died within a year of this gift leaving an estate worth £75,000. The IHT due on his death was £200,000: (£700,000+ £75,000 – £275,000) x 40%.

Stamp Duty Land Tax (SDLT)
If there is a mortgage on the property that exceeds the SDLT zero rate threshold (£120,000 or £150,000), the recipient of the gift will have to pay SDLT at 1% to 4%.

Example:
You give your son a flat which is not in a disadvantaged area, and he takes over the mortgage of £130,000. He has to pay SDLT of £1,300 (1% x £130,000) and you may have a CGT liability based on the full market value of the property.

Pre Owned Asset Tax (POAT)
If you give away a property and at a later date live in the same property, or enjoy the proceeds from that property, you could be charged income tax under the pre-owned asset tax regime. These new rules are very complicated so please talk to us if you think you are in this situation.

Tax Deadlines

6 July
Forms P11D must be with Revenue and copies with employees. Should now have all the information to complete your 2004/05 tax return.

31 July
Second instalment of 2004/05 income tax due. Further £100 penalty if 2003/04 tax return is still outstanding and 5% surcharge on any 2003/04 tax still not paid.

30 September
Tax Credit renewal forms must be returned. Paper version of 2004/05 tax return must be submitted if the Revenue is to complete tax calculation, or collect tax due of up to £2,000 through your 2006/07 PAYE code.

1 October
Corporation tax payable by private companies with 31 December year end.

5 October
If no tax return has been received you must inform the Revenue of any tax liability for 2004/05 that has not been covered by tax deducted at source.

Tax tip

When somebody dies make sure the deceased's assets are valued on an 'as is basis' which will give a lower probate value than an insurance 'new-for-old' basis. The lower the total probate value of the deceased's estate, the less inheritance tax is payable.

Should my company buy investment property?

Compare the total tax payable

The answer will depend on your marginal tax rates for income and gains compared to corporate tax rates and reliefs, as well as your long term plans for property investment.

If you already have a trading company that has accumulated some surplus funds, investing in a buy-to-let property can make commercial sense, providing the company can secure a mortgage for the balance of the purchase price. The company will pay corporation tax at 19% to 30% on the rental profits, where as you would pay income tax on the same profits at 22% or 40%. But to get your hands on the cash you need to extract value from the company in the form of dividends, salary or other benefits, which will normally generate an additional tax charge for you personally.

If you plan to churn your investment properties every few years to realise the capital profit that has built up, the tax charges are likely to be lower if you hold the properties personally. The company does not have an annual capital gains exemption and can't reduce the capital gain with taper relief. However, if you want to hold the investment property for some years until you retire, using a company has some advantages.

As a corporate landlord you may find it easier to open trade accounts with suppliers. If your company is already VAT registered due to the existing trade, it can reclaim the VAT charged on the property related purchases, as long as the VAT on those items does not average out to more than £625 per month. Residential property is exempt from VAT so great care is needed over VAT returns when the company also has sales bearing standard rate VAT.

If you are considering the corporate route please talk to us first to explore the tax effect of each option.

UK tax on overseas property

If you invest in overseas property you must declare the profits in the UK. Unless you are classified as non-UK domiciled, you are taxed in the UK on all your income and gains wherever those profits arise.

If you let your overseas villa you should inform the tax authorities where the property is located, which may mean completing a tax return for that country, so you will need local tax advice. The property agent may also be required to deduct withholding tax from the rents, as a down-payment for the local income tax due.

The income and expenses from your foreign property need to be reported on the foreign income pages of your UK tax return. Any foreign tax you pay on that income can normally be off-set against the UK tax due, where a double taxation agreement exists between the UK and the country where the property is situated. Unfortunately you can't reclaim foreign tax if the UK tax bill is lower.

Declare the profit

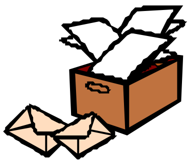
Also be aware that other countries have different rules for tax deductible expenses, and may require rental profits to be calculated over the calendar year. This means you may need to draw up two different sets of property accounts.

Record keeping for landlords

Spring may inspire you to turn out your cupboards and throw away those dusty old papers. But think before you bin as you could land yourself in trouble with the Revenue!

As a landlord you are required to maintain complete records of all expenses incurred, and the income received from your properties. This means not only hanging on to every relevant receipt, but also keeping details of any personal assets you used for the property business. For instance note down the details of all journeys you make concerning your property business, the time spent using your own computer, and the portion of your home used to process related paperwork.

If you use an internet-only bank remember to print off your bank statements at least once a quarter, as these may contain the only record of rents you receive electronically. Deposits should be recorded separately, with the dates of when they were received and returned.



All the records relating to your property business must be kept for five years after the tax return filing date. So details for the year to 5 April 2005 should be retained until 31 January 2011. Sale and purchase contracts and receipts relating to property improvements should ideally be kept for six years after the end of the tax year in which the property is sold, just in case the Tax Inspector asks about the capital gain shown on your tax return.

Finally a word of warning: failure to retain tax-related paperwork can result in a fine of up to **£3,000**.