

#### USING THE COMPANY AS A RETIREMENT FUND

A potentially attractive route is to consider the property investment company as a 'retirement fund'. If the properties are retained into retirement, it is likely that any initial financing of the purchases of the property has been paid off and there will be a strong income stream. The profits of the company (after paying corporation tax) can be paid out to you and/or your spouse as shareholders.

To the extent that the dividends when added to your other income do not exceed your personal allowances and the starting and basic rate bands (just over £39,825 currently), there will be no income tax to be paid.

#### SELLING THE SHARES

The advantages of taper relief can still be achieved if the shares in the property investment company are sold (after ten years of ownership) rather than the properties.

This may also be more attractive to the purchaser of the properties rather than buying the properties directly, as they will only have 0.5% stamp duty to pay rather than the potentially higher sums of stamp duty land tax on the property purchases.

#### OTHER RECENT TAX CHANGES - STAMP DUTY LAND TAX (SDLT)

SDLT is payable by the purchaser and is a flat percentage of the consideration paid (up to 4%). If the property is in a 'disadvantaged area' (see [www.hmrc.gov.uk](http://www.hmrc.gov.uk) for further details) there is no SDLT where the consideration, on residential property only, is £150,000 or less.

#### HOW WE CAN HELP

If you have rental income, the law requires you to declare it to HMRC, even if you do not believe taxes are payable. If you do not comply with this legislation by the deadline, you could be liable to fines and/or penalties. We can assist you to comply with the current legislation and ensure you have peace of mind. We can also help you to develop and achieve your long term personal and business strategies.

At Adams & Moore, we have a dedicated team of qualified professionals that deal with rental income. We currently declare income from a total portfolio worth hundreds of millions of pounds on behalf of our clients. We are experts in this field so you can be sure that you will be in good hands.

To find out how we can help you, please contact us.

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# Tax Aspects of Property Investment



Investment in property has been and continues to be a popular form of investment by many people. It is seen as a route by which:

- relatively secure capital gains can be made on eventual sale
- income returns can be generated throughout the period of ownership
- mortgage finance is covered in repayment terms by the security of the eventual sale of the property and in interest terms by the rental income.

Of course, the net returns in capital and income will depend on a host of factors. But on the basis that the investment appears to make commercial sense what tax factors should you take into account?

This factsheet summarises the main tax issues which apply for the current tax year 2007/08.

In the 2007 Pre-Budget report it was announced that there will be radical reforms to the CGT system for 2008/09. The reforms include the abolition of taper relief and indexation allowance for CGT and the introduction of a flat rate of CGT for individuals of 18%. Details of the proposed changes are outlined in the factsheet Capital Gains Tax Reform. Please do get in touch for more information on how these changes will affect you.



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### WHO OR WHAT SHOULD PURCHASE THE PROPERTY?

An initial decision needs to be made whether to purchase the property:

- as an individual
- as joint owner or via a partnership (often with a spouse)
- via a company.

There are significant differences in the tax effects of ownership by individuals or a company. Which is the best medium will depend on a number of factors but if the property is commercial rather than residential, the likely answer is that the investment is made as an individual or as a joint owner.

### COMMERCIAL PROPERTY

The current capital gains tax (CGT) regime makes personal investment in commercial property a potent source of tax savings.

A sufficient condition for 'business assets taper relief' to be due on eventual sale of a commercial property is that the property is used in the trade of an 'unquoted trading company' or an unincorporated business.

Where the maximum amount of business assets taper relief is available, 75% of the capital gain is removed from the charge to tax and therefore the maximum CGT rate applying would be 10% (assuming that the top rate of tax in the year of disposal is 40%).

So in the following scenarios, there would be a low tax rate on a gain if:

- you own a property which is used by your trading company
- your (prospective) tenant is trading as an unquoted company/unincorporated business.

You are currently trading as a limited company  
The personal purchase of new offices or other buildings and the charging of rent for the use of the buildings to your company is very tax efficient. In addition to the low

CGT rate compared to corporate ownership:

- the rental you receive from the company allows sums to be extracted without national insurance
- the company will claim a corporate tax deduction for the rent
- finance costs will be deductible from the rents
- the net sale proceeds will be received in your hands (and not the company's).

An alternative route would be to have a company pension scheme owning the property. In this situation, the rental would be tax free in the pension fund (but then there would be no relief for the financing costs).

### YOUR PROSPECTIVE TENANT IS TRADING AS AN UNQUOTED COMPANY

The same benefits as described above are also applicable. The company using the property does not have to be your company or, indeed, one with which you have any connection other than through the landlord/tenant relationship.

This also means that, if you are currently trading as a limited company, it is possible for your spouse to have a joint interest in the property (or own it entirely) without prejudicing CGT business assets taper relief.

But note that you do need the right type of tenant otherwise the maximum taper relief would be 40% (giving an effective top CGT rate of 24%) and that is only available after ten years of ownership. Currently the tenant needs to be either an unquoted trading company or an unincorporated business to qualify.

### RESIDENTIAL PROPERTY

The decision as to who should own a residential property to let is much more evenly balanced.

The answer will be dependent on the following factors:

- do you already run your business through your own company?
- how many similar properties do you want to purchase in the future?
- do you intend to sell the property and when?

### DO YOU ALREADY HAVE A COMPANY?

If you already run your business through a company it will generally be more tax efficient to own the property personally.

This will enable you to have the benefit of taper relief of 40% after ten years ownership and use of your CGT annual exemption (and spouse's annual exemption if jointly owned).

The net rental income will be taxed at your marginal rate of tax, but if you are financing the purchase with a high percentage of bank finance, the income tax bill will be relatively small.

In contrast, the company has an indexation allowance to reduce the capital gain. This effectively uplifts the cost of the property by the increase in the Retail Price



Index over the period of ownership. So this may, or may not, give less relief over the ten years.

But there are other factors to consider:

- there may be a further tax charge should you wish to extract any of the proceeds from the company
- inserting the property into an existing company may result in your shareholding in that company not qualifying for business assets taper
- if you form another company to protect the trading status of the existing company, that may increase the corporation tax bill on your trading company (because of 'associated company' rules).

### IF YOU DO NOT HAVE A COMPANY AT PRESENT

Personal or joint ownership may still be the more appropriate route due to the CGT taper advantages but there are currently significant other advantages of corporate status particularly if you expect that:

- you will be increasing your investment in residential property and
- you are unlikely to be selling the properties on a piecemeal basis or

- you are mainly financing the initial purchases of the property from your own capital.

If so, the use of a company as a tax shelter for the net rental income can be attractive.

### USE OF COMPANY AS A TAX SHELTER

Profits up to £300,000 are taxed at 20%. This rate applies for trading companies or property investment companies.

Where profits are retained the income may be suffering less than half of the equivalent income tax bills. That means there are more funds available to buy more properties in the future.

### TAX EFFICIENT LONG-TERM PLANS

There are two potential long-term advantages of the corporate route for residential property which mitigate the disadvantage in losing taper relief on the disposal of properties:

- is there an intention to sell the properties at all? May be the intention is to retain them into retirement (see below Using the company as a retirement fund)
- can the shares be sold rather than the property?(see below for issues regarding Selling the shares)