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How to Save Property Tax

By Carl Bayley BSc FCA

Important Legal Notices:

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TAX GUIDE – "How to Save Property Tax"

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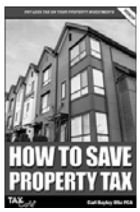

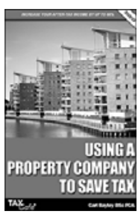

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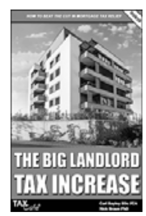

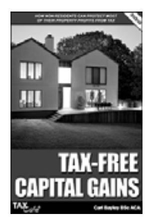

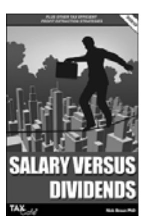

About the Author

Carl Bayley is the author of a series of ‘Plain English’ tax guides designed specifically for the layman and the non-specialist. Carl’s particular speciality is his ability to take the weird, complex and inexplicable world of taxation and set it out in the kind of clear, straightforward language that taxpayers themselves can understand. As he often says himself, “my job is to translate ‘tax’ into English”.

Carl enjoys his role as a tax author, as he explains: “Writing these guides gives me the opportunity to use the skills and knowledge learned over more than thirty years in the tax profession for the benefit of a wider audience. The most satisfying part of my success as an author is the chance to give the average person the same standard of advice as the ‘big guys’ at a price which everyone can afford.”

Carl takes the same approach when speaking on taxation, a role he frequently undertakes with great enthusiasm, including his highly acclaimed annual ‘Budget Breakfast’ for the Institute of Chartered Accountants.

In addition to being a recognised author and speaker on the subject, Carl has often spoken on taxation on radio and television, including the BBC’s ‘It’s Your Money’ programme and BBC Radio 2’s Jeremy Vine Show.

Carl began his career as a Chartered Accountant in 1983 with one of the ‘Big 4’ accountancy firms. After qualifying as a double prize-winner, he immediately began specialising in taxation.

Having honed his skills with several major international firms, Carl began the new millennium by launching his own tax and accounting practice, Bayley Miller Limited, through which he provides advice on a wide variety of taxation issues; especially property taxation and tax planning for small and medium-sized businesses.

Carl is the Chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales and a member of the Institute’s governing Board. He is also a former President of ICAEW Scotland and has co-organised the annual Practical Tax Conference for the last 16 years.

When he isn’t working, Carl takes on the equally taxing challenges of hill walking and creative writing – his Munro tally is now 104 and he has just completed his first novel.

Carl lives in the Scottish Borders and has four children.

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Introduction

This guide was first published in 2002, as a response to the huge demand for advice on property taxation issues which we had been experiencing at Taxcafe.co.uk. That demand continued to grow at a phenomenal pace and is responsible for the fact that now, 16 years on, this guide is in its twenty-second edition, and has expanded to the eight chapters which you have here.

People in the UK have invested in property for centuries, but substantial increases in personal wealth and disposable income over a number of decades prior to the banking crisis in 2008/9 combined with difficulties in other areas of investment and the pensions industry to make this a significantly important area of personal financial planning.

The first few years of this century, in particular, saw phenomenal growth in the property sector, not just in the amount of property investment activity but also in the sheer numbers of people entering the property market as investors, developers and dealers. Whilst the big flotations of the 1980s acted to spread investment in stocks and shares into all sectors of society, the late 1990s and early years of this century witnessed a similar spreading of property investment.

'Property Investment' itself is a very wide term. A few years ago, the majority of new investors tended to be purely interested in the 'Buy-to-Let' market. As the property sector grew larger and more sophisticated, however, many other types of activity began to proliferate more widely, including 'Buy-to-Sell', 'Let-to-Buy' and, of course, a great deal of renovation, conversion and development activity. Beyond these, there also lie the fields of property trading and management.

When increasing property prices raised the barrier to entry, people found other ways to invest in property, such as investing abroad, or clubbing together to invest through joint ventures, syndicates or special purpose vehicles (often called 'SPVs').

All of these different types of activity are subject to different tax regimes and establishing the correct tax classification for each property business can be quite tortuous. One of our first tasks in this guide is therefore to help you understand how your own business will be treated for tax purposes and this is something which we will consider in depth in Chapter 2.

There are also many different reasons for becoming a property investor. Some fall into it by accident, finding themselves with a second property through marriage, inheritance or other changes in personal circumstances.

Others move into the property sector quite deliberately, seeing it as a safe haven providing long-term security and perhaps an income in retirement. Still others see the property market as a means to generate a second income during their working life.

An ever-growing proportion of landlords are choosing to enter the property business as a professional career.

In fact, given the ever-increasing volume of rules and regulations which the private rented sector has to contend with, a professional approach to property investment has now become essential: whatever reasons you may have for entering the property market in the first place.

This is no bad thing: a professional approach has always been desirable. Those who are prepared to devote substantial time and resources to their business are generally rewarded with better results – including those who plan their tax affairs carefully.

The last decade or so has seen enormous changes in the property market and in the economy as a whole and previously held views on the certainty of capital growth and the whole philosophy of 'you can't lose' have been questioned and found wanting.

Whilst these changes have been disastrous for some, they have created opportunities for others and the lower level of interest rates enjoyed by many investors over the last few years have brought healthy rental profits to many.

In effect, the economic difficulties created by the 2008/9 banking crisis and its aftermath can be seen as part of an evolutionary process. The fittest property businesses have survived to become part of a stronger property sector.

Now, the property sector faces a new challenge: a challenge which I can only describe as an unprecedented level of attacks via the tax system from a Government that would appear to be hell-bent on the sector's destruction. Quite where the Government expects to house all the former tenants that are likely to be made homeless as a result is a mystery to me!

Nonetheless, despite the difficulties which it continues to face, I personally believe that the property investment sector as we know it today is here to stay. Naturally, the sector will have its ups and downs, as any other business sector does, but the philosophy of property investment as a 'career move' is now so well entrenched that it has become impossible to imagine it could ever disappear altogether.

Changes in both the economy and in tax legislation have always had a dramatic impact on the tax planning landscape for property investors and will continue to do so in the future. Before the banking crisis, Capital Gains Tax was many investors' biggest concern. Then, as capital growth slowed, or even stalled, and interest rates fell, Income Tax became increasingly important.

Now, with capital growth having returned to many areas, Capital Gains Tax rates on residential property still relatively high; and punitive Income Tax changes which deny proper tax relief for many landlords' biggest cost starting to bite; planning for both of these taxes together has become more crucial than ever.

Tax and tax planning are a vital part of every business's strategy. Property businesses are clearly no exception!

Whatever reasons you may have for entering the property investment market, and whatever type of property business you may have, my aim in this guide is to give you a better understanding of how the UK tax system affects you and show you how to minimise or eliminate your potential tax liabilities.

In the first two chapters, we will set the scene by looking at the different UK taxes which you will meet as a property investor and how they apply to the various different kinds of property business.

Chapters 3 to 7 are then devoted to explaining in detail how the UK tax rules apply to property investment and other types of property business and how you can minimise your own tax burden. In Chapter 8 we will examine some more advanced tax planning strategies which will help to reduce your tax burden.

There are plenty of **'Tax Tips'** along the way to help you minimise or delay your tax bills, as well as **'Wealth Warnings'** designed to keep you away from some of the more treacherous pitfalls awaiting the unwary, and **'Practical Pointers'** which will make the whole process of meeting your tax obligations as painless as possible.

I believe that this guide is comprehensive enough to meet the needs of almost every property investor based in the UK and I hope that, with its help, you will be able to enjoy a much larger proportion of the fruits of your endeavours.

Finally, I would just like to thank you for buying this guide and wish you every success with your property investments.

Scope of this Guide

This guide aims to help you understand the current UK tax system applying to property and also to help you plan for the future. We aim to cover as much as possible of the UK tax implications of investing in property, or running some other kind of property business.

Whilst this edition primarily focuses on the current tax year and the future, we will generally continue to include the rules which form the basis for the preparation of tax returns for all years from 2016/17 onwards. (As explained in Section 3.6, tax returns for 2016/17 may currently still be amended.) Rules applying in earlier years will generally only be included where they continue to be relevant. For full details of the rules applying in earlier years, see previous editions of this guide.

There are three different types of property investor for whom UK tax will be an issue. These three types of investor may be summarised as follows:

(i) UK residents investing in UK property
(ii) UK residents investing in overseas property
(iii) Non-UK residents investing in UK property

Obviously, the same person might have investments falling under both (i) and (ii) and we will cater for that situation also.

The UK tax position for non-UK residents investing in property is summarised in Section 2.15.

For tax purposes, the UK does not include the Channel Islands or the Isle of Man but comprises England, Scotland, Wales and Northern Ireland.

Wealth Warning

It is important to remember that both UK residents investing in property overseas and non-UK residents investing in UK property may also face foreign tax on their property income and capital gains. Each country has its own tax system, and income or gains which are exempt in the UK may nevertheless still be liable to tax elsewhere.

Additionally, in some cases, citizens of another country who are resident in the UK for tax purposes may still have obligations and liabilities under their own country's tax system. The USA, for example, imposes this type of obligation on its expatriate citizens.

It is only when talking about taxpayers who are both UK residents and UK citizens, who are investing exclusively in UK property, and who are neither residents nor citizens of any other country, that we can be absolutely certain that no other country has any right to tax the income or gains arising.

The tax-planning strategies outlined in this guide represent a reasonably comprehensive list of the main techniques available to individual property investors based in the UK.

This guide is aimed primarily at those who are running a property business personally, jointly with another individual, or through a partnership. Whilst many of the principles will remain the same where another type of legal entity or investment vehicle is used, it should be noted that some of the points covered in this guide will not apply. Detailed guidance on the implications of using a property company is contained in the Taxcafe.co.uk guide *'Using a Property Company to Save Tax'*.

Those who have the benefit of being non-UK resident or non-UK domiciled may be able to employ some more specialised tax-planning techniques which are covered in further detail in the Taxcafe.co.uk guides *'Tax Free Capital Gains'* and *'Non-Resident & Offshore Tax Planning'*.

'Tax Free Capital Gains' also contains detailed guidance on how to become non-UK resident, through emigration, and how to maintain your non-UK resident status whilst still investing in UK property.

From 2017/18 onwards, the Scottish Parliament has powers to vary the Income Tax rates applying to Scottish taxpayers (and has done so). We will look at Scottish Income Tax rates in detail in Section 7.22, together with some worked examples illustrating the differences arising in practice. Throughout the rest of this guide, unless stated to the contrary, I will refer only to the Income Tax rates applying to non-Scottish taxpayers. It is worth noting, however, that it is only the tax ***rates*** which are different and all of the other principles discussed throughout this guide remain equally relevant to Scottish taxpayers.

From 2019/20 onwards, the Welsh Assembly will also have powers to vary the Income Tax rates applying to Welsh taxpayers. No further information is yet available on future Welsh Income Tax rates. However, it is important to note that, as with Scottish taxpayers, it will only be the tax ***rates*** which may be different and all of the other principles discussed throughout this guide will remain equally relevant to Welsh taxpayers in future.

Finally, the reader must bear in mind the general nature of this guide. Individual circumstances vary and the tax implications of an individual's actions will vary with them. For this reason, it is always vital to get professional advice before undertaking any tax planning or other transactions which may have tax implications. The author cannot accept any responsibility for any loss which may arise as a consequence of any action taken, or any decision to refrain from action taken, as a result of reading this guide.

A Word about the Examples in this Guide

This guide is illustrated throughout by a number of examples. Unless specifically stated to the contrary, it is assumed that all persons described in those examples are:

i) UK resident and domiciled for tax purposes
ii) Not subject to the High Income Child Benefit Charge (see Section 3.3)
iii) Not claiming the marriage allowance (see Appendix A)
iv) Not Scottish or Welsh taxpayers (see Section 7.22 for the Income Tax rates applying to Scottish taxpayers; Welsh taxpayers will be subject to different Income Tax rates from 6th April 2019 onwards)

In preparing the examples in this guide, I have assumed that the UK tax regime will remain unchanged in the future except to the extent of any announcements already made at the time of publication. To assist in illustrating a number of examples, I have also prepared a set of estimated tax rates and allowances for the tax year 2019/20 which are set out in Appendix A. Whilst I am confident that these are reasonable estimates based on the best information currently available, readers must bear in mind that these are nevertheless still just my 'best guess' and are likely to be subject to some change.

Readers should also understand that some Government proposals are not yet law and may undergo some alteration before being formally enacted.

Furthermore, if there is one thing which I can predict with any certainty, it is the fact that change **will** occur. The reader must bear this in mind when reviewing the results of the examples in this guide.

All persons described in the examples in this guide are entirely fictional characters created specifically for the purposes of this guide. Any similarities to actual persons, living or dead, or to fictional characters created by any other author, are entirely coincidental.

Abbreviations Used in this Guide

Generally, at Taxcafe, we don't like using abbreviations or jargon because we want to keep our guides as simple as possible. To save some space in this guide, however, I have allowed myself a few abbreviations. I think they are fairly obvious ones, so they should not cause any confusion. I will explain what each abbreviation means the first time I use it and they are set out again in Appendix C for your ease of reference.

Large numbers, such as £1,000,000 or more, are also abbreviated by use of the letter 'm'. For example, £2,500,000 will be written as £2.5m.

Chapter 1

What is Property Tax?

1.1 KNOWING YOUR ENEMY

We will begin this guide with an explanation of how the UK tax system applies to property investment and other types of property business.

This is essential because you cannot begin to consider how to save property tax until you actually understand what property tax is. In other words, you must 'know your enemy' in order to be able to combat it effectively.

It is important to understand that there is no single 'property tax', but rather a whole range of taxes which can apply to property. There is no point in avoiding one of these taxes only to find yourself paying even more of another!

Horror stories of this nature happen all too frequently, such as the taxpayer who managed to avoid 1% Stamp Duty on part of his new house, only to find that he was stuck with a 17.5% VAT charge instead!

Worse still was the taxpayer who undertook some Inheritance Tax ('IHT') planning on the advice of his lawyer only to find himself with a £20,000 Capital Gains Tax ('CGT') bill without any cash sale proceeds from which to pay it.

If only they'd spoken to a <u>real</u> tax expert first!

In this introductory chapter we will therefore take a brief look at the taxes which can affect the property investor and give some consideration to the relative importance of each.

Later, when we begin to consider tax-planning strategies, it is vital to bear in mind that it is the overall outcome which matters most, not simply saving or deferring any single type of tax.

In fact, I would go even further than that…

> ***Bayley's Law***
>
> *The truly wise investor does not seek merely to minimise the amount of tax payable, but rather to maximise the amount of wealth remaining after all taxes have been accounted for.*

If this seems like no more than simple common sense to you, then all well and good. However, in practice, I am constantly amazed at how often people lose sight of this simple fact and, in trying to save tax at any price, actually end up making themselves worse off in the long run!

1.2 WHAT TAXES FACE A PROPERTY INVESTOR?

There are a few UK taxes which are specific to property. These are:

- Council Tax (for residential property)
- Business Rates (for commercial property)
- Stamp Duty Land Tax ('SDLT') (and its equivalents throughout the UK – see further in Section 1.4)
- The Annual Tax on Enveloped Dwellings ('ATED') (for residential property owned by companies and other 'non-natural persons')

However, as much as these taxes can be a painful 'thorn in the side' of any property investors that they apply to, they are rarely as important as some of the other taxes which often apply. In fact, property investment is exposed to a huge range of UK taxes.

Tax is levied when property is purchased (SDLT), rented out (Income Tax) and sold (CGT). Property investors have to pay tax when they need to buy goods or services (VAT), when they make their investments through a company (Corporation Tax) and even when they die (IHT).

Those who are classed as property developers or property traders will pay Income Tax and National Insurance ('NI') on the profits derived from their property sales (or Corporation Tax if they use a company). Property developers must also operate and account for tax under the Construction Industry Scheme ('CIS') when using sub-contractors for even the most routine building work.

When the successful investor needs to employ help in the business, he or she will have to pay PAYE and employer's NI. Doubtless, the investor will also be paying Insurance Premium Tax, as well as Road Tax and duty on the petrol they buy as they travel in their business. They may even be paying Air Passenger Duty if their business takes them far.

Faced with this horrifying list, investors might be excused for turning to drink: only to find themselves paying yet more tax!

1.3 WHICH TAXES ARE MOST IMPORTANT?

For most property investors, two taxes comprise the vast majority of the actual or potential tax burden which they will face during their lifetime. These are Income Tax and CGT and they are covered in detail in Chapters 3 to 6.

The exact way in which these two very important taxes will actually be applied to your property business will depend on what type of property investor you are.

For tax purposes, there are a number of different categories into which a property business might fall and it is crucial that you understand how your business is likely to be classified before you can attempt to plan your tax affairs. I will return to this question in more detail in Chapter 2.

For some classes of investor, NI will form what is effectively an additional layer of Income Tax and we will examine this extra tax burden in Chapter 5. Other taxes which may also have a significant impact include VAT and the various forms of Stamp Duty on property. These are covered in Chapter 7.

For those investors using a company, Corporation Tax will become of equal, if not greater, importance to the two main taxes and IHT is also likely to be a major concern for most property investors. These two important taxes are covered in the Taxcafe.co.uk guides *'Using a Property Company to Save Tax'* and *'How to Save Inheritance Tax'*.

1.4 PROPERTY STAMP TAXES

There are now a number of different forms of Stamp Duty on purchases and transfers of UK property. The type of Duty arising will depend on which part of the UK the property is located in, as follows:

England:	Stamp Duty Land Tax
Scotland:	Land and Buildings Transaction Tax
Wales:	Land Transaction Tax
Northern Ireland:	Stamp Duty Land Tax

The rules applying under each form of Duty are broadly similar and are explained in detail in Chapter 7. For the sake of simplicity, I will refer only to Stamp Duty Land Tax, or 'SDLT', throughout the rest of this guide, but readers should bear in mind that a slightly different tax will apply to purchases of property in Scotland or Wales.