Planned Succession
Personal Estate & Business Succession Planning

The Society of Will Writers

Tax Planning for Investment Property Owners

Investing in property is one of the best ways of generating income and capital growth, yet few people, if any, have taken or, for that matter, received comprehensive or joined up professional advice as how to balance the often contradictory demands of taxes such as Capital Gains Tax (CGT), Corporation Tax (CT), Inheritance Tax (IHT), Stamp Duty (SDLT) and Income Tax.

Personal/Partnership ownership

Individuals (sole-traders), Partnerships and LLP's (the latter both being groups of individuals working together for gain) are subject to the same rules. The only advantage of owing investment property this way is that it's attractive from a CGT perspective with any gains being subject to rates of either 18% or 28% depending upon the tax payer's marginal rate, although investment property owners tend to end paying CGT at 28%.

The disadvantages are that net rental income will be taxed at the individual's highest rates of tax currently being paid (45% in the current tax year), and that the value of any properties held this way form part of your estate for IHT which is levied at 40% on anything above the nil-rate band (currently £325,000), albeit this is often deferred if the properties are gifted to your spouse or civil partner on death.

A Trust

The transfer of assets to a Trust is a disposal by the donor both for IHT and CGT purposes, though it is possible to 'hold over' the gain so that the Trustees are deemed for CGT purposes to have acquired the assets at what they cost the donor originally.

If the value of the gift exceeds the NRB then an immediate charge to IHT arises at 20% on the value of the excess. Within the Trust any profit made on the sale of an asset is taxed at 28%, income is taxed at up to 45% and IHT is payable every ten years at the rate of 6% on the extent to which the value at that time exceeds the then NRB, with a proportionate charge arising as and when any capital funds are transferred to beneficiaries.

Investment Company

Companies only pay tax at 20% (Corporation Tax) and, if you're selling the whole business and not individual assets piecemeal, then SDLT for the purchaser is only 0.5% as opposed to as much as a usurious 7% for individual property purchases.

If you're disposing of individual properties, then the downside is that the company would suffer corporation tax at 20% on the gain on the sale and if the shareholders were extracting the remaining proceeds via a dividend then and, if they were high earners, they would incur income tax on the net dividend received of up to 30.6%, giving an overall tax rate of over 50%.

Moreover, should you in turn sell or transfer any of your shares in the company and make a profit, even though tax has already been paid by the company on any gains it makes, you will be liable to pay CGT in your own right. There is, thus, a potential for a double CGT charge, albeit Hold-over and other CGT reliefs may be available.

Trading company
If you're already a shareholder operating in a trade or profession, you may use the trading profits to purchase a property within your existing trading company rather than setting up a separate property business, thus avoiding the income tax on extracting trading profits to make a purchase.

Upon retirement the main business may be sold separately to the property part, and only paying corporation tax rates (20%) on the gain. The properties are then left in the company, which is now deemed as an investment company and the shareholders will then be in a position to draw down a retirement income from the business in the form of dividends which would incur no further tax liability if by then the owner is only a basic rate taxpayer.

Tax Exempt UK Company
Companies can be set up as what is known as a 'Tax Exempt UK Company', which is owned and controlled by, say, you and your family. You and your family are the shareholders and directors, the company banks in the UK with a standard UK bank account and only you or those who you mandate sign the company cheques. There is no one else involved in the company or its banking arrangements.

This type of 'Management Company' controls all of your assets; it can purchase new assets and sell existing ones and, when it does, there will be no CGT, corporation or personal tax due, as both it and any income produced from the assets are deemed to be tax-exempt.

In theory a Tax Exempt UK Management Company' will: -
- allow you to receive investment income tax free
- remove the need to pay CGT if and when you sell investment property
- shelter your property from IHT on death
- ring fence your assets from divorce, business creditors or the receiver in bankruptcy
- remove your trading profits and personal income from tax

Conclusion
As with everything else in life, there's no one right answer and the decision as to which structure to use should be made with reference to both taxation and commercial issues. In which regard, the decision as to whether to own your properties in one of the personal formats or company formats depends on the strategy you have for your property portfolio.

If you own perhaps only one or two properties as a current investment, and intend to dispose of them in the short to medium term, then it is probably more beneficial to suffer the higher rates of income tax on the rental income but enjoy the lower rates of capital gains tax when you sell.

If, however, you intend to build a larger portfolio of properties over the longer term and retain the rental income with the intention to pass the portfolio etc. on to future generations, then a limited or management company route is perhaps the right way to go.

Planning Basics
Come what may, you still need to put in place the right foundation planning as without up to date Wills that specify how you own your home and other properties (joint tenants/tenants in common) and have locked the legal mechanisms to save £130,000 in IHT, and Lasting Powers of Attorney, then it's pointless doing the more sophisticated stuff.

You should please note that this fact sheet is for general information only and is based on our understanding of current taxation, legislation and HM Revenue & Customs practice as at April 2015, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) will depend upon your individual circumstances and you should contact us before taking any action.

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