TAX LIFE-CYCLE OF A PROPERTY INVESTOR...

Different taxes come into play, during the life-cycle of a property investor. This means the tax strategy needs to be monitored constantly, to ensure that, over the whole investment life-cycle, every possible tax-planning opportunity is considered. **Specialist property accountant Stephen Fay ACA looks at how tax considerations for property investors change depending on where they are in the 'property investment life-cycle'.**

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EDUCATION & FINANCE-RAISING

Many investors, sensibly, take time to understand what property investment is about, before 'taking the plunge'. Books, courses, seminars, networking events etc are 'pre-commencement expenses' (going back up to 7 years) which are generally income tax deductible.

With the new tougher lending environment, investors often need to borrow funds for deposits and buying costs. These funds are often generated via a draw-down on the family home, or via personal loans or low-rate credit cards. Ensuring that good records are kept will enable the maximum finance interest deduction to be claimed. There needs to be a clear trail between the sourcing of the funds and the funding of the property rental business for the interest payable to be income tax deductible.

Interest on borrowings can be offset against rental profits up to 100% of the purchase price of the property – NOT just the 75% LTV mortgage finance.

FIRST ACQUISITION

Many investors will incur marketing costs in order to find their investment properties. For investors, these costs are acquisition costs, and so can be added to the purchase price (tax relief is obtained on eventual sale). For property traders (who buy and sell on for short-term profits), these marketing costs are trading expenses.

Investors should be careful to keep a good file of all capital costs, as it is often not until 20+ years later that a property is sold – visit our website for a FREE Property Capital Account Tracker template.

Most investors will refurbish a new property before initial letting. Contrary to popular belief, these costs are usually 'revenue' (i.e. deducted from rental prof its), rather than 'capital' (i.e. added to the purchase price), provided that the property was in a lettable condition already. This is an area where an inexperienced accountant can cost investors dearly!

OWNERSHIP STRUCTURE: PERSONAL OR COMPANY?

The property ownership structure is very important for all investors. Generally, owning property in your personal name is the best tax strategy (and also ensures that finance at maximum Loan To Value can be obtained). This is because most Capital Gains Tax reliefs are available only to individuals, rather than companies, and because many investors run at an overall loss.

However a Deed of Trust can be used to buy property in your personal name, and then transfer beneficial title to the company after completion.

Using a property company can be tax-efficient for investors who already pay Higher Rate income tax, and expect to make significant rental profits. This enables corporation tax at 21% to be paid, rather than Higher Rate income tax at 40% (or, now, even 50%!). Profits can be used to buy further investment property, pay down debt, or be extracted tax-free at a later date when the investor becomes a Basic Rate taxpayer (e.g. in retirement).

Companies are often used by investors looking to the very long-term, and who don't need to draw on the rental profits for personal spending. Take professional advice when assessing if a company is right for you.

EXPANDING THE EMPIRE

As many investors will know, property can be addictive! Many investors taste initial success, and aim to go further than a couple of properties. The trick is to maintain a balance between expansion and 'staying in the game'.

Although it is income tax-efficient to maintain high debt levels (since the interest is tax-deductible), it's essential to maintain good cashflow, ensure your properties are well-maintained, and have a good chunk of working capital to survive during tough times. Lots of investors run shaky property businesses in order to save tax ... and then come unstuck when life throws them a 'googly'! Keep an eye on the down-side at all times.

With the credit crunch biting, many investors are using a 'mortgage host' to allow further portfolio expansion. It's then possible to out a 'Day 2 Deed of Trust' in place to assign beneficial ownership of the property to the investor.

MAKING RENTAL PROFITS

Generally, investors make rental losses, or break even, in the first few years of property investing. It is important to ensure that professional-standard rental accounts are produced every year. These losses can then be used in later profitable years.

Each year, a specialist property accountant should prepare your property accounts carefully, picking up every expense, claim and allowance possible. Then, a review of detailed tax-planning options should be completed, considering the investor's wider financial circumstances. This is needed every year, as the financial performance of the property rental business changes, and new tax changes come into play, as well as changes to the investor's personal circumstances.

Income tax-planning options might include changing the ownership structure (e.g. gifting a larger share of a property to a spouse), or even setting up a Property Management Company (PMC).

OTHER PROPERTY STRATEGIES

Buy To Let is a long-term game, and many investors wanting to generate immediate income look to branch out into other forms of property investment, such as development and trading, or even sourcing deals for other investors.

The tax position for such trading activity is that income tax and National Insurance is payable, rather than Capital Gains Tax. This is because the intention is short-term profit, rather than long-term investment. Using a limited company is often the most tax-efficient strategy for trading activity, as this allows Higher Rate personal income tax, and National Insurance, to be avoided.

Often, investor want to 'dip a toe' into other areas, and so operating, initially, as a Sole Trader enables the investor to 'test the water' before committing to the responsibilities of running a company.

WINDING DOWN ... AND PASSING ON!

The final stage for many property investors is the winding down of the portfolio, selling off some properties and using the sale proceeds to repay the outstanding mortgages on the remaining properties. This process can require several years of planning to slowly, and tax-efficiently, unwind the portfolio.

Many investors want to maintain a healthy retirement income, but also pass on their assets to their family. This 'winding-down and passing on' stage needs to be managed carefully, to make best use of capital gains tax options, exemptions and reliefs. Options such as emigration, or investing the gains into a trading company, can virtually eliminate any tax due.

Passing on the portfolio needs to be planned carefully – it is not for nothing that inheritance tax is sometimes called 'the voluntary tax'! Professional advice is needed to consider tax-planning options suitable for your circumstances (for example making use of the transferable nil rate band, using a discretionary trust, & making Potentially Exempt Transfers).

AND FINALLY...

Investors need to a tax strategy that fits their personal circumstances, and kept under constant review over the years, as the investor moves from one stage of the 'property investment life-cycle' to the next.

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