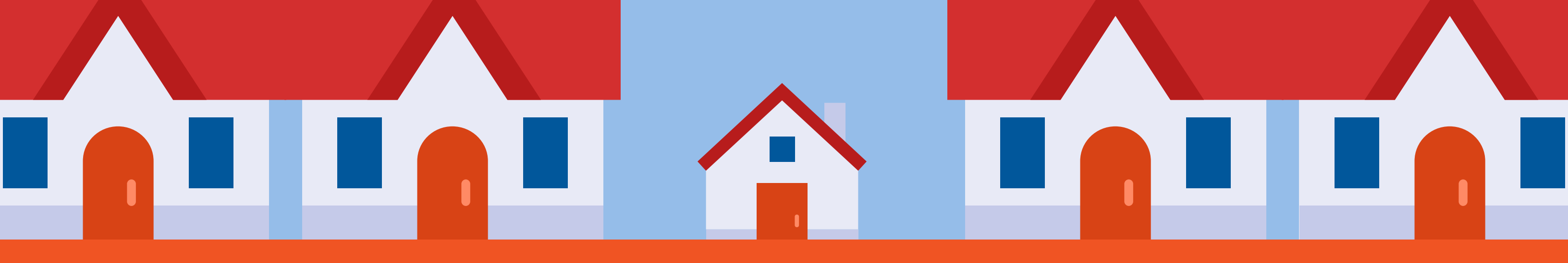


RESIDENTIAL PROPERTY PURCHASE PITFALLS

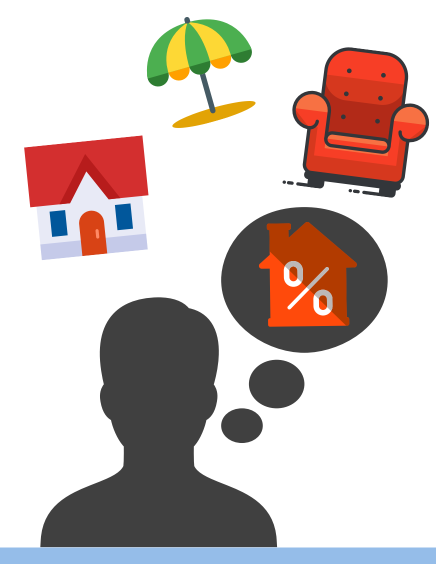
Purchasing your own property is a major undertaking, especially if you and/or your partner already own another residential property.

It is very important to get your purchase structured correctly from the start so that you avoid some very nasty tax pitfalls and costs, particularly due to:

- The new mortgage interest rules, now starting to bite.
- The Annual Tax on Enveloped Dwellings ("ATED") reporting required on high-value properties.
- Higher rates for Stamp Duty Land Tax ("SDLT") applying to residential purchases by companies and second-home owners.

First

You should try to be as clear as possible regarding your plans for the property. Your intentions can really impact the tax liability for you, those connected to you, or those involved in the property. Whether you intend to develop, buy to let, use personally, furnish for a holiday let, whatever you decide: it can have a significant effect on everyone's potential tax bills.



Secondly

You need to think about a) who is going to benefit from the income, and b) who owns the property itself. Will it be you? A company? Shared with your partner/spouse/family? Whoever is involved and/or receives the income may also have potential taxes to pay. If you plan things correctly, you can better manage your income from a tax perspective, especially as a family. An earner already experiencing higher rates of tax, for example, could be best allowing a lower earner to receive a larger amount of the income. With the right structure, you could ensure that everyone's various tax-free allowances and lower income tax rates are being used to their max, to keep your combined tax bills as low as reasonably possible.

Thirdly

Whether taking a long-term view for inheritance tax purposes later or a short term view for personal tax now, the tax lifecycle has different disadvantages and benefits at each stage. Depending on "when" you are, you will have potential gains and losses from a tax perspective. Making sure that you know all your options, now, is the best way to the make right decision going forwards.

One option to look at is whether you want to 'incorporate' or not. Here are a few points to think about:

Should you incorporate (ie: set up a company to hold the property)? Maybe, maybe not.

Having a company set up to hold your property portfolio can be more secure and tax efficient in the long term, but it entirely depends on your personal circumstances and income levels.

If you do want a company to hold residential property, you are generally better off starting with the company buying the property in the first place, rather than transferring in. If you transfer it at a later date, it is highly likely that you will be subject to a Capital Gains Tax charge on disposal of the property to the company and the company will have **Stamp Duty Land Tax ("SDLT")** to pay – at the 'company' residential property rate.

SDLT is a banded tax where the value which falls within each slice is taxed at the relevant rate. For individuals buying a second residential property, the rate is the same for them as for companies buying a residential property – an additional 3% added to each normal SDLT tax band. However, if you invest in a high value property (£500k+) for your own use but buy via a company, you'll be hit with a staggering 15% SDLT rate across the board – an additional minimum £75k to the price of the original property.

Other rules potentially apply if more than one residential property is bought at the same time.

Mortgage interest, that's an allowable expense, right…?

If you intend to use the property for Buy-To-Let, there are some rules to be aware of.

For individuals, the new mortgage interest rules mean that higher rate and additional rate earners, in particular, will suffer more from residential property income. In place of being able to deduct mortgage interest in full as an allowable expense against property rental income, the interest is being steadily transferred into a tax credit of 20% (applied after net income and tax is calculated) instead.

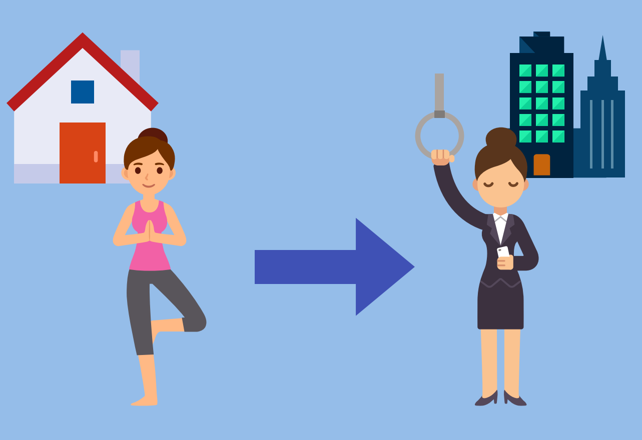
In 2019-20, the allowable interest deduction is just 25%, and the tax credit 75%. By 2020-21 and onwards, interest will become a 100% tax credit. The effect this has is to a) increase an individual's taxable income level – enabling more to be taxed at a higher rate (say 40%/45%), and b) in extreme cases potentially result in cash negative income for the property as a whole, once tax is taken into account.

However, these new rules do not apply to companies who can continue to happily deduct the mortgage interest in full against their rental income.

Buying a house for Granma

Try not to promise your grandmother/brother/children that they can stay in the house for free. For one thing, it may invalidate your Buy-To-Let mortgage policy if you allow someone to stay for free when you should be renting it out. For another, close relatives and others may end up with a hefty benefit-in-kind charge on the market value of the rent and annual value of the property - especially if the property is owned by a company.

Additionally, on a high value property (£500k+) owned by a company there are other potential pitfalls. ATED is a flat-rate tax and the return needs to be made every year whilst the property is being used non-commercially. And, when you go on to sell the property, it would be taxed at 28% on the proportion of the property gain incurred during personal use – in contrast to the current Corporation Tax rate of just 19%. This may still be worth the pain in the end as the whole gain may be taxed at 28% for a higher or additional rate tax for an individual owner, but it certainly bears thinking about.



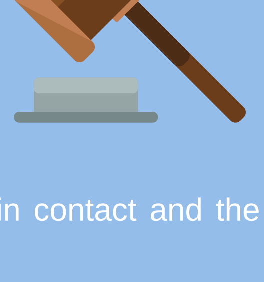
Overall, what goes for a company is rarely the same for an individual. A company can be useful, but it depends entirely on what you plan for your property and how much it costs. Additionally, a company can restrict your liability to debts – important if you're concerned about keeping your own personal assets and business assets separate – but with that comes compliance and reporting requirements as well.

Other boring things – like getting married…

It's a terrible idea to get married or join in a civil partnership with someone just to reduce your tax bill. BUT, it adds a tasty royal icing topping to the whole proceedings, knowing that your nearest and dearest will have various automatic legal protections in place over the other's assets. Amongst other things, a spouse's estate – assuming there are no other provisions – will usually revert to the remaining spouse, including their inheritance tax allowance of £325k (2019-20). Moreover, and less morbidly in the case of property and other assets, ownership can be swapped around with many fewer tax consequences. A big caveat to that with properties is to watch out for the sting in the tail in regards to mortgages and SDLT. Also as a couple, if one of you owns a property, then ANY second property is treated as a second property for both. You can't get two each! (Sorry)

Finally, tax rules don't stay the same forever, so relying on what you think you knew from 5 years ago to help guide you today is likely to get you into tax trouble.

Along with new legislation, HMRC is constantly challenging taxpayers in court over various interpretations of the law. It is vital not to make a mistake that could cost you thousands down the line – especially if someone has already gone through the same problem before you. It's much cheaper in the long term to learn from their mistake.



If you have any doubts or would like a quick and friendly chat, please do get in contact and the tax team at Chadsan will be happy to help.

Some questions you may need to consider the answers to:

Who is financing the property?
What is the value of the property?
Who will own the property?
Are you a higher rate or additional rate tax payer?
Do you or your partner already own another residential property?
Are you planning to renovate or develop?
Are you buying commercial but converting to residential use?
Will you be renting the property out commercially or letting eg: a relative stay for free?
Are you in a tourist area and would you prefer to let short term?

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