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Capital Gains Tax (CGT) buy to let

Tax is difficult but predicting the future can be even less certain and much more difficult. The property market is variable but the gains which occurred in the last four decades are less likely to recur in the future.

With interest rates so low, rental income can look like an attractive plan. Attractive yields are possible and there is the potential for capital growth. Many entering the buy to let market do so on the expectation of building a portfolio of properties which yield a reasonable income and have the potential for capital growth.

This podcast does not attempt to offer advice or commentary on the form of investment. The aim is to consider the exit strategy and the CGT implications.

This podcast has been prepared on the basis of the UK legislation which is in force at 31 August 2013. In tax, the law can change with Finance Acts, Statutory instruments and decisions of precedent which includes not only decisions of the British Courts but also the European Courts.

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Some people enter the property renting business because a residential move is necessary for their job or domestic circumstances and they retain what was their only or main residence (OMR) but on moving let it out to tenants. The good news is that under the current law, the sale of an OMR is exempt from CGT and that exemption is extended for 36 months after leaving the property and may be extended even further if the move was for work reasons.

It is worth mentioning briefly that letting a room in an OMR can benefit from the rent a room scheme relief which is an income exemption of £4,250 a year and this would not affect the gain on disposal which would remain exempt.

The exemption for gains realised on the disposal of an only or main residence is extended in relation to disposals after 5 April 1980 where the owner has let all or part of the dwelling-house as residential accommodation (TCGA 1992, s. 223(4)). As a pre-requisite, the property must at some time during its ownership have been the only or main residence of the taxpayer.

The chargeable gain otherwise arising as a result of the letting is reduced by the lesser of (TCGA 1992, s. 223(4)):

(1) an amount equal to the exemption of the gain in respect of occupation by the owner (or by the occupier under the terms of a settlement as his main residence), and

(2) £40,000 (for disposals after 18 March 1991; before 19 March 1991 the fixed amount was £20,000 and before 6 April 1983, £10,000).

Relief is available both where the whole residence is let, so that the owner is not in occupation, and to letting of part of the residence. In the former case, the owner does not have to re-occupy the property to claim relief.

Not surprisingly, many property owning clients want advice on how to establish a property as their only or main residence with the frequent question being ‘how long do I need to live in it?’ Decisions of the Court

show it is not just the length of the period of occupancy but perhaps more importantly the quality of the occupation and HMRC will test this if and when a large gain on disposal accrues. They'll seek evidence of utility bills, bank statements, correspondence etc.

A hotel is trading as would be most B&B trades. There is also the special category which has stringent occupancy tests of furnished holiday accommodation but this podcast is about the exit strategy from property acquired as a business activity. Watching programmes like 'Homes Under the hammer' there can be little doubt that some properties are acquired with a view to renovating and refurbishing and then onselling at a profit. This is trading in property but each project can be time consuming and market conditions are variable. Income may oscillate from feast to famine and a way of smoothing the tax consequences can be to trade in this way using a limited company which pays tax on its profits of up to £300,000 at 20%. If the recipient of dividends is a basic rate taxpayer, they can extract the retained profit as a dividend with no further tax liability. The exit strategy is at the end to liquidate and obtain the benefit of the entrepreneur's rate on liquidation of 10%

Property inside a limited company gets indexation allowance which means that inflationary gains are not taxed.

Contrast this with Property owned by an individual which no longer gets indexation allowance. This means that inflation may increase the value in monetary terms but there is no real increase. Despite this that individual may need to pay CGT on an inflation gain if it exceeds the relatively generous annual allowance available to individuals.

So should you own property using a limited company? Once inside a company, it can be difficult and expensive to extract and there are potential double charges to tax. So from the outset it is important to consider what looks like the best option and that will depend on the client's intentions and his view of the property market and inflation. If the client does not know and is just testing the water, it is probably best to own it personally.

If they can achieve the exemption of OMR, the tax advantages are obvious. Otherwise, they face CGT on the sale of the property but individuals have still a generous annual exemption and this may reduce the effective rate of tax on what is a non-business asset from 28% to something less. The exempt amount for 2011–12 and 2012–13 is £10,600.

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