

Taxation of Properties Briefing

With the current climate more and more people are turning to investing in the property market to make their money grow.

Buying a Second Property

If you are buying a second property you will have to consider making an election to the HM Revenue and Customs (HMRC) identifying which property you want to be treated as your Principal Private Residence (PPR). If the second property would potentially make a larger gain then it would be sensible to have this treated as your PPR to reduce your tax bill. You have 2 years from buying the second property to make this Election, if no Election is made, the HMRC will treat your PPR as where you actually live.

If your second property is bought to let then there will be income tax due each year on the net rental income and also a liability to capital gains tax when it is sold. The capital gains tax will be assessed on the net proceeds less the cost. If a property was bought as a PPR and then let out when you moved to your next PPR then the gain would be apportioned and the number of months when you were not resident would be chargeable.

If the property has ever been your home then the last 3 years would be exempt. This is a very useful relief as it can even reduce your gain to nil. If a property was bought for the sole purpose of letting, it would be advisable to live there and intimate your change of address to the HMRC and on the Electoral Roll. A period as short as one month may be sufficient to qualify for this relief. It may seem a bit extreme but the savings could be substantial in the current climate. For example a house with a net gain of £50,000 which was held for 6 years would see the taxable gain be reduced to half. The tax rate is 18%. It is also useful to consider the transfer of assets held in a single name into joint names. This transfer is exempt from capital gains tax between husband and wife and each would have their capital gains tax exemptions to use against the gain.

Letting part of your Principal Private Residence

If you let out part of your house there are different rules to consider:-

“Rent-a-Room” Scheme

If you let out a room of your house and the income is less than £4250 per annum this is free of income tax and capital gains tax. However if you rent out part of your house which does not qualify for this exemption you will be liable to Income Tax on the whole income and any gain will be chargeable to capital gains tax when the house is sold. The gain would be apportioned and the part let out would be taxed accordingly. As mentioned earlier, as this was once your PPR the last three years would be exempt.

Letting Relief

If the gain is more than £40,000 it would be beneficial to claim this relief as the gain would be reduced to this amount. There are a number of conditions to be met to claim this relief and certain circumstances preclude a claim, for example if part of the building was altered to include a separate entrance for the rented part of the property then this relief could not be claimed.

Business Element

If you currently work from home and claim a proportion of household expenses against your profits, when you sell your home part of the gain will be chargeable to capital gains tax. The chargeable gain would be calculated by reference to the number of years you have been claiming the deductions of your household bills and the percentage of the property used. If you owned the house jointly you would divide the original gain by half before using the apportionment figures.

Job-related Accommodation

If at any time during the period of ownership of your property it is necessary for the performance of your employment to live elsewhere then as long as it meets the Inland Revenue's conditions then your property will still qualify as your PPR.

Gifts

Gifts are deemed to be a chargeable disposal at market value at the date of the gift whether or not there was any consideration paid. The only exceptions are transfers between Spouses/Civil Partners. These are exempt from Capital Gains Tax and the Transferee would take these at the original cost.

The Transferor is liable to Capital Gains Tax of any gain made from the date of acquisition to the date of disposal (subject to certain reliefs which can be claimed to reduce the gain). The Transferee's acquisition cost and date is the market value at the date of the gift. If the gift was made for less than market value the difference would be deemed a Potentially Exempt Transfer for Inheritance Tax purposes.

Trust Property

Trustees who hold a property for a beneficiary who resides in the trust property may be able to claim PPR if this is sold. The election has to be made jointly by the beneficiary and the trustees.

As you will see from the above there are a number of reliefs that can be claimed to reduce your tax bill but this is just a guide.

Lindsays can advise you on all aspects of tax including how to minimise your tax bill. For more information please contact Stephanie Dodds, Tax Manager.

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