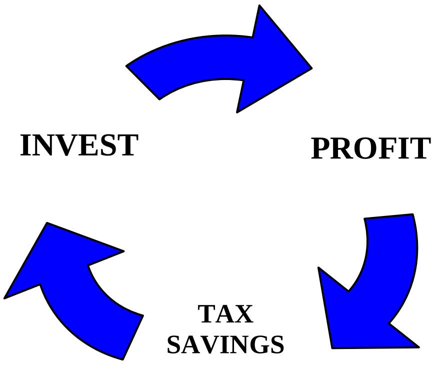
C. Charles & Co. Ltd

CHARTERED CERTIFIED ACCOUNTANTS & TAX CONSULTANTS



8 Strategies to Reduce Your Property Tax – Legally!

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- Recognised as a Fellow Chartered Certified Accountant in May 2009
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- Non Executive Chairman of Penny Power Limited
- Non Executive director of Frontier Limited and BanktotheFuture.com
- Ambassador of Assay Heritage
- Entrepreneurial accountant who specialises in connecting successful entrepreneurs & investors
- Provides tax and property consultancy for high net worth clients

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1. HOW TO AVOID PAYING TAX ON YOUR PROPERTIES!

I have been asked this so many times by clients and members alike, that I thought it was about time I wrote my own articles on this subject! Please note that what I will ONLY discuss avoiding tax using legal methods rather than evading tax which is completely illegal. At the end of the day we want to make money but we do not want to go to jail!

In essence minimising your tax bill is relatively straight forward – keep your income as low as possible but your expenses as high as possible. Simple really but with 1 big problem - we want to be rich and therefore maximise our income and our profits. So surely high income can only mean a high tax bill? Wrong! All that you need is good tax planning and you can still earn money whilst keeping your tax bill as low as possible. In fact the super rich tend **not** to pay any tax at all! Did you know that in October 2005 Philip Green paid himself a dividend, from the Arcadia Group of Companies that he owned, of **£1.17 billion**! From this income he paid **NO TAX** (yes that is correct no tax) whatsoever saving himself an estimated £285 million in tax. This is why the rich get richer!

On a smaller scale, which is a lot more relevant to us, there are still some excellent tips which I can show you in order to minimise your tax liability. Remember you need to minimise your income and maximise your expenses in order to achieve low rental profits on which you will pay tax on.

Allowable Losses

Please note that if you make a loss on a property that loss can be offset against any profits that you have made from your other properties. Also if you decide to sell a property because it is making losses you can still continue to utilise those losses against your entire portfolio as they are not 'locked' to the property (unlike in Ireland).

Any losses that you incur on your properties can be carried forward into the next year and can be used to reduce your tax liability for that year. **YOU CANNOT OFFSET YOUR PROPERTY LOSSES AGAINST OTHER INCOME SUCH AS YOUR SALARY!**

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Minimising 'taxable rental income'

This is difficult to do but not impossible. Taxable rental income is deemed to be any rental income **earned** in the period. The period is usually taken as the tax year from 6th April to 5th April the following year. Clients keep forgetting that earned rent is the total amount **DUE** from the tenant and NOT what the tenant has actually paid.

There is one trick! If a tenant is in arrears by 14 days or more then you can consider that debt as a bad debt and therefore not include this as taxable rental income. If the tenant does end up paying then you will include the income in the following tax year. 14 days outstanding rent may not seem much but if you multiply this across your portfolio the amount can become sizeable especially if you have a large portfolio. However the main advantage of this tip is cash-flow because you defer the tax charge on this rental income until your next return in the following year.

Maximising Expenses

I have already covered this topic in detail so I kindly ask you to read and review Chapter 3 'Maximising Allowable Expenditure'. However I will cover key areas including questions that I keep getting asked about.

All expenses must be **wholly and exclusively** for the purpose of your rental business to be allowable and therefore deductible from your rental income when arriving at your taxable profits. The Inland Revenue has given two pure definitions that you need to remember for allowable expenditure and tax deductible expenses:

1. Any costs you incur for the sole purposes of earning business profits
2. Capital allowances on the cost of buying a capital asset, or a wear and tear allowance for furnished lettings.

Is the membership fee for property related websites an allowable expense?
Yes it is, because it is a direct source of learning about property investing.

What about the purchase of DVDs that are based on property investing, are the cost of these allowable?
Yes 100%

Are the high fees paid towards Inside Track allowable as an expense?
If you were unfortunate enough to pay the extortionate fees that Inside Track charged for their seminars (one of my clients paid about £10,000 even though I

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told him not to. He has since realised the errors of not listening to his accountant!), then at least I can give you some good news. Their seminars are a **FULLY** allowable expense. The amount of money you spend on a seminar is irrelevant as long as it is wholly and exclusively for the purpose of your rental business (I am deliberately repeating myself here). At the end of the day it's your commercial decision on how much you want to spend on learning about property so if you spend £1 or £10,000 it is irrelevant as long as the seminar/DVDs/books are directly linked to your property investment business.

IMPORTANT NOTE: You must already be a property investor to be able to offset the entire cost of a property seminar. If you paid for a seminar BEFORE you purchased your first rental property then the cost is NOT allowable! You can only offset the entire cost if you are UPDATING your skills in your current profession.

Is the mortgage interest that I pay on my personal property allowable?
No your personal property is NOT part of your investment portfolio. However if you decide to move out and then rent your property then the mortgage interest becomes an allowable expense from the day that you made your property available for renting. In Year 1 you will have to pro-rate the interest expense from the date that the property ceased being your personal property and became a part of you investment portfolio.

I recently re-mortgaged my property and used the additional money to purchase an investment property. Is this an allowable expense?
The amount of interest that you pay on the additional borrowing is a fully deductible expense. If the additional borrowing was simply added to your existing mortgage then you will need to calculate the proportion of the interest that relates to your investment income. For example if you borrowed an additional £20,000 to purchase a buy-to-let property and your total mortgage went up from £80,000 to £100,000, the allowable interest expense would be calculated as follows:

£20K/£100K x the chargeable interest from the date that the investment property was purchased.

Please refer to chapter 5 - Utilising Interest for a more detailed explanation on maximising your interest deductions.

What is the difference between repairs and improvements?
All repairs and maintenance costs are fully tax deductible. Improvements are added to the purchase price when it comes to calculating the capital gain when (or if) you decide to sell the property. Examples of repairs and maintenance expenditure that are fully allowable are:

- Painting and decorating
- Damp treatment
- Roof repairs
- Repairs to goods supplied with the property i.e. an oven.

Examples of improvements are as follows:

- Extensions
- Loft conversions
- Replacement of a kitchen with a more expensive luxury kitchen

Any interest that you pay on a loan that you took out to acquire a property is fully tax deductible. However please remember that it is **only the interest** and not the capital repayment part that is tax deductible. Interest on loans taken out to pay for personal items such as holidays is not allowable.
Examples of allowable finance charges are:

- Interest on the mortgage taken out to get the property
- Interest on any secured or unsecured loans taken out to get the property.
- Arrangement fees charged by the lender.

What professional fees are allowable?

- Lettings agents fees including the VAT (unless you are registered for VAT)
- Legal fees for evicting tenants
- Accountancy fees for preparing your accounts (preparation of tax returns are NOT an allowable expense)

Disallowable legal fees are as follows:

- Surveyor fees paid out to value the property
- Legal fees incurred to purchase the property

Other types of allowable expenditure
Please note that this is NOT an exhaustive list so if you do have any further queries then do not hesitate to contact your accountant and if he/she doesn't know the answer then you can always ask me!

- Ground rent
- Service charges
- Stationary such as paper, envelopes, and postage
- Council tax, electricity, water and gas if you pay this for your investment properties.
- Buildings insurance, Contents insurance and rental guarantee insurance
- Advertising costs to get your property rented out (such as Rightmove)
- Letting agent costs
- Bad debts
- Bank charges

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For further information on how to minimise your tax liability on your property portfolio please contact our offices via phone or email. The details are as follows:

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2. NEVER SELLING YOUR PROPERTY MEANS NO TAX!

How Does the Strategy Work?

Quite simply, the strategy involves growing a portfolio without ever selling a single property. As the property prices continue to increase, the owner would then release equity from the property, using it to:

a) Provide a means of living

b) Acquire more property

c) Both of the above

The Benefits of the Strategy

The main tax benefits can be summarised as follows:

1. Zero tax on the equity release.

   This is probably the 'biggest tax' selling point of this strategy. Whenever equity is released from a property, no tax is due. So, let us consider an example where John buys a property for £15,000. The property price increases to £200,000. John withdraws £20,000 equity from the property. **There is no tax due on this equity release.**

2. Zero capital gains tax (CGT).

   Capital gains tax can be avoided purely because the property is never sold. When the owner dies, there is no CGT to pay, because there is never any CGT on death.

3. Zero (or minimal) inheritance tax.

   Inheritance tax is only due on the net value of assets (i.e. the total assets owned, minus the total debts owed) for the inheritors of the estate. Because equity has continuously been released on the property then the amount of debt on the property is likely to be high, usually between 75% to 85%.

   Because the current IHT threshold level is £325,000 there will need to be a sizeable portfolio before the net assets exceed the IHT threshold limit.

It sounds like the perfect tax strategy, doesn't it?

By never selling a property you can take tax-free lump sums from your property, will never pay any capital gain taxes and your loved ones may be able to avoid inheritance taxes.

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Before you surge ahead and decide that this strategy is for you then you should also consider the following potential pitfalls.

The Drawbacks of the Strategy

If you have a 100% loan on the property, and the market value of the property has risen since you acquired it, and therefore you want to release further equity from it, then the following three points need to borne in mind:

1. Greater income taxes.

   It is important to understand that by releasing equity you will not pay any less in annual rental income taxes. If the equity release is used to provide a living, or supplement a lifestyle, then considerably more tax may be due on the rental income profits.

2. Strategy depends on increasing property prices.

   For the strategy to work, property prices must increase. If property prices do not increase then there simply won't be any equity available for release.

   We all know that property prices have increased significantly over the past few years, but we are now going through a period where property prices have stalled or are even dropping in some areas.

   This, of course, means that you may not be able to release equity for several years!

3. What if rental yield does not increase?

   This strategy is also dependant on rental yields increasing. Rental yields must typically also increase before any further equity can be released.

   If you have invested in apartment blocks where there are a huge number of existing investors, then you may need to wait a very long time before any of the rental yields increase and further equity can be released.

4. What if you want to sell up?

   Let's face it, being a landlord may sound like a good idea now but what if, in the future, you want to sell your entire portfolio and rid yourself of the challenges facing landlords.

   You may not be able to sell a single property if your debt ratio is so high that the sales proceeds do not even cover the tax liability.

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Even when capital gains tax was reduced to 18% on 6th April 2008, you may still not be able to avoid the 'capital gains' tax trap.

5. Minimal inheritance tax

   If you plan to pass down a sizeable estate to your loved ones, then this strategy is unlikely to provide any significant tax free lump sums.

Summary

Blindly adopting this strategy can create big problems, such as bankruptcy, as well as tax issues! However, it ***can*** work if your 'investment' strategy is discussed with a tax advisor and you fully understand the tax and the non-tax implications.

3. Maximising allowable expenditure

This is easier to do than minimising rental income. This is because the Inland Revenue grants certain allowances based on certain definitions as well as allowable expenditure. This means expenditure and allowances can be deducted from the taxable rental income to derive the taxable profit. The two pure definitions that you need to remember for allowable expenditure and taxable allowances, as stated by the Inland Revenue, are:

1. **Any costs you incur for the sole purposes of earning business profits'**
2. **Capital allowances on the cost of buying a capital asset, or a wear and tear allowance for furnished lettings'**

<u>1. Any costs you incur for the sole purposes of earning business profits'</u>

Any expense you incur 'wholly and exclusively' for the business is ***<u>fully</u>*** deductible from your rental income. Any personal expenditure that you make that relates to the business is ***<u>partly</u>*** tax deductible from your income.

Please find below our list of fully tax deductible expenses:

Expense	Description
Repairs & maintenance	All repairs and maintenance costs are fully tax deductible. Where the property has been altered extensively so as to deem the property being reconstructed, the property is then considered to be modified rather than repaired; hence no amount of the expense is allowed. The only amount allowed would be the estimated cost of maintenance or repair made unnecessary by the modification. Examples of repairs and maintenance expenditure that are fully tax deductible are: • Painting and decoration • Camp treatment • Roof repairs • Repairs to goods supplied with the property i.e. washing machine

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Finance charges	Any interest you pay on a loan that you took out to acquire a property is fully tax deductible. It is only the interest and not the capital repayment part that is tax deductible. If any of the finance raised (the loan) is used for personal use, such as a holiday, then the interest paid on the amount paid for the holiday is not tax deductible. The typical interest payments that are allowed are: • Interest on the mortgage taken out to get the property • Interest on any secured or unsecured loans taken out to get the property Arrangement fees charged by a lender are also tax deductible. Interest paid on the car you use to run the property business is partly tax deductible - see future newsletters.

<table>
<tr><td>Legal & professional fees</td><td>Allowable expenditures are:

Letting agents fees for the collection in rent including the VAT (unless you are VAT registered)
Legal fees for evicting tenants
Accountancy fees for preparing your accounts

Disallowable expenditure is:

Surveyor fees initially paid out to value the property (unless the survey was unsuccessful and you never acquired the property, in which case it is a fully deductible expense)
Legal fees incurred due to the purchase of the property

These expenses are added to the purchase price. When it comes to calculating the capital gain when you sell the property:

Gain = selling price - purchase price

This results in the purchase price being higher than the actual price paid due to the addition of initial professional fees. So the taxable gain is lower. These fees are subject to full indexation, as is the purchase price, to allow for price inflation. So you do get some tax relief but only further down the line, when you sell the property.</td></tr>
<tr><td>Council Tax, electricity, water & gas</td><td>If you are renting out all the rooms then all the usual running costs involved with a property are fully tax deductible. This assumes that none of the tenants make a contribution to the bills. If you let out your property inclusive of all the bills then you can fully charge all the bills you include with the rent. If you let out your property exclusive of all bills (which is the usual way) then you cannot claim. Remember, you can only claim the expense if you actually paid it!</td></tr>
</table>

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Insurances	• Buildings insurance • Contents insurance • Rental guarantee insurance The above are fully tax deductible. Life assurance premiums are not as this is personal expenditure. Car insurance is, but only partly - see below.
Advertising	Any advertising costs in connection with finding a tenant or selling your property are fully tax deductible. This includes: • Newspaper adverts • Agent's commission
Ground rent	This is the rent you pay if you own a lease-hold flat, typically a nominal amount of £50 per annum.
Service charges	Service charges are incurred if you own a lease-hold flat. If you pay these charges then they are fully tax deductible.
Letting agent fees	Any fee that is charged by a letting agent is fully tax deductible, apart from any fees charged for leases created for longer than a year. If a fee is charged for creating a 5-year lease then only one fifth of the fee can be charged for each year.
Stationery	Any stationery costs incurred in connection with running your property business are fully tax deductible. This will include items such as: • All paper and envelopes • Postage • All printing expenditure

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4. HOW TO SAVE ON COUNCIL TAX

BEWARE: Since 01 April 2013 the rules on council tax exemption have changed! The 100% exemption for unoccupied and uninhabitable properties has now been reduced to just 1 month!

Under normal circumstances the tenant is responsible for paying their council tax. If however the property is empty then YOU are responsible for paying the council tax. The council tax departments are hot! They somehow know how to track you down to pay the tax so there is no point avoiding their charge. If you do you could face being up in front of a magistrate and ultimately having your goods seized by registered bailiffs.

There are ways of reducing you council tax bill for you and your tenants for the following scenarios:

- Up to **25%** discount for 1 adult living on his own
- Councils can give furnished second homes or holiday homes a discount of up to **50%**
- Households where **everyone's a full time student** don't have to pay Council Tax. This is very important for any landlords utilising student lets as their investment strategy as you may have to apply for an exemption. To count as a full-time student your course must:
    - Last at least 1 year
    - Involve at least 21 hours study per week
- You will get a Council Tax bill if there's someone in your household who's not a full-time student, but you might qualify for a discount.

Please ensure you communicate to the council the status of the property to ensure you can claim all the exemptions allowable to you.

TAX TIP: Every Council has their own rules regarding exemptions and discounts for Council Tax. Make sure you either contact your local council or visit their website to see if your property qualifies for an exemption and/or a discount.

5. UTILISING INTEREST

What types of 'interest' can be offset against my property income?

It is common knowledge that it is possible to offset 'interest' payments against property income. However, what the vast majority of investors do not understand is exactly what types of interest can and cannot be offset against property income.

Well, do not worry as in this strategy we will explain and illustrate **THREE** different types of interest that you can offset.

Remember: **'knowledge is power'** and the more you know about property tax, then the greater chance you have of reducing it.

No doubt, most of you will be paying some or even all of these types of interest, so it means that you CAN start reducing your tax liabilities further!

Just like the previous Property Tax Strategy, we recommend that you print off and file this strategy away so that you have easy access to it whenever you are off-line!

So, let's get on with learning what they are!

1 Interest on mortgages

It is probably fair to say that this is the most common type of interest that is associated with property investors.

This interest relates to the amount you pay back to your mortgage lender that is above and beyond the initial amount that you borrowed.

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It does not matter if the mortgage is a 'repayment' or an 'interest-only' mortgage. Only the interest element of your loan repayments can be treated as an allowable expense.

Let me illustrate this through the following case study.

Case study (1)

John buys an investment property for £100,000.

The finance for the property is made up of a £20,000 deposit (provided from his personal savings) and an £80,000 buy-to-let mortgage, provided by NatWest bank.

In the first year of the mortgage he pays £2,500 in interest. This WHOLE amount can be offset against his income from the property.

This means that if he received £5,500 income from his property, then he would be liable to pay tax on only £3,000!

2 Interest on personal loans

If you take out a personal loan that is used 'wholly and exclusively' for the purpose of the property, then the interest charged on this loan can also be offset.

The important point to note here is that personal loans MUST be used in connection with the property.

Here are some examples when the interest charged on a personal loan CAN be offset against the property income.

a) Using a loan to provide a deposit.

Most buy-to-let mortgage lenders require you to provide a 20% deposit before they will lend you the remaining 80% in the form of a mortgage.

If you do not have the 20% deposit readily available, then it is likely that you may well need to finance the deposit by getting a personal loan.

If you do take out a personal loan for the 20% deposit, then the interest charged on this loan CAN be offset against the property income.

If you are considering or have already done this, then what this means is that you have a 100% financed investment property, where interest charged on both the mortgage and the personal loan can be offset against the rental income.

b) Loan used for refurbishments/developments.

Periodically, you will need to refurbish or even develop a property.

Imagine that you have just purchased a property that needs total redecorating and modernising.

If you take out a loan for carrying out this work, then the interest charged on the loan can be offset against the property income.

Alternatively, you might decide to embark on a more expensive property extension, i.e., build a conservatory.

Again, the same rule applies here - the interest charged on the loan can be offset.

Okay, so you now know some typical scenarios in which you can offset interest payments.

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Well, what about some scenarios in which you cannot offset the interest payments?

Good question!

Here are some examples when the interest charged on a personal loan CANNOT be offset against the property income:

a. loan used for paying for a family holiday;
b. loan used for buying a new car;
c. loan used for paying children's tuition fees, etc.

It is clear from the above examples that all these scenarios have one common characteristic:

*They have **ABSOLUTELY NOTHING** to do with the property investment! *

So, suffice it to say that if the loan has nothing to do with your property investment, any interest repayments CANNOT be offset.

Our best advice on this is to keep things simple and always ask yourself 'Is the loan being used for the sole purpose of my property?'

If the answer is 'YES,' then you can offset the interest. If the answer is 'NO,' then you cannot offset the interest.

3 Interest on remortgage

If you have a mortgage on your investment property, then it is highly likely that you will consider moving to another lender at some point.

The main reason for this is likely to be because you are looking for a better mortgage deal.

As interest rates have been falling over the past few years, more and more people have been remortgaging their investment properties to capitalise on the better deals and to help grow their property portfolios.

Here are some pointers about remortgaging.

a) If you remortgage your outstanding mortgage with another lender, then you can STILL offset the interest repayments.

Case study 2

Timothy has an outstanding mortgage balance of £50,000 on his investment property. He decides to move his mortgage from the NatWest to Lloyds TSB as they are offering a lower rate of interest.

Timothy can still offset the entire interest charged by Lloyds TSB on the £50,000 remortgage.

b) If you remortgage for a lower amount, then you can still offset the whole interest

Case study 3

Timothy has an outstanding balance of £50,000 on his investment mortgage.
However, he inherits £20,000 from a family member. He decides to use this toward lowering his mortgage liability.
Therefore he only remortages to the value of £30,000 with Lloyds TSB.
Again, the entire interest charged on the £30,000 can be offset against the property income.

Right at the outset of this strategy I mentioned that **'knowledge is power.'**

Having read this strategy, you will now appreciate that the more you know about property tax, the more you can plan ahead and reduce it.

Just as important is the fact that your tax education will help you from getting into unnecessary trouble should you be unlucky enough to be investigated!

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6. Using a Partnership

1 Partnerships - Simple, but very tax effective!

One of the simplest and yet most effective property tax strategies is to buy a property with multiple owners in the form of a partnership.

The number of partners is irrelevant, but the two most important considerations are that:

a. your partners must not be higher-rate taxpayers (by this I mean that they must not be taxed at 40%);

b. they **MUST** be trustworthy.

The latter point is so important that I am going to stress it again!

2 Partners MUST be trustworthy!

If you buy in a partnership, then you MUST make sure that the partners with whom you are purchasing are people that you implicitly trust, i.e., a spouse, your mother or father, etc. This is not just for tax reasons but is just simply good **BUSINESS PRACTICE**.

As a golden rule, if you are a higher-rate taxpayer, i.e., YOU pay tax at 40%, then ALWAYS try to purchase with either a lower-rate taxpayer or, even better, with someone who pays no tax at all.

3 How are partnerships split?

All property owned jointly between husband and wife is treated as an equal 50:50 split by default by the Inland Revenue.

However, this is not the case for property owned between non-husband and wife. This is because the property ownership must be based on fact, e.g., Jo has funded 10% of the deposit and Jack has funded 90% of the deposit. In this case the property would be treated as a 90:10 split in Jack's favour.

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4 Do you have a non-income-generating partner?

If your partner does not work, then the first £6,475 (2009/10) that your partner earns through property income will be exempt from tax!

This means that if you pay tax at 40% but have a 50:50 split with your non-working partner, then on the basis of an equal profit of £6,475 from your property income, you will pay **£2,590 less in tax on a yearly basis.**

This is achieved just by having the property in joint ownership!

Even better, over a ten-year period, this would equate to a minimum tax savings of £25,900!

BUT do not forget, the tax bands change every year, so your tax saving is likely to be greater than this!

Now, if you had a choice between paying the taxman £2,590 yearly or spending the same amount on a family holiday, which would you choose?

5 But what if my partner does generate income as well?

As long as any of your partners pay tax at a lower rate than you, then to put it simply, there is a TAX SAVING to be had!

So do not miss out!

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Case Study

John is a 40% taxpayer and his wife pays tax at 20%. Their employment income is £60,000 and £20,000, respectively. They also earn £5,000 each from their property investments.

Therefore John pays £2,000 tax on his £5,000 property income, and his wife pays £1,000.

They are saving £1,000 in taxes per year by not having the property solely in John's name!

Again, over ten years, this equates to **£10,000** in tax savings!

6 But what if I have already bought in my sole name?

Do not worry, you will not be the first (I did it before you), and you certainly won't be the last!

YES, ideally, if we knew there was a significant tax saving, then we would all purchase in a partnership from the outset; BUT we learn as life goes on and that is exactly what this strategy is for - to help you LEARN!

It is VERY EASY to switch a mortgage into multiple ownership, but most people think it is a long and complicated process.

Well, it is NOT!

It will cost in the region of £300-400 to have a property transferred into multiple ownership. But do not forget, this is NOTHING if you consider the potential tax saving you could make! So, sacrifice a short-term cash outlay for a long-term tax saving!

Here are the steps you will need to follow:

1. **Contact your mortgage lender.**
   Tell them why you want to transfer. They will then send you new mortgage forms form for you to complete in joint ownership.

   YES, that is right, in most cases you effectively have to apply for a new mortgage.

   Normally, the property will be put into joint names on the same terms as the original contract.

   However, if interest rates have reduced, then be CHEEKY and ask if you can also have it at the new reduced interest rate!
   My philosophy is, 'if you do not ask, you will never know what the answer would have been!'

2. **Contact a solicitor.**
   Once your mortgage has been approved, your solicitor can have all relevant documents changed into joint names pretty quickly. It is as easy as that and it can all be done in about one month!

7 Will a partnership BENEFIT me when we decide to sell the property?

Absolutely, YES! Now, if you have a property in multiple names, then you will definitely make a tax saving.

If for no other reason, then this is due to the fact that each owner will be able to use their own personal CGT allowance, which currently stands at £10,100 per person for the 2009-2010 tax year. So, this means that if husband and wife own an investment property jointly, then you can reduce any CGT tax liability by a minimum of £20,200 i.e., 2 x £10,100.

7. Five Simple Methods of Reducing Your Tax Liability

1. Look to claim costs as 'Revenue' costs

If you can claim large costs as 'revenue' costs rather than 'capital' costs then you can reduce your annual property income tax bill in a big way.

Sometimes it is easy to determine whether a cost is of a capital nature or not. For example, if you have had a new conservatory built, or even a new bedroom added, then this is clearly a capital expense. This is because it has increased the value of the property.

However sometimes distinguishing between the two costs is not so clear.

Consider the replacement of windows. If you currently have rotten single glazed windows then you will be able to replace them with UPVC double glazed windows and offset the entire cost against the rental income. There will be no need to class this as a 'capital cost'.

This is because it is generally accepted that the standard windows used in modern properties are UPVC and not wooden single glazed windows. So you are replacing the current standard window fitting with a like-for-like window.

Remember: If you can class a cost as a 'revenue' cost then it will improve your cash-flow as you will pay less property income tax.

2. Claim tax relief on ALL revenue expenditures

Remember the golden rule: ***If you have incurred a revenue expense for the purpose of your property, then you can offset it against the rental income***.

This means that you can continue to lower your tax bill - *legitimately*. Most investors are aware that they can offset mortgage interest, insurance costs, rates, costs of decorating/repairs, wages and costs of services.

However so many investors fail to claim the following costs, which when added together can provide a significant tax saving:

- Costs incurred when travelling back-and-to the investment property
- Advertisement costs
- Telephone calls made (or text messages sent) in connection with the property
- Cost of safety certificates

- Cost of bank charges (i.e. overdraft)
- Advisory fees e.g. legal and accountancy
- Subscription to property investment related magazines, products and services

3. Make sure you register any rental losses

We cannot stress this point enough.

The generally low rental yields on buy-to-let investment properties purchased over the past few years has meant that an increasing number of people have been making an annual rental loss.

By registering these losses with the Inland Revenue you will be able to take these losses forward and offset them against *future* profits. Given that the past few months has seen a rise in rental yields, there is a strong likelihood that your investments will now be starting to return an annual profit.

Therefore by having registered your previous year's losses you will be reducing your tax liability going forward.

Although it is not a compulsory requirement to register your losses with the Inland Revenue, it will work to your advantage and most importantly will save you tax.

4. Switch property ownership with your spouse if they are lower rate taxpayers

If you have a spouse who is a lower rate (or even nil rate) taxpayer and you are a higher rate taxpayer, then consider moving the greater portion of the property ownership into their name.

This means that a greater part of the profit will be attributed to the lower (or nil rate) taxpayer thus meaning that any tax liability could be significantly reduced.

This is a very powerful strategy if your spouse does not work, as any tax liability can be legitimately wiped out.

Please note: that in order to use this strategy you partner must be trustworthy as legally they will 'own' a greater share of the property.

5. Mix and match the 10% wear and tear allowance

If you are offering a fully furnished property then it may be tax beneficial to use the 10% wear and tear allowance.

This is because you can start to claim the relief as soon as you start to receive income from the property.

If you have purchased a property in the last twelve months and have fully furnished it then you MUST consider the costs incurred for furnishing the property.

If the cost was high, then it may be better to start using the 10% wear and tear allowance.

This is because:

- You will be providing high-quality furnishings and will not expect to replace them for a good few years, i.e., 5-7 years.

  Therefore by claiming the 10% wear and tear allowance you will be able to start claiming the relief immediately. This means that up to 10% of your rental income will be deducted

  If you do not claim the allowance then you will be using the 'renewals' basis method, which will not be used until you replace the furnishings. So, for example if you spend £7,500 furnishing a brand new property before you let it then none of this cost can be offset against your income until it is replaced, which could be 5-7 years in the future.

- If you decide to sell the property before you renew the furnishings, then by using the 'renewal basis,' you will not have managed to offset any renewals cost at all against your property.

  This means that you will have incurred unnecessary taxes!

  However, if you use the '10% wear and tear allowance,' then you can claim this from the date you purchased the property.

Also, if you have purchased a property that includes furniture and furnishings then again it will be beneficial to claim the allowance.

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8. How to Pay Off Your Residential Mortgage AND Claim Interest Relief

Now, doesn't that sound like a great idea – getting tax relief on the mortgage interest that you pay on your main residence?

Well, you will be pleased to hear that it ***is*** possible by following a simple (and relatively unknown) tax relief and some creative financial planning.

The Basics

As most property investors are aware, it is not possible to claim interest relief on your main residence. This is because your main residence does not form part of the property business.

Therefore you cannot claim interest relief against your income because no rental income is received from your main residence (with the exception being the rent-a-room-relief).

However, you will also be aware that you can claim interest relief on properties that form part of your property business i.e. your buy-to-let portfolio. In such instances you can offset your mortgage interest on your let properties against any rental income received.

The Solution!

We have identified a little known strategy that gives landlords the opportunity to release equity from their investment properties and offset the interest regardless of what the equity release was used for.

The only restriction is that the equity release cannot be greater than the market value of the property when it is brought into the letting business. If the property had been originally bought for letting, this amount would be the purchase cost of the property.

So How Do We Get Tax Relief on Our Main Residence?

Well there are two ways to achieve this:

1. **Remortgaging existing buy-to-let property/portfolio**

Those of you who have or are growing a buy-to-let portfolio are likely to have equity in the property. The example below shows how/when this equity can be released to give you a tax benefit.

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Example

John buys a property for £200,000. He provides a £40,000 deposit and borrows £160,000. 5 years later the property has increased to £250,000. This means that he has £90,000 equity in the property.

He decides to remortgage the property to a value of £200,000 thus releasing £40,000 of equity from the property. He uses the £40,000 equity release to reduce the mortgage on his main residence by £40,000 and still claims interest relief on this equity release.

So how is this possible?

Well, do not forget the property was bought into the lettings business when it was purchased for £200,000. The additional amount of equity released has not taken the borrowing over £200,000, so the entire interest amount charged can still be offset against the rental income.

So, if say, for example he is paying £200 a month interest on the £40,000 then he will be able to now offset this interest against his rental income.

Result:

- Reduced debt on the main residence
- Borrowing moved to buy-to let property upon which interest relief can be claimed against the rental income

Now, this is just an example of a single property. Imagine if you have 2, 3, 4 properties or more and have the ability to withdraw equity as in the example shown above?

By using this same strategy on a number of properties, you could shift the entire debt from your main residence on to your buy-to-let property portfolio and claim interest relief on the entire amount!

2. **Moving Equity from Previous Residence**

Another useful tax trick is to remortgage a previous main residence. Again this strategy is best illustrated by an example.

Example

Lisa and John buy a property for £100,000 (£20,000 deposit and £80,000 mortgage). They live in the property for five years and then decide to buy another property. Instead of selling their existing residence they decide to get onto the buy-to-let ladder and let the property out.

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The cost of the new property is £200,000, and at the time of letting, their previous residence is worth £150,000.

They increase their debt on the previous residence from £80,000 to £150,000 i.e. they release £70,000 of equity. They then use this equity release to reduce their mortgage on their main residence by £70,000.

Once again, because the additional amount of equity released has not taken the borrowing over £150,000 (the price when it was brought into the lettings business), the entire interest amount charged can still be offset against the rental income. If the interest charged on this amount was £250 per month then this is a significant saving every month.

Once again, with this little trick we have:

- Reduced debt on the main residence
- Moved borrowing to buy-to let property upon which interest relief can be claimed against the rental income

Conclusion

As you can see, sometimes with a little bit of creativity you can bring significant tax savings! It is possible to get even more creative with this tax break but we'll leave these strategies for another time.

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Take action, ring our offices today and ask for an individual quote on any of the following services:

- **Preparation of rental accounts and tax returns**
- **One to one property consultancy and portfolio building**
- **Tax efficiency review of your property portfolio**
- **Stamp Duty Planning**
- **Using Capital Allowances to get tax rebates**
- **Capital gains tax planning**
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