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inspired property investment

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It's a new dawn, it's a new day, it's a new year?

Unfortunately 2013 is unlikely to prove to be the new dawn that the stock markets seem to be heralding as the year gets underway. By all accounts the US fiscal cliff still looms large and threatening, the Eurozone has not resolved its issues, and China may yet experience a hard landing. Debt in the western world is still rising at alarming levels as Governments tinker with policy and look no further than the next polling day.

The future remains uncertain at best and it is hard to see a genuine cyclical recovery in global markets. The debt question remains an elephant in the room; the numbers are so huge as to become meaningless. Someone came up with a simple way of understanding the US position recently as follows:

U.S. Tax revenue:	$2,170,000,000,000
Fed budget:	$3,820,000,000,000
New debt:	$1,650,000,000,000
National debt:	$14,271,000,000,000
Recent budget cuts:	$38,500,000,000

Let's now remove 8 zeros and pretend it's a household budget:

Annual family income:	$21,700
Money the family spent:	$38,200
New debt on the credit card:	$16,500
Outstanding balance on the credit card:	$142,710
Total budget cuts so far:	$385

So, no new dawn in 2013.

On the plus side however, companies hold record levels of cash, and businesses have adapted to the new world with this being reflected in new improved levels of efficiency and productivity. There are very real signs of life in the all important US housing market, and in the UK it is no longer a political taboo to talk of structural reform of welfare.

Governments' largesse in recent years (QE) will have to be addressed before too long. Inflation looks likely to be the outcome and stock markets will continue to be volatile as equity investors prefer to realise short term gains rather than hold and build value for the long term. Therefore many investors will continue to lean towards solid assets with gold predicted to rise ever higher. Land prices have seemingly boomed in all corners of the earth and cash heavy prime property looks solid even if prices may flat line for a while.

2012 was overshadowed by many Governments' talk and actions on taxing 'the rich'. In the UK, as with other parts of the world, it was politically expedient to see the upper end residential markets cool off and various measures were introduced to that effect. The UK has had its own version of such actions - widely greeted with cries of alarm and indignation. Rational analysis suggests less reason to be so concerned, either about impacts on large numbers of individuals or on the market as a whole. Our own thoughts on the subject are laid out below.

UK Residential Property - Tax Changes

This summary is intended as a general reflection on recent public announcements. Its content should not be relied upon for the purposes of investment or tax planning. We recommend that specific professional and legal advice be sought before any action is taken.

The UK Government finally published its Finance Bill 2013 just before Christmas. The bill confirms the general announcements made in the budget statement back in March 2012 but provides much needed clarification of detail following the consultations and refinements which have been on-going in the interim.

Although the delay in getting to the detail has been frustrating, the final results are less far reaching and less punitive than had been feared by many. A lot of alarming material has been circulated, and even some more recent headlines could mislead people to assume that wholesale tax penalties have been introduced on property investors in the UK. This is far from the truth. In fact the measures now being implemented are quite closely targeted and, we believe, need have little or no affect on the majority of our clients and prospective investors. Property investment in the UK has historically been relatively benign from a tax perspective, and for most investors will continue to be so.

There are essentially three parts to the tax changes which have captured the headlines:

- The introduction of a new 15% penalty rate of Stamp Duty Land Tax (SDLT).
- The introduction of a new Annual Residential Property Tax (ARPT).
- The introduction of a new Capital Gains Tax charge (CGT).

Each of these applies only to specific categories of property purchaser/owner and only to specific types of property. It may be easiest to establish first those categories of investors who are **not** affected:

- None of the new tax charges apply to investors in commercial property.
- None of the new tax charges apply to investors in residential property with a value below £2 million.
- Exemptions from the new tax charges apply to any investor purchasing and owning higher value residential property in their own personal name. For those concerned about privacy, nominee structures are exempt. For those concerned about Inheritance Tax (IHT) properly organised trustee structures will not be liable for IHT, and can retain the new property tax exemptions allowed for private individuals.
- Exemptions from the new tax charges apply to corporate investors in higher value residential property which are genuine commercial landlords (property rental businesses) which do not rent their property to related parties.

- Exemptions from the new tax charges apply to corporate investors in higher value residential property which are genuine property traders and developers.
- A range of other exemptions apply to investors in properties open to the public, properties used to provide employee accommodation, working farmhouses, and others.

Observing the detail of the tax regulations, as ever, is important to ensure that an investor who by rights should not be caught by the new rules is able to protect and evidence their position so as not to risk challenge – for example even one overnight occupation of a buy-to-let property by a connected person could trigger liability for all three new taxes. The dates for introduction of the new charges and exemptions vary and need to be taken into account to avoid inadvertent timing issues. Investors may also be required to complete a tax return to claim exemptions they believe they are entitled to, rather than assuming the rules do not apply. We would always recommend taking appropriate specialist professional advice on these matters.

Turning to those more directly affected, it is now clear that the Government's intention is to target the tax changes at buyers/owners of higher value residences which are used as part time or occasional residences for the owners or their family members and who at the same time use corporate vehicles to own the properties and thereby envelope or shelter their UK or international tax position. The worst case concern that CGT liabilities could be back dated and based on the original purchase price of such properties have not been realised and values are to be re-based only to tax gains arising from April 2013. However, going forward owners and new investors in such properties will be hit with a double or triple whammy of penalty SDLT at 15% on purchase price, on-going ARPT at rates ranging from £15,000 per annum (for properties worth between £2 million and £5 million) up to £140,000 per annum (for properties worth over £20 million), and CGT of 28% on gains at disposal. There is clearly a major incentive to avoid or reconsider the use of a corporate holding vehicle in these circumstances, and for existing owners to take advice on the potential benefit of "de-enveloping" their property before April 2013.

Obbard work closely with a number of legal/accountancy firms and can make recommendations and introductions accordingly to clients who believe these new changes will impact them.

Residential Stamp Duty Land Tax rates

Up to £125,000	zero
Over £125,000 to £250,000	1%
Over £250,000 to £500,000	3%
Over £500,000 to £1 million	4%
Over £1 million to £2 million	5%
Over £2 million	7%
*Over £2 million penalty rate	15%

(*Only applicable if purchased by certain categories of non-natural persons)

Annual residential property tax

Only applicable to properties held by certain categories of "non-natural" persons

Property value	Annual charge
£2m-£5m	£15,000
£5m-£10m	£35,000
£10m-£20m	£70,000
£20m+	£140,000

Source: HMRC

This week's headlines reporting record levels of sales at the newly released Battersea Power station scheme would appear to indicate that overseas, and local, appetites for residential investment property remains undented despite the changes above and concerns over targeted taxes on foreign owners. The Government has seemingly channelled investor's interests towards 'lower' value apartments preferring to be seen to attack the oligarchs in Knightsbridge. Typical prices for a one bedroom apartment along the south of the river in one of the numerous new schemes start from close to £500,000 which is around 14 times the average Londoner's salary. To achieve the promised 4% yields, an annual rent of £20,000 will be needed which would account for around 70% of post tax salary.

We will discuss more about the South of the river bubble in our next commentary.