TAXATION OF PROPERTY PARTNERSHIPS AND JOINT OWNERSHIP

2020/21

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PROPERTY

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Taxation Of Property Partnerships And Joint Ownership

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About Lee Sharpe

Lee is a creative Chartered Tax Adviser with more than 20 years' experience of advising property investors and family businesses on tax matters.

He is also an experienced tax writer. As well as writing for taxationweb.co.uk and Bloomsbury Professional, Lee is a lead writer for Property Tax Insider (taxinsider.co.uk) and its sister publications. He has written a number of specialist property tax saving reports that are available through the Tax Insider website.

About This Guide

This guide will focus on property businesses held by joint owners and partnerships. Generally speaking for co-owned Buy To Let property businesses, all partnership property is held jointly by its partners, but not all jointly-held property is in a property partnership. We shall consider this fundamental point in further detail, later in the report (see Partnerships and Capital Gains Tax, and Appendix A).

The report is intended for taxpayers and their advisers. To cover all of the idiosyncrasies of partnership tax law and practice would require a book instead of a mere report, but the report is intended to cover the key tax-centric issues that property business owners should be aware of and, perhaps most importantly, to have a sense of when it would be appropriate to take specialist advice.

Please note: at the time of writing, the respective tax rules for each part of the 'United' Kingdom are inexorably diverging, like tectonic plates. Readers must take particular care when contemplating transactions that may rest on different property or tax law, such as:

- in England and Wales, the law tends to look through the partnership as a 'transparent entity' and hold the individual partners to account; under Scottish law, however, partnerships have their own distinct legal personality; and
- the Scottish Land and Buildings Transaction Tax (LBTT), and the Welsh Land Transaction Tax (LTT), are now distinct from Stamp Duty Land Tax (SDLT). The regimes are, of course, almost identical, having common ancestry in SDLT, but differences are beginning to emerge in the finer detail, which one would do well not to get the wrong side of. For example, while Scotland also has the relatively new 4% SDLT surcharge for additional residential property purchases, it adopted an earlier draft of the new regime for its LBTT purposes, and there are several small differences as a result.
- The Scottish Income Tax regime has also moved a little away from the rest of the UK in terms of earnings and property income. So, for example, the Scottish Higher Rate starts for earnings over £43,430 in 2020/21, (and is chargeable at 41%), whereas it is £50,000 (and chargeable at 40%) elsewhere in the UK. We shall be using 'rest-of-UK rules, rates and thresholds' in this report, as follows for 2020/21:

	Band	Ceiling	Tax Rate on 'Ordinary' Income
Personal Allowance	£12,500	£12,500	0%
Basic Rate Band	£37,500	£50,000	20%
Higher Rate Band	£100,000	£150,000	40%
Additional Rate Band		£150,001+	45%

'Ordinary' income means income from earnings such as self-employment or salary, income from letting property and – for the most part – income from savings such as bank interest. Different rates apply to dividend income.

1 Why Bother With Joint Ownership?

Broadly speaking, a joint enterprise can involve numerous benefits, such as:

- Scalable investment / finance – the more investors who can join an enterprise, the larger or more valuable the property portfolio can be. Alternatively, having more investors means that each investor can reduce their personal investment exposure to an acceptable level of risk.
- Economies of scale – it should be possible to apply a cost-effective business model with decreasing marginal cost for additional properties; savings may also be made in the context of access to finance and to professional fees.
- Expertise – a business partner or joint investor with many years' experience in, say, student letting, may significantly improve the business' performance in that sector, to the benefit of all joint investors.

Unsurprisingly, this report will focus on the tax implications of 'lightening the tax load':

- Reduction in tax cost – last but by no means least, is that better use may be made of people's tax allowances and lower tax rate bands, if income is spread from one taxpayer to several. Of course, this is relevant mostly in the context of joint investment between close friends and family members, as per the following example:

Example 1: William And Kate

William and Kate, who are married to each other, each have their own profitable trading business and pay income tax at the higher rate of 40%. Kate is about to have their first baby and decides to put her business 'on hold' for a year. William thinks they should invest in a buy-to-let property which will yield £10,000 a year in net income after letting expenses.

If he invests on his own, William will pay £4,000 in tax and receive net only £6,000.

William on his own:

£10,000 @ 40% = £4,000 tax, i.e. £6,000 net income

If he and Kate invest jointly, then they will be taxed on £5,000 net rental profits each. William will again pay tax at 40% so he will pay £2,000 in tax and receive £3,000, net of tax.

But assuming Kate has no other income while her business is on hold, her tax-free personal allowance (£12,500 in 2020/21) will more than cover her half-share of the rental profits, so she will pay no tax and gets to keep all of her rental profit.

This means that investing together will net them £2,000 in tax savings:

	William	Kate	Total
Income	£5,000	£5,000	£10,000
Rate	40%	0%	
Tax	£2,000	£0	£2,000
Net	**£3,000**	**£5,000**	**£8,000**

As a couple, they have £8,000 net or £2,000 more than if William were to invest on his own.

Clearly, where one spouse pays tax at a higher rate than the other, putting income into the hands of the lower-paying spouse will benefit the couple overall.

Of course, if Kate were to invest on her own, then she would receive the full £10,000 net rental profit and utilise most of her £12,500 personal allowance, leaving no taxable income at all:

Kate	£
Income	10,000
Personal Allowance	(10,000)*
Taxable	£0
Rate	20%
Tax	£0
Net income	**£10,000**

**Restricted to no more than chargeable income*

Although an equal joint investment is significantly better than William 'going it alone', having Kate as sole investor reduces the tax bill to Nil, saving a further £2,000 in tax.

So, whoever, within a couple, owns the income-generating property, and therefore receives the income, has a potentially very significant effect on the tax that is due.

How net incomes may be distributed between spouses, etc., from one year to the next is also important: if, having enjoyed 100% of the income in Year 1, Kate returns to work in the following year as a solicitor earning £95,000 annually, then she would rather not risk losing her tax-free Personal Allowance (as the additional rental income would take her over £100,000 of adjusted net income, such that her Personal Allowance would start to be 'tapered off' at a rate of 50%, in accordance with ITA 2007 s 35 (2)). As a couple, Kate and William would probably prefer then to re-allocate the net rental income at least 50% in William's favour.

There are special tax rules for dealing with the allocation of income between spouses and civil partners, as we shall see later. We shall look at how incomes are allocated – and potentially re-allocated – amongst spouses, partners and joint owners more generally.

1.1 Tax Saving Through Joint Ownership – Summary Of Benefits

The precise saving potentially to be made will depend on the particular circumstances, **with due regard to adjustments for pension contributions,**

gift aid, and particular types of income and gains, but as a general rule, for 2020/21:

- Where a 40% taxpayer is able to share his or her income with another who has unused 20% Basic Rate band, then the overall tax saving can be as high as £7,500 for each additional joint owner (Basic Rate Band of £37,500 @ (40% - 20%)).
- Where a 40% taxpayer is able to share his or her income with another who has no other income at all, such that all of their tax-free Personal Allowance is also available, then the tax saving can be as high as £12,500 per additional joint owner – more in some cases.

Other factors potentially to consider where prospective joint owners are close family, etc:

Benefits entitlement – a person may lose entitlement to state benefits if his or her income increases (although several income benefits are assessed by reference to overall household income anyway, so the first investor's income may already be 'counted');

Student and Postgraduate Loan Repayments – a liability is triggered once income exceeds a certain threshold (£19,390 for 'Plan 1' loans in 2020/21; £21,000 for Postgraduate loans and £26,575 for 'Plan 2' loans) so receipt of additional income can trigger a loan repayment, while a fall in assessable income may reduce exposure – note that the Postgraduate Loan repayment can be *in addition* to any amount due for Student Loans, bringing the aggregate repayment rate to as much as 15%;

Capital Gains Tax – access to the lower rate(s) of CGT of 10% (18% where disposing of an interest in residential property) depends on the extent to which the taxpayer has unused Income Tax Basic Rate Band (TCGA 1992 s 4 *et seq.*);

Transferrable Marriage Allowance – the flexibility to transfer 'unused' Personal Allowance to one's spouse or civil partner may be forfeit if either the 'donor' or 'donee's' income is too high. But, in most circumstances, it will be at least as efficient for each taxpayer to keep and utilise their own Personal Allowance in full (ITA 20017 s 55B, 55C);

Access to the full £1,000 New 'Savings Allowance' – the effective 0% rate band attaching to any savings income above the Starting Rate for Savings falls from £1,000 to £500 when the taxpayer has 'higher rate income' (ITA 2007 s 12A, 12B);

High Income Child Benefit Charge/Clawback – where 'Adjusted Net Income' (ANI) exceeds £50,000 then any Child Benefit must be repaid at a rate of 0.01% for every £1 by which ANI exceeds £50,000, such that once ANI reaches £60,000, all Child Benefit must be repaid. The liability falls on whoever is the higher earner in a couple looking after eligible children, so where both taxpayers are exposed, balancing ANI between the two taxpayers may retain the most Child Benefit and therefore prove most efficient (ITEPA 2003 s681B – H);

Loss of tax-free Personal Allowance – as mentioned in the above example, the Personal Allowance which for most people means that the first £12,500 of income is tax-free, is tapered away at a rate of

£1 for every £2 of 'Adjusted Net Income' exceeding £100,000 (ITA 2007 s 35);

Access to 'Tax-Free' Childcare – also, where either parent in a family has 'Adjusted Net Income' in excess of £100,000, the new regime of childcare 'tax breaks' will not be available (the limit has been temporarily raised for 'critical workers' such as doctors during the current pandemic);

Proximity to Additional Rate Threshold – where income is taxed at 45%, generally for adjusted income exceeding £150,000 (ITA 2007 s 10);

Access to the reduced £500 New 'Savings Allowance' – reduced to nil where the taxpayer has 'additional-rate income' (ITA 2007 s 12A, 12B); and

Restriction of the Pension Annual Allowance – tax relief for pension contributions is restricted by clawback where contributions exceed the taxpayer's Annual Allowance; the standard Annual Allowance is £40,000 but is tapered at a rate of 50% where 'adjusted income' exceeds £240,000 (£150,000 in years prior to 2020/21). Note that 'adjusted income' includes rental income and does not comprise only the 'relevant earnings' that are required in order to make pension contributions in the first place (FA 2004 s 228ZA).

Access to losses, additional CGT Annual Exemptions, and exposure to the 3% SDLT surcharge for additional residential properties may also be relevant for joint owners.

Finance Cost Restriction for Joint Residential Investors (including Partnerships) – The impact of the restriction of tax relief for interest and affiliated costs for those letting residential property will also affect the business model, but merits special consideration. The new regime does not 'care' whether the property is let in sole names, joint names, or as a 'full' partnership since it applies to all entities that are subject to Income Tax. (ITA 2007 s 272A *et seq.*)

The basic mechanism for individuals is that their (respective shares of) finance costs are disallowed, but they will get a corresponding 20% Basic Rate tax 'credit' to offset against their eventual tax bill. In theory, this means that only 40% Higher Rate taxpayers and above will be affected, **but those BTL investors who are currently 'only' 20% Basic Rate taxpayers should <u>not</u> assume that they will escape the new regime:** many such taxpayers will end up as 40% Higher Rate taxpayers because of the way that the system works, as per the following example:

Example 2: Harry And Meghan

Harry has a paid employment earning £30,000 a year, together with rental income from a BTL property portfolio generating £15,000 net income after all expenses, including mortgage interest of £20,000. Let's assume that his income and expenses stay conveniently static for several years. The new regime has progressively disallowed interest in four equal tranches from 2017/18 through to 2020/21, as follows:

£5,000 disallowed in 2017/18 but a tax 'credit' of £1,000 to offset against his actual tax bill.