PROPERTY TAX PLANNING – THE FUTURE IS CAPITAL AND LOANS

by Patrick Soares

“Capital Fees” for Developers

The rate of tax on income profits in the hands of individuals and trustees is 40% and going up next year to 50%. There is an unmistakable clear trend in property transactions for individuals (through LLPs) and trustees to make capital profits where the tax rate is 18%.

An investor who is employing a developer to provide him with development services may well pay him a fee in the form of a land interest. The value of that interest would be chargeable to income tax. However, if the land interest is paid over in return for the services at a time when the interest has a low value, then the amount of that charge to income tax will be low and the future growth in the property assuming, it is held as a capital asset by the developer, will (depending on all the facts of the case) only bear tax at 18%.

These structures are based on (inter alia) the House of Lords’ decision of *Abbott v Philbin* 39 TC 82 where an option to buy shares was given to an employee who was taxed on the value of that option but not taxed on the growth in the value of the option: the profit made on the exercise of the option, which arose from that growth, was thus free of income tax. The growth did not derive from the employment but from the exercise of the option. It seems that the same argument would apply if an interest in land were given ab initio as the fee, even though the developer would be working on that land pursuant to the contractual obligations he entered into with the investment landowner.

Accountancy advice would have to be obtained as many of the key tax questions in these areas are determined by what is commonly accepted accountancy practice.

It is not too dissimilar from situations where an accountant may take on a new client and agree not to charge for tax and other advice in connection with the earlier years of the venture when the client is cash starved and takes instead a small shareholding in the company. If ultimately it is proved successful and the company is sold the accountant should make a capital profit taxable only at 18%.

“Cheap Loans”

The other area of planning concerns loans.

If a company makes a loan to an employee, who is not a shareholder in the company or connected to a shareholder, the annual income tax payable, charge on present rates, on the benefit of that loan, is a mere 1.9%. Note there is also an annual NIC on present rates on the benefit of the loan of .608%.

If shareholders want to receive loans, it may be necessary for the company to settle monies into an employee benefit trust which then makes the loan.

Inheritance tax has to be taken into consideration but in many cases one should be in a position to rely on the exemption in IHTA 1984 s.10. See *Postlethwaite's Executors v HMRC* (2007) STC (SCD) 83 but note the recent HMRC statement of 12th August 2009 (designed to spoil some taxpayers' summer holidays) entitled "HMRC's view on the IHT position in relation to Contributions to an EBT".

Conclusion

The trend is to think capital but if you must think income then think in terms of making loans.