

BUY-TO-LET INVESTORS GET £4bn TAX BOOST

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Savers are expected to stockpile up to £11 billion in their pension funds over the coming months, ready to buy property when new tax perks come into force next year.

From April 2006, investors will be able to buy residential property, such as holiday homes and buy-to-lets, with a personal pension. The property would therefore be free from tax on rental income and capital gains. You will be able to put both new and existing properties in a pension.

Ros Altmann, an independent adviser to Downing Street, said: "This is the biggest tax giveaway for higher earners that I have ever seen. Frankly, I find the proposals astonishing from a Labour government."

Savers who contribute to their pension schemes in order to buy property will get tax relief on the money. The government pays 22p for every 78p that you invest, taking the total contribution to 100p. Higher-rate taxpayers get a further 18p through their tax return. So someone who wants to purchase a £100,000 property would need to contribute only £78,000. Higher-rate taxpayers would get a further hand-out of £18,000.

Labour would pay more than £4 billion in higher-rate tax relief if investors contributed £11 billion to pensions.

Once a buy-to-let or holiday home is in your pension, the rent will have to be reinvested in the fund and used to pay off any mortgage, but it will be free from income tax at 40%, assuming you are a higher-rate taxpayer. Any capital gains when you sell will also escape tax.

The perks could almost double returns from buy-to-lets, according to Savills, a property firm. Someone who bought a £150,000 property outside a pension with a 50% mortgage and sold it 10 years later might net a profit of about £75,000. The figures assume that any surplus rent after tax and mortgage interest is used to clear the debt and that house prices grow by 4.5% a year.

If the property were held within a pension, however, the tax breaks would boost your profit to about £140,000.

However, you will not be able to access the cash until the age of 50, rising to 55 from 2010, when you can take 25% of your pension fund as a tax-free lump sum and use the rest to provide a taxable income. You will be able to continue working even after taking the benefits.

Experts say investors are already boosting pension contributions to take advantage of the new rules. Pension schemes will be able to borrow only 50% of the value of their existing assets to buy property, so you would need a fund of £100,000 to buy a typical property worth £150,000 in April 2006.

Trevor Abrahamsohn of Glentree International, an estate agent, said: "Clients are already putting money in pension funds and keeping it in cash. The new rules will unleash a wall of money into the residential property market."

Investors will typically use self-invested personal pensions (Sipps) to buy property. People who already have standard personal pensions - about 6m - can switch to a Sipp at any time.

Another 10m people in occupational pensions cannot currently take out Sipps alongside their company schemes, but this rule will be lifted from April 2006. If they want to build up their pension contributions in the meantime, they could take out a free-standing additional voluntary contribution scheme and switch into a Sipp next year.

John Lawson of Standard Life, the insurer, estimates that savers will use a combination of existing pension assets and new contributions to purchase buy-to-let properties worth between £7 billion and £11 billion from April 2006 - or 10% to 15% of the current market.

Millions of pounds more could flood into the market from new purchases. Abrahamsohn said: "This can only serve to increase demand and push up prices."

The government's new rules could even help the housing market to avoid a severe downturn. Last week, Halifax said prices rose by 1.1% in December after two months of falls. However, it expects house prices to slip by 2% this year; other economists are predicting falls of up to 15%.

Even if the new rules prop up prices, however, most economists expect house-price growth to be lacklustre at best over the next few years. This has raised fears that some pension savers could be disappointed with the returns from buy-to-let.

Andy Bell of AJ Bell, a Sipp firm, said: "There is a danger that inexperienced investors could be getting sucked into the property market at precisely the wrong time and be left with all their eggs in one basket."

Alternatively, savers could buy holiday homes abroad with their pension funds - although they would have to pay rent to their scheme when they used the property and they might be taxed in the foreign country.

Steve Bee of Scottish Life, a pensions firm, said: "Millions of well-heeled people in company schemes will now be able to set up a Sipp to invest in a much broader range of assets, including their gite in France."

How you can take advantage

EXPERTS say the new pension rules will boost profits for property investors. We show you how to take advantage.

What property will I be able to buy with my pension fund?

The government will allow your main residence, holiday home or buy-to-let to be held within a pension fund from April 2006.

However, you cannot simply transfer an existing property into your fund; the scheme will have to buy it. If you sell a holiday home or a buy-to-let to your scheme, you will have to pay capital-gains tax on any profits.

Savers are unlikely to sell their main residence to their pension because they would have to pay rent to the scheme. But the advantage is that they would release cash from their fund.

Your pension will have to pay stamp duty on any property purchases.

How would it work?

Suppose you wanted to buy a £150,000 property with your pension. You could make a contribution costing £60,000, which would be boosted to £100,000 by higher-rate tax relief. The pension could then borrow 50% under the government's rules — half of the value of your fund.

In reality, contributions are limited to a proportion of your earnings, although this restriction will be lifted next year. From April 2006, you will be able to contribute your entire earnings, up to a maximum of £215,000 a year and a lifetime limit of £1.5m.

Once the property is within the fund, any surplus rental income after mortgage interest is free from 40% tax. Any profits when you sell will also be free from tax.

Suppose the value of your property grows by 4.5% a year and is worth £232,945 after 10

years. You sell the property and the profit — £82,945 — is free from capital-gains tax. Outside a pension, the gain would be subject to tax at 18%.

Your profit would be £140,000, according to Savills, a property firm, compared with £75,000 outside the pension.

Do I have to sell when I retire?

No, but you may want to if you need your fund to produce an income. The income would be subject to tax.

If you do not need to sell the property for income and you hold it within a so-called "family Sipp", the property could pass to other members of the pension when you die — including your heirs.

This will apply even after the age of 75 because the government will no longer require you to buy an annuity, subject to some restrictions. At present, the transfer to your heirs would

be free from inheritance tax. But Labour is expected to clamp down on this perk.

Can I start making contributions now?

Experts suggest you start contributing as soon as possible to build up a big enough fund. Suppose you are 40 years old, earning £55,000 and you have a personal pension of £50,000.

You could pay £11,000 into your pension this year and next. If you made no payments in 2003-4, you could use the "carry back" regime to make a further contribution of £11,000 now as though it had been made last year.

In April 2006, you could make a final contribution of £17,000. Your fund would be worth £100,000, enabling you to borrow another £50,000 — enough for the average property.

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