Summer 2011

Property Agent Matters

Opening the doors to future prosperity

Virtual Reality

Is it time to lose the high street office?

I hope you have all had a good summer and many of you managed to get away for a couple of weeks and recharge your batteries. The summer months are normally quiet for agents, but is often a time when potential movers are sitting at home with the children, whilst they are on school holidays, bemoaning about the lack of space and logging on to Rightmove (or other similar portals!) to check out their options. This could well explain the increase in activity between September and Christmas. Let's hope that happens again this year.

It can also be a reflective time for agents. Sunbathing with a Pina Colada in hand, thinking about their business and the ways of both reducing costs and increasing profits.

Other than staff, what would be one of your biggest costs? More than likely the answer is property. Not just the rent (or mortgage interest) but light and heat, rates, repairs and maintenance; the list goes on.

It is, perhaps, no surprise, therefore, that a lot of new agents starting up have no high street presence at all. They are the new breed of agent, and they are purely virtual.

When I talk to my agent clients and ask them what percentage of new leads come from the internet as opposed to footfall, the normal response is about 99% internet. With that sort of statistic, it does make you wonder about the need for offices.

Granted, it does show that you mean business by having an office; you look professional; you can showcase the properties in your window, but these come at a price, and I really do question whether it is these things that get you new instructions, or is it your reputation for good service? Maybe it is based on the number of signboards up in that area (certainly the number of "Sold" signs helps!), but I am not convinced that the office has much, if anything, to do with it.

Of course, it is much easier for a new agent to set up from scratch without a high street presence, it takes a much braver agent to come away from the high street, when competitors may try to use it to their advantage. However, with those new virtual agents building up their reputation for good quality service, and with a lower cost base, they can be keener on commission rates. As a result, it would be no surprise if they increase their market share, which may force agents with offices to rethink their strategy.

I do believe that offices will be in the minority in, perhaps, ten years time; so if you haven't thought about it yet, perhaps you should. If you are thinking about opening another office in a different area, would the money be better spent taking out advertising hoardings confirming you service that area? At least that way you are not tied into a lease, or commitment to incur capital costs to fit out the office.

Virtual is already reality; you really need to plan to avoid being left behind.

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The Property Ownership Conundrum

As people involved in the property market you may have already invested in property, or are currently considering it. One of the questions I get asked quite a lot is, "How should I hold the property - in a company, personally, or something else?"

Unfortunately, my answer is always the same - it depends! There really is no "one size fits all" answer and there needs to be some number crunching carried out to decide on the most tax efficient route.

Let's consider the situation on a disposal for a gain of £100,000. If you hold it personally, the situation is relatively straightforward. Ignoring annual exemptions and assuming you are a higher rate taxpayer, any gain is taxed at 28%. So, on my £100,000 gain, the individual is left with £72,000.

What about for a company? Well, if we assume the company pays the small rate of 20%, this leaves £80,000 in the company. This may, at first glance, seem a better result than personal ownership, but we are not comparing like with like. With personal ownership, the cash rests with the individual. With company ownership, the cash is locked in the company, unless it is distributed.

There are two ways to distribute the cash tax efficiently, dividends or through a capital distribution on liquidation.

With dividends, a higher rate taxpayer will pay an effective rate of 25%. If their taxable income exceeds £150,000, the effective rate becomes 36.1%. Table A below shows the net cash position depending on the individual's marginal rate of tax.

As can be seen, personal ownership provides the best result. What about distribution through a liquidation of the company? In that scenario, it is hard to see the company qualifying for Entrepreneurs' Relief as it is unlikely to meet the qualifying conditions. This leaves us with the situation that, either basic rate capital gains tax is paid at 18% (unlikely unless numerous shareholders) or, more realistically, the higher rate of 28% is payable. The results are shown in Table B.

Again, personal ownership comes out on top.

This is not, however, the end of the story. If debt is being taken on to purchase the property, you need to consider the repayment of that debt. The capital is not tax deductible so the more post tax cash you have available, the quicker you can repay the debt.

It is, perhaps, not surprising that, given the income tax rates of 20%, 40%, 60% (between £100,000 and £114,950 due to the erosion of personal allowances) and 50%, the corporation tax rate for small companies of 20% represents a much cheaper option and the ability to repay debt far sooner from the same level of rental income.

Still, we haven't reached the end of the story, what about pensions? Of course, there are some restrictions on what pensions can hold (residential property is not allowed), but commercial property can be held.

The benefit of the pension holding property is that any income it receives and capital gains it makes are within a tax free environment, which is excellent news and represents far better tax efficiency than personal or corporate ownership. However, there are drawbacks.

Firstly, debt can only be raised equivalent to 50% of the pension's value. You may be able to raise more personally or in the company.

Secondly, the cash is still locked in the pension. You can obtain a 25% tax free lump sum, but the remaining 75% would be subject to Income Tax at one of the rates referred to above. This gives effective tax rates of 15%, 30%, 45% and 37.5%. Compared to the Capital Gains Tax rate, only the 15% is favourable, but compared to income tax rates, the pension offers some savings.

I hate confusing things, I would far rather be able to give you a simple answer but each situation needs to be considered to assess the best structure. Despite HMRC's slogan of "tax doesn't have to be taxing", nothing, unfortunately, could be further from the truth with property ownership!

For more information, please get in touch using the contact details below.

Table A	Personal	Company and 25%	Company and 36.1%
Gain	£100,000	£100,000	£100,000
Corporation Tax	£0	(£20,000)	(£20,000)
Income Tax		(£20,000)	(£28,889)
Capital Gains Tax	(£28,000)	£0	£0
Cash in hand	£72,000	£60,000	£51,111

Table B	Personal	Company and 18%	Company and 28%
Gain	£100,000	£100,000	£100,000
Corporation Tax	£0	(£20,000)	(£20,000)
Capital Gains Tax	(£28,000)	(£14,400)	(£22,400)
Cash in hand	£72,000	£65,600	£57,600

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