Property development – are you trading?

For many, buying a property, doing it up and selling it for a profit is an attractive proposition. However, it will not always be clearcut when the line between simply investing in property and trading is crossed. From a tax perspective, the distinction is important as the tax consequences are not the same.

Which tax?

Assuming the goal of selling the property for more than it cost to buy and do up is realised, for tax purposes, it is important to determine whether that surplus is a chargeable gain liable to capital gains tax or a trading profit liable to income tax.

A gain in an investment property is taxed as chargeable gain (and conversely, if the property market fell and the property was sold at a loss, the loss would be an allowable loss). To the extent that it would remain available, any gains in excess of the annual exempt amount would be charged at the residential property rates of capital gains tax, which for 2017/18 are 18% where the taxpayer is a basic rate taxpayer and 28% where the taxpayer is a higher or additional rate taxpayer.

By contrast, a property developer who is trading and running an unincorporated business would be taxed at his or her marginal rate of tax once the personal allowance has been utilised – 20% for a basic rate taxpayer, 40% for a higher rate taxpayer and 45% for an additional rate taxpayer.

Investment vs trading – a question of intention

The starting point for determining whether the taxpayer is investing in property or trading is the original intention when buying the property.

Scenario 1

Ben buys a run-down property as a long-term investment with a view to doing it up and then renting it out. Following a change in his personal circumstances, he sells the property shortly after completing the renovations, realising a gain of £30,000. His intention was to hold the property as an investment and this has not changed as a result of the sale. The gain is, therefore, chargeable to capital gains tax.

Scenario 2

Bill also buys a run-down property, but he sees it as an opportunity to make a quick profit. He renovates the property and sells it once the renovations are complete. He makes a profit of £30,000 which he invests in another property that he also does up and sells, this time realising a profit of £50,000.

Unlike Ben, Bill is trading. His intention is to buy and sell property to make a profit. The profit is charged to income tax as trading income.

Determining intention will not always be clear cut. HMRC will consider factors such as how long the taxpayer owned the property, whether the sale and purchase is a one-off or one of series of transactions, whether the property has been rented out, whether it was acquired for personal enjoyment and whether there is a connection with the existing trade. This will provide a picture that determines whether the taxpayer is investing in or trading in property.

To ensure that the unwary do not get caught by unintended tax consequences, the question of whether the taxpayer is making an investment or trading should be determined at the outset.