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Accounting & Tax Advisory Services

Buy-to-let property market company ownership.

A series of recent tax changes have been introduced which will have a significant impact on buy-to-let (BTL) landlords over the short term:

- Tax relief for interest payments against rental income to be restricted to basic rate deduction
- Wear and tear allowance to be replaced with a deduction for capital expenditure incurred
- Additional 3% Stamp Duty Land Tax on acquisition
- Retention of the 28% CGT rate on residential property gains

Personal ownership may not be the most tax efficient way to hold BTL properties.

Company ownership offers additional advantages:

1. Corporate tax rates reducing to 19% (2017) and 17% (2020) with further possible reductions
2. Full interest relief
3. Flexibility of extraction of surpluses to spouses / adult children
4. Indexation allowance on corporate gains (deduction for inflation)
5. Better governance
6. Limited liability

Taxation of residential property comes in many forms

- Income Tax
- Corporation Tax
- Capital Gains Tax
- SDLT
- ATED
- VAT

UK tax type	Individual 2016/17	Partnership/LLP 2016/17	Company
Tax on income	From 20-45%	From 20-45%	20% (reducing to 17% from 2020)
Tax on sale	18/28%	18/28%	20% (28% on ATED related gains)
Tax on extraction	N/A	N/A	7.5%-38.1%
Other considerations	May be easier to finance property purchases	Flexible allocation of profits	ATED may apply. Double tax charge on extraction

Case study 1

Individual A is a higher rate tax payer with a portfolio of 15 BTLs which are valued at £3million, funded by 80% debt.

Under the new rules being phased in for interest deductibility, Individual A will have a further tax cost equal to 10% of the interest payments made to the lender. For highly geared portfolios this is likely to result in a cash negative position annually until the debt is paid down.

Case study 2

In contrast, Individual B owns shares in Company A which holds the same portfolio of properties.

The interest will continue to be deductible and the exposed surplus income is taxed at 20% rather than 40-45%. A further tax point is only triggered if cash is extracted and only on the extracted amount.

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Why structure makes a difference to your returns

Many residential property landlords, or so-called BTL landlords are starting to question the fairness or otherwise of the UK tax system.

A series of recently introduced tax changes will have a significant impact on BTL landlords over the short term. This has put how BTL landlords structure their property portfolios under the spotlight.

Generally BTL landlords are not the profit obsessed capitalists intent on squeezing out first time buyers and owner-occupiers as some politicians and journalists would like to lead us to believe.

The reality for many is that they have become BTL landlords by chance rather than by design. It may be they've retained a flat when buying a new home. Or it could be they've inherited a property and chosen to retain it and let it out.

Many BTL landlords will not have considered how they hold their interests in property. Owning the property personally is simple, it requires a minimum fuss and often banks are more amenable to lending to individuals, rather than companies. So why use a company?

The problem with personal ownership is that for many it isn't very tax efficient, which means the post-tax returns on investments are lower.

Income Tax on rental profits can be anything up to 45%, whereas a company currently pays Corporation Tax at 20% (reducing progressively to 17% over the next four years). So if the rental profits are not needed to live on or they are being used to repay loan capital, a company starts to look attractive. Add to this that from 2017 loan interest will be restricted for Income Tax, but not Corporation Tax, and the use of a company looks more compelling.

When residential properties are sold, individuals pay Capital Gains Tax ('CGT') at up to 28%, whereas on residential property gains, other than in limited circumstances, companies pay Corporation Tax at the lower rates detailed above. In addition companies are often taxed on a lower gain because they can claim an inflation allowance (known as indexation).

So on tax rates alone a company starts to look like the preferred option compared to personal ownership. Company structures tend to lend themselves to better governance, which is no bad thing as portfolios grow.

The use of a corporate structure is designed to enable participation of a wider range of investors as shareholders, rather than having a direct interest in the properties. This also assists in Inheritance Tax planning making it easier to pass assets to the next generation without having to transfer the property. For BTL landlords, with adult children say, it may be appropriate to introduce them as minority shareholders. Or, with generous grandparents, grandchildren can be made shareholders and dividends paid to them to fund school fees or other expenses, rather than grandparents paying out their taxed revenue. Dividends can also be paid to the wider family group, which is likely to improve overall tax efficiency.

So, in summary, prospective and existing BTL landlords should be considering their ownership structure when purchasing properties.

For those BTL landlords who own portfolios personally they may be wondering how these could be moved into a company. This is possible, but for those who are inadequately or poorly advised the risks of triggering CGT and Stamp Duty Land Tax ('SDLT') liabilities could be high with no cash to settle them.

Our property tax team at Price Bailey is very experienced in this area and have successfully assisted clients reorganise BTL landlord property portfolios without incurring these 'dry' CGT and SDLT charges.

For a free initial review of your property portfolio, please

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