MORTGAGES

# BUY TO LET OWNERSHIP OPTIONS


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# Should the property be owned personally or through a limited company?

**There is no simple answer to this question. It depends on a number of factors such as how many properties you hold, whether you need the income quickly and how long you want to hold the properties for. It therefore depends on your individual circumstances.**

**Why do I read in the press that lots of landlords are using companies for Buy To Lets (BTL)?**

The main reason that companies are currently being promoted as the way forward for owning BTL properties is due to the mortgage interest relief restriction that came in for personal ownership from 5th April 2017.

Prior to April 2017, income tax was payable on your net rental income after deducting allowable expenses including mortgage interest. This meant that landlords paying higher (40%) or additional (45%) rate income tax could claim tax relief at their highest rate.

However, from April 2020 tax relief can only be reclaimed at the basic rate of income tax (20%), whatever rate of tax the landlord pays. The rules are being phased in over 4 years commencing April 2017.

Companies are not affected by this restriction, so on the face of it they appear advantageous. However we need to look at what types of tax a company pays.

# Corporation tax

**A company is a separate legal entity distinct from its owners so pays corporation tax instead of income tax.**

Companies currently pay corporation tax at 19% on its profits whatever its level of profits – (income tax for individuals is 20%, 40% or 45% depending on the individuals level of income).

The corporation tax rate reduced to 19% from the 1st of April 2017, and will reduce to 17% from 1st April 2020.

On the face of it, a company would get full relief for the actual mortgage interest paid as well as paying corporation tax at a much lower rate than higher rate income tax payers. But the net income belongs to the company and not the individual at this point (see page 9).

Corporation tax years run from 1st April to 31 March so if your year end is for example 31 December you will have 9 months taxed at one rate and 3 months taxed at another rate while the rates are reducing.

Corporation tax is payable 9 months and 1 day after the year end if the company is deemed 'small' otherwise the tax is payable in 4 quarterly instalments starting 6 months after the year starts.

This means that tax payments will have to be estimated with the risk of incurring penalties and interest if tax is underpaid. The definition of a small company can be found on the Gov.uk website.

A corporation tax return will need to be filed electronically with HMRC together with a full set of company accounts within 12 months of the year end.



# Capital disposals

## So what happens when a BTL property is sold?

Companies do not pay capital gains tax, they only pay corporation tax, so gains are taxed at 19%.

Individuals pay capital gains tax on BTL properties at 28% or 18% depending on their levels of income.

Unlike individuals, companies do not have an annual allowance for capital gains tax. They do however have something called indexation allowance which you can claim from day of purchase to day of sale. This can help reduce any gain if the asset is held for a long period of time.

If a loss is made on a capital disposal then it belongs to the company and can be offset against future years, as long as the rental business continues in the company.

From 1st January 2018 indexation has been fixed using the December 2017 rate, effectively removing any further indexation after 31st December 2017. This measure was announced in the 2017 Autumn budget.

So based on your individual circumstances and the amount of potential gain, you may pay less tax as an individual as a result of using your annual CGT allowance.



**For example**

A BTL property sold with a capital gain of £30,000.

| Gain on sale of £30,000 | Company | Individual at basic rate | Individual at higher rate |
|---|---|---|---|
| Corporation Tax at 19% | £5,700 | | |
| Capital gains Tax at 18%/28% after annual allowance of £11,300 | | £3,366 | £5,236 |

So in this example both a lower and higher rate payer is better off holding the property privately as an individual. But what about a larger gain?

| Gain on sale of £150,000 | Company | Individual at basic rate | Individual at higher rate |
|---|---|---|---|
| Corporation Tax at 19% | £28,500 | | |
| Capital gains Tax at 18%/28% after annual allowance of £11,300 | | n/a as gain pushes into higher tax bracket | £38,836 |

In this example the company will pay a lower level of tax.

## How do I get money out of the company?

Although on the face of it a company appears to pay less tax on the income and potentially less tax on capital gains, the net income (the cash) belongs to the company and not the individual.

If the individual needs access to the cash then they need to get it out of the company.

Getting cash out of the company also has tax consequences which can negate any benefit of putting the BTL properties in the company.

To get the cash out companies can either pay dividends to shareholders or salary to staff/directors.

## Dividends

**These are payments to shareholders based on the number of shares they hold in the company. The dividend is paid after corporation tax has been deducted.**

The company will pay no further tax on a dividend made, however, they are taxable in the hands of the recipient shareholder.

From April 2016 dividend tax changed so as:

- All individuals can receive £5000 of dividend tax free each year, reducing to £2000 from April 2018.
- There are three dividend tax bands: 7.5%, 32.5% and 38.1%

This means that for a shareholder who receives £10,000 dividend who is a basic rate taxpayer will pay 7.5% on £5000, 32.5% if they are higher rate and 38.1% for additional rate.

For example. If my BTL properties generated £30,000 net income and I was a higher rate tax payer and took the cash out via dividends currently benefiting from £5000 allowance.

| £30,000 net income | Company | Individual (higher rate) |
|---|---|---|
| Corporation Tax at 19% | £5,700 | |
| Dividend paid | £24,300 | |
| Income tax at 32.5% after £5,000 annual allowance | £6,272.50 | |
| Income tax at 40% | | £12,000 |
| Net cash to individual | £18,027.50 | £18,000 |

In this example company ownership is slightly more advantageous. However, with full relief in the company for mortgage interest payments then the net income in the company may be higher and therefore the net cash out may be even higher in the company.



## Salary

**The alternative way of extracting cash from a company is to take a salary. Taking salary out of a company means that you will have to register for PAYE for employers.**

This means that you will have to deduct tax and national insurance and pay it over on a monthly basis to HMRC. It will also involve operating the new Real Time Information system (RTI) which involves sending electronic data to HMRC every month on or before you pay your employees. Employers also have to pay Employers National Insurance which is 13.8% on any earnings currently over £680 per month.

For a higher rate tax payer, any income would be taxed at 40% and they would also pay employees NI. In addition, the company would bear employers NI at 13.8%. This can make it an expensive way of extracting cash from a company.

## Other non tax considerations for owning BTL properties in a company

Accounts will have to be filed with companies house within 9 months of the year end (6 months if the company is a plc rather than a private limited). An annual return will also have to be completed each year and filed at Companies House, with penalties if the deadlines are not met.

The company may also need an audit if it does not meet the definition of small company as per the gov.uk website.

This will involve paying for a qualified firm of auditors to review the books and records and determine whether the accounts are a true representation of the company's finances.

## What happens if I want to sell the company?

**Company rental property businesses are currently not automatically deemed as trading for tax purposes so may not qualify for certain trading company reliefs.**

The reliefs of note that this could affect are:

- Entrepreneurs relief - this can reduce Capital gains tax payable on the sale of shares in a company.
- Rollover relief is not available – this means you cannot carry the gain forward and deduct it from the base costs of any new assets when bought within 3 years or 12 months before selling the assets whose gain you want to roll over.

The test HMRC seem to use is how active you are day-to-day in the property business. However the case law is not clear on what tests you need to pass to ensure it is a trading business and not an investment company.

If you wish to think about claiming reliefs for trading companies you must obtain professional advice to ensure your particular circumstances may be considered trading.

## Family members

There may be some scope for giving shares in the company to family members to utilise annual exemptions and basic rate bands but these can be subject to capital gains tax and inheritance tax issues.

Potentially these are exempt transfers but independent tax advice should be sought before taking any such action.

This will also require the lender's consent, which could affect your ability to do this.



## I already own a property. Can I transfer it to a company I have set up?

**Any transfer will be deemed to be at market value at the time of the transfer so capital gains tax may be payable at the time of the transfer.**

For example: A property originally costing £175,000 is transferred to a company at a market value of £250,000 crystallising a gain of £75,000.

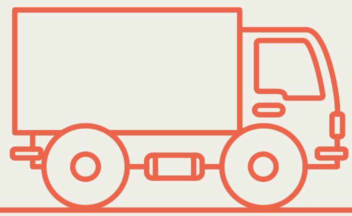
| Gain of £75,000 | Tax payable | |
|---|---|---|
| CGT at 28% | £17,892 | After annual allowance |
| Stamp duty payable | £10,000 | Payable immediately |
| Total tax payable | £27,892 | |

**This example also assumes the following:**
The individual is a higher rate taxpayer;
And that the property has never been the owner's main residence.

Both these charges will be a one off but need to be factored into the savings being made by changing to a company.

Please note the new lower rate of capital gains tax introduced in April 2016 does not apply to residential property.

Early repayment charges on current mortgages may also apply, as any mortgages will have to be taken out in the company's name rather than the individual.





## Summary

**Careful planning is therefore required as the initial cost in transferring BTL property to a company may outweigh any benefits in the short term. The mortgage interest restriction is taking 4 years to reduce to basic rate tax relief only, so landlords do have time to plan.**

New BTL property purchases might, however, be more beneficial for tax purposes to be put straight into a company if the plan is to hold the property for the long term.

If the rental income is required for day-to-day living then you will need to consider how the income will be extracted from the company, because it may negate some or all of the tax savings you made by putting the BTL property into a company in the first place.

It is therefore essential that tax advice is sought before rushing into setting up a property company.

Get in touch and we'd be happy to help with
expert buy to let mortgage advice.

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