

Tax structures for property landlords

The period since 2010 has seen a reduction in corporation tax rates coupled with higher rates of income tax than had prevailed previously. Further, in the aftermath of the financial crash of 2007 and 2008, whilst interest rates have remained at historically low levels, the appetite of many lenders towards the buy-to-let market has been at best mixed, with many lenders looking to exit the market.

Unwelcome attention to the buy to let market by George Osborne started exacerbated matters: The announcement of the phased reduction in interest relief to a 20% tax credit rather than a full deduction gives reason for buy-to-let owners to look at how they own their properties.

Buy-to-let ownership: personal or company?

Many property investors are considering transferring these property businesses to a Limited Company. At a glance, some of the differences between ownership as an individual or via a company for tax purposes are summarised in the table opposite.

Why bother to incorporate?

The mortgage interest relief rules, low rates of corporation tax and ability to carry out effective succession planning if properties are held through a corporate structure make incorporation potentially more attractive in the current climate.

The decision as to whether to incorporate needs to be considered seriously, however, regard must be had to the issues that may act as a bar or contra indication to incorporation.

Commercial factors

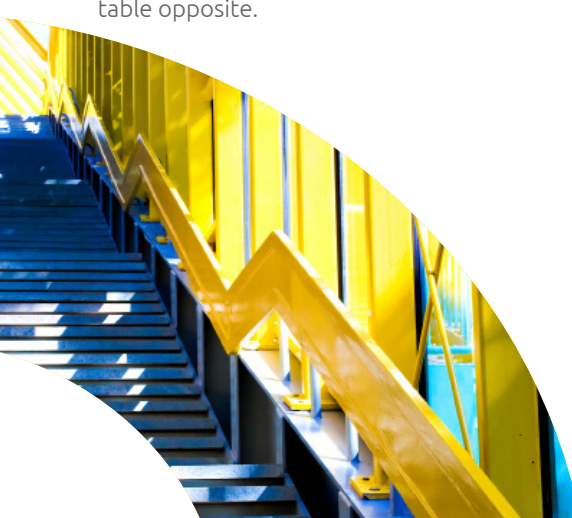
- The regulatory compliance burden on a company is greater than for personal ownership.
- Legal costs will be incurred in respect of the transfer of the properties.
- Existing loans secured against property may well be on terms that would not be replicated post incorporation.

Taxation factors

- Capital gains tax in respect of the transfer of the properties, unless you qualify for incorporation relief.
- SDLT on the transfer of the properties to the company - the basic position is that a transfer to a company is treated as a sale at full value for SDLT purposes. This position can be relieved where the transfer is from a partnership to a company under the ownership of the partners.
- One way street - whilst it may be possible to plan matters so that incorporation of a property portfolio is possible without CGT or SDLT cost, it must be understood that reversing the process i.e. reverting to personal ownership of those properties is unlikely to be possible without, making you a hostage to fortune regarding the future of the tax system.

Notwithstanding the constraints, it may well be that incorporation of a property portfolio is something that should be considered and actioned.

Let us now look at some comparisons...



	Held personally	Held through company															
Computation of profits	<p>Mortgage interest tax relief is gradually being withdrawn from April 2017 as follows:</p> <table border="1"> <thead> <tr> <th>Year</th> <th>% of costs deducted profits</th> <th>% of costs available as a basic rate deduction</th> </tr> </thead> <tbody> <tr> <td>2017/18</td> <td>75%</td> <td>25%</td> </tr> <tr> <td>2018/19</td> <td>50%</td> <td>50%</td> </tr> <tr> <td>2019/20</td> <td>25%</td> <td>75%</td> </tr> <tr> <td>2020/21</td> <td>-</td> <td>100%</td> </tr> </tbody> </table>	Year	% of costs deducted profits	% of costs available as a basic rate deduction	2017/18	75%	25%	2018/19	50%	50%	2019/20	25%	75%	2020/21	-	100%	Mortgage interest fully tax deductible
Year	% of costs deducted profits	% of costs available as a basic rate deduction															
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Tax	<p>Income Tax Taxed on profits at marginal tax rate (up to 45%), regardless of when the money is withdrawn from the business.</p>	<p>Corporation Tax</p> <ul style="list-style-type: none"> Letting is a business for corporation tax purposes. Profits and gains on disposal are taxed at 19%. <p><i>Profits must then be extracted – liable to income tax in hands of shareholders</i></p> <p>Income tax</p> <ul style="list-style-type: none"> Potential double tax charge when profits extracted as dividends by higher rate taxpayer, or by basic rate taxpayer. All individuals can receive £5,000 dividends tax free regardless of other income Three dividend tax bands: 7.5%, 32.5% and 38.1% 															
Tax on disposal of the property: UK resident	Subject to capital gains tax (CGT) at 18%/28%, after deducting any available annual exemption.	An indexation allowance is available to companies, tax due is at corporation tax rates, as above.															
Annual Tax on Enveloped Dwellings (ATED)	No exposure to ATED charge.	The ATED regime applies to high value residential properties held by non-natural persons (e.g. a company) however there is an exemption from the charge when the property is let on a commercial basis.															
Stamp Duty Land Tax (SDLT)	Charged on purchase. From April 2016 a 3% premium applies on the purchase of an additional residential property.	Charged on purchase from or gift by an individual to their connected company, unless a transfer from a partnership. From April 2016 a 3% premium applies on the purchase of residential property by companies.															
Succession planning	Harder to pass properties onto next generation.	Easier to pass properties onto next generation.															



Getting over the incorporation hurdles

The principal barriers to incorporation of a property portfolio are CGT and SDLT. But they are not insurmountable.

CGT

The CGT code recognises that there are circumstances in which it is commercially right for a business to cease to be carried on a non corporate/LLP format and instead operate through a limited company.

The relevant provisions state that relief from CGT will be given where:

- There is a transfer of a *business*- when looking at property portfolios and incorporation, it will be the case that some portfolios do meet the test of a business, however, some will not. For example, the holding of a property or a small number of properties, administered by a letting agent, may not be found to be a business. The greater the number of properties held and the greater the input to the operation of those properties by the owner, the greater the chance that the activities undertaken will be viewed as being business activities.
- The business must be a *going concern* i.e. the company must carry on the letting business post incorporation.
- *All of the assets* of the business must be transferred to the company (except cash where there is discretion) - it is not possible to 'cherry pick' properties to be transferred.
- The company must issue *shares* to the transferor/(s) in consideration for the transfer of the business and assets.
- There is no mention made of the *liabilities* of the business. HMRC, however, accept that liabilities that are transferred to the company do not compromise availability of the relief.

SDLT

There is a deemed market value consideration rule for SDLT purposes when property is transferred to a connected company.

However, the partnership charging regime contains special provisions that can apply to mitigate the SDLT in full where family partnerships are incorporated.

They can also apply to mitigate in whole or in part the SDLT on an incorporation of a non-family partnership, with careful planning.

Does a partnership exist?

Where one is seeking to establish that a partnership exists, an express agreement will obviously assist. Where no agreement exists, however, it is considered that the requirements of a partnership have existed over a period of time gone by, it may well be appropriate to put a partnership agreement in place that recites that it has been put in place not only to reflect the relationship going forward but also to reflect the relationship that has existed previously. This should be coupled with ensuring that there is the evidence that one would in any case wish to exist regarding the existence of a business.

What MHA MacIntyre Hudson can do for you?

The tax position is often complex but we have successfully advised property investor clients on the incorporation of their property businesses without incurring any CGT or SDLT charges.

We have also been involved in the re-financing of the property portfolio by assisting and advising the lenders throughout the incorporation process.

There is an increasing number of lenders in the market of offering mortgages to limited companies. There is no simple, one size fits all, solution. Please contact us for further advice in relation to your own position.



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