Should you set up a limited company for residential buy-to-let property?

As mortgage interest relief was phased out in 2020 and replaced by a tax credit, based on 20% of mortgage interest payments, buy-to-let landlords are increasingly considering whether to set up a limited company to hold their investment properties.

Holding them in a limited company will mean that they are assessed for tax differently, including being able to claim full mortgage interest tax relief. It is a complicated decision that requires detailed analysis to assess the most efficient way of holding property.

If you already have buy-to-let properties which are held personally, there is further consideration as they will need to be transferred from your personal ownership into a limited company. This can trigger additional Capital Gains Tax, Stamp Duty Land Tax, legal fees and re-mortgage fees. Reliefs may be available but if not and unless you intend to hold these properties as a long-term investment, these costs are likely to make the transfer cost prohibitive.

Ultimately, the decision will be guided by:

- Your personal circumstances
- How long you intend to own the property
- The likely amount of capital gains generated, if the property is going to be disposed of at a future date
- Your own income tax position
- Whether you rely on the income generated or wish to roll up the income for further investment
- The level of debt on the property

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Here are your options for owning buy to let property

Personal Ownership

With the changes to Mortgage Interest Relief in 2020, the decision to hold a buy-to-let property personally has become much more complicated. These changes resulted in a tax credit, based on 20% of mortgage interest payments and pushed a lot of investors into higher tax bands. For these investors, it may be more prudent to hold these properties as limited companies.

If you are looking to dispose of the property in the future, you may be liable for Capital Gains Tax on any increase in value on the property. This is calculated at 18% of the increase, if the gain means you remain in the basic rate tax band or 28% for the higher rate tax band. You only pay Capital Gains Tax on your overall gains above your tax-free allowance (the Annual Exempt Amount) which is currently £12,300. Certain costs can also be deducted, such as Stamp Duty Land Tax and allowable purchase and disposal fees.

Transfers to spouses of civil partners are free from Capital Gains Tax. This may be a solution for you, but there could be Stamp Duty Land Tax if debt is transferred.

Corporate Ownership

Corporate ownership means the property has been purchased by a limited company (or transferred into one) where the investor(s) are directors and shareholders of the company.

Companies must pay the higher Stamp Duty Land Tax rates for any residential property they buy. However, limited companies can offset all mortgage interest relief and the profits generated are subject to Corporation Tax, rather than Income Tax or Capital Gains Tax. Corporation tax is currently just 19%.

This is a good option if you do not intend to extract all of the profits out of your investments and instead intend to reinvest some of the profits in the company. If you do need to take a salary or dividend out, further consideration needs to be given to this.

If you require a salary, then the most efficient option is usually part salary, part dividends, though the structure of this and the tax implications would depend on other incomes and investments held. If a director receives no other or a low income, then they can earn a total salary, subject to normal tax rules, of up to £8,840 per annum with no liability for national insurance contributions or income tax. Salaries paid are an allowable expense against company profits. This level is also above the Lower Earnings Limit, which means NI credits will still be earned, which count towards a state pension.

Corporation Tax relief is also available for pension contributions from limited companies that are paid for the benefit of employee directors.

Additional costs associated with limited companies

There are costs associated with setting up and running a limited company, as well as increased legal costs, due to the added layer of complexity involved. Whilst these costs are not often prohibited, a good understanding of these is always recommended before deciding to utilise this option. Mortgage costs may also be higher.

Summary

What may seem like a straightforward choice on the surface, the decision on how to structure a buy-to-let investment has many layers of complexities, based on personal circumstances and what you wish to get out of the investment. What is right for one person, will not be right for another.

Because of this, it is always worth speaking to a property tax expert, who can discuss your own circumstances, and guide you through the various options available. Below are some of the pros and cons of the two options:

Personal Ownership

Pros

- ✔ A Capital Gains Allowance, currently £12,300 per annum, per person, is available for disposals
- ✔ If you own the property jointly with a spouse, there may be tax savings as the profits can be split

Cons

- ✖ Mortgage interest relief was replaced by a 20% tax credit in 2020 and is no longer available
- ✖ For higher rate taxpayers, capital gains tax is 28%

Limited Company

Pros

- ✔ All mortgage interest relief can be claimed
- ✔ Profits generated are subject to Corporation Tax, rather than Income Tax or Capital Gains Tax, which is currently lower
- ✔ Corporation Tax relief is available for pension contributions from limited companies for the benefit of employee directors

Cons

- ✖ It can be difficult to take an income out of the company efficiently
- ✖ There will be some additional costs associated in setting up and running a limited company
- ✖ If property is already held individually, it can be cost prohibitive to transfer these to a limited company, especially for short term holdings
- ✖ Generally, companies must pay the higher Stamp Duty rates for any residential property they buy (although you may have to if you own in personally in any case)

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Why Alexander & Co

At Alexander & Co, we have a specialist property tax team that can assist you in weighing up all your options and working out the best solution for you.

Our property experts have a wealth of knowledge in this field and have worked with companies, entrepreneurs, individuals, trusts and organisations in the commercial and residential sectors for many years. If you are looking for a chartered accountant and tax advisor with the right property know-how, then Alexander & Co are here to help.

www.alexander.co.uk
info@alexander.co.uk
0161 834 4841