BWMacfarlane
CHARTERED ACCOUNTANTS

Tax

How to Hold a Buy-to let Property

Personal or company name?

The points to be considered are:

- Who will you own the property with?
- What are your intentions – to hold the property for the short or long-term?
- Are you currently tax resident in the UK, and if not where else are you tax resident?
- Where will you be tax resident when you come to sell the property?

You then need to consider the potential advantages and disadvantages of owning the property either as an individual or through a company.

Individuals

- If the rental property is in the UK, an individual will pay income tax on his rental profits at 20% to 45% depending on the level of income, regardless of where he lives.

- If he is UK-tax resident or an EU citizen (in addition to some other criteria), he will be entitled to an annual tax-free allowance to be set against his rental income.

- As for gains arising on the sale of rental property, individuals are entitled to an annual exemption, unless they are non-UK domiciled and claiming the remittance basis.

- If he qualifies as non-UK tax resident for capital gains tax purposes, currently he will suffer no UK capital gains tax on a disposal.

- Disposals in years of emigration and immigration and in periods of temporary non-UK residency, should be considered carefully. This is particularly important following the introduction of the statutory residence test and the split-year treatment applicable from 6 April 2013.

Companies

- For virtually all companies, the tax rate is 20% on rental profits up to £300,000. Higher levels of profits carry 23% tax, falling to 21% from 1 April 2014, although from 1 April 2015 the tax rate will be 20% regardless of the profit level.

- This tax is chargeable as corporation tax for UK resident companies and as income tax for non-resident companies with no UK “permanent establishment”.

- Where capital gains arise, companies can also claim indexation allowance in their capital gains tax computations. If the company is non-UK tax resident, there is currently no tax on gains arising in off-shore companies. However, bear in mind that gains of off-shore companies can be apportioned to their UK resident shareholders. Also, where the ATED charge applies then regardless of the residence of the owner, the gain in the company is chargeable to capital gains tax at 28%, not corporation tax.

- Companies will have higher set-up and running costs, especially if they are off-shore.

Advantages of each

Many reliefs and tax considerations apply equally to companies and individuals, for example the furnished holiday lettings rules (mostly) and VAT on commercial property.

But what are the main differences?

A. Own name

An individual may be better off acquiring a property in his own name in the following circumstances.

1. Use annual exemption

   He is considering a sale in the short to medium-term and needs to utilise his annual capital gains tax allowance to cover any gain that arises.

   Where two or more individuals are to acquire a property, they may feel the combination of their capital gains tax exemptions should exceed the indexation relief granted to a company on the eventual sale of the property, thus reducing the chargeable gain.

2. Move in

   The property is likely to become his main residence at some stage and it will qualify for principal private residence relief and lettings relief (both only available to individuals), which can reduce the amount of chargeable gain. It should be borne in mind that, in most cases, the principal private residence relief final period exemption is to reduce from 36 months to 18 months from 6 April 2014.

3. Only income source

   An individual is acquiring one or two buy-to-let properties that are to be his only source of income (either in retirement, or their UK income if he moves abroad). If he is entitled to income tax allowances, these allowances may cover all profits so no income tax charge will arise, whereas in a company all profits are taxed regardless of the level of profits achieved in the year.

4. FHL

   Where the property also qualifies as furnished holiday lettings (FHL), the profits would count as net relevant earnings for pension purposes.

5. Losses

   In certain circumstances, where there are excess capital allowances creating or enhancing a rental loss, or where losses arise on certain agricultural property, those losses can be relieved against other income an individual may have. A property-owning company may only have one source of income, i.e. the rental income, so rental losses can only be carried forward.

B. Company name

An individual may be better off acquiring a property in a company in the following situations:

1. High tax rates

   He is a higher or additional rate taxpayer and currently does not need the rental income.

   An individual is a higher rate taxpayer and wishes to expand his property portfolio. As the company's rental income is taxed at 20%, a higher surplus becomes available to use for the next property purchase.

2. Pension plan

   The property is acquired as part of his pension plan. The company's rental income is taxed at only 20%, leaving the reserves to roll forward to take in retirement. Any loans to the company, for example to provide all or part of the purchase costs, could be withdrawn, tax free, simply as repayment of director's loan account. Of course, if the rental property is sold, extracting the proceeds from the company in a cost-effective manners needs to be considered too.

   Where the property is to be held long-term. Companies still benefit from indexation on acquisition costs and their gains are taxable at 20%, while individuals could be liable at 28%, so acquiring the property in a company could mean a lower tax liability on an eventual disposal.

3. Current property

   The property is already owned, perhaps as a home or a recently inherited property, so there are no gains to consider. A sale of the property to a company controlled by the client could mean the income from that property moves from a higher/additional income tax regime to a corporate 20% regime. Also, such a sale with an outstanding balance could mean monies owed are paid out from net rents as and when cash-flow allows it, at a rate equivalent to what he would have received had he owned the property directly, but with no tax cost. Other issues need to be considered in this scenario, such as stamp duty land tax and legal costs, as well as future plans for the sale of the asset.

4. Non-resident

   An individual is non-UK tax resident. He may consider acquiring a property initially in a company and then, prior to his return to the UK, he might look to liquidate the company to extract and acquire the property.

   If you have any property related queries please contact Sue Stephens or John Elliott.