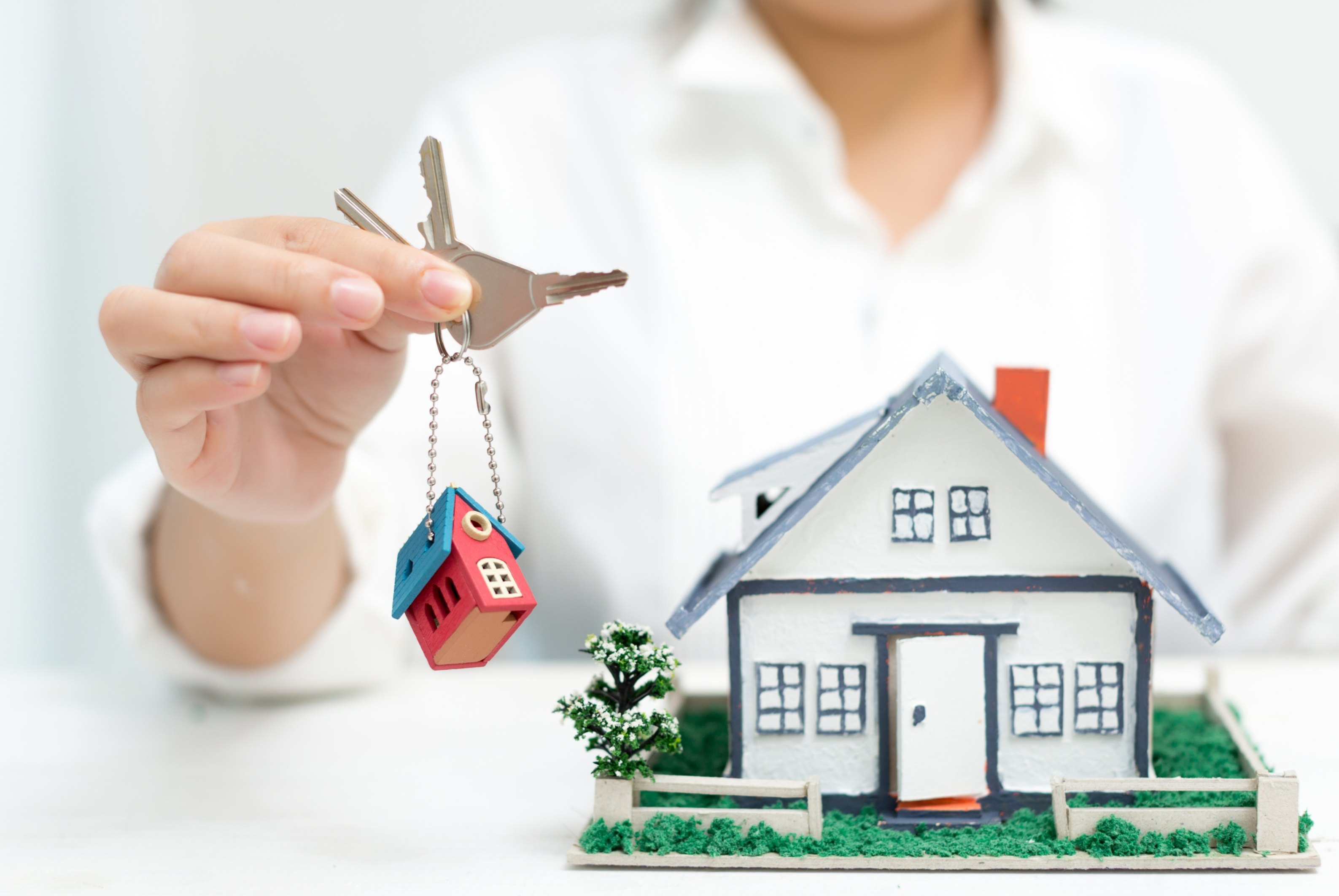


dns accountants

Property guide

Structures to buy property

Introduction

Land and Property can take many forms and sizes, as well as have a diversity of owners and uses.

HMRC assesses taxes annually on income from property, and on the increase in value at sale. Hence there are many opportunities to optimize your taxes just by planning and timing your actions.

Additionally, HMRC wishes to promote some types of action, so it may be to your advantage to take these opportunities, while available.

Here we have outlined some of the key opportunities available to you.

If you want to know more about any of these or book a meeting with an independent financial advisor, then do contact dns accountants.

Table of contents

Content	Page

Introduction **02**

Structures to buy property **05**

- Sole personal ownership 05
- Joint tenants 06
- Tenants in common 06
- Partnership 07
- Limited liability partnership (LLP) 07
- Limited company 08
- Pension fund 08
- Trust 09

The property business **10**

- Property development 10
- Buy to let 10
- Furnished Holiday Lettings (FHL) 10
- Commercial property 11
- Historic home 11

Taxes **12**

- Income Tax 12
- Capital Gains Tax 12
- Corporation Tax 13
- Annual Tax on Enveloped Dwellings (ATED) 13
- Inheritance Tax 13

Frequently asked questions **14**

- What is Stamp Duty Land Tax (SDLT) and are the rates the same for companies? 14
- Are there any Stamp Duty Reliefs? 14
- Do banks lend to property companies? 14
- How easy is it to secure a mortgage/commercial loans for buying a property via a company? 14
- What are the recent changes the government has proposed for landlords? 14
- How are the new rules going to affect me? 15
- Example 1 – The effect of the new interest rules for residential property 15
- Example 2 – Capital gains on Disposal 16
- What is the most tax efficient solution to avoid the changes? 17
- What are the advantages of buying property through a company? 17

- Can I transfer existing properties to my new company? 17
- What is incorporation relief? 18
- What are the inheritance tax (IHT) implications of transferring properties to the company? 18
- Is there any tax efficient structure for buy-to-let properties? 18
- Is it advisable to setup an off-shore company for buying properties? 18

Conclusion 19

Structures to buy property

As with any other project some advanced planning is a good idea. Only when you know what you want to do can we make some judgments as to what structure is best for this project.

- Why are you buying property?
- What are you going to use it for?
- Will it bring in income?
- How is it going to be financed?
- Is this a long term or short-term project?
- Will it be sold? Will it make capital gains or losses?
- Are you going it alone or with others? Who?
- How are you going to split tasks, income, gains etc.?
- What about taxes?

Once you have decided to go ahead with your planned purchase, then you must choose your route.

The main two routes are Sole personal ownership and Limited Company, however for completeness here are the full range of options.

- Sole Personal Ownership
- Joint Tenants
- Tenants in Common
- Partnership
- Limited Liability Partnership
- Limited Company
- Pension Fund
- Trust

Sole personal ownership

One person owning a property is usually the way people start or end their time as a property owner. It can be the simplest, especially if you have money in the bank to make the purchase and are living in the property alone.

However, if you are not living in the whole property, the whole time then there can be more tax efficient options.

Please note, if you are developing the property to sell, then you will be classed as a sole trader business.

Advantages

- Simple
- Everything is on you personally – income, bills, taxes
- Tax free allowances for casual income and lodgers
- No tax on sale if lived in the property as your main family home for whole period of ownership
- Capital gains tax free allowance on sale

Disadvantages

- National insurance and income tax if developing the property for gain
- Reduced tax deduction for interest if renting residential property
- Less flexibility – all income and hence tax is yours today

Joint tenants

One way of purchasing property with others is as Joint Tenants. This is usually for cohabiting partners and their family as each of the joint tenants has rights to the whole property; if one of them dies then the other gets the whole property automatically.

Advantages

- Joint incomes to use as basis for loans
- Joint income to pay bills etc.
- No need for a will, waiting for probate etc.
- Tax free allowances each for casual income and lodgers
- No tax on sale if lived in the property as your main family home for whole period of ownership
- Capital gains tax free allowance each on sale
- Any income automatically split 50:50 for tax
- Can choose to advise HMRC of underlying ownership to tax income in these proportions
- Stamp duty relief if any tenant is a first-time buyer

Disadvantages

- National insurance and income tax if developing the property for gain
- Reduced tax deduction for interest if renting residential property
- 3% surcharge on stamp duty if any tenant already owns property
- Cannot choose who is to inherit

Tenants in common

Another way of purchasing property with others is as Tenants in Common. This is usually for friends or relatives, but can also be very useful for partners with stepchildren, as each owns a share of the property and if one of them dies, they can leave their share to whomsoever they wish.

Advantages

- Joint incomes to use as basis for loans
- Joint income to pay bills etc.
- Tax free allowances each for casual income and lodgers
- No tax on sale if lived in the property as your main family home for whole period of ownership
- Capital gains tax free allowance each on sale
- Any income automatically split 50:50 for tax
- Can choose to advise HMRC of underlying ownership to tax income in these proportions
- Stamp duty relief if any tenant is a first-time buyer
- Can decide beneficiaries for share of property on death

Disadvantages

- National insurance and income tax if developing the property for gain
- Reduced tax deduction for interest if renting residential property
- 3% surcharge on stamp duty if any tenant already owns property

Partnership

A business partnership is very like a sole trader but you have others involved. It may be set up to run a traditional business with property on the side or a property trading business such as property developing, or furnished holiday letting.

You do not need to have an official partnership for an investment property, but you may choose to do so in order to gain income flexibility between partners

A business partnership can be a great idea, you share the journey and its ups and downs including responsibility, liabilities and profit. But as with any partnership, the big question is how to make it work? Or at the very least, how to avoid the worst pitfalls? A partnership agreement is recommended.

Advantages

- Flexibility on income split
- Capital gains tax free allowance each on sale
- Stamp duty relief if any tenant is a first-time buyer
- Can decide beneficiaries for share of property on death
- Set your own rules by putting a partnership agreement in place

Disadvantages

- Additional paperwork and liabilities for a partnership tax return
- National insurance and income tax if developing the property for gain
- Reduced tax deduction for interest if renting residential property
- 3% surcharge on stamp duty if any tenant already owns property
- Fewer tax allowable expenses than a limited company
- Less flexibility – all income and hence tax is yours or your partners today

Limited Liability Partnership (LLP)

Some protection may be achieved by setting up a Limited Liability Partnership (LLP) however you then loose some of the advantages of privacy and simplicity; and gain the disadvantage of statutory obligations as regards accounts preparation and filing. They can however work well for risky or short-term development projects, especially when you have third party investors rather than bank mortgages.

Advantages

- Ability to share income with other partners
- Limited Liability
- Simple investment strategy

Disadvantages

- Fewer tax allowable expenses than a limited company
- Less flexibility – all income and hence tax is yours or your partners today
- Rules and deadlines – for accounts at Companies House
- Lack of privacy – details on public record at Companies House

Limited company

A limited company is a type of business structure, which is incorporated into a legally distinct body. If an individual opts to own and run the property business as a limited company, the business will

- be legally distinct from the person responsible for running the business;
- maintain separate finances for both business and personal finances; and
- own assets, such as the property

Owning investment property via a company has become a very tax efficient way of working in recent years, especially if requiring bank finance.

Advantages

- Full tax deduction for finance interest on residential properties
- Ability to share income with other parties
- Flexibility to earn or make gains spasmodically, and spread personal tax liabilities
- Flexibility and hence lower average tax rates on withdrawals
- Financial control of your money
- Ability to maintain a separate pool of assets at low tax rates

Disadvantages

- No capital gains tax allowances
- Admin – you must be diligent to avoid penalties (dns accountants can help you with this)
- Annual tax on Enveloped Dwellings (ATED) is charged on larger residences

Pension fund

Some pensions funds may invest in property, but many are prevented from investing in residential property. A Small Self-Administered Scheme (SSAS) Pension scheme, as you may have via your company, can offer benefits to that company by way of purchasing commercial property to be leased back to your business (or a third party).

Advantages

- No third-party loans, can purchase for cash
- Rents go back into the pension fund
- Rents get tax relief in the company
- Tax efficient and secure investment for the pension fund

Disadvantages

- More admin for the pension fund
- Rents pay tax in the fund

Trust

A Trust is a legal arrangement to give property or cash etc. to someone else for the benefit of a third person. Property held by the trust is outside your estate for inheritance tax etc.

Some trusts may be able to invest in property too, provided they have the necessary income for trust purposes. Depending on the rules of the trust, it may be able to keep the property longer than an individual and hence not generate either capital gains or be subject to Inheritance tax.

For long term property ownership, such as a historic property, then this may be the way forward, to set up a family trust.

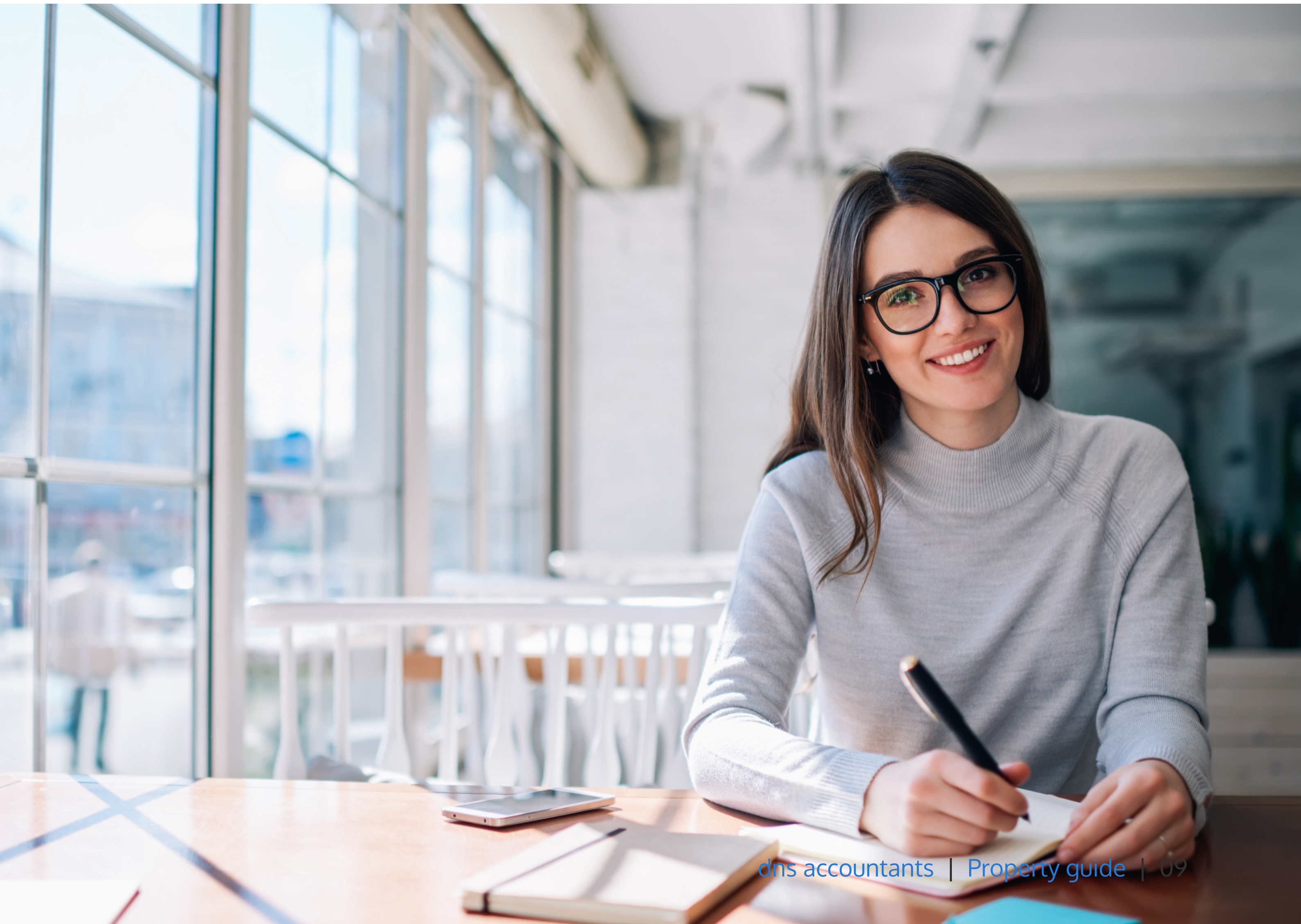
Advantages

- Reduced inheritance tax
- Reduced Capital Gains tax

Disadvantages

- Lots of admin for trust
- Beware taxes on setup

We do recommend legal advice on setting up a trust, and talk to DNA Accountants about tax planning.



The property business

If the property in question is your own home, then there may be little need for special property structures. But if you are exploiting the property for profit then the structure can be key.

Here are some activities for consideration and remember that the tax man considers the tax based on the intention at time of purchase and at subsequent change of plans.

Property development

If buying property to develop then this is a trading activity, subject to income tax and national insurance, or corporation tax if in a limited company. As a trading activity then VAT may also become liable.

Joint investors and risk may be the key factors here.in choosing a structure hence the most common for a single big project is a Limited Liability Partnership. But if joint investors are not required then a Limited Company can be best for a long-term business, recycling profits for the same owners.

Buy to let

Residential property that you buy, or keep, for the purposes of renting out, e.g. houses or flats, is generally called buy to let. Following recent tax changes to the way interest is allowed for tax, many investors are changing structure to ensure this income is not that of residential property income in the hands of an individual.

Hence the most popular structure for a residential property portfolio with lots of finance is a Limited Company. For a small property portfolio, with little or no finance then a Limited Company may be overcomplicating the position.

Furnished Holiday Letting (FHL)

There are special rules available for furnished accommodation let short term for holidays etc. which then make this type of activity a trade.

Some overseas properties are forced to be operated via a Limited Company in order to fulfil local requirements, so do take local tax advise too.

Careful operation, with hands on involvement can earn other tax breaks as business property, if owned personally.

Care must be taken if making personal use of such property, especially if owned through a limited company.

Do talk to dns accountants about your planned activities and how the tax can change based on your actions.

Commercial property

If you rent out property for commercial use then this is commercial property e.g. shops, business units etc.

Capital gains tax is lower on sale of commercial property, than on residential property.

If the use is for your own business, then capital gain tax and inheritance tax may be reduced in certain circumstances – do talk to dns accountants in the planning stages.

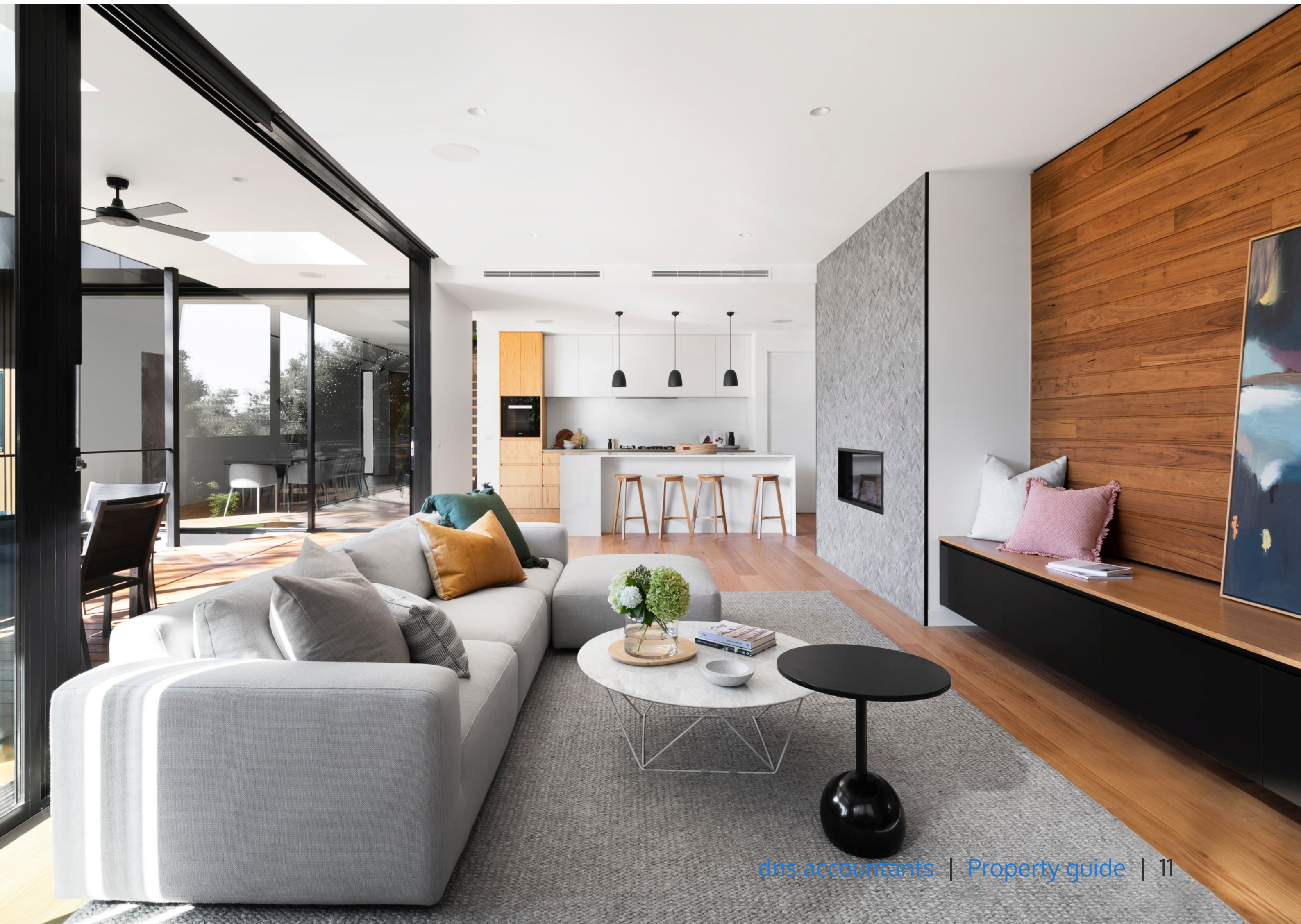
You pension fund can invest in commercial property, tax efficiently, even for your own business premises.

There is a new annual allowance for building commercial property after October 2018, whether for your own use or investment, available each year the property is in commercial use, to all ownership structures including limited companies. This allowance lasts up to 34 years and may be handed on at sale. However, this allowance is just an advance as capital gains tax or corporation tax may be increased at point of sale as a result of claiming this allowance.

Do discuss the potential benefits to you with dns accountants.

Historic home

A property that you will want to hand on generation after generation could benefit from the inheritance tax benefits of being in a company or trust.



Taxes

If you just use your property as your main family home and have no other home, then you are unlikely to have any further tax to pay on that property. But if you are exploiting it for profit then you need to be aware of what taxes may be incurred.

Income Tax

All property income, net of expenses, is subject to tax annually. A limited company will pay corporation tax, but all other structures pay income tax on this income.

Trading income of an individual is also subject to national insurance.

If you rent out or in any other way charge others to use or stay in your home, then there are two allowances you may use instead of collating costs and preparing rental property accounts: -

- Property Allowance – £1,000, as a deduction from total property income, provided none of that income is from your employer. Or as an exemption from reporting gross property income below £1,000.
- Rent a room relief - £7,500 as a deduction from the gross income received from letting out furnished rooms in your own home. Or as an exemption from reporting such gross income below £7,500

There is also a special rule for interest on residential property mortgages & loans

Residential property owned by an individual does not have an income deduction for loan interest, but instead has a potential tax reduction of just 20% of the interest. A company owning property on the other hand, gets a full deduction for all loan interest, against income.

These interest rules can be complicated so do discuss the impact with dns accountants before you commit; budgeting is critical as the taxes can create annual losses.

Capital Gains Tax

At some stage you may want to sell your investment. When you sell a property then you may receive more or less than you paid for it. The difference between selling price and purchase price is your basic capital gain. The exception is if the property is part of the trading activities such as property development, in which case the gain will be classed as trading income and taxed accordingly.

Costs of buying and selling are allowable deductions from this gain before it is taxable.

If you have improved or enhanced the property these costs may also be deductible e.g. new conservatory or extension to a flat lease. So do keep a note of these costs as they occur, as evidence for deduction at point of sale.

There is no deduction for finance costs - loans or mortgages.

Gains by a company are subject to corporation tax, other structures may have to pay capital gains tax.

Such taxes need reporting and paying within 30 days of sale so make sure you plan, in advance.

The exception is a property that has only ever been your family's only home and does not have surplus grounds.

Individuals and partnerships have an annual allowance of £12,000 before paying tax on capital gains; for trustees it's £6,000.

Do talk to dns accountants about the tax and returns due.

Corporation Tax

Income and capital gains of a Limited Company are subject to corporation tax. After tax funds are still in the company and an extraction strategy may be required to release these funds. Different strategies may have additional taxes to pay.

Funds not extracted are available for reinvestment within the company, without extra taxes.

A non-UK company buying UK property is subject to UK taxes on income, on gains since 2015 and inheritance tax. Additionally, it may be subject to ATED tax if not let out on commercial terms.

Also, from April 2021 there will be a 2% stamp duty land tax surcharge if a residential property in England or Northern Ireland is purchased by a non-resident company.

dns accountants can help with preparing company accounts, extraction strategies and advise.

Annual Tax on Enveloped Dwellings (ATED)

A UK dwelling valued at over £500,000, owned wholly or partly by a company, is subject to Annual Tax on Enveloped Dwellings (ATED) – based on property value.

Exemptions from this tax are available e.g. for property management or property development, but the exemption must be claimed on the annual submission.

Inheritance Tax

Investment property is an asset for inheritance tax purposes.

Shares in a company that only owns investment property are also investment property for inheritance tax purposes, even if that property is a small close company. Additionally, investment property may change the nature of a trading company for capital taxes purposes, such that higher taxes are due.

Transfer of properties to a company can also incur inheritance tax, at lifetime rates, if full consideration is not received or the company is owned by different parties.

Planning for succession is recommended.

Talk to your dns accountant

Frequently asked questions

What is Stamp Duty Land Tax (SDLT) and are the rates the same for companies?

Stamp Duty Land Tax (SDLT) is a tax paid when properties change hands. It is paid by the purchaser, based on land or property value, location and nature. It is due within 14 days with penalties and interest for late filing or payment.

However, there is 3% surcharge if this is not the only residential property owned or a residential property is being purchased by a company.

Also, from April 2021 there will be a 2% surcharge if a residential property in England or Northern Ireland is purchased by a non-resident person or company.

SDLT ranges from 0-12% for individuals – e.g. zero of first £125.000, 2% on next £125,000 etc.

SDLT for most company purchases is 15%.

Are there any Stamp Duty reliefs?

If this is your first purchase, then First Time Buyer relief may be available to reduce your SDLT bill for properties worth less than £500,000.

If you are purchasing more than one property at a time, then you may be entitled to SDLT relief for multiple dwellings.

Do banks lend to property companies?

Yes, banks will lend to companies, but may charge higher commercial rates and may want guarantees or additional security.

How easy is it to secure a mortgage/commercial loans for buying a property via a company?

A new limited company may well find it very difficult to get loan finance in its name, hence the involvement of other types of investor and the use of Limited Liability Partnerships. However, these may be mitigated by personal guarantees, securing loans on the property and/or other assets of the company by way of a registered charge.

What are the recent changes the government has proposed for landlords?

The most recent changes are:

- From April 2020, in place of an income deduction for interest, that is now disallowed, residential landlords will receive a 20% credit to set against the income tax payable on the rental income. Any unused tax credit may be carried forward to be relieved against tax payable on rents in a future tax year.
- From April 2020 there will no longer be a deduction from capital gains for a property you have rented out and was once your main home – previously up to £40,000 per person.
- There are plans to restrict the ability of landlords to evict tenants.

Overall the recent changes are so significant that operating as a buy to let investor in a partnership or as a sole trader can lead to a negative cash flow and have a devastating effect on landlords with high interest charges – see example 1 on page 15. So, make sure you budget costs in advance.

How are the new rules going to affect me?

Many buy to let landlords with rental property will be seriously affected by the recent changes, with overall tax payable increasing to such an extent that the rental property may be creating a loss annually. Please refer to Example 1 below which shows how the mortgage restriction affects the tax liability. Some investors may not be able to continue and may have to sell or look for other jobs to cover the losses. The only other options available will be restructuring including:

- Let the residential properties as furnished holiday lettings.
- Sell residential properties and reinvest in commercial buildings.
- Transfer the residential properties into a company.

Example 1 – The effect of the new interest rules for residential property

Alex lets out a property, which is subject to a large mortgage with an annual interest charge of £36,000. He just covers the interest payment with £36,000 as rent received per year. Alex's salary is £28,000, so he pays income tax at 20% and is entitled to child benefit.

In the past it did not matter if this property were residential or commercial- the results were the same and Alex may have done affordability calculations based on the results. However, with the new rules for residential property the tax and hence affordability is very different.

The below calculation compares Alex's tax position if the property were commercial (the same as the old pre 2016 rules), with residential property which is subject to the new interest rules which from 2020/21 will be fully implemented.

We have assumed the personal allowance is £12,500 and the basic rate band is £37,500.

	Commercial (or pre 2016)	Residential 2020/21
Salary	£28,000	£28,000
Letting income	£36,000	£36,000
Interest deduction	(£36,000)	Nil
Total net income	£28,000	£64,000
Personal allowance	(£12,500)	(£12,500)
Taxable income	£15,500	£51,500
Basic rate band limit	£37,500	£37,500
Tax charged @ 20%	£3,100	£7,500
Tax charged @ 40%	Nil	£5,600
Tax credit on interest at 20%	Nil	(£7,200)
Total tax payable	£3,100	£5,900
Child Benefit – 2 Children	£1,789	£1,789
Child benefit rebate	0	£1,789
Personal Tax liability	£3,100	£7,689

In 2020/21 all of the mortgage interest on residential property is disallowed. This increases his taxable income but not his actual income. His higher taxable income means he pays tax at 40% and he loses all of his child benefit because his total income is over £60,000. Alex receives a tax credit to set against his tax liability, which is calculated as 20% of the lower of:

- Finance costs not deducted from income (£36,000).
- Income from the property business before interest (£36,000).
- Total income exceeding allowances (£51,500).

Alex makes no actual profit on his lettings business, but in 2020/21 the residential letting business makes a taxable profit as the interest payments are disallowed. He thus pays tax of £4,589 on the residential lettings business, although there is no cash available to pay that tax.

Example 2 – Capital gains on Disposal

Jon purchased two identical buy-to-let properties in March 2015 for £120,000. One was purchased in his own name, the other was acquired by his company: JV Ltd. The properties are sold for £160,000 each on 30th April 2020. Jon is a higher rate taxpayer, so pays CGT at 28%. JV Ltd draws up its accounts to 31 Dec and pays corporation tax at 19%. Ignoring the costs of acquisition and disposal, the tax due in each case is calculated as follows:

2020/21	Jon	JV Ltd
Sales proceeds	£160,000	£160,000
Less purchase price	(£120,000)	(£120,000)
Gain before indexation	£40,000	£40,000
Indexation allowance to 31/12/17 (0.082 x 120,000)	Nil	(£9,840)
Annual exemption	(£12,000)	Nil
Taxable gain	£28,900	£30.160
CGT due at 28%	£8,092	Nil
CT due at 19%	Nil	£5,730
Tax payable by	31st May 2020	1st September 2021

Properties purchased by a company before 31st December 2017 are still eligible for indexation allowance to 31st December 2017, deductible from taxable profits

Gains made by the company still need to be extracted unless reinvested

Personal Capital Gains on disposal after 5th April 2020 will need reporting and paying within 30 days.

The nature of the person or structure that holds the property (individual, joint ownership, company) has a significant effect on the level of tax payable.

What is the most tax efficient solution to avoid the changes?

One straight forward solution if you have a portfolio of properties, is to structure these investments through a limited company. The immediate benefit is that the full mortgage interest is allowed as an expense against rental income before tax. Additionally, you can use a number of other means to benefit from using a limited company.

What are the advantages of buying property through a company?

- The tax payable by the company is 19% compared to marginal rate (of up to 45%) for individuals. If the extraction of profits from the company is conducted in a tax efficient manner, the overall tax liability may be lower, and in the interim profits may be reinvested without paying higher taxes.
- Mortgage or finance cost restrictions will not apply. You can claim all mortgage interest as an expense again property income.
- Tax payable on the disposal of property within a limited company is at the corporation tax rate of 19%, where it may be reinvested with no further taxes to pay or extracted; whereas with a sole trader or partnership, Capital Gains Tax (CGT) on residential property has been set by the government at 18% or 28% depending on income.
- If you intend to buy further properties, you can use the funds already available in the company without the need to extract the funds from the company. This will give you an advantage as you will have more money left in the company after tax than you would if you owned the property as an individual.
- You can tailor the set-up of a limited company with flexibility in income, voting and capital distribution; whereas with a sole trader or partnership it is tough to achieve such flexibility.

Can I transfer the existing properties to my new company?

This is a very complex area, but yes you can transfer properties you own to a limited company. The main issues are as follows

- This will be treated as a disposal at market value, so there may be capital gains tax to pay as if you had sold the lot.
- There will be Stamp Duty Land Tax (SDLT) to pay on the market value of the properties changing hands, but there is a relief if this is done in one go.
- If the properties are mortgaged, then the Mortgage companies may have something to say about this e.g. needing new security or even recalling the mortgage.

How you structure the company and treat the transfer is another question you may wish to discuss with dns accountants.

What is incorporation relief?

One way of transferring a business to a company is as an exchange - the whole business for Company shares.

A business incorporation done in this way is entitled to incorporation relief whereby it is not treated by HMRC as a disposal for capital gains tax purposes, but just a change in the same asset held.

The business transferred in this way and hence eligible for this relief, may be a property business.

What are the inheritance tax (IHT) implications of transferring properties to the company?

Firstly, inheritance tax is not triggered on incorporation if the parties who owned the properties before transfer have not suffered any reduction in the value of their estate, i.e. they have been recompensed in full with cash, promises of cash or shares etc.

Inheritance tax charges maybe triggered if value has changes hands e.g. by the company having different owners or the properties being gifted or not eligible for incorporation relief. Tax is payable on the value reduction at a lifetime transfer charge of 20%. If death occurs between 3 and 7 years of transfer, then this charge may be offset against the inheritance tax due on death.

Such charges also apply to transfers of property to trusts or partnerships etc.

Is there any tax efficient structure for buy-to-let properties?

With the new rule changes then a portfolio of buy to let properties is probably most tax efficient to be run as a limited company. But every structure has its advantages and disadvantages and tax is just one, so a full review is best before making a decision.

Do talk to dns accountants about what is best for you.

Is it advisable to setup an off-shore company for buying properties?

Not anymore. You will end up paying additional stamp duty, and if not letting out on commercial terms then ATED. There is also Capital Gains tax to be paid for the value gained by the company after 06/04/2015. In addition, from April 2017, the government has brought these properties within IHT charges as well.

Conclusion

This guide is only a quick insight into a very big topic. Each property and circumstance is unique and HMRC is always changing the rules and guidance for implementation.

Please speak to dns accountants about what is currently available to you before taking any actions.

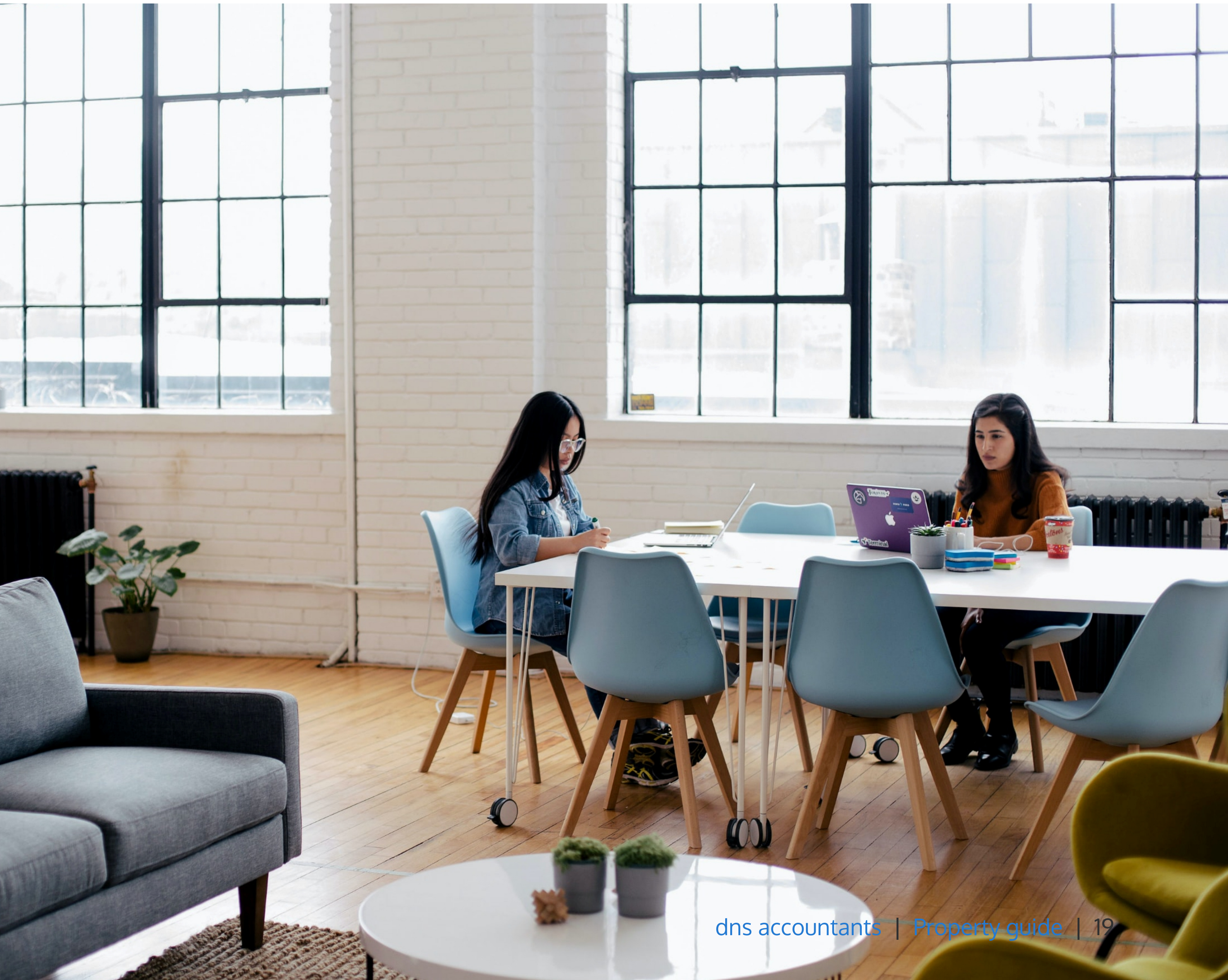
There is no limit to tax saving and planning, and there may be new opportunities available to you. We are passionate for our clients to pay the least amount of tax legally.

Ask to see our other guides in this series

Property Guide – First Time Buyers

Property Guide – First Time Landlords

Property Guide – Buying Property Through a Limited Company



dns accountants

Award winning accountants

accountingexcellence FINALIST Client Service Award 2021

The Contracting Awards2020 BEST CONTRACTOR ACCOUNTANT - 1,000 - 2,499 CLIENTS HIGHLY COMMENDED

accountingexcellence FINALIST Client Service Award 2020

accountingexcellence FINALIST Investing in People Award 2020

British Accountancy Awards 2019 SHORTLISTED

Get in touch

DNS House, 382 Kenton Road,
Harrow, Middlesex, HA3 8DP

www.dnsaccountants.co.uk

info@dnsaccountants.co.uk

03300 88 66 86