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INVESTING IN PROPERTY – PERSONAL OR COMPANY OWNERSHIP

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PROPERTY

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About Jennifer Adams

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- Tax Tips For Company Directors
- How To Use Trusts To Reduce Property Taxes
- Dividend Tax Savings Strategies Explained

About this guide

Anyone considering becoming a landlord will already be aware that their money will be tied up for the long term. Many landlords consider investing in rental properties as part of their retirement income planning, either for the monthly rental yields or by selling the property in later years. With extra red tape increasingly being imposed on landlords by the government, rising mortgage interest rates and pressure on tenants' incomes from the cost-of-living crisis, some may be wary of getting involved in what is potentially an investment for many years. However, with careful thought and research, the UK property market remains a suitable option for many investors.

Whether you decide to invest in property as an individual or via another medium, be that a limited company, partnership or limited liability partnership, or whether the property is commercial or residential, there are tax issues to consider. This guide sets out the tax implications for each method of ownership, highlighting any tax traps in property investment from the initial investment, through letting to the eventual disposal.

1 Property investment options

Direct investment in property can be undertaken within various structures, the more common being as an individual (or partnership) or as an investment company limited by shares. Other options include using a limited liability partnership (LLP), a trading company or a pension scheme.

Although recent years have seen several changes to the taxation of property, those changes have been with respect to residential property rather than commercial, the exception being the extension of the capital gains tax (CGT) regime to include non-resident landlords owning UK commercial property.

The following section compares the differences between investing as an individual purchaser or partnership (including LLPs) and investing as a shareholder in a company that buys or holds the property (an investment company).

1.1 Differences between individual and company ownership

- **Legal identity**

A company has its own legal identity, so third parties contract with the company, not individual directors or shareholders. A separate identity enables a company to survive the owner's death and there is also the added flexibility for different directors or shareholders. A company will only cease when formally dissolved.

Another reason for using a company is that, unlike individuals, a company has limited liability for the debts of the business, the extent of which being the amount paid for the shares plus any unpaid amount on nil or partly paid shares (if any). In practice, the liability is usually restricted to the amount paid for the shares unless any personal guarantees have been given. However, in certain circumstances, a company director can be held personally responsible for the company's debts where the company continues trading whilst insolvent. This limitation on the shareholders' liability contrasts with sole traders or partnerships where there is the potential for unlimited personal liability (e.g., the individual's private residence could be at risk of being repossessed).

- **Taxation**

Holding a property within a limited company has become popular in recent years due partly to the restriction for interest and finance costs that applies to residential property held by an unincorporated property business. The restriction does not apply where property (whether residential or commercial) is held within a limited company as any associated interest and finance costs can be deducted in full when computing the taxable profit.

Since 1 April 2023, the rate at which a company pays corporation tax

on its profits depends on the level of those profits. Where those profits are less than the lower profits limit of £50,000 for a company with no associates, the small profits rate of 19% applies. Where a company has profits above the upper limit (set at £250,000 for a company with no associates), corporation tax is charged at the main rate of 25%. Profits falling between these two limits are taxed at the main rate of 25%, as reduced by marginal relief.

Non-tax considerations:
However, there are other reasons for incorporation, such as:

- Liabilities are limited to the value of the company.
- Mortgage lenders often require personal guarantees but many other liabilities are 'ring-fenced' due to incorporation.
- Ability to raise funding by adding new shareholders.
- Ability to make pension contributions.
- Project planning (see section 13).

1.2 Family investment companies (FIC)

The use of such companies is particularly attractive to director-owners of family businesses who have children, as an FIC enables wealth to be passed to the next generation without inheritance tax being charged (although the seven-year survivorship rule may apply where the shares are gifted). Shares are passed to successive generations rather than fractional shares in properties. The shareholders are family members only and the arrangement takes advantage of alphabet shares. The parents can be directors of the company and, assuming they hold all the voting rights, will have control over the assets held by the FIC.

Once the FIC has been created, generally, funds are introduced into the company by the family shareholders either in cash or assets where no chargeable gain has yet to accrue or possibly as a loan from a main trading company. The investment company acquires assets (e.g., property), which generate a return. Income is either reinvested within the company or used to repay the loan from the trading company. It needs to be ensured that the loan amount is manageable such as not to affect the trading status of the lending company.

Any rental profits made by the FIC will be liable to corporation tax and, where the parents lend money to the FIC personally, they should be able to withdraw those funds tax-free. The use of an alphabet share structure enables dividend payments to be tailored without falling foul of company law requirements.

1.3 Partnerships

Where a genuine partnership exists, the profits and losses from that business can be allocated between the partners in any ratio that the partners agree and that ratio may vary from year to year. This can be

advantageous where property is owned jointly as it provides greater flexibility for allocating profits and losses than where jointly owned property is held outside a partnership, particularly if the joint owners are spouses or civil partners.

Being a partner or owning assets used in a partnership business generally means that such individuals may take advantage of more exemptions or deferment claims on disposal of assets or part or all of the partnership share (provided all the other conditions associated with the particular relief apply) than are available to companies.

However, stamp duty land tax (SDLT) may be due when forming a property investment partnership and possibly where the profit share changes (regardless of whether formed or changed as a precursor to incorporation).

Where an asset owned personally but made available for use in an otherwise qualifying partnership may still qualify for business property relief, the IHT relief would be only 50%. In contrast, direct ownership by the partnership itself could qualify for 100% relief (see section 8.1).

Limited liability partnerships (LLPs)

LLPs are a popular vehicle for holding a property portfolio. The main value is that each partner's liabilities are limited to the amount they each invested in the business.

LLPs are not partnerships as such, but corporate entities sharing most features in common with companies (i.e., separate legal personality, limited liability protection, etc.), except that the individual owners are taxed on their share of the LLP's profits and liable to capital gains tax on their share of any gains on disposal. However, unlike a traditional partnership, an LLP can hold property in its own right and properties transferred to the LLP are held in trust. The income tax rates applied are at each partner's marginal rate of tax, which could be as high as 45%, and there may be National Insurance implications irrespective of whether those profits are extracted by the partners or retained and reinvested in the business. The planning comes by allocating profit to the partner or partners with the lowest marginal tax rate.

2 Tax rates

Calculation of profit or losses

Whether the calculation is for an individual, partnership or company, it should start by allocating the profit or loss of the properties into separate 'pools' depending on the type of property (i.e., furnished holiday lets (FHL), residential, commercial, foreign). Individuals should also separate rent-a-room relief from the other properties. This method of separation ensures that losses on FHL, for example, cannot be offset