



Taxcafe.co.uk Tax Guides

Using a Property Company to Save Tax

By Carl Bayley BSc ACA

Important Legal Notices:

Taxcafe®
TAX GUIDE - 'Using a Property Company to Save Tax'

Published by:

Taxcafe UK Limited
67 Milton Road
Kirkcaldy
KY1 1TL
Tel: (01592) 560081
Email address: team@taxcafe.co.uk

Ninth Edition, January 2011

ISBN 978-1-907302-33-6

Copyright

Copyright © Carl Bayley 2003-2011. All rights reserved.

No part of this publication may be reproduced or transmitted in any form or by any means (electronically or mechanically, including photocopying, recording or storing it in any medium by electronic means) without the prior permission in writing of the copyright owner except in accordance with the provisions of the Copyright, Designs and Patents Act 1988 or under the terms of a licence issued by the Copyright Licensing Agency Ltd, 90 Tottenham Court Road, London, W1P 0LP. All applications for the written permission of the copyright owner to reproduce or transmit any part of this Tax Guide should be sent to the publisher.

Warning: Any unauthorised reproduction or transmission of any part of this Tax Guide may result in criminal prosecution and a civil claim for damages.

Trademarks

Taxcafe® is a registered trademark of Taxcafe UK Limited. All other logos, trademarks, names and logos in this Tax Guide may be trademarks of their respective owners.

Disclaimer

Before reading or relying on the content of this Tax Guide please read carefully the disclaimer on the last page which applies. If you have any queries then please contact the publisher at team@taxcafe.co.uk.

About the Author

Carl Bayley is the author of a series of 'Plain English' tax guides designed specifically for the layman and the non-specialist. Carl's particular speciality is his ability to take the weird, complex and inexplicable world of taxation and set it out in the kind of clear, straightforward language that taxpayers themselves can understand. As he often says himself, "my job is to translate 'tax' into English".

Carl enjoys his role as a tax author, as he explains: "Writing these guides gives me the opportunity to use the skills and knowledge learned over almost twenty-five years in the tax profession for the benefit of a wider audience. The most satisfying part of my success as an author is the chance to give the average person the same standard of advice as the 'big guys' at a price which everyone can afford."

Carl takes the same approach when speaking on taxation, a role he frequently undertakes with great enthusiasm, including his highly acclaimed annual 'Budget Breakfast' for the Institute of Chartered Accountants.

In addition to being a recognised author and speaker on the subject, Carl has often spoken on property taxation on radio and television, including the BBC's 'It's Your Money' programme and BBC Radio 2's Jeremy Vine Show.

Carl began his career as a Chartered Accountant in 1983 with one of the 'Big 4' accountancy firms. After qualifying as a double prize-winner, he immediately began specialising in taxation.

After honing his skills with several major international firms, Carl began the new millennium by launching his own tax and accounting practice, Bayley Miller Limited, through which he provides advice on a wide variety of taxation issues; especially property taxation, Inheritance Tax and tax planning for small and medium-sized businesses.

Carl is a member of the governing Council of the Institute of Chartered Accountants in England and Wales and a former Chairman of ICAEW Scotland. He has co-organised the annual Peebles Tax Conference for the last nine years.

When he isn't working, Carl takes on the equally taxing challenges of hill walking and writing poetry and fiction. Carl lives in Scotland with his partner Isabel and has four children.

Contents

Foreword	1
Chapter 1 Why Use a Company?	11
1.1 Introduction	11
1.2 Why the Government Likes Companies	13
1.3 Non-tax Reasons for Using a Company	15
1.4 Overview of Company Tax Pros and Cons	19
Chapter 2 Plain English Guide to Corporation Tax	24
2.1 What Taxes do Companies Pay?	24
2.2 Introduction to Corporation Tax	26
2.3 Corporation Tax Rates	27
2.4 Save Thousands with 'Marginal Rate' Planning	29
2.5 Future Corporation Tax Rates	31
2.6 Paying Corporation Tax	34
2.7 Cashflow Benefits of Using a Company	35
2.8 Company Tax Returns	37
2.9 Penalties	38
Chapter 3 Different Types of Property Company	40
3.1 Introduction	40
3.2 Property Investment Companies	42
3.3 Property Development Companies	45
3.4 Property Trading Companies	47
3.5 Property Management Companies	49
3.6 Companies with a 'Mixed' Property Business	50
Chapter 4 Property Rental Income and Expenses	53
4.1 Corporation Tax on Rental Profits	53
4.2 Calculating Rent Receivable	55
4.3 Expenses You Can Claim	56
4.4 Capital Expenditure You Can Claim	59
4.5 Furnished Lettings	70
4.6 Furnished Holiday Lettings	74
4.7 Interest and Finance Costs	76

Contents cont...

4.8 Tax Treatment of Rental Losses	78
4.9 Other Property Investment Income	82
4.10 Lease Premiums	83
Chapter 5 Property Trading Income and Expenses	86
5.1 How Property Trading Profits are Taxed	86
5.2 Trading Profits versus Rental Profits	86
5.3 Properties as Trading Stock	88
5.4 Work-In-Progress & Sales Contracts	94
5.5 Capital Allowances for Trading Companies	97
5.6 Trading Losses	100
Chapter 6 Corporation Tax on Capital Gains	105
6.1 When Does a Capital Gain Arise?	105
6.2 How to Calculate the 'Proceeds'	105
6.3 How to Calculate the 'Base Cost'	109
6.4 How to Calculate the Indexation Relief	111
6.5 Making the Most of Capital Losses	113
Chapter 7 Capital Gains Tax on Company Shares	115
7.1 Introduction	115
7.2 Capital Gains Tax Rates	116
7.3 Entrepreneurs' Relief	117
7.4 Entrepreneurs' Relief for Property Investment Companies	120
7.5 Entrepreneurs' Relief and Couples	120
7.6 Holdover Relief	121
Chapter 8 Stamp Duty for Property Companies	123
8.1 Introduction	123
8.2 Stamp Duty on Shares	123
8.3 Stamp Duty Land Tax	124
8.4 Stamp Duty Land Tax on Leases	126
8.5 Disadvantaged Areas	127
8.6 Zero-Carbon Housing	127
Chapter 9 VAT and Property Companies	128
9.1 VAT on Property	128

Contents cont...

9.2 Residential Property Letting	128
9.3 Holiday Accommodation	129
9.4 Commercial Property Letting	129
9.5 Residential Property Sales	131
9.6 Commercial Property Sales & Purchases	132
9.7 VAT on 'Build to Let'	133
9.8 VAT on Conversions	134
9.9 VAT for Property Management Companies	135
9.10 Interaction with Corporation Tax	136
Chapter 10 Saving Tax When You Extract Profits	137
10.1 Profit Extraction Principles	137
10.2 Salaries, Etc	138
10.3 Dividends	138
10.4 Income Shifting: The Gathering Storm?	140
Chapter 11 Personal vs Company Ownership	148
11.1 Introduction	148
11.2 Personal Tax Changes	149
11.3 Balancing Act	151
11.4 Rental Profits Kept in the Company	152
11.5 Rental Profits Extracted from the Company	154
11.6 Basic Rate Taxpayers with Rental Profits	155
11.7 Basic Rate Taxpayers Extracting Profits	158
11.8 Making the Most of the Basic Rate Tax Band	159
11.9 Investors with No Other Income	161
11.10 The 'Optimum Scenario'	162
11.11 Trading Profits	163
11.12 Traders with Rental Income	165
11.13 Trading Profits Extracted from the Company	167
11.14 Basic Rate Traders	169
11.15 Traders with Alternative Forms of Income	170
11.16 Traders with Employment Income	171
11.17 Traders with No Other Income	173
11.18 Capital Gains	175

Contents cont...

11.19 Summary	177
11.20 Older Property Investors	179
11.21 Tax Credit Claimants	179
Chapter 12 Making the Big Decision	181
12.1 The 'Big Picture'	181
12.2 Types of Property Business Revisited	183
12.3 The Rental Income Position	184
12.4 Reinvesting Rental Profits	186
12.5 Capital Gains	188
12.6 Winding Up the Company to Reduce Tax	191
12.7 What if the Company Still Holds Property When Wound Up?	193
12.8 Long-Term Reinvestment	193
12.9 Retaining the Wealth	197
12.10 Long-Term Reinvestment Conclusions	201
12.11 The Benefits of Reinvestment for a Trading Company	202
Chapter 13 The Importance of Interest Relief	209
13.1 Introduction	209
13.2 Who Should Borrow the Funds?	210
13.3 Borrowing to Invest in Shares	211
13.4 Borrowing to Lend to the Company	213
13.5 Corporate Borrowings	214
13.6 Deeds of Trust	217
13.7 Rolling Up Interest In A Company	218
13.8 Personal Interest Relief	221
Chapter 14 How to Set Up Your Own Property Company	223
14.1 Who Can Help and How Much Does it Cost?	223
14.2 The Company's Constitution	223
14.3 Other Company Formation Formalities	225
14.4 Changing Your Company's Accounting Date	226
14.5 Dealing with Companies House	227
14.6 Statutory Accounts	228

Contents cont...

14.7 Choosing an Accountant or Auditor	229
Chapter 15 How to Put Existing Property into a Company	232
15.1 Introduction	232
15.2 Gifts of 'Business Assets'	233
15.3 Incorporation Relief	236
15.4 Which Relief is Best?	238
15.5 Pay Now, Save Later	241
15.6 'Trading' Businesses	245
15.7 Furnished Holiday Lettings	246
15.8 Tax Planning with Incorporation Relief	247
15.9 Turning Investment Property into 'Trading' Property	250
15.10 Property Investment Businesses & Incorporation Relief	253
15.11 Other Investment Properties	256
15.12 Stamp Duty Land Tax on Transfers	258
15.13 VAT and Business Transfers	261
Chapter 16 Some Other Important Tax Issues	263
16.1 Close Companies & Investment Holding Companies	263
16.2 The Dangers of Private Use	264
16.3 Selling the Company	265
16.4 Benefits and Dangers of Multiple Companies	267
16.5 Short and Long Accounting Periods	270
16.6 Becoming Non-Resident	273
Chapter 17 Specialised Property Companies	277
17.1 Property Management Companies	277
17.2 The EIS Pub Company	279
Chapter 18 In Conclusion	284
18.1 Weighing it all Up	284
18.2 Future Tax Changes	285

Contents cont...

Appendix A – Tax Rates and Allowances for Individuals	288
Appendix B – Forecast Future Tax Rates and Allowances	290
Appendix C – Marginal Corporation Tax Rates 2009 to 2015	292
Appendix D – Connected Persons	294
Appendix E – Retail Prices Index	295
Appendix F – Short Leases	297
Disclaimer	298

Foreword

By the author

People in the UK have invested in property for centuries. Substantial increases in personal wealth and disposable income over the last few decades, together with problems in other areas of investment and in the pensions industry, have, however, combined to make this an important new area of personal financial planning.

Despite recent difficulties in the UK property market, I personally believe that the property investment sector as we know it today is here to stay. Naturally, the sector will have its ups and downs, as any other sector does, but the philosophy of property investment as a 'career move', or a 'pension plan', is now so well entrenched that it is impossible to imagine that it could ever disappear altogether.

In 2002, in response to the huge demand for advice on property taxation issues which we had been experiencing at Taxcafe.co.uk, we published the first edition of *How to Avoid Property Tax*, the sister publication to this guide. In the following years, the demand for property taxation advice continued to grow at a phenomenal pace and this is responsible for the fact that our first guide is now in its fourteenth edition and this guide is now in its ninth.

But it isn't just the ***quantity*** of advice being demanded that we have seen increase, it is also the level or, if you like, the ***quality*** of advice being demanded that we have seen increase significantly.

We have also seen a huge broadening in the type of activities undertaken by the typical property 'investor', many of whom will now, at least partly, be classed as property developers, dealers or managers. This guide, along with its sister publication, has evolved in line with our readership and now caters for the whole range of property businesses which our readers undertake.

As I have already suggested above, a strong trend has emerged for people to enter the property investment business as a profession or as a means to save for retirement.

This 'new breed' of property investor is entering the market with a much higher degree of sophistication and is prepared to devote substantial time and resources to the business.

Almost every one of these 'professional investors' asks me the same question: "Should I use a company?" Very often, they are hoping for a nice, simple, single-word answer and, being the helpful chap that I am, I give them one: "Maybe!"

Being an accountant, you may think that my slightly evasive response is merely a ploy to enable me to earn more fees from consultancy work. However, you would be quite wrong, as "maybe" is the only answer that I could possibly give. This question is not an easy one to answer. There are a huge number of factors to be taken into account, not all of which relate to taxation, and it is therefore impossible (not to mention inadvisable) to simply give a straightforward "yes" or "no" answer. (And, in any case, I have plenty of consultancy work already, thank you!)

The first aim of this guide, though, *is* to answer that question, not in a single word, but in the many thousands of words that, in reality, the answer to this highly complex question actually requires. So, to provide you with a truly thorough answer to this crucial question, we will begin, in Chapters 1 and 2, by looking at the basic tax (and non-tax) implications of using a company.

The UK tax regime for companies is quite different from that applying to individuals, or indeed to partnerships, trusts or other potential investment vehicles. The company tax regime has quite a few quirks, which can prove to be costly traps for the unwary. It is therefore extremely important that any property investor considering the company route understands what they are getting themselves into!

In Chapters 3 to 10, we will move on to a more detailed look at the taxation of UK property companies. Here we will discover that there are several different types of property company and that each gives rise to a different set of tax implications which need to be considered carefully by the prospective corporate property investor.

Chapter 11 then provides a summarised comparison of the tax position of companies and individuals.

Following that, in Chapter 12, we will take a detailed look at all the factors involved in making the decision whether to use a company and their implications for the property investor. This is illustrated throughout by several examples designed to highlight the key issues.

In Chapter 13 we will begin to apply what we have learned so far by focussing on one of the most important benefits of using a property company: interest relief.

As most readers will know, individual property investors can only set interest costs against their rental income, often leading to rental losses which can generally only be carried forward and cannot usually be set off against other income or even capital gains on the same property.

One of the main benefits for a property investor in using a company is the ability to set interest on funds borrowed for a company's property investments against other income or capital gains within the company or even the investor's own salary or other income.

In Chapter 13 we will see the difference that this different treatment of interest costs can make to a property investor over many years as the economic cycle produces both short-term losses and long-term gains.

Reaching a Conclusion

In the end, only **you** can really decide whether a property company is appropriate for you - by undertaking a detailed examination of your own individual position and weighing up all of the factors involved.

My aim in this guide is to enable you to reach that unique individual conclusion and make a well-informed decision armed with a strong understanding of the many issues involved.

Whether you're one of those 'professional investors' whom I referred to earlier, or one of the many 'gifted amateurs' whom I also frequently meet; whether you see your property business as your pension plan or just a good way to supplement your income; whether you're developing, dealing, managing or just renting out your properties; whether you've always had a master plan or you stumbled into property investment by accident; in fact, whatever your circumstances may be, this guide will help you understand the questions you need to ask yourself before you can make a truly informed decision whether to use a property company or not.

And you may also find that "yes" or "no" are not the only answers to the property company question that you come up with. Many of my clients, with my guidance, decide that the answer for them is "partly" or "later".

There is absolutely nothing to stop an investor from running two property businesses in parallel – one as an individual and one through a company. Many investors also find that the best route for them is to start with a small property business owned personally and then to start up a second property business in a company later on.

Operating Your Property Company

Once you've made the decision to operate some or all of your property business through a company, whether with the help of this guide or not, you will then want to run your company in the most beneficial way possible.

The second function of this guide is therefore to provide the tax-planning advice and the warnings of potential pitfalls that you will need to know in order to minimise your tax burden as a property company owner.

Hence, as well as providing the overall summary of the property company tax regime in the early chapters of this guide, many more potential planning possibilities and possible pitfalls are covered in Chapters 14 to 16.

Chapter 17 then introduces some more specialised property company structures before lastly, in Chapter 18, at the end of the guide, our detailed findings are neatly summarised, giving you a final opportunity to weigh the whole thing up.

Tips and Warnings

Sprinkled throughout this guide, you will also find many '**Tax Tips**' and '**Wealth Warnings**' designed to highlight key points where there are extra savings to be made or traps to catch the unwary! Watch out for both of these as you read the guide.

Predicting the Future

In order to reinforce the issues discussed in this guide, I will demonstrate the tax implications of corporate property investment through the use of several worked examples.

In my examples, I have naturally had to make various assumptions about external factors beyond the control of the property investor, including:

- The growth of property values
- The future rate of inflation
- Interest rates
- The rates of return on property investment (i.e. market rental levels)
- Future changes to the UK tax system

I have made my assumptions as reasonable as possible, based on my experience of the property investment sector and the UK taxation regime.

However, if I can predict one thing with any certainty it is that the future will not be exactly as any of us may predict. Hence, whilst I believe that the conclusions that I have been able to draw in this

guide are validly based on sound principles, the reader must nevertheless bear in mind that those conclusions are, to some extent, dependent on uncertain predictions about the future.

In preparing the examples in this guide, I have assumed that the UK tax regime will remain unchanged in the future except to the extent of any announcements already made at the time of publication and some purely inflationary increases to tax bands, exemptions and allowances.

As far as any purely inflationary increases are concerned, I have used the increase in the Retail Prices Index to September 2010 (4.6%) as the basis for the one figure not yet announced for 2011/12 and an estimated annual inflation rate of 3.5% for all future years. Subject to any announcements already made by the Government, I have then applied these estimated inflation rates to:

- Income Tax personal allowances
- The annual Capital Gains Tax exemption
- Income Tax and National Insurance rate bands below £100,000
- The rate of weekly Class 2 National Insurance contributions

The resultant future estimated personal tax rates for the tax years 2012/13 to 2014/15 are set out in Appendix B.

Most of the personal tax rates and allowances for 2011/12 were announced in December 2010 and these are included in Appendix A. The only estimate which I have had to include there is the annual Capital Gains Tax exemption and even that should now be reasonably accurate. Note, however, that the Government has not yet confirmed the Capital Gains Tax rates for 2011/12. In Appendix A, I have assumed that these will remain unchanged from current rates, but this cannot be guaranteed.

For later years from 2012/13 onwards, please remember that all of my assumptions are made simply for illustrative purposes and are only my 'best guess'; so some variation from my figures can be expected. The further we look into the future, the greater that variation is likely to be.

In reality, we are bound to see more significant changes to the UK tax system at some point in the future, especially following the recent change of Government. Whilst we have no idea when such changes will take place, they will almost certainly occur within the timescale which most long-term property investors are considering.

In Section 18.2, at the end of the guide, I have therefore attempted to analyse the potential impact of any further changes to small company taxation that we may see over the next few years.

Nevertheless, despite the ever-present possibility of changes to the tax regime, I remain firmly of the opinion that there will always still be a great many property investors for whom the use of a company vehicle to hold their investments will continue to be highly beneficial.

As with any other tax planning, my advice is this:

Hope for the best,
Plan for the worst,
Review your position constantly, and
Expect the unexpected!

About the Examples

In addition to the points made above regarding the future of the UK tax regime, please note that, unless specifically stated to the contrary, all persons described in the examples in this guide are UK resident, ordinarily resident and domiciled for tax purposes.

All persons described in the examples in this guide are entirely fictional characters created specifically for the purposes of this guide. Any similarities to actual persons, living or dead, or to fictional characters created by any other author, are entirely coincidental. Likewise, the companies described in the examples in this guide are similarly fictional corporations created specifically for the purposes of this guide and any similarities to actual companies, past or present, is again entirely coincidental.

Scope of this Guide

This guide is aimed primarily at UK resident property investors considering or using a UK resident company to run their property business (although issues facing non-resident investors or non-resident companies are covered briefly in Section 16.6).

The reader must bear in mind the general nature of this guide. Individual circumstances vary and the tax implications of an individual's actions will vary with them. For this reason, it is always vital to get professional advice before undertaking any tax planning or other transactions that may have tax implications. The author cannot accept any responsibility for any loss that may arise as a consequence of any action taken, or any decision to refrain from action taken, as a result of reading this guide.

Married Couples & Registered Civil Partnerships

Throughout this guide you will see me refer several times to 'married couples', 'husbands and wives' or 'spouses'.

Since December 2005, same-sex couples have been able to enter into a registered civil partnership affording them all of the same legal rights and obligations as a married couple.

This equality of treatment also extends to all UK tax law and hence, throughout this guide, any reference to 'married couples', 'husbands and wives' or 'spouses' should be taken to also include registered civil partners.

It is important to remember however, that unless specified to the contrary, the tax treatment being outlined will be available to legally married couples and same-sex couples in a registered civil partnership only.

Remember also that marriage, or civil partnership, is not always advantageous for tax purposes. It really is a case of 'for better or worse'!

The Last Word

Finally, to close this foreword, may I just say that whatever type of property investor you are, and whatever decision you reach about the possible benefits of using a company, I would like to thank you for reading this guide and wish you every success with your investments.

If you have enjoyed reading the first few pages of this publication, please

[CLICK HERE](#)

to add it to your shopping cart at

£24.95
(+ £1.95 P&P)

You will also receive a FREE PDF copy so you can read the entire book just seconds after placing your order!