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USING A PROPERTY COMPANY TO SAVE TAX



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Using a Property Company to Save Tax

By Carl Bayley BSc FCA

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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. His aim is to help landlords, other business owners, and families understand the taxes they face and make savings through sensible planning and by having the confidence to know what they can claim. Carl's speciality is his ability to take the weird, complex world of taxation and set it out in the kind of clear, straightforward language taxpayers can understand. As he often says, "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 more than forty 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 information as the 'big guys' at a price everyone can afford."

He takes the same approach when speaking on taxation, a role he 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, Carl has spoken on taxation on radio and television, including the BBC's 'It's Your Money' programme and BBC Radio 2's Jeremy Vine Show.

Beginning his career as a Chartered Accountant in 1983 with one of the 'Big 4' accountancy firms, Carl qualified as a double prize-winner then began specialising in taxation. He worked for several major international firms until beginning the new millennium by launching his own practice, through which he provided advice on a wide variety of taxation issues; especially property taxation, inheritance tax, and tax planning for small and medium-sized businesses, for twenty years, before deciding to focus exclusively on his favourite role as author and presenter.

Carl is a past Chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales; President of ICAEW Scotland; and member of the ICAEW Board. In 2023, he stepped down after almost twenty years on the Institute's governing Council. He co-organised the annual Practical Tax Conference from 2002 to 2019.

Aside from his tax books, Carl is an avid creative writer and has just published his first novel, *Trinity of Souls*. When he isn't working, he takes on the equally taxing challenges of hill walking and horse riding: his Munro tally is now 106 and, while he remains a novice rider, his progress is cantering along nicely. Carl lives in the Scottish Borders, where he enjoys spending time with his partner, Linda. He has three children and his first grandchild arrived in April 2021.

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Introduction

Welcome to this seventeenth edition of *Using a Property Company to Save Tax*, fully updated for all the latest changes in both property and company taxation, and substantially revised to give readers a more thorough understanding than ever before of all the taxation benefits, pitfalls, and practical issues involved in running a property business through a company.

When I wrote the first edition of this guide in 2003, relatively few people invested in property through a company. It wasn't so much that using a property company was an entirely new idea, more that many investors, and perhaps more importantly, many lenders, were wary of it. This was why earlier editions of this guide placed a great deal of emphasis on the process of deciding whether a property company was a good idea or not (the answer was, and still is, 'maybe', as we shall see later).

In the twenty years since that first edition, however, many people have embraced the idea of using a company to invest in property and it has become considerably more commonplace. Indeed, recent statistics suggest more than half of all new entrants into the private rented sector are now investing via a company.

No doubt, we at Taxcafe have played our part in these changes but, in view of the fact that many property businesses are now well established as companies, we felt it was time to revamp this guide to make it more relevant not just to those who are trying to decide whether to use a property company, but also to those who have already made that decision and are now operating as a company, or indeed have been for many years.

We will start in Chapter 1 by taking a brief look at the rationale behind using a property company and the tax and non-tax issues to be considered. We will also begin to explore what taxes are paid by property companies and their owners, and how these differ from the taxes paid by those investing in property as individuals.

As we will begin to see in this opening chapter, the company owner's personal tax position is as important as the company's, and understanding the way these two tax regimes combine is a key part of getting the best out of your property company.

In Chapter 2, we will then start to look at the main tax paid by companies, Corporation Tax, how it works, the rates applying, and its scope. We will begin to see how the tax is affected by the type of business you are running through the company. Finally, the chapter closes with a look at some of the tax deductions available to any type of company, and how to make the most of them.

Chapter 3 covers one of the most important areas for property companies, capital expenditure. We will see how the treatment of expenditure in your company's accounts relates to how it is treated for Corporation Tax purposes and explore the maze of different allowances and reliefs capital expenditure may attract.

In Chapter 4, we focus on property investment companies. While many important principles will already have been covered in earlier chapters, there are many quirks to be aware of when your company is running a property letting business.

Chapter 5 does the same for property trading companies, including companies engaged in property development, property dealing, and property management. We will see how the treatment of expenses and, in particular, property purchases and sales differs from property investment companies.

Chapter 6 looks at capital gains arising in the company and how to minimise the tax burden arising. This chapter includes a detailed case study to explain how it all works, including how capital gains and capital allowances interact on a property sale.

In Chapter 7 we look at the equally important issue of Capital Gains Tax on the company shares, including some tips on how to keep it to a minimum when selling the company, winding it up, or transferring shares to a family member.

Chapters 8 and 9 cover two other important taxes for property companies, Stamp Duty Land Tax (and its equivalents in Scotland and Wales), and VAT.

A property company does not exist in isolation, of course, and in Chapter 10, we look at the crucial issue of how a property company owner can extract funds from their company tax efficiently... and even when taking money out of the company actually saves tax!

Chapter 11 explores the different methods of financing a property company and compares their relative merits, as well as looking at some tax saving ideas, including one structure that can potentially turn a loss before tax into a profit after tax: effectively getting the Government to fund your property business.

In Chapter 12 we look at some of the formalities involved in setting up and running a property company, including how the company can get tax relief for expenditure incurred before it was even formed.

Considerably larger numbers are involved in Chapter 13 when we look at how to transfer an existing property business into a company. This can be a costly exercise, although it often pays off in the long run; but there are

also ways to cut the costs involved and even to create significant long-term tax savings in the process.

Chapter 14 picks up on some other important tax issues, including a potential pitfall awaiting many property companies this year, and key issues for non-UK residents, Scottish taxpayers, and company owners with young children. Chapter 15 then covers some specialised property companies.

We close in Chapter 16 by returning to the question of whether, and when, a property company will save you tax. In this edition of *Using a Property Company to Save Tax*, I've approached the issue in a fresh and easier to follow style. But the conclusions remain the same: a property company can provide substantial tax savings and significantly better after tax returns on your investments, but you have to know how to make the most of the potential benefits available.

Tips and Warnings

Sprinkled throughout this guide, you will 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. There are also a few '**Practical Pointers**' designed to make life easier. Watch out for all of these as you read the guide.

Finally

Whether you are considering using a property company in future, have only just started, or have been operating one for many years, my aim in this guide is the same: to help you save as much tax as possible through sensible planning measures, understanding your rights and obligations, and a better appreciation of what you and the company are able to claim.

Finally, I would like to thank you for buying this guide and wish you every success with your property business.

Scope of this Guide

This edition of *Using a Property Company to Save Tax* incorporates all relevant Government proposals announced prior to the date of publication, up to and including the Chancellor's November 2023 Autumn Statement. Some proposals are not yet law and may undergo alteration before being formally enacted. As we have seen in recent times, it is also not unknown for Government proposals to be abandoned altogether.

While this guide primarily focuses on the current position and the future, I will generally continue to include rules that form the basis for the preparation of Corporation Tax returns for periods commencing after 31st March 2020 and, where relevant, personal tax returns for all years from 2021/22 onwards (Corporation Tax returns may generally be amended up to two years after the end of the company's accounting period; personal tax returns for 2021/22 may be amended until 31st January 2024). Rules applying in earlier periods will only be included where they continue to be relevant.

As far as tax **rates** are concerned, unless stated or implied to the contrary, the Corporation Tax rates quoted throughout this edition are those applying for the 2023 Financial Year commencing on 1st April 2023 and the Income Tax rates used are those applying for the 2023/24 tax year commencing on 6th April 2023.

This guide is aimed at property investors who are either already using a company to run their property business, or who are considering using a company in the future. In the latter case, this might only relate to new investments, or may involve the transfer of an existing property business, and both these situations are catered for.

While many of the principles involved in taxing rental, trading, or other income derived from property, are the same for both personal and company ownership, there are also many differences. In this guide, unless stated to the contrary, we will only be considering company ownership of property or property businesses.

Naturally, many property company owners also have a property business owned and run as an individual. I will take this into account when analysing the interaction between your company's tax position and your personal tax position, but this guide does not look in detail at how your personal property business is taxed.

The company owner's personal tax position is, of course, highly relevant to the company's tax-saving potential and we will consider this as and when necessary. But what we will **not** be looking at is personal ownership of property or a property business: except to the extent

necessary to draw comparisons or look at how it interacts with income or capital gains derived from your property company.

We will touch on property partnerships to some extent: not so much as a main focus of this guide but, as we will see later, because of the important role they can sometimes play in transferring a property business to a company.

For a detailed examination of the tax treatment of: individual landlords owning property personally; sole traders running another type of property business; partnerships (including limited liability partnerships); and trusts, see the Taxcafe guide *How to Save Property Tax*.

Primarily, for the purposes of this guide, we will be focussing on UK resident company owners running a property business through a UK resident company. We will cover the UK tax implications for UK resident companies investing in property anywhere in the world. However, it is important to understand that investing in overseas property is likely to have foreign tax implications, even for a UK resident company. Foreign tax issues are beyond the scope of this guide.

UK tax issues facing non-UK resident company owners, or non-UK resident companies, investing in UK property are covered in Section 14.5.

Current or potential future variations in taxes apply in the devolved nations within the UK. These variations are covered within this guide as follows:

- i) Income Tax rates for Scottish taxpayers: Section 14.8
- ii) Land and Buildings Transaction Tax on purchases of property in Scotland: Section 8.11
- iii) Land Transaction Tax on purchases of property in Wales: Section 8.12
- iv) Corporation Tax for companies operating in Northern Ireland: Section 2.2

The implications of these variations are covered within the relevant sections noted above. Throughout the rest of this guide, I will ignore the variations listed above unless specifically stated to the contrary. In particular, I will generally refer only to Stamp Duty Land Tax on purchases or transfers of property. Readers should, however, be aware that different rates of tax apply on purchases or transfers of property in Scotland or Wales, and the name of the tax will be different.

The reader must also 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 and Taxcafe UK Limited 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.

About the Examples

This guide is illustrated throughout by numerous worked examples. In preparing the examples, I have assumed the UK tax regime will remain unchanged in the future, except to the extent of any formal Government announcements already made at the time of publication. However, if there is one thing I can predict with any certainty, it is the fact change **will** occur. The reader should bear this in mind when reviewing the results of examples in this guide.

Unless specifically stated to the contrary, individuals described in the examples in this guide are:

- i) UK resident and domiciled for tax purposes
- ii) Not subject to the Child Benefit Charge
- iii) Not claiming the marriage allowance
- iv) Not Scottish taxpayers (i.e. pay Income Tax at normal UK rates);

Companies described in the examples in this guide are:

- i) UK resident for tax purposes
- ii) Close companies but not close investment holding companies (see Section 14.2)
- iii) Stand-alone companies with no associated companies
- iv) Drawing up accounts for a period of twelve months;

And properties described in the examples in this guide are located in England or Northern Ireland.

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, are again entirely coincidental.

Abbreviations and Terminology

Generally, at Taxcafe, we don't like using jargon because we want to keep our guides as simple as possible. To save some space, however, I have allowed myself a few abbreviations. I think they are fairly obvious ones and should not cause any confusion. Some, like UK or VAT, are in common usage. I will explain what the others mean the first time I use them, and they are all set out again in Appendix E for ease of reference.

- The word 'Limited' (as in 'Taxcafe UK Limited', for example) will be abbreviated to 'Ltd'.
- Large amounts, such as £1,000,000 or more, are abbreviated by use of the letter 'm'. For example, £2,500,000 will be written as '£2.5m'.
- Business asset disposal relief (mentioned several times in this guide) was formerly known as entrepreneurs' relief.

Throughout this guide, unless expressly stated to the contrary, the term 'company' means a company limited by shares, also known as a 'limited company'.

A 'spouse' includes a civil partner, but only includes spouses who are legally married (or legally registered civil partners). Similarly, a 'married couple' refers only to legally married couples or registered civil partners. Unmarried couples are subject to different rules for tax purposes.

While civil partners can, of course, also be business partners (as can any spouses), these are entirely different things.

Unless expressly stated to the contrary, all references to partnerships in this guide mean business partnerships and include limited liability partnerships ('LLPs'). Where it is necessary to distinguish LLPs from other business partnerships, the term 'traditional partnership' will be used to describe those other partnerships.

The term 'partner' may mean a business partner or an unmarried life partner, depending on the context. However, where there is any risk of confusion, I will use the more specific term 'business partner' to clarify the position. Whether this specific term is used or not, business partners include members of an LLP unless expressly stated to the contrary.

When I refer to a 'disposal' of property, this includes property sales. However, disposal is a broader term, as it also includes gifts or transfers to an individual, or to an entity such as a trust or a company.

The term 'tax year' means the tax year applying to individuals, being the calendar year ending on 5th April. For example, the 2023/24 tax year is the year ending 5th April 2024. This is different to the Financial Year used for setting Corporation Tax rates, or the company's own accounting period, and these terms are explained in Section 2.1.

A company is a legal person so, in tax terminology the word 'person' generally encompasses companies. When I wish to refer to an actual, real, living person, I will refer to them as an 'individual'.

Chapter 1

Why Use a Property Company?

1.1 ISN'T IT OBVIOUS?

At first glance, the benefit of running a property business through a company seems obvious. Whereas individual landlords pay Income Tax at rates of up to 45%, and owners of property-based trading businesses pay combined rates of Income Tax and National Insurance ('NI') of up to 47%, the maximum rate of Corporation Tax ('CT') paid by a company is just 25%.

Add to this the fact that companies generally get full tax relief for their interest and finance costs, whereas individual residential landlords get only restricted relief at the basic rate of Income Tax, and the idea of using a company starts to look like a 'no-brainer'.

But this is just the beginning of a far more complex story, involving many other factors which we will examine throughout the course of this guide. While the initial tax saving on annual rental or trading profits is an important issue, it is only one of many.

A company can be set up at a relatively modest cost but it brings significantly higher annual running costs in terms of accountancy fees and other formalities. And transferring an existing property business into a company can be extremely costly, although it often brings substantial long-term benefits too.

Another thing about companies is they are far easier to get into than to get out of. It reminds me of how my grandmother once lamented that little boys have a habit of getting into things without any idea how they are going to get out of them. As I recall, she was talking about climbing trees at the time, but the principle applies equally well to forming companies: you don't necessarily need a fully thought out exit plan, but you should at least have some idea of where your company will ultimately be headed.

Long before then, most company owners will want to extract some of their company's profits for personal use. This generally brings additional tax costs and it is an absolutely crucial area to consider when deciding whether to use a company, and in operating it as tax efficiently as possible once you've set it up.

As if all this wasn't enough, there are other taxes to consider too, including Capital Gains Tax ('CGT'), Stamp Duty Land Tax ('SDLT'), VAT, and the Annual Tax on Enveloped Dwellings ('ATED').

All in all, using a property company poses a great many challenges. But fear not: help is not just at hand, it's already in your hands. In this guide, we will examine all the factors described above, as well as many others, either to help you decide whether you want to use a property company, or to help you realise the best tax-saving potential out of a property company you already have.

1.2 NON-TAX FACTORS

Before we go on to examine the tax implications of using a company for a property business, it is first worth having a brief look at some of the non-tax factors involved.

Limited Liability Protection

A company is a separate legal entity and, as such, is responsible for its own debts and other liabilities.

The usefulness of this, however, is often limited. Banks will often insist on personal guarantees from the directors or shareholders before they will lend money to the company. Furthermore, modern insolvency law passes a large part of the company's financial responsibilities to its directors, who may find themselves personally liable where the company has been used in an attempt to avoid the payment of liabilities arising in the normal course of its business.

Nevertheless, limited liability can be useful when the business faces unexpected losses or legal liabilities. This can be particularly important when the economy takes a turn for the worse!

Limited liability status can also be obtained by using an LLP. For property investors, however, LLPs suffer the major drawback that interest relief is not available for funds invested in an LLP engaged in property investment.

Flexibility of Ownership

Without the use of a company, it is difficult to involve many other people in the ownership of your property business. Joint ownership with your spouse or partner is easy enough to achieve but as the business grows you may wish to involve adult children or key employees. It is far easier to spread small parcels of ownership of the business through the medium of company shares.

Separation of Ownership & Management/Succession Planning

A company structure will also enable you to separate ownership and management. As your business grows and the years go by, you may eventually wish either to retire or move on to other ventures. However, you may still have a highly profitable business you do not yet wish to sell.

Using a company will enable you to retain ownership (as a shareholder) while passing management responsibility to others (the directors). A company structure also enables this business succession process to take place at a more controlled pace.

Tax Tip

A company is often a good vehicle for passing wealth to children (or other intended beneficiaries). The problem with a property investment or letting business is it does not qualify for property relief for Inheritance Tax ('IHT') purposes. Hence, on the owner's death, the whole portfolio is exposed to IHT.

What a company can provide in this situation is a means to effectively allow the owner to pass ownership to their beneficiaries over a number of years. A sophisticated share structure may also enable you to keep control of your company while passing on a significant proportion of the underlying value to your children. For further details of how companies can be used to pass wealth to your beneficiaries tax efficiently, including a full chapter on the benefits of Family Investment Companies for property investors, see the Taxcafe guide *How to Save Inheritance Tax*.

Finance

Many investors wishing to hold properties through the medium of a company find it difficult or more expensive to obtain the finance they require. This problem seems to most affect those who are just starting their property business, or have only one or two investment properties. Conversely, for larger portfolios, corporate status seems to become a positive factor in the eyes of many lenders.

Some advisers suggest a 'Deed of Trust' could be used to get around the difficulties of raising finance for a property company. We will look at how this type of arrangement might work in Section 11.7.

Legal Rights

If you run your business through a company, you personally will no longer own property. Instead, you will own company shares. Legally, these are an entirely different kind of asset, giving rise to different legal rights. What kind of difference this will make to your affairs will depend on your personal circumstances, as well as what part of the UK (or other country) you and your properties are located in.

As I am not a lawyer, I will not attempt to advise property investors on these issues. The advice I **will** give is you should get legal advice on the implications of owning your properties through a company.

Company Law

If you use a UK-registered company, you will be subject to the requirements of UK company law. This, for example, may restrict your ability to utilise funds from your business for private purposes. (Although borrowing from your own company is now far easier and more flexible than it used to be.)

Audit and Other Statutory Requirements

Larger companies require a statutory annual audit of their accounts. Even the smallest companies must file annual accounts and certain other documentation with Companies House. We will take a closer look at these requirements in Chapter 12.

Costs

Inevitably, the additional statutory requirements involved in running a company will lead to increases in accountancy and other professional costs. These additional costs must be weighed against the tax and other benefits the company brings.

1.3 WHAT TAXES DO COMPANIES PAY?

Corporation Tax ('CT')

The main tax paid by companies is CT. A UK resident company pays CT on its total profits, made up of its worldwide income, profits and capital gains. The CT position for non-UK resident companies is covered in Section 14.5.

We will look at how CT works in Chapter 2, and take a detailed look at its application to property companies in Chapters 3 to 6.

Stamp Duty Land Tax ('SDLT')

Companies are subject to SDLT (and its equivalents in Scotland and Wales) on purchases and other acquisitions of property. We will cover these taxes in detail in Chapter 8.

VAT

Broadly speaking, a company is liable for VAT in the same way as any other business entity. We will examine VAT for property companies in Chapter 9.

The Annual Tax on Enveloped Dwellings ('ATED')

ATED applies to companies owning UK residential properties worth in excess of £500,000, which are not in 'business use'. We will look at this charge in more detail in Section 14.6.

Residential Property Developers Tax

This new tax applies from 1st April 2022 and is charged on annual profits in excess of £25m derived from developing residential property in the UK. The tax is charged at a rate of 4% and effectively operates as a CT surcharge. As it only applies to large property development companies or groups, we will ignore it for the rest of this guide.

National Insurance ('NI') and Compulsory Pensions

If your company employs anyone to help you in its property business, it will be liable for employer's secondary Class 1 NI, at the rate of 13.8% (subject to the £5,000 employment allowance and other exemptions covered in Section 10.3).

The company is also liable for Class 1A NI on any benefits in kind provided to employees and Class 1B NI on any voluntary settlements negotiated with HMRC (e.g. on the cost of sandwiches provided at lunchtime business meetings).

Furthermore, like any other employer, the company has to deduct primary Class 1 NI from its employees' pay and account for this through the PAYE system.

All of this is exactly the same as when you employ someone to help you in a sole trader or partnership business. The key difference, however, comes from the fact that NI will also be due if you pay yourself a salary out of the company's profits, or provide yourself with any benefits in kind (such as a company car). We will look further at the implications of this in Section 10.3.

Most employers now also have to make compulsory pension contributions on behalf of their employees under yet another Government-enforced business burden, auto-enrolment.

For more information on the tax consequences of employing people in your company, providing benefits in kind, and compulsory pensions, see the Taxcafe guide *Putting it Through the Company*.

Business Rates

Companies are liable for Business Rates on commercial property they occupy for use in their business in the same way as any other business entity.

Council Tax

Companies owning vacant residential property may become liable for Council Tax in the same way as other landlords.

Other Taxes Paid by Companies

The taxes listed above are the main taxes encountered by property companies. This is by no means an exhaustive list, however, and

companies may be liable for other taxes in the same way as individuals or other business entities. Vehicle Excise Duty, Landfill Tax, Air Passenger Duty, and Insurance Premium Tax are just a few that spring to mind... there are many others.

Taxes Not Generally Suffered by Companies

Some major taxes are not generally suffered by companies, including:

Income Tax: As explained above, companies pay CT on their income rather than Income Tax. Occasionally, a company may suffer a deduction of Income Tax at source on part of its income, but this can be deducted from its CT liability for the same period. Companies do have to deduct Income Tax from salaries paid to employees and account for it to HMRC under the PAYE system, but they are only acting as the Government's unpaid tax collector rather than suffering the tax themselves. The same principles apply to any deductions under the Construction Industry Scheme ('CIS') that the company is required to withhold from payments to sub-contractors.

National Insurance: Except as discussed above, companies do not pay any other class of NI. In particular, companies do not suffer Class 2 or Class 4 NI on trading profits.

Capital Gains Tax: Capital gains made by companies form part of their profits subject to CT. Companies no longer pay CGT under any circumstances.

Inheritance Tax: Companies are only liable for IHT in the most exceptional of circumstances and, even then, the tax only arises as a result of external factors involving the company's shareholders. A company does not die, so IHT does not arise. Instead, companies are wound up and we will come to the implications of this later in the guide.

1.4 WHAT TAXES DO COMPANY OWNERS PAY?

When it comes to looking at the tax implications of using a property company, it is equally important to consider the taxes paid by the company owner.

A company may be owned by many different entities, including one or more other companies or a trust. However, for the purposes of this guide, we will focus on companies owned by individuals, as most small companies are.

An individual company owner is subject to all the same taxes as any other individual. However, what we are concerned with in this guide is the taxes that arise through their ownership and management of their property company.

Income Tax

In Chapters 10 and 11 we will look at how company owners can extract funds from their company tax efficiently. The possible methods available include salaries, dividends, rent and interest. Subject to the available allowances and reliefs, all of these attract Income Tax and we will explore this subject in detail.

National Insurance ('NI')

Subject to the available exemptions and allowances, paying yourself a salary from your company may attract primary Class 1 NI at up to 11.5% (10% from 2024/25). This again is covered in Chapter 10.

Capital Gains Tax ('CGT')

A sale or transfer of your company shares will attract CGT. We will look at this issue in detail in Chapter 7. CGT may also arise when you wind up your company, and we will look at this in Chapter 16.

Stamp Duty

A purchase of company shares is subject to Stamp Duty at 0.5%. However, Stamp Duty does not apply to an issue of new shares. We will take a brief look at Stamp Duty in Section 8.2.

Inheritance Tax ('IHT')

The value of your property company shares forms part of your estate for IHT purposes. We will touch on this briefly in a few parts of this guide but for a thorough analysis see the Taxcafe guide *How to Save Inheritance Tax*.

1.5 DOES IT MATTER WHAT TYPE OF PROPERTY BUSINESS YOUR COMPANY HAS?

A property company might only carry out property letting (sometimes called property investment); might only carry out a property trade, such as property development, property dealing, or property management; or might carry out a mix of these activities.

While these different types of property business are taxed slightly differently, it does not usually make a significant difference to how the company is taxed. For example, a property investment company pays CT on its rental income and on any capital gains it makes when it sells its investment properties. A property development company pays CT on the profit it makes when it sells its development properties.

But both companies pay the same tax at the same rates on all their taxable income, so the different types of property business a company might carry on generally make very little difference to its overall tax position.

For individual property investors the type of business involved has a significant impact on their overall tax liability, including issues such as whether CGT or Income Tax is due on a property sale, and whether NI is due on their profits. The Taxcafe guide *How to Save Property Tax* has a chapter devoted to determining whether property businesses should be treated as a trading activity or an investment activity.

Since the issue is far less significant for companies, that chapter is not repeated in this guide, although we will have a brief look at the different types of property business a company might carry on in Section 2.8.

Nonetheless, the question of whether a company is classed as a trading company or a property investment company is important for the purposes of the company owner's tax position, as it can affect their CGT liabilities on a sale or winding up; their IHT position on death; and both the CGT and IHT consequences of a lifetime transfer of their shares.

We will examine how a company's status is determined for CGT purposes in Section 7.3. The IHT treatment of property company shares is briefly reviewed in Section 16.13, and is covered in detail in the Taxcafe guide *How to Save Inheritance Tax*.

1.6 OVERVIEW OF COMPANY TAX PROS AND CONS

To conclude this opening chapter, let's take a brief look at the main tax pros and cons of running a property business through a company.

Using a Company: The Pros

- Companies pay CT at a maximum rate of just 25% on any level of annual profits
- Companies are not subject to the horrendous restrictions on relief for interest and finance costs that apply to individual landlords renting out residential property
- A company may claim relief for interest and finance costs on rental properties against any income or capital gains arising in the same period or, in many cases, against income or capital gains of future periods (but see Section 4.8 regarding furnished holiday lets)
- A company may also claim relief for other losses arising from a UK property letting business against other income or capital gains it has for the same period or, in most cases, a later one (this does not apply to losses on furnished holiday lets)
- An investor may claim relief for interest on funds borrowed to invest in a property company against any other income, including salary, self-employment income, pensions, or their own personal rental income. The relief is not restricted, even if the company is investing in residential lettings, although it is subject to other limitations: see Section 11.11

- Companies can get tax relief for pension contributions made on behalf of directors, regardless of the type of business carried on by the company (subject to the points discussed in Section 10.13)
- Companies are eligible for the additional allowances covered in Section 3.7, which are not available to individuals or partnerships
- Only companies are eligible to claim land remediation relief
- You may choose any year-end accounting date for your company and it will apply for CT purposes

Using a Company: The Cons

- Companies do not get a personal allowance
- Companies do not get an annual exemption for capital gains purposes
- Companies are not eligible for business asset disposal relief (see Section 7.3)
- Any personal use, by the investor or their close relatives, of properties owned by the company, may have severe tax consequences
- Personal tax liabilities usually arise when extracting trading or rental profits, or property sale proceeds, from the company
- It may be more difficult to obtain tax relief for certain administrative expenses, such as 'use of home as office', when investing via a company
- Companies cannot have a private residence, and hence are unable to claim private residence relief or rent-a-room relief
- Companies cannot calculate taxable profits on a cash basis

In addition to the above points, companies may end up suffering CT at an effective marginal rate of up to 26.5% on capital gains. While this is lower than the 28% CGT rate applying to gains on residential property realised by higher rate taxpayer individuals, it is considerably higher than the maximum CGT rate of 20% applying to gains on other assets, including non-residential property.

Conversely, the maximum CGT rate on a sale of company shares remains 20%, even if the company invests in residential property.

As we can see, property companies carry many 'pros' and 'cons', making the question of whether the company is beneficial overall an extremely complex issue. That is why the rest of this guide really serves two purposes:

- To help you decide whether to use a property company, and
- To help you make the most of your property company if you already have one, or if you decide to use one in future

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