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Hamptons
THE HOME EXPERTS

Pros and cons of putting a buy-to-let into a limited company

Landlord Guide

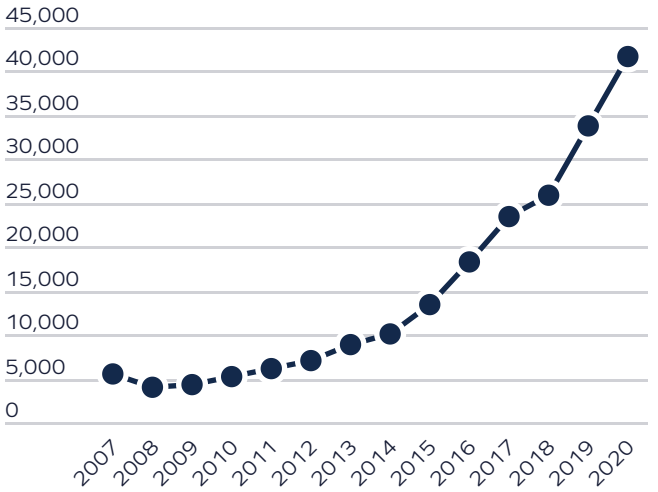
INTRODUCTION

Buy-to-let owners have been hit by several punitive tax changes since 2016, resulting in more than a quarter of a million fewer rental properties than when the sector peaked in 2017. One of the biggest changes has been the removal of tax relief available on mortgage interest payments.

While the changes began to be phased in in 2017, the rules for the 2020-21 tax year mean landlords will only be able to offset 20% of their mortgage interest payment when filing their tax returns. This will eat into the profitability of a buy-to-let investment, particularly if you are a for higher rate taxpayer.

One way to cushion the blow is to put a property, or properties, into a company or SPV (special purpose vehicle) as it is often known. While individuals owning buy-to-lets are effectively taxed on turnover, company buy-to-lets are taxed on profits. This is one of the reasons why more companies have been set up to hold buy-to-let properties between the beginning of 2016 and the end of 2020, than in the preceding 50 years combined. And in the last year alone a total of 41,700 new buy-to-let limited companies were formed, an increase of 23% on 2019.

Buy-to-let companies set up annually (Great Britain)



Source: Companies House & Hamptons

HOW DO I PUT A PROPERTY INTO A BUY-TO-LET COMPANY

The process of incorporation essentially involves setting up a limited company and putting a buy-to-let into it. Typically the company will be set up with the two following SIC codes:

- 68209 – Other letting and operating of own or leased real estate
- 68100 – Buying and selling of own real estate

This is important both for accounting purposes, but also for mortgage lenders too. Most lenders will only lend to companies used solely for buy-to-let purposes. The lender will also require the company to have its own bank account.

If the property is not already owned by you, stamp duty is simply payable at the rate paid by an investor purchasing in their own name.

If the property is already owned by you and in your personal name, the process of putting it into a company involves paying stamp duty on the transfer and potentially capital gains tax too. But if landlords do so before March 31 2021, they will benefit from the stamp duty holiday. For example, an investor buying or transferring a property worth £180,000 would pay £1,100 less in stamp duty if they did so before April.

While a company can be set up relatively quickly and cheaply, the property must be sold to the company at market rate, which will require an independent valuation for stamp duty purposes. If the property is mortgaged, this transfer will also require the lenders' consent. However, some buy-to-let lenders won't lend to a company, meaning it's usually best to transfer the property when the mortgage reaches the end of a fixed term.

HOW DO THE SUMS STACK UP?

The tax benefits of holding property in a company derive from the ability of landlords to offset 100% of mortgage interest against profits, while those holding property in their own name can offset just 20%. For landlords owning a property without a mortgage, its only the higher rate taxpayers that will benefit from incorporating.

This means that someone who owns a £250,000 property with a 75% LTV mortgage generating £1,000 a month in rent in a company will pay around £1,033 per year in tax. While a lower rate taxpayer owning the same property in their own name would pay 42% more or £1,463 each year. And a higher rate taxpayer would pay £3,863 each year, 274% more than someone using a limited company.

But while landlords holding their property in a company can offset more costs against their rental income, mortgage interest rates tend to be higher, although these have come down in recent years. This means that setting up a company to hold a buy-to-let property tends to benefit higher-income taxpayers or those with multiple buy-to-let properties.

Tax payable during 2020/21 tax year on a £250k property with 75% LTV mortgage

	Limited Company	Personal (lower rate)	Personal (higher rate)
Purchase price	£250,000	£250,000	£250,000
Rent	£12,000	£12,000	£12,000
Mortgage interest	£6,563	£4,688	£4,688
Gross profit	£5,438	£7,313	£7,313
Tax due	**£1,033**	**£1,463**	**£3,863**
Net profit	**£4,404**	**£5,850**	**£3,450**

The above calculation assumes a 75% LTV interest-only mortgage with a rate of 2.5% on a property held in a personal name and 3.5% for a property held in a limited company. Gross profit is calculated after costs but before tax. Net profit is calculated after all costs, including tax.

IS IT ALWAYS MORE PROFITABLE TO OWN A BUY-TO-LET IN A LIMITED COMPANY?

In short, no. As you can see from the example above, setting up a limited company tends to benefit higher rate taxpayers or those with multiple buy-to-let properties.

Incorporation is also more likely to profit landlords who own buy-to-lets in London and the South. Given the high cost of property, generally, landlords based in the South are more likely to have bigger mortgages (in cash terms) which means that their mortgage interest bill is likely to be higher. Therefore, the benefits of incorporating a buy-to-let portfolio into a company tend to be bigger, since the mortgage interest can be offset.

This is why more than a third (34%) of all companies set up to hold buy-to-let properties in 2020 were in London. Together, London and the South East accounted for almost half (47%) of all incorporations.

PROS

- **All expenses are tax-deductible using a limited company. 100% of mortgage interest can be offset from the tax bill.**
- **Corporation tax is charged at 19%.**
- **Stamp duty rates are the same as buying as an investor.**
- **No national insurance.**
- **No capital gains tax to pay when the property is sold following incorporation.**
- **If the limited company is sold to another investor, stamp duty is paid at a rate of just 0.5%.**
- **As companies are taxed at a lower rate, banks will often lend more, reducing the amount of deposit required. This is because less rental income is being used to pay tax bills.**

CONS

- **There are costs involved setting up a limited company, including legal fees.**
- **If transferring a property owned in your own name into a company, stamp duty is payable. Capital Gains Tax may also be payable on the transfer.**
- **Some lenders do not lend to companies. Mortgage interest rates for company buy-to-lets tend to come at a premium. Many also come with hefty arrangement fees (although these are also tax deductible).**
- **Accountancy costs tend to be higher.**
- **Limit on taking money out of the company. The first £2,000 in dividends per company director is tax-free each year. If you want to take out more money than that, after using up their £12,500 personal allowance basic rate tax payers current pay 7.5% and higher rate taxpayers pay 32.5%.**