

Should we buy investment property through a company?

Gerry Jackson

Director of Gerry Jackson Ltd

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Summary

- In some circumstances using a company to own investment property will save tax
- But not always



Received wisdom

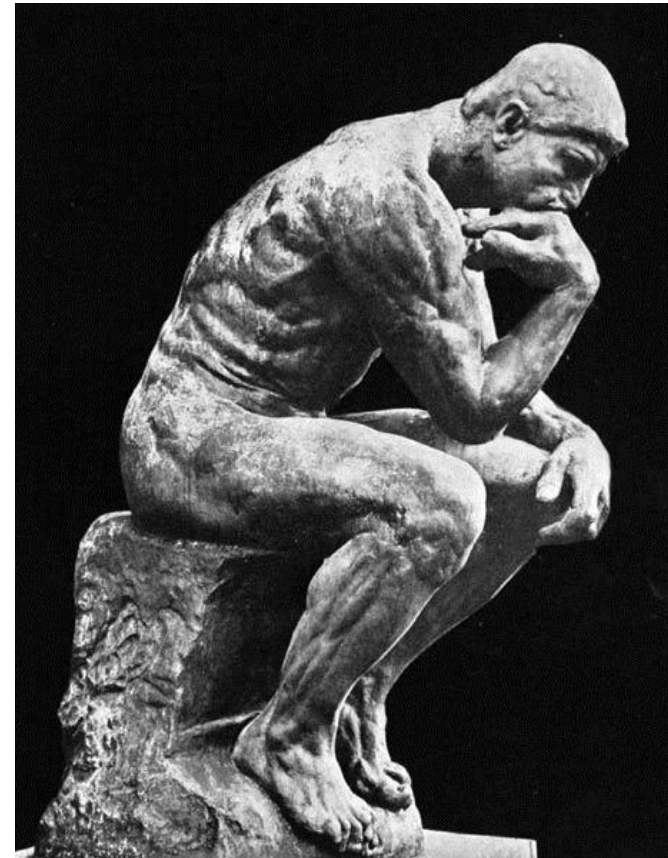


- The conventional view serves to protect us from the painful job of thinking.
 - John Kenneth Galbraith (1908 - 2006)



The “old” wisdom

- Better to own investment property personally rather than through a company
- Why?





Own it personally...

- When you come to sell it, you pay CGT
- You get annual exemption(s)
- CGT rate of 18%
 - Although we now have 28% for higher-rate taxpayers



Own it through a company...

- Corporation Tax on any gain
 - Rate from 21% to 29.75%
 - Don't forget companies get Indexation Allowance
 - Rates will go down on 1 April
- More tax on getting cash out of company
 - Maybe as dividend
 - Maybe as capital gain



But things have changed

- 28% CGT rate
- Indexation may be more important
 - If inflation picks up
- CT rate is easing
 - Small company rate to become 20%





Assumptions

- Tax rates won't change over next 10 years
 - 50% rate? My example doesn't use that rate
- Inflation will be significant for a number of years
 - Companies will continue to get indexation allowances
 - People won't
 - Allowances will keep pace with inflation



So an example

- I buy a property now for £300k
- In 10 years it's worth £600k
 - But that's partly because inflation has been 5% pa





So an example

- By then I'll be retiring
 - And I'll want the money for my retirement
- I won't otherwise be a higher-rate taxpayer
 - My pension's not that good!





If I own it personally

- Gain (£600k value - £300k cost) £300,000
- Annual exemption (say in 10 years) £17,000
 - Assume no joint ownership with spouse
- Taxable £283,000
- Taxable at 18% (say) £30,000
 - Again assume no joint ownership with spouse
- Taxable at 28% (the balance) £253,000
- **CGT payable** **£76,240**
- **Cash after tax** (£600k less tax) **£523,760**



If a company owns it

- Gain (£600k value - £300k cost) £300,000
- Indexation allowance £189,000
- Taxable at 20% £111,000
- **CT payable** **£22,200**
- **Cash after tax** (£600k less tax) **£577,800**
 - (still in the company)
- So far, better off by £54,040



Then get it out

- Pay gain out as dividends
- Tax free if I stay within the basic rate
 - Expensive if I don't!
- Maybe £28,000 pa for 10 years
 - Or whatever figure means no higher-rate tax
- **Total tax saving: up to £54,000**



What happens to rental profits in the mean time?

- If property is owned personally, they're mine
 - Taxed at my tax rate
- If the company's, it pays CT
 - Take it out when I want to, as dividend



Borrowing money?

- If I buy property personally
 - Interest deductible against rental income
 - Losses can be carried forward
 - May never be used



Borrowing money

- If company borrows money
 - Interest deductible against rents
 - Losses can be set against other company income
 - If any
- If I borrow money and lend it to company
 - Interest deductible **against my other income**



Another example

- Fred has a salary of £115,000
 - Ouch! No personal allowances!
- He wants to buy a £300k investment property
- And he'll borrow £300k
 - Say 6% which is £18k a year interest



If he does it personally

- £18k interest against rental income
- May create a loss
- Carry it forward?



Via a company

- Lends to a company
 - Doesn't charge interest
- Claims tax relief of £18k against his income
 - Which is now £97k — allowances reinstated
- Company pays CT on rental profit
 - Maybe pays it out to Fred's wife



Some other points, however

- Will lenders lend if property is to be in a company?
- And if they do will the interest rate be higher?
- SDLT — pay it again if you already own the property
- Oh, and there are running costs of a company



Other ways to use a company?

- Sheltering rental profits from Income Tax
- Incorporating just before a sale



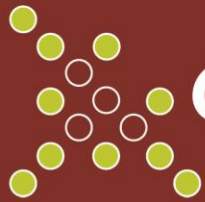
Conclusion

- There is no answer which is right in all circumstances. Sometimes using a company will be advantageous. Sometimes it won't be.
- You should take professional advice.



Remember

- In theory
Theory and practice are the same
- In practice
They aren't



critchleys
CHARTERED ACCOUNTANTS
& BUSINESS ADVISERS

Gerry Jackson
01865 261106

gjackson@critchleys.co.uk

