Broadcast

FACTSHEET: INCORPORATING A PROPERTY BUSINESS

SPECIAL ISSUE

01753 888211
www.nhllp.com

If you have a property rental business, you may be running it through a limited company, or you may be operating as an unincorporated business and wondering whether you should incorporate.

There are advantages and disadvantages to incorporation.

Incorporating an existing property rental business

If you already run a property rental business and want to incorporate that business you will incur some up-front costs, which may be significant.

One of the main disadvantages is that stamp duty - SDLT (or LBTT in Scotland or LTT in Wales) - has to be paid again as the properties are being transferred to a connected company. Any SDLT will be based on the market value of the property(ies).

You may also realise a chargeable gain when you dispose of properties that you own personally to your limited company. However, where the consideration is in shares, incorporation relief (which applies unless you disclaim it) provides for the gain to be held over until the shares are sold, deferring the time at which any capital gains tax needs to be paid.

You may also encounter difficulties refinancing loans or mortgages secured on any transferred properties.

Setting up a new limited company and purchasing property

If you are thinking of starting a property rental business and running it as a limited company, you will need to set up a company. Once set up, the company will need to acquire the rental properties (securing finance if required). SDLT (or LBTT in Scotland, LTT in Wales) will be payable when the properties are purchased.

Tax on rental profits

One current attraction of operating as a limited company is that you will pay corporation tax at 19% on your profits, if you are a standalone company with profits under £50,000, rather than income tax at 20%, 40% or 45%. However, since 1 April 2023, the rate of corporation tax has increased to potentially 25% if your profits are more than £50,000; the small profits' rate remains at 19% where profits are below £50,000. The rate is set at 25% where profits are in excess of £250,000. Where profits are between £50,000 and £250,000, corporation tax is charged at 25% as reduced by marginal relief. The taper from 19% where profits are up to £50,000 to 25% where profits are over £250,000 means that between these limits, the marginal rate is more than 25%.

Another important consideration that will need to be considered is that if you have more than one company, the upper and lower profits limits are divided by the number of associated companies plus one.

This increase in corporation tax may impact on whether incorporation is worthwhile. The decision will depend on the rate at which you pay income tax and the rate at which you pay corporation tax from April 2023. However, even beyond April 2023, the higher and additional rates of income tax still exceed the 25% main corporation tax rate.

It is worth noting that a company does not have a personal allowance, so corporation tax is payable from the first £1 of taxable profit. Unless your personal allowance has been abated (which starts where adjusted net income exceeds £100,000) or used against other income, you may be able to enjoy the first £12,570 of your 2024/25 property income, tax-free.

You can deduct expenses wholly and exclusively incurred for the purpose of your property business when working out your taxable profits.

Finance costs

The tax relief available to landlords running unincorporated property businesses has been gradually restricted over the last few years. As an unincorporated landlord, you can no longer deduct finance costs, such as mortgage interest, when working out your taxable profits. Instead, you will receive relief as a tax reduction of 20% of the finance costs, regardless of the rate at which you pay tax. This is capped at 20% of property profits or 20% of adjusted net income if lower. The restriction does not apply to furnished holiday lettings (FHL) although the tax breaks afforded to FHL businesses are being abolished from 6 April 2025.

By contrast, a limited liability property company can deduct allowable finance costs in full when working out its taxable rental profits. This means relief is given at the corporation tax rate.

Also, the issue of unrelieved interest does not arise as it is deductible in full, even if this creates a loss.

Capital gains

If your limited company disposes of a property, your company will pay corporation tax on any chargeable gain at the corporation tax rate, Potentially at 25% for the financial year 2024.

By contrast, if you dispose of the property personally and you have income and gains in excess of the basic rate limit (set at £37,700 for 2024/25), you will pay capital gains tax at 24% on the disposal of a residential property and at 20% on the disposal of a commercial property. If your income and gains do not exceed the basic rate band, you will pay capital gains tax at, respectively, 18% and 10%.

However, your company will not benefit from the annual exempt amount (set at £3,000 for 2024/25).

Your company must pay corporation tax on any chargeable gains as part of its corporation tax liability nine months and one day after the end of its accounting period.

If you make a residential property gain personally, you must report it to HMRC within 60-days and make a payment on account of the capital gains tax due within the same period.

Annual tax on enveloped dwellings

If your limited company holds residential property valued at more than £500,000 you will need to consider whether a charge to the annual tax on enveloped dwelling arises. However, you can benefit from relief if you are running a qualifying property rental business. This will be the case if you are carrying on a property rental business on a commercial basis with a view to profit.

Extracting profits from your property company

Although you may pay less tax on your rental profits if you run your business through a limited company, rather than as an unincorporated property business, this is not the full story.

If you want to make use of the rental profits for personal purposes, you will need to extract them from your company, and this may trigger personal tax and National Insurance liabilities depending on the extraction route taken.

Extraction options could include salaries and/or dividends. Salaries may create income tax and National Insurance liabilities for directors and tax on dividends are punitive for higher rate taxpayers.

This increases in the tax and National Insurance cost of extracting funds from a company and should be considered when deciding whether to operate as a limited company.

We can help

As with most tax planning exercises, deciding on the best outcome will depend on all the issues described in this update PLUS consideration of any other income streams or business interests you may have.

Before making any firm decision, it is worth preparing an impact assessment so you can make your decision based on hard facts.

We can help you do this, call us on **01753 888 211** or email **info@nhllp.com** we would be happy to help.