SHOULD I TRANSFER INDIVIDUAL PROPERTIES INTO A COMPANY?

By specialist property accountant **Stephen Fay FCA**

Many landlords own mortgaged residential property in their personal name and are affected by Section 24 mortgage interest relief restrictions. Ideally, they would therefore like to transfer individual properties into a property company, to avoid the new restrictions. However the CGT and SDLT cost of doing this is often prohibitive … but not always!

Why should I consider transferring my personally-owned properties into my property company?

Many residential landlords now own a property portfolio that is split between personal and company ownership – certainly those who were landlords before July 2015 when the then-Chancellor George Osbourne announced Section 24 mortgage interest restrictions would begin from tax year 2018, phasing in over the 2018, 2019, 2020, 2021 tax years, replacing a direct tax deduction for residential finance costs with a flat-rate tax credit on 20%.

This can mean that mortgaged personally-owned residential property can be subject to high rates of taxation, so there is an incentive to transfer such property into a company, where Section 24 doesn't apply.

Example

Mrs Miggins is employed on a salary of £60,000, and therefore is a higher rate (40%) taxpayer. She owns three residential properties on Pie Shop Lane in her personal name. Each Pie Shop Lane property is valued at £125,000, yields a net rent (after repairs and insurance) of £500 pcm and has a mortgage costing £250 pcm.

From tax year 2021 onwards, Mrs Miggins will pay annual income tax of £1,800 on each Pie Shop Lane property, using these figures, a marginal tax rate of 60% on cash profit.

What's the issue when transferring residential property into my property company?

Using a property company for new acquisitions has made tax sense for many landlords since Section 24, as finance costs remain fully-deductible in a company.

However the key issue with transferring existing personally-owned residential property into a company is that for tax purposes, the landlord and the company are treated as 'connected' and the properties are deemed to be transferred at market value for tax purposes.

CGT

Often the capital gain on a property transferring to a company is either nil or modest, because there may not be a capital gain as such (many areas of the UK have not seen house price growth for a decade), or because the CGT Annual Exemption (double for joint property owners) covers the gain, or because the landlord has capital losses to utilise.

SDLT

Companies acquiring residential property are subject to a 3% SDLT surcharge, which can make a property transfer into a company a prohibitively expensive option.

However, there are some SDLT-mitigating options that may reduce the SDLT cost to an acceptable (as far as paying SDLT can ever be acceptable!) level:

1. The government has reduced the SDLT charge on properties purchased by (or transferred into) a company to a flat-rate of 3%, up to a value of £500,000. This change began on 8 July 2020 and lasts until 31 March 2021, and has much reduced the SDLT due on many properties. (Eg a £500,000 property transfer to a company would now cost £15,000, rather than £30,000.)
2. Multiple Dwelling relief (MDR) – where two or more properties are transferred, the average value of the properties can be used for SDLT purposes, which can sometimes lead to a lower overall SDLT bill.
3. When six or more properties are transferred to a company, the non-residential rates of SDLT apply, which means the 3% SDLT residential surcharge doesn't apply.

What are the benefits of transferring residential property into my property company?

1 Reducing personal income tax by avoiding Section 24 mortgage interest restrictions

Mrs Miggins's Pie Shop Lane property above would be taxed at £570 in a company (@ 19% corporation tax rate), a reduction of about a third of the personal income tax cost (the marginal tax rate for personal ownership was 60%).

If Mrs Miggins had a credit on her company director's loan account, she could extract the post-tax profit from the company tax free. Or she could retain the funds in the company and save it towards a new property deposit, pay into a company pension, pay down company mortgages etc.

2 Property equity is credited to the director's loan account

This is potentially where a Higher Rate taxpayer can get a major tax benefit. When a property is transferred from personal to company ownership, the equity is treated as a credit to the director's loan account, which in turn allows the director to extract that amount from the company tax-free.

If Mrs Miggins's Pie Shop Lane properties were mortgage free, the full £125,000 value would be credited to her director's loan account. As Mrs Miggins is a higher rate taxpayer, this means that she would not need to pay the 32.5% income tax rate that would otherwise apply, because she now has a £125,000 credit in her director's loan account. This then could potentially save her 32.5% x £125,000 = £40,625 in income tax, if she wanted to extract the company's profits for personal spending.

Even if the properties were mortgaged, the equity would still be credited to the director's loan account, eg a 60% company mortgage would mean that 40% of the £125,000 property value (£50,000) would be credited to the director's loan account.

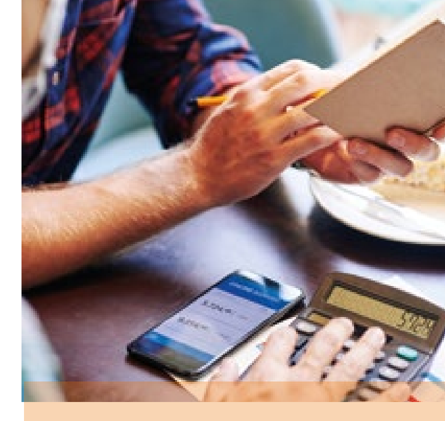
For Higher Rate taxpayers wishing to access their property company's profits but without incurring personal Higher Rate income tax to do so, this is an extremely valuable benefit.

3 Property profits taxed at corporation tax rate (19% as at August 2020)

A key benefit of company property ownership is that there is a flat corporation tax rate, as opposed to a tiered income tax regime, and residential finance costs are fully-deductible. This therefore allows a property company to have a much larger portfolio size compared to personal property ownership, while still benefitting from a flat, low tax rate.

How do I decide whether it's worth transferring a property into my company?

1. Establish the market value of the property in question – bear in mind, if using a company mortgage to facilitate the transfer from personal to company, the lender's surveyor will, effectively, set the valuation of the property.
2. Calculate the SDLT that would be payable on the transfer of the property into a company – bearing in mind the temporary SDLT rate reduction, and the option to use Multiple Dwellings relief (two or more properties transferred) or non-residential SDLT rates (six or more properties transferred). Add the cost of any CGT payable.
3. Calculate the annual tax saved by having the property within a company ie compare the personal tax annual bill to a company tax annual bill = the annual saving. Then, consider the overall benefit of transferring the property into the company.



For example:

Annual tax saved (personal income tax rate vs company tax rate) eg, for Mrs Miggins's Pie Shop Lane property, this was £1,800 - £570 = £1,230

SDLT cost: £3,750 (£125,000 @ 3%)

Payback Period: 3.3 years

(As a general guide, the ideal payback period should ideally by 2-5 years, to justify incurring tax now, to save tax in the future.)

4. Finally, factor in the benefit of a substantial credit on the director's loan account. For Mrs Miggins's mortgage-free Pie Shop Lane property, valued at £125,000, there would be the benefit of being able take £125,000 of profits from the company without suffering a 32.5% income tax charge.
5. Finally, make a decision! Usually the most suitable properties to transfer into a company on an individual basis are those of modest value (since SDLT is lowest for lower value properties), that aren't standing a significant capital gain (so CGT on transfer is nil, or low) and are keepers – good, solid rental properties that are worth retaining for the long-term, to make the transfer cost worth incurring.

Conclusion

Transferring individual personally owned properties into a company incurs potentially CGT, and certainly SDLT. However, it may well be the case that some upfront tax cost to move personal properties into a company can be worth incurring, to save rental profits from being taxed at high marginal tax rates as a result of Section 24.

And, there is the benefit of a credit to the director's loan account, which can save 32.5% dividend tax for a higher rate taxpayer, and be a useful way for higher rate taxpayers to access their property company's profits without paying the punitive 32.5% higher rate of dividend tax.

Many property investors have cheap tracker mortgages that they would have to replace with more expensive company mortgages if they transferred a property to a company – and so a full incorporation (transferring **ALL** personally-held property into a company) isn't an ideal option.

However, that doesn't mean that there isn't a benefit in cherry-picking individual properties that are long-term keepers, with modest CGT and SDLT due on transfer to a company, which can result in a substantial overall tax saving when factoring in income tax saved and the credit added to the director's loan account.

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