# End times …
# exiting BTL tax-efficiently

By specialist property accountant **Stephen Fay** ACA

**Most professional landlords think about what life would they be like if they didn't own a property business, and instead owned truly passive investments, such as stocks and shares.**


Many landlords, who are thinking about a 'traditional' retirement, are interested in exiting the private rental sector permanently, but are put off from doing so because of tax concerns.

This article looks at how private landlords (ie those who own their properties personally) could transfer their properties into a company prior to selling their portfolio, and benefit from the 're-basing' of their property purchase prices, potentially saving significant sums in capital gains tax.

## Why would a landlord want to exit BTL?

Most portfolio landlords are hands-on in their property business, albeit with varying degrees of personal involvement. Even for landlords who employ letting agents, there is still a certain amount of work involved and effort required to manage what is effectively an active business (as opposed to investments like stocks and shares of course, which don't require managing in the same way).

Renewing insurance, ensuring gas and electrical compliance, managing rental income and expenses, renewing mortgages, risk and uncertainty about Section 21, tax challenges … there is no denying that being a portfolio landlord requires time and effort. For many landlords this is a major concern in later life.

Not all landlords have family that they want to pass on their property portfolio to (some do, but the family don't want to be landlords!), and many landlords do want to retire in the traditional sense … in other words, sell up completely and exit the BTL business.

## But won't selling my properties mean I have less income to live on?

This is usually the nub of the issue … BTL makes financial sense largely as a result of leverage, ie the ability to own an asset (property) but having only paid (usually) 25% of the purchase price, as the mortgage lender provides the other 75% of the purchase price. This then allows the landlord to effectively buy four times as much property than all-cash would allow, hence potentially quadrupling their income and capital gains.

So, all things being equal, a landlord will earn less income from un-leveraged assets such as stocks and shares than from leveraged assets like mortgaged residential property.

## The question then essentially becomes … is the income that I could earn from my property equity (assuming say a 5% return) sufficient to support me in retirement if I converted it to stock and shares?

For example … a landlord with £4m of property assets and £2m of mortgage debt has net equity of £2m. As a landlord, the net income that this £2m equity might generate could be £150,000, whereas assuming the same amount invested in stocks and shares, the return might be £100,000 (5%).

Of course, the above simple example ignores volatility of assets and income, interest rate and leverage risk, diversification and many other factors when trying to compare property with other assets … though it does highlight the better return that property investing can generate as a result of (1) leverage and (2) personal day to day involvement and management by the landlord. **BUT**, the extra return comes at a price – your time, energy, personal responsibility etc!

## OK, I've decided I want to exit BTL permanently … but the tax would kill me – wouldn't it?

This is usually a major factor for older portfolio landlords who are thinking about a life without tenants and mortgage applications, but who have significant capital gains on which a significant tax bill would arise.

Many landlords will have built up their residential property portfolio over the past 20-odd years of BTL, in their personal names, and as a result of Section 24 mortgage interest restrictions are now Higher Rate taxpayers (meaning, they have taxable incomes of >£50,000 per year). This in turn means that CGT is charged at 28% on residential property capital gains in excess of the CGT Annual Exemption (2022: £12,300).

And, of course, there is no re-investment relief for a private landlord who might simply sell all his properties and re-invest the proceeds into other assets, such as stocks and shares.

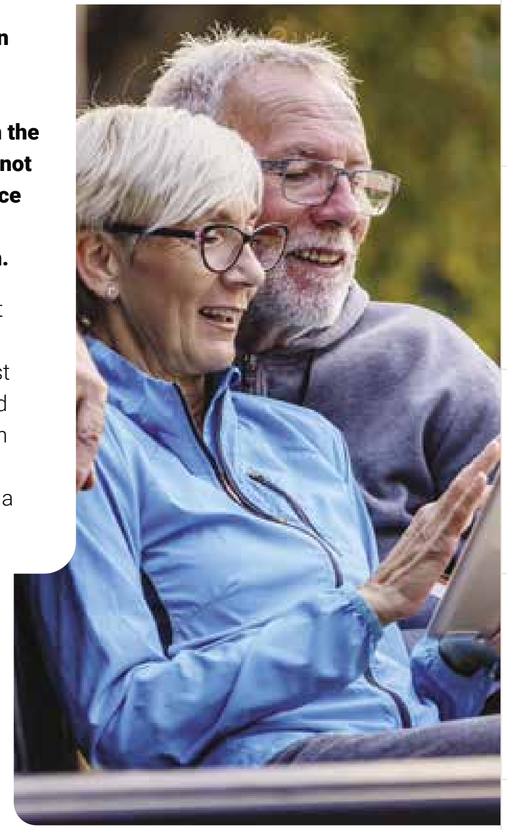
And this is where transferring a property portfolio into a company – known as an incorporation – can really help …

## I've considered incorporating, but it's not for me – or is it?

Of the private landlords who have incorporated in recent years, the large majority have done so to avoid the impact of Section 24 mortgage interest rate restrictions. This restriction doesn't apply to companies, and so companies receive a direct, full deduction for mortgage interest.

However, there is another reason why incorporation of a personally-owned property portfolio could make tax sense …

**When a property portfolio operated as a partnership is transferred to a company, the property 'base cost' becomes the market value of the property at the date of incorporation.**



**This acts to reduce the tax payable in the future when the company comes to sell the property, as the gain is calculated on the market value when the company received the property, and not the individual's original purchase price … which acts to 'wash out' the pre-incorporation part of the capital gain.**

**For example:** Mr & Mrs Landlord want to sell their £4m property portfolio, with £2m mortgage debt, and re-invest the net equity released into stocks and shares, and retire. However, faced with a £1m capital gain (having paid £3m for the £4m portfolio), there would be a £273,000 capital gains tax bill to pay.

## How would incorporation help?

Assuming that the property portfolio is operated as a partnership and qualifies for incorporation relief, there would be no CGT or SDLT to pay on transferring the portfolio into a company. (**Note**: ***this article isn't focussed on the detail of how incorporations work, just on the benefit of the re-basing of property values.***)

And, crucially, the base cost of the properties would become £4m, rather than the £3m figure which would apply if the properties remained in personal ownership.

This would mean that if the company were to sell the properties, the tax payable by the company would be much reduced as the capital growth up to the point of incorporation has been 'washed out', ie not taxable.

In practice, the company directors would be well advised not to sell the entire property portfolio immediately after the incorporation as there is a risk that HMRC would regard the incorporation as a sham, done solely for tax-planning purposes.

However, usually in such cases the portfolio would in any event be sold off over several years, as the owners would prefer to stagger the sales to avoid a large reduction in current income, and ensure that full value is achieved for the portfolio sale.

## OK, then what?

Typically, the net sale proceeds released from each property sale would be re-invested into non-property assets, such as stocks and shares, by the company. Care obviously needs to be taken to ensure that re-deploying large amounts into new assets is done in a financially efficient way, which is normally achieved by investing in a steady way to avoid market peaks and troughs.

In this way, Mr & Mrs Landlord transition over a period from 100% property-focussed to 0% property-focussed. The incorporation allows this to be done while paying little tax, given the only tax payable would be on any capital growth achieved after the company had acquired the properties at market value.

In terms of extracting funds from the company, as outlined in a previous article ("Is this the perfect retirement BTL portfolio?"), a combination of salary and dividend to use both directors' annual Personal Allowance and Basic Rate tax bands (totalling £100,540 for a couple for the 2022 tax year) can mean that a personal income of around £8,000 per month can be tax-efficiently taken from the company, with any remaining investment profit being retained within the company.

## Horses for courses …

Of course, incorporation of a personally-held (albeit via a partnership) property portfolio prior to a gradual sale of that property portfolio, and re-deployment of the equity into assets that require very little management compared to property, is a big decision. There are pros and cons of retaining rental property vs switching to more passive assets.

This article has sought to highlight a benefit of incorporation that some landlords may be unaware of (incorporation as a way to avoid Section 24 being the more common motivation). For those who feel that the property business isn't for them any longer, especially older landlords with significant property equity, an incorporation to avoid a sizable CGT bill could be a useful option, and could tip the decision for them.

**GET IN TOUCH**
**www.fyldetaxaccountants.co.uk**