

POST-CLAUSE 24

WHAT SHOULD I DO WITH MY PROPERTIES?

By specialist property accountant Stephen Fay FCA

Claue 24 is the legislation that has now been given Royal Assent and so will mean restricted mortgage interest relief for landlords from April 2017 to the Basic Rate of income tax (20%), albeit on a sliding scale for four tax years to 2020-21. (See previous articles on this topic in YPN and on our website).

As a result, for those landlords who don't wish to (or are unable to) fully-incorporate their portfolio – see next month's article – there is now the unenviable and unforeseen task of having to re-assess whether each rental property held makes sense to be retained personally with a mortgage, given the potentially punitive tax chargeable to do so.

WHY DO I NEED TO RE-CONSIDER MY PORTFOLIO AT ALL?

The new mortgage interest relief restrictions (MIRR) will mean that many portfolio landlords will be faced with large increases in their income tax bills when these new restrictions start to take effect (from tax year 2018, phasing in over four successive tax years until full impact in tax year 2021).

The 'elephant in the room' tax-planning option is to transfer an entire residential rental portfolio into a company, as borrowing costs on residential rental property held in a company are unaffected by the new MIRR.

However, the majority of private residential landlords have mortgages on at least some (in many cases, all) of their properties, and the sheer costs of re-financing their portfolio into a company isn't a feasible option (especially given that many landlords will have significant amounts of attractive pre-credit crunch tracker mortgages which they would not wish to redeem), as well as CGT and SDLT to pay on transfer.

NOTE – some commentators have proposed that it is possible to 'allocate' personally-owned-and-mortgaged rental



property into a company **WITHOUT** re-financing the underlying personally-mortgaged rental property – via a deed of trust (or equivalent) – **AND** while qualifying for a full-portfolio 'section 162' incorporation.

This is clearly 'the Holy Grail', and readers should beware that even a barrister's opinion as to the validity of such a move is just that – an opinion – and the barrister (and the promoting person) will almost certainly **NOT** insure or indemnify the landlord should they proceed with such an action (often at great expense). Therefore, proceed with extreme caution when following such un-insured advice, as should your lenders take issue with your plan, YOU would be faced with having to defend repossession action by your lender(s).

WHERE DO I GO FROM HERE?

Portfolio landlords for whom the new MIRR are going to cause significant extra tax charges should review their portfolio and assess which properties could be transferred and re-financed into a company.

This per-property review should consider:

1. Do I want to retain the property into the long-term?

Clearly, most landlords transferring

properties into a company will incur costs to do so – whether CGT, SDLT, or financing costs.

So, the investment performance of each property needs to be properly assessed. This means a review of:

- **RENTAL YIELD** – does the property generate sufficient rent to justify its retention as a rental property? Many rental properties simply do not generate sufficient NET (after voids / direct costs) rental income to justify their purchase
- **MORTGAGE "QUALITY"** – tracker mortgages on attractive rates are likely to be the cheapest borrowings that to day's property investors are ever likely to see. By moving the property into a company, does the redemption of the mortgage really make financial sense?
- **BUILDING CONDITION** – is the property itself in a good enough condition to mean that medium-to-long term ownership won't result in large refurbishment bills? Many landlords refurbish their properties to a high standard, which may not always translate to a higher sale price. On the flip side, many landlords consciously **DON'T** refurbish their properties to a good standard, and therefore know that sooner or later there will be a major refurbishment bill arising!

- **TENANT PROFILE** – do I 'like' dealing with the typical tenants of this property? Do I see myself dealing with such tenants for a decade or more to come? Can the tenant type be improved?

Use a RAG-rating approach (R=Red, A=Amber, G=Green) to rate each property according to the above, and any further, criteria to help you decide what to do with each property.

2. If I DON'T want to retain the property

If, after having considered the points above, on balance a sale of a property is preferred, i.e. the target property is not to be retained for the long term, given the new MIRR:

- Calculate the capital gain on the sale of the property: have all costs and reliefs been considered? Is the sale price attractive? Is the CGT on sale and the equity released after mortgage repayment attractive? What can I do to reduce any CGT payable?
- Can I re-deploy the capital (equity) into a better personally-owned property and thereby keep my overall gearing levels

"For many, the sheer costs of re-financing their portfolio into a company isn't a feasible option"

below the point at which the new MIRR rules cause a problem?

- Am I keen to invest the property sale proceeds into a tax-efficient (but not necessarily cash-flow-efficient!) investment such as SEIS shares – to reduce the CGT on sale?

3. If I DO want to retain the property – and transfer to my company

Consider the costs of transfer to a company:

- **CGT** – is it generally feasible to sell the property to the company and pay any CGT to do so? For properties standing at a low capital gain the long term benefit of a transfer may be worthwhile, despite some initial costs.
- **SDLT** – In addition to any CGT due on a

transfer of a rental property to a company, SDLT is payable at the transfer value – is this a feasible figure to pay, regardless of any CGT due? (And, bear in mind the new BTL SDLT additional 3% as of April 2016.)

- **FINANCE** – is it possible to procure a company mortgage at an acceptable LTV and rate (the former being the more important since rates are likely to fall in the medium-term for corporate BTL mortgages)? Is cash required to lower the LTV to 'fit' the corporate LTV requirement?

SUMMARY

The decision as to whether to sell, retain, or transfer a property to a company, is a current conundrum for many property investors, and is likely to remain so for several years.

This article has tried to decipher a plan for portfolio landlords – which properties to sell or retain, and why. Ultimately many investors will need to refer to their tax accountant to determine the best course of action at a per-property and a portfolio level over the next few years.

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