Factsheet 1

Setting up a limited company for buy-to-let property investment

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There's a boom in the number of landlords buying properties via limited companies, with good reason.

Mortgage rates are at an all-time low and rents remain strong, yet investing in property is much tougher than it used to be. Increased regulation, stamp duty changes and decreasing tax relief means many property investors have seen a reduction in their rental revenue. However, for many Britons living in a world of low savings interest rates, volatility in the stock market and economic uncertainty, investing in bricks and mortar still feels like a safe long term investment.

To combat these new difficulties more and more investors are deciding to buy properties through a limited company. A staggering 77% of all buy-to-let mortgage applications were made through limited companies in the first half of 2019.

This increase is mostly due to the different treatments in taxation. Instead of paying income tax as an individual, a limited company pays corporation tax. Running your own property investment company won't be for everyone, but if you're considering investing in a buy-to-let it's an important option to consider. Getting your business structure right could make a big difference in the amount of tax you'll be paying. Let's take a look at the pros and cons.

Advantages of limited companies

Improved tax efficiencies and planning

Holding property in a limited company can offer tax benefits. If you're a higher rate taxpayer or plan on owning multiple properties, you'll especially find there's a tax saving. When you own a property personally in your name, the rental profit is added to your other earnings (such as from your job) and taxed as income tax. Rental profits on properties held in a limited company are not taxed at your personal tax rate but the current rate of corporation tax, which tends to be around half of the higher rate of income tax. As a director, you then have the flexibility to choose what to do with the profits - invest in further properties, top up your pension or pay out the profit using tax-efficient dividends. This flexibility can help with your personal tax planning compared to personally owned properties.

You can read more about tax for property investors in factsheet #4.

Portfolio expansion

Planning to expand your property portfolio? You can retain your profits within the company to fund future purchases without them being subject to income tax (until you decide to draw the profits out of the company). Retaining earnings within the company helps to protect them from tax liabilities, so you can repay any debt and expand your property portfolio faster.

Inheritance planning

Property held within a company gives more options when it comes to planning for inheritance tax. If you plan to pass your business on to your family in the future, it's much simpler to transfer a limited company than a privately held property. In this circumstance, as the property remains owned by the company, it could also be protected from stamp duty, inheritance tax and capital gains tax liabilities.

Disadvantages of limited companies

No capital gains tax allowance

When a limited company sells its property, there is no capital gains tax allowance. An individual selling a property would only have to pay capital gains tax on the overall gains above their tax-free allowance. A company will be liable to pay tax on all gains. However, this can be offset by the increased tax efficiency available throughout the rental lifetime of the property, and, for higher rate taxpayers, the tax rate paid through a company could be lower. The tax implications are complicated, and everyone's personal tax liability will be different. It's well worth getting independent tax advice before making any big decisions.

Dividend taxation

If you intend to take your profits out of the company (to spend on your living costs, for example), you'll be taxed on the dividends you take. You do, however, have a personal tax-free dividend allowance which you can take advantage of.

Mortgage rates and choice

Currently, many lenders charge higher interest rates and fees to limited companies compared to individual buy-to-let mortgages. However, with so many lenders now going down this route thanks to the tax incentives, this is changing. It's worth shopping around for the best deal. Thankfully the differing tax treatment also means that lenders' stress testing is often more favourable for lending to limited companies over personal ownership.

You can read more about tax for property investors in factsheet #3.

As you're probably starting to see, there are a lot of different variables at play. You need to take the time to weigh up all the pros and cons and chat to an expert before you choose what works best for you and your investments.

The role of an accountant

Many people think that limited companies are complicated and difficult to maintain. While there is an extra layer of responsibility, it can easily be incorporated into your investment plan and requires little effort relative to the potential benefits.

As a director of a company, you'll legally be required to keep accurate company and financial records and submit the appropriate accounts and returns to Companies House and HMRC. There is, of course, time and cost associated with this and that's why most company owners use an accountant to support them. That's exactly what we do here at Provestor: we're a specialist accountant firm and we'll manage the majority of your accounts for you, while you focus on building your portfolio.

Limited company setup for BTL property investment

A limited company that holds property for buy-to-let and investment purposes is known as an SPV (Special Purpose Vehicle). The company doesn't conduct any trading activity, it just has rent coming in and expenses going out.

A trading limited company is one that has a primary activity other than owning property. For example, if you buy, renovate and sell properties, you are a trading company, or you might be a marketing consultant working through a limited company.

It is important to understand the difference as buy-to-let mortgage lenders typically require the limited company to be an SPV. This allows them to manage their lending, as they don't have to consider and underwrite the risks associated with the trading activities of a business.

Incorporating your limited company

Before you can start building your property portfolio, you'll need to incorporate a limited company. For property investors, this involves registering a limited company with Companies House and registering for taxes with HMRC. Here at Provestor we will manage the incorporation of your property investment company for you.

Other practical considerations should be taken into account, such as opening new bank accounts in the company's name and ensuring you have the right insurance in place.

Becoming a director

Once your company is set up, you will become a director. While this is a great feeling and experience, it does carry responsibilities. Directors are responsible for meeting legal requirements and keeping the annual accounts up to date. Whilst it's likely you'll ask an accountant to support you with much of this, you still need to ensure that you have adequate oversight as you are the one legally responsible.

When borrowing money through a limited company, a lender will typically take a "personal guarantee" from each company director. This means, should the company not be able to pay its debts, the directors will personally pay them. For example, should your company fall behind on mortgage repayments, the bank will ask the directors to make repayments personally.

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Share structure of a limited company

A shareholder is someone who owns shares in a company. This usually means they have voting rights and influence over the running of the company. Shareholders are paid dividends based on the number of shares they hold. It's a crucial part of ensuring your business is running as tax-efficiently as possible, so you need to set up a distribution of company shares that works for you. It's common for spouses, and even children, to be shareholders and receive a share of the company's profits.

Choosing the right accountant

When considering if a limited company set up is right for you it is important to fully understand the advantages, disadvantages and your duties. If you're trying to invest in property, be a hands on landlord, while potentially still working, the day to day administration of a limited company could quickly become a burden. Tax and legislation for landlords is a complex topic, many people find it's not practical or recommended to prepare and submit their own company accounts and returns.

As a property investor, it's important to have the right accountancy service at your side. You already have plenty to be managing. You don't need to be chasing after an unresponsive accountant or trawling the web trying to become a financial expert yourself.

That's why we set up Provestor – to deliver an effortless accountancy service specifically for property investors. We combine insightful accounting software with our friendly team of expert accountants, meaning you can manage your property investments with confidence. Visit www.provestor.co.uk to find out more.

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Our factsheets do not offer investment, tax or financial advice and nothing in them should be construed as advice. Our factsheets provide information and education for investors who can make their decisions without advice. If you are unsure of any investment decision you should seek a professional financial advisor.

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