

Property Investment - Tax Aspects

Investment in property has been and continues to be a popular form of investment for many people. It is seen as a route by which:

- relatively secure capital gains can be made on eventual sale
- income returns can be generated throughout the period of ownership
- mortgage finance is covered in repayment terms by the security of the eventual sale of the property and in interest terms by the rental income.

Of course, the net returns in capital and income will depend on a host of factors. But on the basis that the investment appears to make commercial sense, what tax factors should you take into account?

This factsheet should be considered only in relation to a UK resident property owner.

Who or what should purchase the property?

An initial decision needs to be made whether to purchase the property:

- as an individual
- as a joint owner or via a partnership (often with a spouse)
- via a company.

There are significant differences in the tax effects of ownership by individuals or a company.

Deciding on the best medium will depend on a number of factors.

Commercial property

You are currently trading as a limited company

The personal purchase of new offices or other buildings and the charging of rent for the use of the buildings to your company is very tax efficient from an income tax position as:

- the rental you receive from the company allows sums to be extracted without national insurance
- the company will be able to claim a corporate tax deduction for the rent
- finance costs are currently deductible from the rents.

Capital gains

Capital gains on the disposal of an asset are generally calculated by deducting the cost of the asset from the proceeds on disposal and reducing this by the annual exemption. Gains are treated as an individual's top slice of income and are generally taxed at 18% and 24% or a combination of the two (10%/20% for disposals of non-residential properties before 30 October 2024). Gains on residential property are charged at 18% and 24% throughout 2024/25.

Capital gains tax (CGT) and Business Asset Disposal Relief (BADR)

Unfortunately BADR is unlikely to be available on the disposal of business premises used by your company where rent is paid. This is due to the restrictions on obtaining the relief on what is known as an 'associated disposal'. These restrictions include the common situation where a property is currently in personal ownership, but is used in an unquoted company or partnership trade in return for a rent. Under the BADR provisions such relief is restricted where commercial rent is paid.

Residential property

The decision as to who should own a residential property to let is a balancing act depending on overall financial objectives.

The answer will be dependent on the following factors:

- Do you already run your business through your own company?
- How many similar properties do you want to purchase in the future?
- Do you intend to sell the property and when?

Company versus personal ownership - eventual disposal

If you already run your business through a company it may be more tax efficient to own the property personally as you will be able to make use of your CGT annual exemption (and your spouse's annual exemption if jointly owned) on eventual disposal to reduce the gain.

However, the corporation tax rates applicable to a company disposing of a property may be lower than the CGT rates applying to an individual on the disposal of residential property (18% and 24%).

Company versus personal ownership - rental income

For personally-owned property the net rental income will be taxed at your marginal rate of tax. Tax relief for finance is limited to 20% as a basic rate income tax reducer.

In contrast, the net rental income will be taxed at the corporation tax rate which may be lower than the income tax rates for an individual depending on the amount of rental and other sources of income. Where the purchase is being financed with a high percentage of loan/bank finance, the corporation tax bill should be relatively small.

But there are other factors to consider:

- there is frequently a further tax charge should you wish to extract any of the proceeds from the company
- inserting the property into an existing company may result in your shareholding in that company not qualifying for BADR. You could however form another company to protect the trading status of the existing company.

If you do not have a company at present

Personal or joint ownership may be the more appropriate route but there are currently other significant advantages of corporate status particularly if you expect that:

- you will be increasing your investment in residential property
- you are unlikely to be selling the properties on a piecemeal basis; or
- you are mainly financing the initial purchases of the property from your own capital.

If so, the use of a company as a tax shelter for the net rental income can be attractive.

Use of a company as a tax shelter

Profits will be taxed at the corporation tax rate which is up to 25% depending on the level of profits. This rate applies to trading companies or property investment companies. Where profits are retained, the income may suffer less than if income tax applied. That means there are more funds available to buy more properties in the future.

Tax efficient long-term plans

There are two potential long-term advantages of the corporate route for residential property:

- is there an intention to sell the properties at all? Maybe the intention is to retain them into retirement (see below, '**using the company as a retirement fund**')
- can the shares be sold rather than the property? (See below for issues regarding **selling the shares.**)

Using the company as a retirement fund

A potentially attractive route is to consider the property investment company as a 'retirement fund'. If the properties are retained into retirement, it is likely that any initial financing of the purchases of the property has been paid off and there will be a strong income stream. The profits of the company (after paying corporation tax) can be paid out to you and/or your spouse as shareholders.

Where the profits are taken by way of dividend:

- the cash dividend is the gross amount potentially subject to tax
- a Dividend Allowance charges the first £500 of dividends received in a tax year at 0%
- for dividends above £500, dividend income will be taxed at 8.75% for basic rate taxpayers, 33.75% for higher rate taxpayers and 39.35% for additional rate taxpayers.

Selling the shares

CGT will be due on the gain on the eventual sale of the shares.

The share route may also be more attractive to the purchaser of the properties rather than buying the properties directly, as they will only have 0.5% stamp duty to pay rather than the potentially higher sums of Stamp Duty Land Tax (SDLT) on the property purchases.

SDLT and devolved property taxes

SDLT is payable by the purchaser of the property in England and Northern Ireland. Land and Buildings Transaction Tax is payable in Scotland and Land Transaction Tax is payable in Wales.

Corporate investment in expensive residential property

Where expensive residential property, valued at more than £500,000, is purchased by a 'non natural person', broadly a company, there is a potential charge - the Annual Tax on Enveloped Dwellings (ATED). The ATED is payable by those purchasing and holding residential property through corporate envelopes, such as companies. In addition a higher rate of SDLT of 15% applies to the purchase.

There are exemptions from the higher rate of SDLT and the ATED charge; in particular, property companies letting out residential properties to third parties.

How we can help

This factsheet has concentrated on potentially long-term tax factors to bear in mind.

You need to decide which is the best route to fit in with your objectives. We can help you to plan an appropriate course of action so please do contact us.