Out of the frying pan and into the Fire! (An article on incorporation)

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Since the introduction of the 3% Stamp Duty (SDLT) uplift and George Osborne's now infamous S24 landlord tax and everything that went with it, landlords have certainly been feeling the heat. And if you do the wrong thing now, you'll be walking towards the flames and not the extinguisher!

A simple Google search will reveal that landlords are being told that the only answer is to incorporate, i.e. move their property portfolio into a limited company.

And, as limited companies can deduct 100% of their finance costs and the like, that would be the obvious thing to do. The trouble is that what landlords are not being told is that incorporation is a one-way street and could end up being the most expensive 'business' decision they ever make. Talk about jumping out of the frying pan and into the fire!

Here's why. Apart from the transactional costs (re-mortgaging, professional fees, etc.) and the significantly higher tax regime that you'll eventually find yourself in, you'll have to qualify for what is known as S162 Incorporation Relief. In basic terms, that means the transfer of ownership of all your 'investment' properties at the same time from being in your name, to that of your limited company, without having to pay CGT or SDLT in the process.

Pretty much up until the end of 2017 HMRC was happy to give non-statutory clearance for S162 applications, meaning that you had the certainty that there wouldn't be a massive and wholly unexpected tax bill upon completion. Sadly, that's no longer the case, which means that you won't know whether you have a tax bill until it's too late to stop.

When it comes to mortgages, upon incorporation you go from being a private individual with a whole raft of consumer legislation protecting you, to becoming a commercial borrower whom the law expects to be able to look out for themselves - a very different world.

And if, perchance, you're being told that by using a Beneficial Interest Company Trust (BICT) you can avoid the need to remortgage, then think again. BICTs constitute a breach of your mortgage terms and conditions, and some lenders have powers to call in your debt if any others do so.

The transactional costs

The value of your time to one side, moving from being a private landlord to a corporate one will incur you in the following costs: -

- CGT and SDLT if you don't qualify for S162 Incorporation Relief
- Early redemption charges
- Brokers fees
- Lenders fees
- Legal fees
- Losses cannot be carried forward

Whilst not in themselves direct transactional costs, being a commercial borrower impacts you in the following ways:

- Significantly reduced choice of lenders and higher interest rates
- Lenders will mostly require full personal guarantees (you remain personally responsible for the debt)
- You're tied in to the first lender and their appetite for further lending (each new acquisition or remortgage may need a new lender and a new company if your existing lender isn't interested)
- If property prices fall thereby increasing the loan to value beyond the point to which the lender originally agreed, you'll have to find the cash difference
- Restrictions on what you can borrow (i.e. remortgage) to fund lifestyle.

The Tax Position*

Limited Companies and the individuals within them are taxed up to seven different ways: -

- **Corporation Tax** (19% falling to 17%, but could be uplifted for 'investment' companies, as CGT was for individuals)
- **Capital Gains Tax** on personal withdraws of capital resulting from selling assets (10%, 18%, 28%)
- **Directors Loan Account Tax** (32.5%)
- **Dividend Tax** (7.5%, 32.5%, and 38.1%)
- **Income Tax** (20%, 40%, 45%, and 60% on the slice between £100,000 and £125,000)
- **Employees and Employers NIC** (12% and 13.8% respectively)
- **Inheritance Tax** (40% - 'investment' companies, i.e. those that hold residential property for 12-months or more for the sole purpose of collecting rents, are fully subject to IHT)

*as of the 2019/20 tax year

"When properly arranged and managed, hybrid tax and property ownership delivers a recognised business arrangement"

For most landlords, the above information will come as something of a shock, even though they may have already received professional advice.

Already incorporated? Don't panic, it may still be possible to reduce the ongoing tax bills, albeit that's sophisticated accounting territory and not something that the average firm either understands or knows how to do.

Thankfully though, there are alternatives to outright incorporation.

You could simply stay as you are; not every landlord will suffer, and those on basic-rate tax with small loan to values should be ok, albeit IHT and CGT will most likely remain a problem.

If, however, your goal is to maximise the commercial benefits of building, running, and growing a recognised professional property business that's fully in line with stated Government policy, and to pass it on as intact as possible to the next generation without suffering the huge disadvantages associated with Incorporation, then a 'hybrid' approach could work for you.

Hybrid Business Structure - The best option for your property business?

When properly arranged and managed, hybrid tax and property ownership delivers a recognised business arrangement that means: -

- **No need to remortgage or change title, thus no CGT or Stamp Duty**
- **Tax from your property income at basic rate regardless of how much you draw**
- **Seamless succession planning with Inheritance Tax typically mitigated within two years**
- **Two layers of commercial limited liability and protection against family/marital break up**
- **Maximum commercial flexibility and choice of finance**
- **Being fully in line with Government policy to professionalise the sector and compliant with both the letter and spirit of the law**
- **Quick, easy, and cheap to unwind if the rules change**

Confused about the Tax changes?

Unsure of your best option?

With a free initial assessment we can help you understand whether restructuring your property portfolio today could be a sensible and profitable option for you.

Fill out the form at the stand or visit lt4l.uk/s24

Less Tax for Landlords is a specialist multi-disciplinary consultancy that helps portfolio landlords maximise the commercial benefits of building, running, and growing a recognised professional property business. Central to this service is understanding your commercial needs and objectives, and devising solutions to help you achieve these objectives.

This necessitates an all-round service which includes business consultancy, legal advice, financial planning and tax advice.

To see if Less Tax 4 Landlords can help you, visit our website and complete our Free Assessment at

Lt4l.uk/s24

Write to **info@lesstaxforlandlords.co.uk**, or call **0203 735 2940**

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