WHY ARE LANDLORDS SETTING UP LIMITED COMPANIES FOR THEIR RENTALS?

Since 2017 the number of limited companies being set up by landlords holding properties has tripled, with 300,000 being recorded in 2022 In fact, it is estimated that 40% of all new buy to let purchases are now made via a company structure.

This change in legal entity for many landlords was brought about by the alternations in the tax relief system which was announced in 2015, known as Section 24 and changed how landlords were taxed on their income.

This blog looks at why personal landlords have started switching to owning properties as a limited company and the pros and cons of such a move.

WHAT IS SECTION 24 AND WHAT DOES IT MEAN FOR LANDLORDS?

In 2020 changes to the tax relief system came into full effect. This change, known as Section 24, means that landlords are now taxed on all the rental income from a property. Prior to this, they could deduct their mortgage interest and other fees from the rental income and were only taxed on the profit.

Under the new system, Landlords can still claim back some mortgage interest costs, but this is now capped at the basic income tax rate of 20%

As a result, since the announcement, there has been a huge increase in the number of landlords setting up limited companies to manage their tax bill, but should all landlords follow suit?

We've listed some of the key benefits and disadvantages but as always suggest that individuals seek independent financial advice before making any changes.

THE BENEFITS OF BECOMING A LIMITED COMPANY

- **Reduced Tax Bill**

The biggest factor driving this shift to limited company status is taxation. When a limited company owns the properties, the landlord, now director, does not pay income tax on the rental profits. Instead, the company pays corporation tax which is set at 25%.

If landlords were previously a higher tax rate payer at 40%, they will pay significantly less tax as a limited company with corporation tax.

- **Limited Liability**

In a limited company, the finances of the business are separate from that of the individual. The property portfolio is owned by the company and not the landlord and can't be claimed by creditors as easily as when they are personally owned.

- **Increased Flexibility with Profits**

The profit from rental income can be used with more flexibility within a company structure. It can be reinvested to buy more properties and increase a portfolio prior to paying income tax. It can be paid into pension funds, used to reduce debts or paid out in dividends making use of tax efficiencies.

- **Change Ownership and Inheritance Tax**

As a limited company, it is far easier to change the ownership of the company and thus the portfolio than as an individual landlord. The properties remain owned by the company, and it may be possible to protect them from stamp duty, inheritance tax and capital gains tax liabilities.

THE POTENTIAL PITFALLS OF SETTING UP A COMPANY STRUCTURE

- **Not Tax Efficient for Lower Rate Tax Payers**

For landlords with just one property or who only fall into the basic rate of income tax, then Section 24 affects them far less and setting up a limited company is probably not going to be tax efficient.

However, if a landlord's profit rises or other salaried income rises and tips them into the high rate of income tax it may be a good point to reassess if a limited company is more cost effective.

- **Properties Need to be Sold to the Limited Company**

Any existing properties owned by the landlord would need to be sold to the company. In doing so stamp duty would be incurred. Many landlords therefore continue to own any existing properties personally and grow their portfolio, buying new ones, through the company.

- **Additional Responsibilities Running a Company**

Directors of a limited company will have more legal and financial responsibilities than if they are a personal landlord. Company tax returns and detailed financial records will need to be submitted to Companies House and HMRC. Many companies pay for an accountant, and this could cost upwards of £1000 per year.

- **Double Taxation Issues**

It's not spoken about much but a limited company pays corporation tax on the profits, but if you want to take out a salary or a dividend, directors have to pay income tax on this.

- **Capital Gains Tax Allowance Doesn't Feature**

When you sell a property as an individual landlord you pay capital gains tax, but there is a tax free allowance. At the time of writing this is £6000. See gov.uk for the latest rates. When a property is sold through a limited company there is no tax-free allowance – however the rate is lower and the other tax efficiencies made by being a limited company which may offset the lack of tax-free allowance.

- **Mortgages are More Expensive for Limited Companies**

As a limited company mortgage fees and interest rates may be higher compared to buy-to-let ones as an individual. Mortgage conditions may also be more complex and there may be less lending products available.

- **Releasing Equity is Not as Straightforward**

As a landlord, you can release equity from a property and use the income personally. But with a limited company whilst those funds can still be released, if they are to go to the directors, they will have to be classed as income and therefore taxed.

HOW SHOULD YOU PROCEED?

There are many considerations to take into account before deciding to become a limited company. But if you are a landlord already in the higher income tax bracket, it may be worth seeking independent financial advice and investigating the options.

As always, our team at Exsus are here to help and support Landlords as much as we can, helping to keep you abreast of legislative changes and requirements and ensuring that your rental properties are compliant as well as advising on the best next buy-to-let investment should you wish to expand your portfolio.

If we can help or assist you in any way, please call our team on 0044 07944430447 or fill out our contact form on https://exsusproperties.co.uk/contact-us/

exsus PROPERTIES