London is a leading world-class city with a booming rental market and prime property that benefits from consistent capital growth. Unsurprisingly, central London areas such as Chelsea, Kensington, Knightsbridge and Mayfair are a magnet for property investors.

In recent years, there has been a substantial move towards buying investment property through limited companies. This has primarily been driven by changes to the mortgage tax relief rules.

As of April 2020, private landlords can no longer deduct their mortgage expenses from the rental income to reduce their tax bill. This has resulted in landlords seeing a considerable reduction in their after-tax profits, for some central London landlords by as much as 40%.

Because limited companies can treat mortgage interest as a cost and corporation tax and dividend tax rates are much less than the income tax rate for higher-rate taxpayers, many private landlords are considering setup up a limited company.

Before making the decision, it is essential to look at the advantages and disadvantages to determine whether buying property through a limited company is tax-efficient for your individual circumstances.

ADVANTAGES OF BUYING THROUGH A LIMITED COMPANY

Tax treatment of profits

For private landlords, profits from rental income are taxed via income tax alongside their other earnings. Income above your personal allowance is taxed at the following rates. Currently, the standard personal tax-free allowance is £12,500 (although this reduces if your income is over £100,000).

Tax Band	Income	Tax Rate
Basic Rate	£12,501 to £50,000	20%
Higher Rate	£50,001 to £150,000	40%
Additional Rate	over £150,000	45%

If you invest in property via a limited company, you will be liable for corporation tax on your profits. The corporation tax rate is currently 19%, but is set to rise to 25% by 2023.

If you are a higher-rate taxpayer you stand to make an enormous tax saving.

You will still be taxed if you want to access your rental income, either via income tax on the salary you pay yourself or tax on dividend payments. More on this later when we look at the tax you'll pay when you take your money out of your company. However, there are ways a tax accountant can minimise the tax you pay.

Tax treatment of mortgage interest

Private landlords can no longer deduct any of their mortgage expenses from rental income to reduce their tax bill. Instead, they receive a tax-credit, based on 20% of their mortgage interest payments. If you are an additional or higher rate taxpayer you won't get all the tax back on your mortgage payments as the credit only refunds tax at the basic rate and not the top rate you paid. Further more, you may also find yourself pushed into the next tax bracket because you'll need to declare the income that was used to pay the mortgage on your tax return.

Unlike privately owned property, mortgage interest is treated as a business expense for limited companies, so you can deduct the cost before paying your corporation tax.

Inheritance tax benefits

Landlords planning to pass their property portfolio down to children or family members could avoid large amounts of inheritance tax by buying the property through a limited company.

DISADVANTAGES OF BUYING THROUGH A LIMITED COMPANY

Mortgage availability

The number of buy-to-let mortgage products on offer for limited companies is must lower than for individuals. You may find it more difficult to arrange a mortgage, and the interest rates may be higher.

Tax when you take money out

To access your rental income, you can pay yourself a salary. This will be liable to income tax but will count as a cost when calculating your pre-tax profit for corporation tax purposes.

Rental profits taken as dividends are not considered a business expense. For tax year 2020-2021, the tax-free allowance on dividends is £2,000. How much tax you pay on dividends above this amount depends on your tax band. The following dividend rates apply.

Tax Band	**Tax rate on dividends above the allowance**
Basic Rate	7.5%
Higher Rate	32.5%
Additional Rate	38.1%

If you plan to leave the rental profits in the company, this is not a problem. However, if you need to live off your rental income, you'll need to do the maths to work out whether a limited company reduces your tax bill. Speak to a tax accountant as there are ways you can maximise your tax-efficiency, such as distrusting dividends to a spouse who is a basic rate taxpayer.

Transferring any properties you own in your own name is costly

It is not just a case of forming a limited company and transferring your property by signing it over. You must sell your property to your new company, and this will attract some costs, for example:

- **Capital Gains Tax** – If the property you own has increased in value over the years, you will be liable for Capital Gains Tax (CGT) on that profit
- **Stamp Duty Land Tax** – Just like property bought by an individual, your limited company must pay Stamp Duty Land Tax and the 3% second home surcharge
- **Conveyancing and legal fees** – You will need to pay a conveyancer to undertake the legal work of transferring ownership to your limited company

- **Early redemption charges and increased mortgage costs** – If the mortgage on your buy-to-let property is still in the early repayment charge period, then you will have to pay this charge.

For some landlords, these costs make moving to a limited company prohibitive. For others, the long-term tax savings out-weigh these costs.

Extra cost and hassle

Limited companies have to file annual accounts, so you will need to pay an accountant. Running a limited company also requires more administration and paperwork.

FREQUENTLY ASKED QUESTIONS ABOUT BUY-TO-LET THROUGH A LIMITED COMPANY

What does setting up a limited company involve?

You will need to choose a company name and register your company with Companies House.

To do this, you will need to :

- appoint at least one director
- decide who the shareholders are and issue shares
- prepare a Memorandum of Association and Articles of Association to agree on how you will run your company

It costs £12 to register a new company. You'll get a certificate of incorporation. This confirms the company legally exists and shows the company number and date of formation.

The gov.uk website has more information about setting up a limited company.

Will my company be able to borrow money?

Yes, but as we mentioned earlier in this article, you may find the interest rates are higher than personal mortgages, as lenders perceive the risk to be higher.

Expect the loan to value percentage to be lower too, many lenders ask for 70% for repayment mortgages and 65% for interest only. This means that you will need a bigger deposit.

Banks are often more wary of lending to companies as they have limited liability, in order for your limited company to get a loan you will probably need to be prepared to provide a personal guarantee.

I'm buying my first buy-to-let property, should I do this through a limited company?

This depends on your future plans as a property investor. If you are only ever planning to rent out one or two properties, setting up a limited company is probably overkill. However, if this is the beginning of a property empire, it may be cheaper and easier to create a limited company from day one.

If you own property in your own name, is it worth transferring it to a company?

This will depend on your personal circumstances and portfolio. If you have just one or two properties yielding a modest income, limited company ownership may not be for you. However, if you have several properties in your portfolio, it may be worth considering.

You will need to calculate all the costs, as outlined above, and weigh this up against the tax savings you could make.