BUYING UK RESIDENTIAL INVESTMENT PROPERTY

CHOICES OF OWNERSHIP

1. Personal ownership in sole name

2. Personal ownership in joint names with another or others

3. UK Company ownership

4. non-UK Company ownership

UK TAX FREE ALLOWANCES AGAINST INCOME

UK citizens with personal ownership receive £12,500 per year personal Allowance, even if non-UK resident, which if unused is wasted.

Non-UK citizens not resident in the UK do not receive a Personal Allowance, subject to any treaty relief that may be available.

All residents of the UK receive a Personal Allowance.

INDIVIDUAL OWNERSHIP

Income Tax

Individuals are subject to Income Tax on the net profit received from the UK rental business.

The first £37,500 of taxable income (after the deduction of all expenses and the £12,500 Personal Allowance for UK residents or non-resident UK citizens) is taxed at 20%.

Any income over £37,500 (£50,000 for UK residents or non-resident UK citizens) and under £150,000 is taxed at 40%.

Any income over £150,000 is taxed at 45%.

All expenses incurred wholly and exclusively for the purposes of the rental business are allowed a tax deduction from the rental income in arriving at the taxable profit figure.

However, specifically, in relation to loan interest paid on a mortgage to buy or improve the property, a full deduction is not allowed against the income. Instead tax relief is granted by way of a credit against the tax liability calculated at 20% of the amount of loan interest paid.

What this does is to restrict the tax relief to 20%, rather than to give relief at the individual's highest rate of tax, which might otherwise occur for instance where there is income subject to tax at say 40% or 45%, a full deduction of the amount paid against the income would save tax at that higher rate. This rule was brought in over the last 4 years and has made a significant difference to the tax liability of landlords with multiple highly leveraged properties, significantly increasing taxable profits and consequently the tax due, causing in many circumstances such landlords to need sell off some of their property.

Capital Gains Tax ("CGT")

If an individual sells a UK residential property for a profit, the resulting capital gain will be subject to CGT at the rate of 28%.

Non-UK resident individuals selling UK residential property which they owned prior to 6 April 2015 are able to substitute the cost of acquiring the property for the 6 April 2015 market value of the property for CGT purposes. This generally results [at the time of writing] in a lower chargeable capital gain and consequently a lower CGT liability.

UK residents selling UK residential property do not have this option open to them and must use the original cost from date of acquiring the property when computing the capital gain.

Non-UK residents moving to the UK who owned a UK residential property before 6 April 2015 should therefore consider the potential CGT saving they could achieve by selling the property before becoming UK resident, if they feel that in due course once UK resident, they might sell the property.

If the property in question was the main residence of the individual at an earlier time, for example if it was initially their home and then they moved overseas and rented out the property and are considering a sale after returning to live in the UK. The capital gain arising on the later sale could be completely free of CGT if the property is reoccupied as the main home for "a period" before selling. It is important to note here that there is no hard and fast rule on the period of re-occupation, but the quality of occupation is of more importance than the length of the period of occupation. However, provided the property is really occupied as the main home for at last 6 month to 1 year, that should usually qualify.

If the property is not reoccupied, but later sold, then the capital gain will be partially exempt from CGT in relation to the period of months occupied as the main residence over the total period of ownership.

COMPANY OWNERSHIP

Separate legal entity:

A company is a separate legal entity and is capable of having its own assets, liabilities, income and expenses, can sue or be sued. A company is owned by its shareholders. A company is managed and operated by its Directors, who are collectively legally responsible for the operation of the company.

If a company cannot afford to meet its liabilities and the shareholders are not prepared to provide further financial support to the company, the company will become insolvent. The shareholders' personal liability for the company is limited to the amount of paid up share capital contributed, plus any further funds loaned to the company.

It is possible for the shareholders of a limited company to become personally liable for the liabilities or debts of the company under certain circumstances where for instance there has been fraud, misconduct, wrongdoing, injustice to third parties, failure to maintain a separate identity of the company or to follow corporate formalities. In such cases, the "corporate veil" is pierced and the liabilities re visited upon the shareholders.

Corporation Tax:

Under UK law companies are subject to **Corporation Tax** on the net Profits Chargeable to Corporation Tax ("PCTCT") for the accounting period. For a UK company worldwide profits are assessed and for an overseas company UK profits only are assessed. The rate of tax is 19% and the UK Government has committed to keeping the same rate until 31 March 2022.

There are no annual allowances for a company.

The PCTCT is calculated by adding together all income and all proceeds from the sale of assets received (in this case UK residential property), less all expenses and the capital cost of acquiring and improving the assets sold.

With a company, full relief is given for all expenses relating to the operation of the company, the generation of the income and gains (profits) of the company.

When compared to individual ownership of UK residential property, the full amount of loan interest paid by the company on a mortgage or to a shareholder or other lender is allowed as a deduction for tax purposes, as opposed to relief granted by way of 20% tax credit.

A company will only pay tax at 19% irrespective of the quantum of PCTCT, whereas the top rate for an individual is 45%, however, in some circumstances there is an additional tax charge on the shareholder to withdraw the profits from the company.

Dividend Tax:

If the shareholder of the company would like to withdraw the post-tax profits of the company, a dividend will need to be paid out, which will be taxable in the following circumstances:

1. a dividend paid by a UK or non-UK registered company to a UK resident individual (subject to the remittance basis for non-UK domiciled individuals receiving a dividend from a non-UK company); or

2. a dividend paid by a UK registered company to a non-UK resident British citizen that in the same year claims their UK personal allowance against other UK sourced (rental) income received.

A UK resident individual or non-UK resident British citizen is entitled to a £2,000 annual dividend allowance in addition to the personal allowance.

Dividend tax is then payable at the rate of 7.5% if the value of the dividend received is under £37,500; 32.5% if under £50,000 or 38.1% if over £150,000, when added to other UK taxable income for the year.

For non-UK residents (British and foreign) who do not claim a UK personal allowance in the UK in the year of receipt of the dividend from the company, there is no dividend tax charge.

Comparing company ownership against individual ownership there is a clear tax saving of 9% on capital gains realised on the sale of UK residential property (28% CGT rate less 19% Corporation Tax rate).

For non-UK residents with no other income in the UK, dividends can be extracted tax free from the company, irrespective of the level of income, whereas personal ownership results in higher tax the higher the income.

Funding the company by shareholder loan:

One significant difference in using a company to own UK residential property is that the company needs to be funded before it can buy any property. This can be done by capitalisation on subscription for shares or by shareholder loan.

The most common and flexible way to do this is to own a nominal amount of shares in the company and then to fund the company by shareholder loan, unsecured, at a rate of interest or interest free and repayable on demand.

This therefore gives the shareholder the ability to withdraw money from the company in the future if there are available funds to make repayment. Specifically, this can defer the need to take a dividend and pay dividend tax, if when there are distributable profits, the company owes money to the shareholder.

Obviously if the company is paying interest, the interest payable (which is deductible for tax purposes against the income) will reduce proportionally. Only once the loan has been fully repaid will there be a need to withdraw a dividend, which could be taxable, as set out above.

UK COMPANY VS OVERSEAS COMPANY

The basic tax treatment of income or gains arising to a company, as a result of ownership of UK residential property, is the same whether the company is UK or non-UK registered.

The tax rate is the same and the principals of arriving at PCTCT (income and gains less expenses and cost) are the same.

Whether a UK or overseas company should be used to acquire and own UK residential investment property is very case specific, but the main determining factors are these:

1. Whether the shareholder(s) is/are resident and or domiciled in the UK; and

2. Whether or not commercial borrowings will be required to acquire the property.

Residence and or domicile of shareholder:

If a non-UK resident individual uses a non-UK registered company to own UK residential property, interest charged by the shareholder to the company will be deductible from the rents for UK tax purposes in the company and so reduce the PCTCT and corporation tax payable. There are limitations on this but if the interest charged is below £2million then the interest will be allowed. Always seek advice as the rules that deal with interest are complicated.

The source of the interest in the hands of the shareholder is the place of residence of the company, which if the shareholder controls the company, will be the same place as the shareholder, and not the UK, and therefore the interest received from the company is not taxable in the UK.

If the shareholder is resident in Hong Kong or Singapore, the interest received from the company is not taxable in either of these places. Other jurisdictions of residence will vary and need to be checked.

If a UK resident shareholder is non UK domiciled, and the company has overseas directors, the same benefits could be obtained, subject to the individual using the remittance basis of taxation to keep the interest outside of the UK tax net.

Alternatively, an overseas trust might own the company that owns the property and the individual funds the trust by gift or loan, to lend to the company, to buy the property; and the interest is paid from the UK rents received by the company to the trust. The individual can claim loan repayments from the trust in the same fashion as with the company and the use of the trust means that the individual doesn't own the interest and the tax charge is avoided.

If the shareholder is UK resident and domiciled, there is no shareholder loan interest tax advantage to using a non-UK resident company. However, the same benefits will apply in terms of the ability to withdraw profits by way of loan repayment as opposed to taking dividends; it is just that the loan would be interest free.

Need for commercial borrowings:

Where there is a need to borrow funds to acquire the property, this can often a deal breaker. Lenders generally see lending to a company as higher risk business than lending to an individual and seek personal guarantees with higher interest rates and lower loan-to-values.

Where the loan is to a UK company the risk is generally considered by the lenders as lower than to a non-UK registered company such as Hong Kong, Singapore, BVI; so the interest rate is likely to be lower and loan-to-value higher, for a loan to a UK company than to an overseas company.

STAMP DUTY LAND TAX ("SDLT")

SDLT is a tax charged on the buyer of UK property at progressive rates. There are rates for individuals and companies, first time buyers, and buyers of additional properties. At the time of writing there is an SDLT holiday until 31 March 2021 where the first £500,000 property cost is at 0% rate for individuals that don't own any other property, or at 3% for additional property purchases by individuals or purchases by companies.

From 1 April 2021 there will be an additional 2% SDLT charged for UK residential property purchased by an overseas buyer (individual or company or trust).

You can see up to date SDLT rates here https://www.gov.uk/stamp-duty-land-tax/residential-property-rates

INHERITANCE TAX ("IHT")

IHT is a UK death tax charged on the value of "Relevant Property" in the estate of deceased persons at the rate of 40%. If the person was domiciled within the UK at the time of death, the worldwide estate is within the scope of IHT. If the person died domiciled outside of the UK then only the UK estate is within the scope of IHT.

There is a nil rate band exemption (at the time of writing) of £325,000 per individual, and some other reliefs and exemptions such as Business Property Relief, Agricultural Property Relief, Gifts out of Income Relief, Annual Exempt amount and certain limited value gifts to family members.

The value of gifts made to individuals falls out of the estate of the donor [for IHT purposes] after 7 years have elapsed and if the donor retains an interest or reserves a benefit in the asset given away, he or she is treated [for IHT purposes] as not having given it away and the value remains in their estate for IHT purposes. Once the benefit reserved ceases, the 7-year IHT clock will start ticking.

A UK residential property is a UK situs asset and therefore is within the scope of IHT for an individual owner in the event of death (irrespective of their domicile status), subject to the reduction in value by any mortgage loan secured against the property.

A company does not die so is outside the scope of IHT, however the company itself is an asset in the estate of the shareholder. A UK company is a UK asset and a non-UK company is a non-UK asset. In the estate of a non-UK domicile a non-UK company is excluded property for IHT purposes, however where the company owns UK residential property, the value of the company which is attributable to that property is treated as UK situs and so within the scope of IHT. Non-UK assets in the company are excluded.

There may be planning opportunities to mitigate the value of the shareholdings by sharing the company among other family members, for example using a Family Investment Company.

We would be pleased to provide advice and assistance in relation to any of the points raised above.

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