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TAX-EFFICIENT WAYS TO GROW A PROPERTY PORTFOLIO

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PROPERTY

Contents

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- Tax-Efficient Ways to Extract Cash from Your Company;
- IR35 – Tax Tips for Contractors;
- How To Maximise Deductions For Business Expenses;
- Tax-Efficient Business Exit Strategies; *and*
- Cash Basis for Landlords.

About this guide

There are various reasons why someone becomes a landlord. It may stem from a conscious decision to invest in property and to grow a property portfolio. Alternatively, fate may play a hand, and a person may become an 'accidental landlord', for example, because they are unable to sell a former home and decide instead to keep it and rent it out, or because they inherit a property which is already let, or which they decide to keep as an investment and let it out.

Regardless of whether a landlord is an accidental landlord or a deliberate landlord, there are common decisions to make if the aim is to grow the property portfolio in a tax-efficient manner.

Property can be held in various ways, and the tax rules differ depending on whether the landlord is a property company or an individual. Consideration can also be given to the use of a property trust.

When expanding a property portfolio, it is necessary to decide what type of property to invest in. Again, different tax rules come into play depending on whether the property in question is residential property or commercial property. For unincorporated landlords, the type of property will determine how relief is given for interest and finance costs. The type of property will also impact on the purchase costs, as different stamp duty land tax (SDLT) rates apply to residential property and to commercial and mixed-use property. Different regimes also apply if a property is sold, depending on whether the landlord is an individual or a company, or, where the landlord is an individual, whether or not the property is a residential property.

It is also prudent to consider how the investment properties can be passed on to the next generation, making inheritance tax planning a must.

1 Choosing the right structure

There are various ways in which an investment property can be held, and the way in which the property portfolio is held, as well as the type of property, will determine the tax regime into which it falls.

For a deliberate landlord who has yet to invest in their first property, it is important to consider the structure up front to minimise the costs associated of moving from one structure to another – it can be very costly, for example, to incorporate an existing property business and transfer ownership of properties held in an individual capacity into a property company. Where the aim is to run a property company, ideally, this decision will be made at the outset so that the investment properties can be purchased by the company, rather than being purchased by an individual landlord and transferred into the company at a later date.

For an accidental landlord, the way in which the property will be held will have already been determined and they will not have the luxury of making the decision from the outset. However, things can always be changed, and a landlord can choose to incorporate an unincorporated property business (or vice versa), but this is likely to be more costly than setting the property business up in the desired way from the outset.

There is nothing to stop a person from having both an unincorporated property business and a property company. An accidental landlord who gets the property investment bug may choose to retain the initial property in a personal capacity, but later on set up a property company and expand their portfolio.

Consideration can also be given to the use of a property trust, as this too can have some tax benefits.

In this section, we will look at unincorporated property businesses, property partnerships, property companies and property trusts.

1.1 Unincorporated property business

The simplest way to hold an investment property is to hold it in a personal capacity. Under the property tax rules, all properties held in the same capacity by the same person or persons form part of the same rental business. However, UK properties and overseas properties form separate rental businesses.

The profits from the property rental business are liable for income tax and are taken into account in calculating the landlord's personal tax liability and are charged to income tax at the landlord's marginal rate. The rental profits form part of the landlord's total taxable income, on which their tax liability is computed. If the landlord lets residential property, relief for any interest and finance costs is given as a basic rate tax reduction, rather than as a deduction in computing the taxable profits of the property business.

Following the end of the special tax regime for furnished holiday lettings (which came to an end on 5 April 2025), properties let as holiday lets are treated in the same way as other residential lets. There is no longer the need to calculate the profits and losses in relation to furnished holiday lets separately from other properties let by the same person. Regardless of the type of property and type of let, all properties held in the same capacity by the same person or persons are treated as the same property rental business (with separate businesses for UK properties and overseas properties).

Example

Anna has a buy-to-let property which she lets on a long-term residential let. She also inherited a workshop, which she rents out, and a holiday cottage, which she lets as furnished holiday accommodation. All three properties are owned solely by her in an individual capacity and form part of the same unincorporated property business.

Anna also owns another residential property jointly with her husband. As this is owned in a different capacity to the properties owned solely by Anna, it forms a separate property business.

The profits or losses for the property rental business are computed for the business as a whole; there is no need to compute the profit or loss for each individual property (although the landlord may wish to do this for their own purposes to assess how each property is performing and whether it remains a worthwhile investment). The calculation of profits and losses for the business as a whole means that if one property makes a loss and another property makes a profit, relief for the loss is given automatically against the profit on the other property. Where the business as a whole makes a loss, the loss can be carried forward for relief against future profits made by the same unincorporated property business. However, it is not possible for the landlord to set the loss against profits of a different property business or against other income that they may have (subject to relief against general income where the loss has a capital allowances connection).

The cash basis is the default basis of accounts preparation for unincorporated landlords with rental income of £150,000 or less. Under the cash basis, it is only necessary to take account of cash in and cash out. Where the rental income exceeds £150,000 or the landlord is otherwise ineligible to use the cash basis, the accounts must be prepared using the accruals basis. A landlord who is eligible for the cash basis can also elect to prepare accounts on the accruals basis if this is preferred or advantageous.

On the initial purchase of the property, a liability to stamp duty land tax (SDLT) (or, as appropriate, land and buildings transaction tax (LBTT) in Scotland or land transaction tax (LTT)) in Wales will arise if the consideration exceeds the relevant threshold. Where the landlord already owns one residential property, the purchase of second and subsequent residential properties will attract the SDLT/LBTT/LTT supplement.

If a gain is made on the disposal of the property, a liability to capital gains tax may arise. This will be the case if the landlord's net gains for the year, less any allowable losses set against the gain, exceed the annual exempt amount. Residential property gains must be reported to HMRC within 60 days and a payment on account of the capital gains tax must be made within the same timescale.

Changes to the tax rules in recent years have reduced the attractiveness of holding investment property in a personal capacity. In particular, changes to the mechanism for relieving interest and finance costs, which moved from relief by deduction (allowing relief at the landlord's marginal rate) to relief at 20% of the interest and finance costs as a tax reduction, have prompted many landlords to consider other property holding structures. The end of the furnished holiday letting tax regime exacerbated this, as relief for interest and finance costs incurred in relation to holiday lets can no longer be deducted in full in calculating the taxable profits; relief is now given as a basic rate tax reduction as for other residential lets. Changes to lettings relief and the need to pay and report residential gains within 60 days have also decreased the attractiveness of holding property as an individual.

1.2 Property partnership

Property may also be held in a partnership. This can be advantageous where property is jointly owned as it provides greater flexibility for allocating profits and losses than where jointly owned property is held outside a partnership, particularly if the joint owners are spouses or civil partners.

Profits and losses are allocated in accordance with the agreed profit-sharing ratio. This can be flexible and can be simply along the lines of 'profits and losses will be allocated as agreed by the partners'. This allows the ratio to be changed each year to secure the best outcome.

Where property is owned jointly by spouses and civil partners outside a partnership, income is allocated on a 50:50 basis for tax purposes, regardless of the partners' actual ownership shares. However, where the property is owned as tenants in common in unequal shares, spouses or civil partners can make an election (on Form 17) for the profits to be allocated in accordance with the actual underlying beneficial ownership where this provides a more favourable result than a 50:50 split. No other allocation is permitted. Where joint owners are not spouses or civil partners, income is usually allocated in accordance with ownership shares. However, the joint owners are free to agree a different split, in which case each owner is taxed on what they actually receive.

However, it should be noted that simply owning property jointly does not in itself create a partnership. For a partnership to exist, the joint owners must do more than merely let the property out; they must also provide significant additional services in return for payment. The question of whether a partnership exists is a question of fact and whether there is a partnership will depend on the degree of business activity involved – there must be a degree of organisation similar to that required by an ordinary commercial business for a partnership to exist.

A traditional partnership is transparent for tax purposes, and the individual partners are liable for income tax on their share of the profits. The partnership profits are taken into account in calculating each partner’s taxable income.

Where an individual partner also owns property outside the partnership in an individual capacity, they will have two separate property businesses – one for their share of the partnership profits and one for the rental properties owned in an individual capacity.

If a gain arises when the property is sold, each partner is liable for capital gains tax (subject to the gain being sheltered by the annual exempt amount and any allowable losses) on their share of the gain.

Property can also be held in a limited liability partnership (LLP); in certain circumstances, this can generate tax advantages. An LLP is something of a hybrid between a company and a traditional partnership. Like a limited company, it offers the advantage of limited liability and, like a traditional partnership, it provides the flexibility to agree on how to share profits between the partners. As with a traditional partnership, an LLP is transparent for tax purposes, with each partner being taxed personally on their share of the profits and liable to capital gains tax on their share of any gain on disposal. However, unlike a traditional partnership, an LLP can hold property in its own right and properties transferred to the LLP are held on trust by it.

1.3 Property company

In recent years, holding a property in a limited company has become popular. This is due in part to the restriction for interest and finance costs that applies in relation to residential property held by an unincorporated property business. The restriction does not apply where residential property is held in a limited company, and any associated interest and finance costs can be deducted in full when computing the taxable profit.

Operating through a property company will necessitate setting up the company with Companies House and agreeing on the shareholding structure. Where there is to be more than one shareholder, using an alphabet share structure whereby each shareholder has their own class of share (A shares, B shares, etc) will provide flexibility to tailor dividends. Companies must file accounts and an annual confirmation statement with Companies House. This comes with filing costs and an associated administrative burden. Companies must also comply with the requirements of the Companies Act 1986.

A new landlord looking to invest in property who wishes to operate their property business through a limited company can purchase the