Guide to Buy-to-let investment

hyde associates
Mortgage and Protection Advisers

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Is buy-to-let right for me?

Investing in a property is not a decision that should be taken lightly. Many people go down this path as a means of making money, but it's important to go into the business with your eyes open and not just simply focusing on the financial gains that can be associated with it. The main thing to bear in mind is your objectives. If your objectives are clear from the start, then you're more likely to get what you want out of your investment.

So, how can you be the most successful landlord?

Plan your finances

Know from the offset what your financial intentions are. Will the money be used as your regular income or will it be set aside as capital growth?

Do your research

With over 160 laws around buy-to-let, realistically, you're never going to remember each and every one of these. You might want to appoint a letting agent who will know more about these rules and regulations, but we still recommend you take the time to learn the main ones in order to maintain the safety of your tenants.

Get advice

Speak to your Hyde Associates mortgage adviser and an accountant to better understand your financial situation and what your options are.

The property investment market can fluctuate, depending on the economic state at any given time, so it's crucial to speak with a mortgage adviser in order to protect your finances and insure your property, should the market take a turn for the worst.

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Exit plan

This is probably the last thing you're thinking about right now, but it's important to consider your exit from the buy-to-let market, just as much as your entrance to it. Having a clear exit plan will also help you settle your finances in the most tax efficient way possible.

In contrast, there are certain things you should always avoid, as a landlord:

- Seeing a property and diving straight into buying it with no wider consideration of the buy-to-let market. This includes not seeking the right mortgage advice, and therefore not understanding the implications of tax and other costs involved with renting out a property - not to mention the responsibility that comes hand in hand with being a landlord.
- Not protecting your property or your finances against the worst-case scenario, should anything happen.
- Not keeping up with the buy-to-let laws and regulations e.g. health and safety, and therefore not protecting your tenants.
- Not understanding exactly what being a landlord entails e.g. keeping the property in good condition, looking after your tenants needs and dealing with paperwork accordingly.

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What does being a landlord entail?

It's important to go into the buy-to-let market with your eyes wide open, aware of all the ins and outs that are involved in being a landlord.

Here are a few things you need to consider upfront, when weighing up whether you're the right sort of person for the job (because afterall, it is a job).

Finding the right property

Never underestimate the amount of time it could take to find the right property. Would you prefer a new build or an older property? Newer properties should come with fewer maintenance issues, but an older property may give you the opportunity to add more value.

Also, think about how many bedrooms the house has and how many tenants it could home. If your property is going to house more than three tenants, who aren't members of the same family (commonly known as a 'house share'), it will be classed as a House in Multiple Occupancy (HMO).

House in Multiple Occupancy

HMO's often offer higher gross rental income but the downside is, they can often suffer from more frequent tenant changes and usually incur higher fees and solicitor costs.

HMOs can sometimes require a different type of licence, and those at higher occupancy levels (five or more tenants) will need to be registered.

As a landlord for this type of property, you need to ensure that:

- The house is suitable and offers comfortable living standards for the number of tenants living there.
- Either yourself, as the private landlord, or the letting agents you've chosen, needs to be 'fit and proper'. This means a clear criminal record and no history of having previously breached any landlord laws or code of practice.
- You need to send your annual gas safety certificate to the council.
- When requested, you can provide safety certificates for any electrical appliances.
- You install and maintain smoke alarms in the property.

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Finding the right tenants

Probably one of the most important things when renting a property is a) finding tenants to occupy the house, and b) finding the right tenants. You don't want to end up with troublesome tenants who cause you nothing but problems.

The type of tenant you want to attract will largely determine the area you look to invest in. For example, if you want to attract families then you'll want to be close to schools and leisure facilities. Whereas if you'd rather have students, consider a property near university grounds.

A letting agent can be really valuable in finding and vetting prospective tenants. They can help with securing references, credit checks etc. which comes at a cost but could be money well spent.

Maintenance

The property is your sole responsibility so anything that needs repairing, maintaining etc. will come down to you. You need to make sure you're easily contactable via phone and email, and it'll be your job to find the right people to fix the problem, whether that be a plumber, electrician etc.

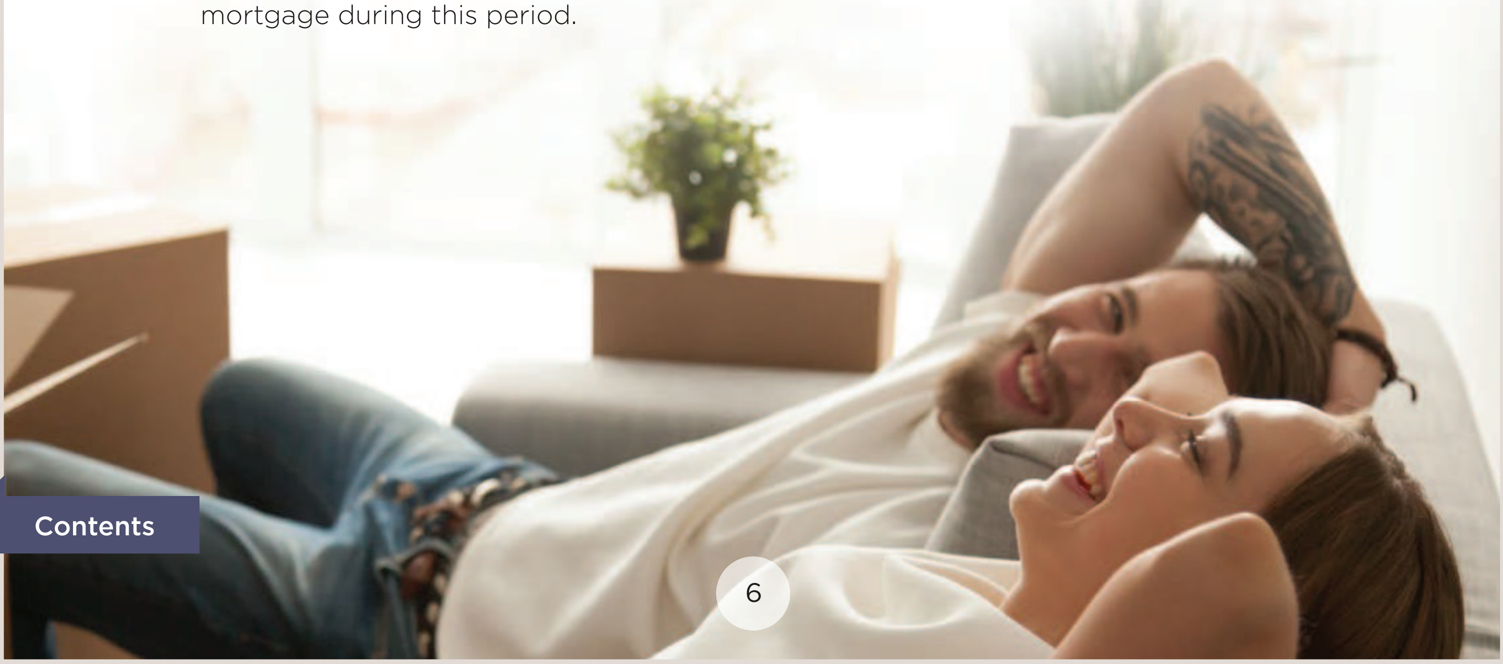
It's also important to remember that it's not always just the inside of the property that needs maintaining. If you invest in a property with a garden, tenants might not maintain it, so to avoid any potential problems you might want to consider either hiring a gardener or making the garden as low-maintenance as possible i.e. patio slabs rather than grass.

Dealing with tenants

You need to be prepared for having to deal with all types of tenants, including the difficult ones. Are you willing to have difficult conversations when needed? This could be anything from missed rent payments, a rise in payments, inspections or handing out an eviction notice? If you think you might struggle with this side of being a landlord, you could employ a letting agent who would be the tenants first point of contact.

No rent coming in

The market can be quite unpredictable at times so it's important to be prepared for this. It's wise to have funds, aside from your landlord income, to insure you against any downturns. As well as changes in the market, there might also be times when your property is unoccupied. You'll need to have a back-up plan for paying your mortgage during this period.



How much can I borrow?

Buy-to-let is a medium to long term investment, so the first thing
you might want to ask yourself is, can I afford to tie my money up for a period of time?

How much to borrow

The terms for a buy-to-let mortgage are constantly changing; it can be difficult to keep up to speed with it. For instance, higher and lower rate taxpayers are often treated differently or a five year fixed mortgage might get you a bigger mortgage than a two year fixed.

Typically, landlord mortgages require a higher deposit than you'd need for a residential mortgage, meaning the loan-to-value (LTV) ratio could be smaller than other mortgages, such as first time buyer mortgages, for example.

Buy-to-let mortgage rates can vary depending on several factors, such as:

- Your credit score
- How much deposit you've put down
- How risky the loan is
- The type of mortgage product recommended for your circumstances

For these reasons, it's always worth seeking advice from a qualified mortgage adviser whose job it is to be 'in the know' when it comes to buy-to-let.

Pricing the rent

Deciding how much rent to charge your tenants can be tricky. Generally speaking, the amount you set the rent at will be determined by the market itself. A good way to get a feel for how much you would charge would be to look online at Rightmove and Zoopla and see what a similar size property in the same area is charging.

Once you've purchased the property, and therefore know the cost for stamp duty etc., and how much you can expect to receive in rent, you can then work out your rental yield.

For example, this could be:

Property value: £165,000
Rental income (monthly): £700.00
Your expected rental yield: 5.09%

If, after you've done the calculations, this amount isn't quite what you expected, then you can make a decision whether to go ahead with your buy-to-let venture.

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Choosing the right mortgage for you

Just as with a standard mortgage, there are different types of buy-to-let mortgages to choose from, and you can discuss all of these in more depth with your Hyde Associates mortgage adviser.

Repayment or interest-only mortgage

First things first, you need to decide whether you want a repayment or interest-only mortgage.

Repayment

During the mortgage term you will pay interest and the capital mortgage balance, so by the end of the full mortgage term the mortgage will be repaid, as long as you do not change this at a later date.

Interest-only

You only pay back the interest and not the capital borrowed. It's common for buy-to-let investors to opt for an interest-only mortgage, especially if you're planning to sell the property at the end of the term. If you do sell the property, you'll repay the mortgage outstanding and you'll also have to pay any tax due on the profit made currently via capital gains.

Interest-only also means your monthly mortgage payment will be lower, as you're only paying the interest and not the capital back, which may leave you with more disposable cash from the rental income to cover additional costs covered later.

Fixed or variable

Fixed rate

As it says on the tin, your mortgage repayments are fixed and won't change month to month. Regardless of what happens to interest rates, your mortgage payments will stay the same whether you fix for two, three, five years etc. Effectively, a fixed mortgage acts as an insurance policy against interest rates going up, therefore you tend to find that fixed rate mortgages have a higher rate as you pay a bit more for the reassurance.

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Variable

With a variable mortgage, your mortgage rate will fluctuate, however there are different types of variable mortgages available:

Standard Variable Rates (SVRs)

A Standard Variable Rate tends to follow the Bank of England rate closely but not exactly. For instance, if the Bank rate is dropped to 0.25%, your SVR might only drop 0.2%. However, when the Bank rate goes up, they often increase it by the full amount. More often than not, you move onto an SVR once your fixed rate term has come to an end.

Trackers

A Tracker mortgage will track the Bank rate exactly. This means that whatever interest rate the Bank of England sets, this is the interest rate that you'll receive on your mortgage. It's common to have a tracker mortgage for a few years and then you'll drop onto an SVR after this period comes to an end. There are also some tracker mortgages that follow Libor which is a rate set by the banks themselves.

Discount Rates

As stated in the name, discount rate mortgages offer a discount off the standard variable rate (SVR). The discount period can be for a short period of time e.g two or three years, or it would be the entire term of the mortgage, depending on the deal.

There are other mortgage types to choose from, but these are the most recognised ones. Your mortgage adviser will be able to discuss all the different options with you.

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Considering all the costs

Before you go ahead and dive into the world of buy-to-let, it's important to know that you need more than just the deposit in order to have a smooth experience of being a landlord.

Arrangement fee

Some mortgages come with a product fee, which is normally larger than on residential mortgages. This can either be paid upfront or tagged onto the cost of your mortgage. There can sometimes also be an administration charge made by the lender for arranging the credit of your mortgage.

Stamp Duty

If the property you're investing in is over a certain price, you'll have to pay a lump-sum tax known as Stamp Duty Land Tax (SDLT) in England and Northern Ireland, Land Transaction Tax (LTT) in Wales, or Land Building Transaction Tax (LBTT) in Scotland. The price you'll pay will vary on the amount you paid for the property. This price will also vary depending on whether you already own a property in the UK.

The below rates are correct as of August 2019

Buy-to-let and holiday home stamp duty rates

Portion of property price	% to pay
£1,500,001 +	15%
£925,001 - £1,500,000	13%
£250,001 - £925,000	8%
£125,001 - £250,000	5%
£0 - £125,000	3%

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Legal fee

Your solicitor will charge a fee for their services, which includes handling the contracts, documentation and searches amongst other things.

Valuation

Many lenders will want to carry out a standard mortgage valuation which you may have to pay for. However, you can look to upgrade to a structural survey or a homebuyers survey report for an additional cost, if you wish.

Insurance

Buildings insurance is a must, and if you're furnishing the property then you'll no doubt want contents insurance too. Just remember that it's a landlord's policy you'll need rather than a residential policy. Don't worry about insuring the tenant's belongings, they're responsible for insuring those themselves.

There are other types of insurance available for landlords, such as landlords and rent insurance. These can cover you for legal expenses for evicting tenants, or if there are periods where the property is empty and you aren't therefore making any money from rent. However, if you're purchasing a flat, this may be included in any service charge that is payable, which as a landlord, you would normally be responsible for paying. Your solicitor will be able to confirm if you still need additional buildings insurance.

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Additional costs to consider

Taxes - Income Tax and Capital Gains Tax

You'll pay income tax on all the rent money you receive. We recommend that you seek independent tax and legal advice as mortgage advisers are not qualified to offer tax advice.

If and when you come to sell the property, if you've made a profit (capital gain) then you're liable to be taxed on the profit, not the total amount you receive.

Letting agent fees

It's common for landlords to haggle with prices when it comes to choosing a letting agent. Letting agents offer a variety of support, depending on which level of service you'd like. For instance, they can offer rent guarantees, tenant replacement and tenant moving out fees. Some even offer a 'fully managed' service where they can arrange for any repairs work to be done using their own contractors. Just make sure you do your research upfront and know roughly what you can afford to pay.

Court and legal fees

Hopefully it will never come to this but it's always best to prepare for the worst-case scenario. If you end up having to evict tenants who aren't paying their rent, then you might have to take them to court in order to resolve the situation.

Repairs, maintenance and decoration

You'll no doubt need to spruce up the property before your tenants move in, and there may also be a few repairs to carry out to make sure the property is in the right condition. If you're pretty hands-on yourself, then you'll no doubt find it easy enough to carry out the maintenance work yourself. However, if you don't have the time, skills or inclination to do this, you might want to consider finding a trusted handyman to carry these jobs on your behalf.

If you already know that your property is likely to need a certain amount of work doing to it, it's worth allocating a realistic budget for this and any ongoing repairs, especially when considering your rental yield.

Gas safety check

This check needs to be carried out annually and will make sure any gas equipment is safely installed and maintained. Make sure the engineer who carries out the check gives you a copy of the gas safety record before your tenants move into the property, or within 28 days of them moving in.

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Legionella risk assessment

As a landlord, it's your duty to carry out a risk assessment for legionnaires disease - a lung infection caught by inhaling contaminated water droplets which can be picked up from water systems in properties. This assessment should be carried out periodically, so make sure you read up on **your exact responsibilities for Legionella risk assessments** as a landlord.

Leasehold properties

Service charges and ground rents are normally all payable by the landlord and not the tenants. You also need to consider the length of lease remaining as this could need extending during your ownership.

Furnished or unfurnished

Your property may be more attractive to prospective tenants if it's already fully furnished, as this saves them a job. However, if you decide against furnishing the property, you don't have to worry about having to replace things with general wear and tear.

White goods

Even in unfurnished properties, many landlords still provide white goods to tenants. For example, a cooker, washing machine, fridge and freezer. If these break or need repairing, you'd need to cover the cost of this.

Who, what and where?

The main deciding factor for where to buy your property will no doubt be influenced by the type of tenants you want to attract, as well as whatever your long-term goal is.

For instance, if you want to attract students or professionals, you'd probably be looking for a property that has maybe 3-5 rooms that can each be rented out individually. In terms of location, for students and young professionals, being within easy reach of the city/town center is often desirable, along with good transport links too.

In comparison, if you're looking for long term tenants then you might want to attract a family looking to settle down for a few years. The location would no doubt be nearby to local schools and amenities, and you'd likely be looking for a 2-3 bed property that you can rent out as one whole unit.

Different tenant types

Prime market tenants

These tenants might be working in the area, or the UK, temporarily, and are often high earners looking for a more upmarket property for a short period of time, and often a fixed amount of time according to their employment contract. These tenants will often rent through a letting agent rather than directly through a private landlord.

Professional tenants

These tenants are likely to rent for a long time, rather than save money to put down a deposit on a house. Professional tenants look for easy transport links to make their commute to work as easy as possible.

Social tenants

Since the selling off of council houses, the private rented sector has become more popular to those living on benefits, than the amount of people living in social housing.

Student tenants

Students are short-term tenants who rent out either in the city center or nearby areas, from around one to three years, typically. Again, this type of tenant would look for excellent transport links in and out of the city and to their relevant campus.

The type of tenants you let to can impact the availability of mortgage lenders, as not all lenders will lend on all tenant types.

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Viewing properties

When you start your property search, you must remember that although you're investing your money into the property, it isn't actually a home that you'll be living in. Therefore, you need to remove your emotions as it doesn't need to meet your personal specification, but rather your business goals instead.

Looking at it purely from an investment point of view, you might want to consider the following:

- Who do you want to rent to?
- How long might it take to secure tenants around this area?
- What is the rental market in the area like? Is it growing or declining?
- Is there the potential to build in capital growth?
- Will the rent you receive cover your costs?
- Can you make improvements to the property in order to increase rental income or capital growth?
- Have you looked at any forecasts for property growth in the area?

Should you rent privately or use a letting agent?

Depending on what type of person you are and what other commitments you have, such as full time work etc. depends on your decision to either rent privately or to use a letting agent.

The advantages of using a letting agent

There are several perks to using a letting agent to help manage your buy-to-let properties:

- Chase any outstanding rent payments
- Assist with the eviction process
- Help with getting references
- Arrange for viewings - this can be particularly helpful if you aren't local to the area
- Ensure that all changes in legal requirements are communicated to you

For those of you who have the time to dedicate to these landlord duties, and things are going well with your tenants, you might feel like it seems you're paying for this service but not getting a lot in return. If that's the case then renting privately might be the right option for you.

However, those of you who have other commitments, you might struggle to find the time to carry out credit searches, check bank statements, pay slips etc. so leaning on an agency might be the right thing for you.

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Applying for a buy-to-let mortgage

We understand that no two mortgages are the same and our knowledge and experience means we're in a great position to help.

It's advisable to sit down and run through your finances so that you can compare the cost you're going to pay for the property, against the rent you're likely to take in from the tenants. A mortgage adviser could talk you through this so you have a clear idea of whether you can comfortably afford the mortgage on your own.

When you're ready to apply for your mortgage, our specialist buy-to-let mortgage advisers will be able to arrange an appointment that easily fits around you, whether that's face to face or over the phone.

How can Hyde Associates help?

Searching the market yourself can be time-consuming, but with our help, we can search thousands of mortgages, including exclusive deals and lenders that you wouldn't otherwise have access to. We have regular contact with a wide range of lenders, some of whom you may not even know exist! With our help, you won't have to search or contact each individual lender in order to compare the mortgage terms and rates; we'll do all that for you.

Our promise to you

Explaining the fees

We'll explain all the different fees involved, what they're for, and take them all into account when finding the right mortgage for you.

Knowledge

Our knowledge of different lenders' criteria can be invaluable. Together, we can go through your expenditure which will be beneficial to you when completing your mortgage application.

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Duty of care

We have a duty of care to you. We take your individual circumstances into account and understand that one size doesn't fit all. It's vital that you and your adviser have honest and thorough conversations in the run up to finding and applying for a mortgage.

Experience

Getting a mortgage can seem like a daunting tasks, but it doesn't need to be. The important thing to remember is that every lender is different in what they view as the 'perfect candidate' to lend to. So even if you don't fit one lender's criteria, it doesn't mean you won't fit anothers. Having an expert on your side will ensure your application goes to the right lender for your individual needs.

Protection

Not only will we help find the right mortgage for you, we'll also make sure you're aware of the importance of having landlords insurance to make sure you're fully protected.

Your property may be repossessed if you do not keep up repayments on your mortgage. There may be a fee for mortgage advice.

Buy-to-let insurances

When you're a landlord, you need slightly different insurance to your usual residential insurances. Some of these may be a requirement of your lender, so it's important to know what each of them are.

Landlord building insurance

This will protect against any risks to the building that might result in replacement or repair work e.g. subsidence, fire, burst pipes etc. This is often a must-have for many lenders.

Landlord contents insurance

Contents insurance for landlords, like for your home, is optional. It will cover you against any fixtures and fittings you have supplied i.e. fridge, washing machine, carpets etc. not the belongings your tenants put in the building. You can extend this to include accidental damage, if you wish to.

Portfolio insurance

If you own five or more properties then this could be a good option. It enables you to cover the buildings and contents (if you want it to) of all the properties you let out, under one policy.

Home emergency cover

This is an optional, extra insurance as an addition to the standard buildings insurance. It can provide emergency assistance for the landlords, should you need certain services e.g. plumbing and heating, roofing, drains and sewer blockages, lost keys, infestations etc.

Rent guarantee

There may be times when your tenants can't make their rent payments. Rent guarantee insurance will protect you from this loss, and will pay out the rent you are down by.

Legal expenses cover

This will provide you with legal protection should you need it for any of the following: property damage, recovering rent arrears, repossession, prosecution defence costs etc.

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FAQs and tips

Q. What is the criteria for being a landlord?

A. The majority of lenders will require that you already own your own home. In addition to this, many also require that you earn at least £25,000 from a source not related to letting but this does differ between lenders. A minimum deposit of normally around 25% of the property value would be required by most lenders.

Q. Can I use my rental income as a form of income to purchase another property?

A. This is dependant on your individual circumstances. It often depends on whether you currently have a mortgage to pay on your existing buy-to-let property. If you do, then ultimately a lender will see this as debt that needs to be taken into consideration. We advise you speak to a mortgage adviser who will look at your individual circumstances and advise on what your options are.

Q. How do I know I'm setting the rent at the right price?

A. Obviously you can do your own research but the lender will also do their own checks to see whether you have set your rent at the right price once they have carried out their property valuation.

Q. Can I raise capital on my own home to put down as a deposit on my buy-to-let property?

A. This is possible but it's best to speak to a mortgage adviser who can look at your individual circumstance and run through your options.

Q. Can I apply for a normal mortgage?

A. No, you have to apply for a buy-to-let mortgage.

Q. Should I take an inventory?

A. Inventories are always worth doing as it's a good way to make a detailed list of all the contents and the condition of your property before the tenants move in. This gives you a good starting point when there is a debate over any damage that might have occured during the tenancy period.

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Q. Will I be taxed on my rental income?

A. As a landlord, you would be taxed on the income you make through the rent payments in line with your personal income tax liabilities. We recommend speaking to an accountant before purchasing your first property.

Q. What is a House in Multiple Occupancy (HMO)?

A. A property is classed as a HMO if there are more than three tenants living there who aren't members of the same family. Another indication is if there are shared facilities i.e. kitchen, bathroom, toilet etc. Your choice of lenders may be limited if you're renting out a HMO, but your mortgage adviser will be able to go through this with you. Councils can also have individual rules around HMO, so if this is something you're considering, we recommend you speak to your local council.

Q. Can I rent my property to a family member?

A. Most lenders restrict letting to family members as a condition of your mortgage. You would normally need a specialist mortgage in order to let to family and would need to speak to a mortgage adviser about this for more information.

Should my buy to let property be owned personally or through a limited company?

There is no simple answer to this question. It depends on a number of factors such as how many properties you hold, whether you need the income quickly and how long you want to hold the properties for. It therefore depends on your individual circumstances.

Why do I read in the press that lots of landlords are using companies for buy to lets (BTL)?

The main reason that this method of ownership is often promoted as the way forward for owning buy to let properties is due to the mortgage interest relief restriction that was introduced for personal ownership from 5th April 2017.

Prior to April 2017, Income Tax was payable on your net rental income after deducting allowable expenses including mortgage interest. This meant that landlords paying higher (40%) or additional (45%) rate Income Tax could claim tax relief at their highest rate.

However, from April 2020 tax relief can only be reclaimed at the basic rate of Income Tax (20%), whatever rate of tax the landlord pays. The rules are being phased in over the 4 years from April 2017 to 2020. Companies are not affected by this restriction, so on the face of it they appear advantageous. However we need to look at what types of tax a company pays.

Corporation Tax

A company is a separate legal entity distinct from its owners so pays Corporation Tax instead of Income Tax.

Companies currently pay Corporation Tax at 19% on its profits, whatever its level of profits – (Income Tax for individuals is 20%, 40% or 45% depending on the individuals level of income).

The Corporation Tax rate is currently 19%, and will reduce to 17% from 1st April 2020.

On the face of it, a company would get full relief for the actual mortgage interest paid as well as paying Corporation Tax at a much lower rate than higher rate income tax payers. But the net income belongs to the company and not the individual at this point.

Corporation Tax years run from 1st April to 31 March, so if your year end is 31st December for example, you will have 9 months taxed at one rate and 3 months taxed at another rate while the rates are reducing.

Corporation Tax is payable 9 months and 1 day after the year end if the company is deemed 'small', otherwise the tax is payable in 4 quarterly instalments starting 6 months after the year starts. This means that tax payments will have to be estimated with the risk of incurring penalties and interest if tax is underpaid. The definition of a small company can be found on the Gov.uk website.

A corporation tax return will need to be filed electronically with HMRC together with a full set of company accounts within 12 months of the year end.

Capital disposals

So what happens when a buy to let property is sold?

Companies do not pay Capital Gains Tax, they only pay Corporation Tax, so gains are taxed at 19%. Individuals pay Capital Gains Tax on buy to let properties at 28% or 18% depending on their levels of income.

Unlike individuals, companies do not have an annual allowance for Capital Gains Tax. They do however have something called Indexation Allowance which you can claim from day of purchase to day of sale. This can help reduce any gain if the asset is held for a long period of time.

If a loss is made on a capital disposal then it belongs to the company and can be offset against future years, as long as the rental business continues in the company. From 1st January 2018 indexation has been fixed using the December 2017 rate, effectively removing any further indexation after 31st December 2017. This measure was announced in the 2017 Autumn budget.

So based on your individual circumstances and the amount of potential gain, you may pay less tax as an individual as a result of using your annual CGT allowance.

For example - A buy to let property sold with a capital gain of £30,000.

Gain on sale of £30,000

Company

Corporation Tax at 19% = £5,700

Individual

Capital Gains Tax at 18%/28% after annual allowance of £12,000

Individual at basic rate = £3,240
Individual at higher rate = £5,040

So in this example both a lower and higher rate payer is better off holding the property privately as an individual. But what about a larger gain?

Gain on sale of £150,000

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Company

Corporation Tax at 19% = £28,500

Individual

Capital Gains Tax at 18%/28% after annual allowance of £12,000

Individual at basic rate = n/a as gain pushes into higher tax bracket

Individual at higher rate = £38,640

In this example the company will pay a lower level of tax.

How do I get money out of the company?

Although on the face of it a company appears to pay less tax on the income and potentially less tax on capital gains, the net income (the cash) belongs to the company and not the individual. If the individual needs access to the cash then they need to get it out of the company.

Getting cash out of the company also has tax consequences which can negate any benefit of putting the buy to let properties in the company. To get the cash out companies can either pay dividends to shareholders or salary to staff/directors.

Dividends

These are payments to shareholders based on the number of shares they hold in the company. The dividend is paid after Corporation Tax has been deducted. The company will pay no further tax on a dividend made, however, they are taxable in the hands of the recipient shareholder.

From April 2017 dividend tax changed so as:

- All individuals can receive £2,000 of dividend tax free for the tax year 2018/19
- There are three dividend tax bands: 7.5% (basic rate), 32.5% (higher rate) and 38.1% (additional rate)

This means that for a shareholder who receives £10,000 dividend who is a basic rate taxpayer will pay 7.5% on £8,000, 32.5% if they are higher rate and 38.1% for additional rate.

For example. If my buy to let properties generated £30,000 net income and I was a higher rate tax payer and took the cash out via dividends currently benefiting from £2,000 allowance.

£30,000 Net Income	Company	Individual
Corporation Tax at 19%	£5,700	n/a
Dividend Paid	£24,300	n/a
Income Tax at 32.5% after £2,000 annual allowance	n/a	£7,247.50
Income Tax at 40%	n/a	£12,000
Net cash to individual	£18,027.50	£17,052.50

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In this example individual ownership is more advantageous. However, with full relief in the company for mortgage interest payments then the net income in the company may be higher and therefore the net cash out may be higher in the company.

Salary

The alternative way of extracting cash from a company is to take a salary. Taking a salary out of a company means that you will have to register for PAYE for employers. This means that you will have to deduct tax and National Insurance and pay it on a monthly basis to HMRC. It will also involve operating the new Real Time Information system (RTI) which means sending electronic data to HMRC every month on or before you pay your employees. Employers also have to pay Employers National Insurance which is 13.8% on any earnings currently over £702 per month.

For a higher rate tax payer, any income would be taxed at 40% and they would also pay employees NI. In addition, the company would bear employers NI at 13.8%. This can make it an expensive way of extracting cash from a company.

Other non tax considerations for owning buy to let properties in a company

Accounts will have to be filed with Companies House within 9 months of the year end (6 months if the company is a plc rather than a private limited). An annual return will also have to be completed each year and filed at Companies House, with penalties if the deadlines are not met.

The company may also need an audit if it does not meet the definition of small company as per the gov.uk website.

This will involve paying for a qualified firm of auditors to review the books and records and determine whether the accounts are a true representation of the company's finances.

What happens if I want to sell the company?

Company rental property businesses are currently not automatically deemed as trading for tax purposes so may not qualify for certain trading company reliefs.

The reliefs of note that this could affect are:

Entrepreneurs relief - this can reduce Capital Gains Tax payable on the sale of shares in a company.

Rollover relief is not available – this means you cannot carry the gain and deduct it from the base costs of any new asset when bought within 3 years or 12 months before selling the assets whose gain you want to roll over.

The test HMRC seem to use is how active you are day-to-day in the property business. However the case law is not clear on what tests you need to pass to ensure it is a trading business and not an investment company.

If you wish to think about claiming reliefs for trading companies you must obtain professional advice to ensure your particular circumstances may be considered trading.

Family members

There may be some scope for giving shares in the company to family members to utilise annual exemptions and basic rate bands but these can be subject to Capital Gains Tax and Inheritance Tax issues. Potentially these are exempt transfers but independent tax advice should be sought before taking any such action. This will also require the lender's consent, which could affect your ability to do this.

I already own a property. Can I transfer it to a company I have set up?

Any transfer will be deemed to be at market value at the time of the transfer so Capital Gains Tax may be payable at the time of the transfer.

This example also assumes that the individual is a higher rate taxpayer and that the property has never been the owner's main residence.

Both these charges will be a one off but need to be factored into the savings being made by changing to a company.

For example: A property originally costing £175,000 is transferred to a company at a market value of £250,000 crystallising a gain of £75,000.

Gain of £75,000	Tax payable	
CGT at 28%	£17,892	After annual allowance
Stamp duty payable	£10,000	Payable immediately
Total tax payable	£27,892	

Please note the new lower rate of Capital Gains Tax introduced in April 2016 does not apply to residential property.

Early Repayment Charges on current mortgages may also apply, as any mortgages will have to be taken out in the company's name rather than the individual.

Summary

Careful planning is required before transferring property to a company, as the initial costs may outweigh any benefits in the short term.

It might be more beneficial for new property purchases to be put into a company, however, if the plan is to hold the property for the long term.

If the rental income is required for day-to-day living then you will need to consider how the income will be extracted from the company, because it may negate some or all of the tax savings you made by putting the rental property into a company in the first place.

It is therefore essential that tax advice is sought before rushing into setting up a property company.

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Disclaimer:

The information provided in this guide is of a general nature. It is not a substitute for specific advice on your own circumstances. You are recommended to obtain specific professional advice from a tax and legal adviser before you take or refrain from any action. Whilst we endeavour to use reasonable efforts to provide accurate, complete, reliable, error free and up-to-date information, we do not warrant that it is such. The information can only provide an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice.

Rates are correct as at 16th July 2019.

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