BUSINESS & PERSONAL TAX SUPPORT

Corporate investment properties

Financing options 2024-25

Rather than owning an investment property personally, it may be preferable if the property were held in a property company. When it comes to financing the property, the director may choose to introduce funds into the company or the company may borrow the funds. We look at the tax implications of each option.

Option 1: Director borrows against main residence and lends funds to the company

If the director has equity in his or her private residence, it may be preferable to raise the funds to purchase the investment property by releasing equity and borrowing against the main residence as the interest rates may be lower than on a commercial loan. If this route is taken, the director would then lend the funds to the company, and the company would pay interest to the director on the loan to cover the interest payable by the director on mortgage. There are tax implications for both the director and for the company.

As far as the company is concerned, the interest payable to the director on the loan is a deductible business expense and can be deducted in full by computing the taxable profits of the property company. Unlike unincorporated property businesses, there is no restriction on the deduction of interest and finance costs. Relief is given in full as a deduction, rather than as a tax reduction, ensuring relief at the rate at which the company pays corporation tax.

However, paying interest on a director's loan does involve some administration on the part of the company. The company must deduct tax at the basic rate of 20% from the interest paid to the director. The company must also submit a quarterly return on form CT61 to HMRC, and pay the tax deducted from the interest over to them. The form is not available to download, but can be requested online (see www.gov.uk/government/publications/corporation-tax-return-of-income-tax-on-company-payments-ct61).

For example, if a director loans the company £300,000 at a rate of 6% per annum (£18,000 a year), and the company paid interest to the director monthly at the rate of £1,500 per month gross, the company will need to deduct tax of £300 (20%) from each monthly interest payment and pay this over to HMRC each quarter. The director would receive net interest of £1,200 a month (£14,400 a year).

The form must be filed within 14 days of the end of the quarter, and the tax deducted from the interest payments paid over to HMRC by the same date. The quarters run to 31 March, 30 June, 30 September and 31 December. If the company does not prepare its accounts to one of these dates, it must also submit a return to its year end. For example, if a company prepares its accounts to 31 May, it will need to file a CT61 for the month to 30 June, the quarters to 30 September, 31 December and 31 March and the two months to 31 May.

The interest received by the director is taxable to the extent that it is not sheltered by his or her personal savings allowance or any unused personal allowance. The director will be entitled to a savings allowance of £1,000 if they are a basic rate taxpayer and £500 if they are a higher rate taxpayer. Additional rate taxpayers do not benefit from a personal savings allowance. If no tax is due on the interest, or the tax due is less than the tax deducted by the company, the director can claim an allowance. If the director is a higher or additional rate taxpayer and the interest received by the company is not covered by the personal savings allowance (where available) or any unused personal allowance, the director will be taxed on the interest at their marginal rate of tax, with credit given for the basic rate tax deducted by the company. The balance due is paid through the Self-Assessment system.

As far as the mortgage interest payable by the director is concerned, tax relief is available for interest suffered on certain borrowings used to lend money to a close company. For the relief to be available, the loan must be used wholly and exclusively by the company for the purposes of the business of the company as long as the company is not a close investment company. The making of investments in land that is, or is intended to be let commercially, is a permitted activity that takes the company outside the definition of a close investment holding company. Thus, for the director to be able to benefit from tax relief on the loan made to the close company, the loan must be used fully by the company and the property purchased with the funds must be let out. As long as these conditions are met, the director will be entitled to tax relief on the interest that is paid on the mortgage taken out on the main residence. Relief is given at the director's marginal rate of tax.

If the property is merely held by the company as an investment, the company will be a close investment holding company, and tax relief on the mortgage interest will not be forthcoming.

Option 2: Company borrows to fund the purchase

Alternatively, the company may take out a commercial mortgage to purchase the investment property. Where this is the case, the company will be able to deduct the interest payable on the loan in full in computing their profits for corporation tax. There is no restriction on the amount of the deduction, meaning that relief is given at the company's marginal rate of tax.

For example, if the company borrowed £500,000 at a rate of 8% per annum, they would pay interest on the loan of £40,000 each year. This would be deductible in full in computing their profit or loss, even if the deduction results in a loss. If the company pays corporation tax at the rate of 19%, the relief would be worth £7,600 a year, reducing the net interest cost to £32,400 (a post-tax interest rate of 6.48%). However, if the company pays corporation tax at 25%, the tax relief would be worth £10,000 a year reducing the net interest cost to £30,000 (a post-tax interest cost of 6%).

We can help

If you are considering your options regarding property acquisition funding and are unsure which way to proceed, please call, we can help.