Extraction of a Property into an LLP

Did you know that to benefit personally from future growth in the value of the property you could face a substantial double tax liability?

How?

Firstly, the company will pay corporation tax on the chargeable gain. The effective rate of tax on these gains is currently up to 21.25%.

Then, if you wish to extract the resultant cash into your own name, you will normally pay income tax on the distribution. For those with incomes over £150,000 the effective tax rate is currently 30.56%

Can you give me an example?

Imagine you have a property in your company which cost £1million a few years ago, is currently worth £750,000 and you hope to sell in 5 years time for £1.5million. Assume that your company has other profits of £300,000 and you have income over £150,000.

Ignoring indexation, the corporate gain is £500,000 and the tax payable in the company would be in the region of £106,250.

After corporation tax the £1.5million would reduce to £1,393,750 and to extract this as a dividend with the current tax rates would mean a personal tax charge of £425,930.

So of the initial £1.5million proceeds, you would be left with just £967,820 after tax.

What are the alternatives?

You could extract the property out of the company into personal ownership. At its current market value of £750,000 there will be no corporation tax charge as it has fallen in value. There may be a personal tax charge on the value of the distribution, however the amount payable should not exceed £229,200.

Then, providing the property is accepted by HMRC as being held in personal ownership for investment purposes, any future gains would be taxed at a maximum CGT rate of 28% (based on current rates).

In some cases Entrepreneur’s Relief may be available to reduce the effective CGT rate to just 10% however each case needs to be judged on its own merits. Even if this relief is unavailable, if you were to sell for £1.5million in 5 years time, the potential CGT liability at 28% would be £210,000.

Of the £1.5million, even with the maximum income tax charge of £229,200 and CGT of £210,000, you are still left with £1,060,800.

The potential tax saving is some £92,980 over retaining the property in the company.

But….. what if I cannot afford to pay the personal tax charge on extracting the property now?

This may not always be necessary. If you have a loan account balance with the company, you may be able to draw the property out in lieu of this.

Alternatively if the property has been or can be funded by external borrowings such as bank debt, it may be possible to take over this personally and thus reduce the net value of the taxable distribution.

But….. what about the limited liability protection that a company offers?

This can still be achieved without a limited company by using an LLP (Limited Liability Partnership). This provides all of the tax benefits of personal ownership, including the present 28% tax rate on capital gains, but with the advantage of limited liability.

But….. what about Stamp Duty?

The extraction of the property into personal ownership would normally give rise to a Stamp Duty Land Tax (“SDLT”) charge. However with careful planning it is possible to organise the withdrawal of the property into an LLP such that no SDLT arises. For further details, please contact us.

But….. what about Inheritance Tax?

Shares in a property investment company would not normally qualify for Business Property Relief nor does investment property even if held by a trading company, so in these circumstances there should be no impact on the IHT position.

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Need help?

For help and advice on any of the matters raised in this guide, please call us and talk to one of our friendly experts. +44(0)330 024 3200

If you hold an interest in an unquoted trading company which holds property from which it carries out its trading activities, then 100% BPR would normally be available on your shares.

Land and buildings owned personally but used by a company you control would only qualify for 50% BPR.

There is therefore a potential reduction in the IHT relief available however in many cases, the potential income tax and CGT saving will far outweigh this. Furthermore, if debt finance is secured on the property once it is in personal ownership, the net value of the asset for IHT purposes will be reduced by the value of the debt anyway, which may mean that the effects of losing part of the BPR are negligible.

I'm interested. Who can I talk to?

This is a specialist area and a strategy for each company should be developed after taking into account its individual circumstances.

Hillier Hopkins LLP have extensive experience of advising on property transactions.

For further information on the potential tax benefits and an indication of the savings that may be available, please contact one of our team for a **FREE initial consultation:**

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Richard assists clients looking to acquire or dispose of a business, ensuring the transaction is smooth and the desired result is achieved with minimum anxiety. He is often involved with designing efficient structures for the ownership of land and property, whether the venture is for investment, development or trading purposes including extensive work in the extraction of property assets from limited company's to Limited Liability Partnership ownership.

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Liam is responsible for managing the tax affairs of a wide variety of clients and his portfolio ranges from individuals and owner managed businesses to AIM listed companies and the subsidiaries of UK and overseas quoted entities. His areas of speciality include property taxes, tax mitigation strategies, capital allowances, group planning, Research and Development claims and employee share schemes.

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