White Dragon Communications

Practical opportunities exist in BTL limited company protection space

Many mortgage intermediaries and investment firms will have been pondering recently how best to help their buy-to-let clients cope with the tax changes that were introduced in April, and will be phased in over the next few years.

We know there is not one simple answer to the conundrum and it will entirely depend on 'whether to SPV or not to SPV'. The answer will be as individual as the client themselves and will depend almost entirely on the size of the portfolio, the income generated and the value of properties held as well as their own personal tax positions.

Once these decisions have been taken however there are opportunities that exist in the protection space to complement those decisions, especially if the SPV vehicle is deemed suitable. As we are now all very much aware an SPV is usually a limited company, set up purely to hold property. Therefore corporation tax (at a rate of 19% since 6th April) is payable on the rental income - instead of 40/45% if it was assessed as personal income for a higher-rate/additional-rate taxpayer. According to Mortgages for Business[1] in April, some 77% of buy-to-let purchases are now being made via a corporate vehicle - such as an SPV.

Setting-up a SPV can be done online for as little as £20[2], and buying a property through it is a similar process to buying it as an individual. Furthermore, customers have an increasing range of mortgages to choose from, as this type of arrangement becomes more popular.

However from a protection perspective this is where the opportunity becomes different. Any mortgage liabilities on buy-to-let properties held within a SPV will be those of the SPV itself and therefore the cover required will be 'business loan protection'.

If we look at the guidance rules offered by the PRA they are principally as follows:

Affordability assessments - should account for a borrower's costs, verify their personal income, and suitably 'stress-test' against the effect of possible future interest rate increases.

Lending to 'portfolio landlords' - to be defined as those with four or more mortgaged buy-to-let properties should be assessed using a specialist underwriting process.

Loans to small businesses - the provisions which reduce the capital requirements on loans to small businesses by around 25% should not be applied for buy-to-let borrowing purposes.

These changes do not automatically create new protection needs from what they were previously but do provide opportunities to discuss key issues and potentially beneficial tax treatments for portfolio landlords who are using SPVs or are considering that vehicle.

The fact remains that the mortgage liabilities held will be a debt within the business and therefore business loan protection can be taken out to cover that debt. As the taxation rules are not definitive, the local HMRC inspector will need to be contacted – however the broad principles are that the premiums paid may be deductible as a business expense and where this is not possible the trading receipt by the company on the death of the shareholder may be treated as tax exempt. As the business will be a standard limited company, other life products can be used to complement the liability.

Given the PRA requirements regarding affordability all brokers will have assessed the portfolios and will have had the opportunity to look carefully at any shortfalls caused by incapacity of the directors. At this stage it would be prudent to inform them of the opportunity to cover any downside risk using any one of a range of products available.

That could be what we regard as 'Individual' Products such as Life Assurance and/or Critical Illness or Executive Income Protection (still available by a limited number of UK Providers) to take advantage of limited company taxation. An alternative would be to consider using a Group arrangement, where Life, CI and IP can be packaged under one arrangement and can be offered to as few as two lives with Paradigm with favourable underwriting and tax treatment for directors.

Finally, when assessing the value of the SPV consideration will need to be given to the Inheritance Tax treatment of the limited company when passed down. Whilst an SPV is a company, business relief can't be claimed if the business mainly deals with land or buildings, or if it only generates investment (rather than trading) income[1]. Clearly property letting is firmly caught within this net.

Unless substantial other services are provided, business relief therefore won't be available, so there remains a need for IHT cover on those with an estate (including the net value of their buy-to-let properties) in excess of the nil-rate band.

Once again this has highlighted the opportunities to write protection business for clients while providing them with some real, valued customer outcomes potentially saving them thousands of pounds.

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1. www.mortgagesforbusiness.co.uk/news-insight/2017

2. www.telegraph.co.uk/finance/personalfinance/investing/buy-to-let