BLICK ROTHENBERG
Chartered Accountants

The 2015 annual tax and residential property update seminar

This white paper provides an overview of salient viewpoints from our seminar held on 10 June 2015 at 16 Great Queen Street

An overview

A volley of residential tax changes since 2012 formed the backdrop to the seminar. At least 12 changes had been implemented or announced by the previous Government, extending over Stamp Duty Land Tax ("SDLT"), the Annual Tax on Enveloped Dwellings ("ATED"), Capital Gains Tax ("CGT"), Inheritance Tax ("IHT") and Value Added Tax ("VAT"). These will yield nearly £2billion over five years from the residential sector and predominantly affect the highest value properties – those now valued at £1million or more.

Frank Nash, partner, confirmed that four of these taxes were currently the highest growth taxes out of the 30 taxes and duties collected annually by HMRC, with the only exception being VAT which was growing in line with economic activity. Annual SDLT had grown by 50% over the period and ATED collection was also set to double in value by 2016. As expected, these taxes are mostly borne in London and the South East. This is due to rising property values and tax thresholds that generally omit most regional properties from ATED.

Statistics from HMRC show that for 2013/14, the first year of ATED, 80% of the tax was collected from the boroughs of Westminster and Kensington and Chelsea, 5% from Camden and Barnet, with the remainder from the rest of the UK.

Homeowners and investors dislike uncertainty. It reduces activity and affects values and the tax yield. There is a general consensus that with the threat of a "mansion tax" fading away in the short term, residential property should be able to look forward to a period of certainty on tax. The prospect of an EU exit remains of some concern, as does the "tax lock" in the Conservative manifesto which may displace any tax rises onto the property sector. Despite all this the consensus remains that investing and living in London residential property is something that should ride out any moderate tax changes over the longer term. Additional taxation is always an annoyance, but making tailored use of various statutory exemptions and reliefs should minimise the impact of property taxation at an individual investor level.

Corporate ownership

The complicated regime for "enveloped dwellings" was set out by Nimesh Shah, partner, based on his experience of structuring high value Central London property within corporate ownership to obtain anonymity and IHT protection for foreign domiciled families living or working in London. Provided early action is taken, UK assets can be placed in an appropriate overseas "trust and company" structure and IHT protection obtained under the "excluded property" rules. Residential property is perhaps the most recurrent asset class held in these IHT efficient structures. This comes at the cost of the annual ATED charge, but many families see this as a more reliable alternative to life insurance, either way the Treasury gets the contribution it seeks.

Further, **a company ownership structure has a form of future-proofing, granting some flexibility on any eventual sale**. This is because the option exists for a family to eventually sell a house in one of two ways. Either the property can be sold out of the company, or the shares in the company can be sold, the property passing on the sale of shares with some discount for inherent CGT. The consensus is that the vehicle of choice for future foreign investors is likely to remain corporate ownership, which may have a premium in value over personal beneficial acquisition, with its associated SDLT at a marginal rate of 12% on each successive property acquisition.

There is no clear cut answer and no "one size fits all" approach. The introduction of Non-Resident CGT, the third significant CGT charge in the last seven years, has added to that complexity. As Nimesh explained, if all the competing needs of tax mitigation, commercial sense and personal preference are established there is every reason for an investor to arrive at an agreeable home ownership structure.

The family home and capital taxation

The exemption from CGT on the family home protects the rise in value of our homes so that the full proceeds can be reinvested in our lifetimes in replacement property. **The relief can be accidentally lost in a number of ways**.

Only one property will qualify, but where an owner has two or more homes an election can be made to nominate a specific property for relief, perhaps the one with the biggest accrued gain. There is a strict two year time limit on making the election which is often overlooked. Failing to reoccupy a main home after a material period of absence will limit the relief and there are also complications in other areas such as divorce and development of garden and grounds. Frank Nash explained that a gift between spouses or civil partners of a property no longer occupied as a home can destroy any prior history of tax relief that the donor spouse or civil partner has accrued.

Mitigating IHT on the family home is becoming harder. It is no longer possible to give away a valuable freehold and reserve a lease which diminishes in value in the donor's estate as they grow older. There are still options available, but they will involve the payment of rent, loans, or, in some cases, the pooling and joint occupation of property. These are not easy decisions.

VAT opportunities

Some good news is available for the conversion, renovation and alteration of qualifying residential property. Alan Pearce, partner, explained that a reduced rate of 5% VAT can apply on costs incurred under two main heads.

Where the number of dwellings in a single property changes, whether an increase or decrease, the reduced 5% rate can apply. This is also the case where non-residential property such as offices, warehouses, public houses, schools and agricultural barns are converted to residential use. Care is needed if no separate dwelling is created, such as "granny annexes" that are incapable of separate disposal because of a condition imposed by local planning consent. The reduced rate can apply on the conversion of "houses in multiple occupancy" or property used for a "relevant residential purpose", such as a nursing home or student accommodation. **The relief can apply both ways**; that is to say a conversion to or a conversion from these types of property to residential.

The second relieving point is residential property that has remained unused for at least two years. Again the 5% rate can apply, provided all the conditions are satisfied. Alan also covered the range of services available for the reduced 5% rate, confirming those that cannot benefit where the higher VAT cost needs to be budgeted into property development financial forecasts. The "zero rating" on resale of converted property or on the demolition and reconstruction of residential property should not be forgotten.

There are significant opportunities to mitigate VAT on many residential property projects. VAT is not generally recoverable on residential property developed and retained for letting, so ensuring the 5% rate applies to expenditure incurred can significantly increase profits.

Summary

- There have been a number of tax changes to shift the tax burden onto the "high value" residential sector since 2012.
- The Central London residential sector is healthy and appears immune to modest tax changes which investment and lifestyle benefits outweigh.
- Corporate ownership triggers a special tax regime: it is not necessarily wrong, but needs some careful contemplation and advice.
- CGT relief on the main residence can be accidentally lost. Thankfully, most of those occasions are reversible if caught in time.
- IHT planning with the family home is now limited to sensible lifestyle choices.
- Getting the VAT wrong on residential development will seriously erode profit margins.

Plan commercially, plan ahead, plan correctly.

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