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PROPERTY TAX VOICE

Issue 01 – December 2015

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Property Tax Voice

Issue 01 – December 2015

CHAIR'S VIEW

Brian Slater
Chairman Property Taxes Sub-Committee

A warm welcome to this edition of Property Tax Voice.

2015 has been something of a year of change in the world of property tax and the Property Taxes Sub-Committee has made a number of representations to HMRC and HM Treasury as a result.

On 1st April the de minimis limit for liability to the annual tax on enveloped dwellings (ATED) dropped to £1,000,000, thereby trawling a significant number of additional residential properties into that tax. That prompted a campaign for a simpler ATED return for those property businesses with a significant number of properties exempt from paying ATED under the rental exemption. A new much simpler return is now being introduced for those properties.

Then the renewals basis of allowances for white goods, carpets etc. installed in unfurnished or partly furnished residential rental properties was withdrawn by HMRC. At first this was not thought to be too serious. Furnished rental properties still had the 10% of rent "wear and tear" allowance available to them and it was thought that items installed in other residential rental properties could obtain relief under s 68 of ITTOIA 2005 (individuals) or s 68 of CTA 2009 (companies). These provide a relief for replacing any "tool". That does not sound promising but a tool is defined as including any implement or article, and arguably a refrigerator could meet that description. However, HMRC then announced that they regarded the sections 68 as covering only low value, high turnaround items such as small tools.

This resulted in a significant protest from the professional bodies and interested parties and now we have a complete revamping of the relief for items installed in rented residential properties. The renewals basis is back for all such properties, but the quid pro quo is that furnished properties have lost the age old "wear and tear" allowance.

There are still issues, not least how to apportion expenditure on a replacement item where an improvement is involved. As it is almost impossible to buy something nowadays that has not been improved (a cathode ray TV to a flat screen internet enabled model for instance) the requirement to exclude the value of improvement is bound to involve landlords in disputes with HMRC.

Finally, the chancellor made the surprise announcement in the Budget that tax relief is to be restricted from April 2017 for finance costs incurred in residential property letting businesses. Much coverage has been given in the financial press to a restriction of tax relief on interest, but note this extends to all costs of finance including arrangement fees etc., which can be quite substantial.

The restriction works by disallowing finance costs in calculating the taxable rental profit, and then introducing a tax credit equal to 20% of the disallowed costs.

There is a form of transitional relief because the disallowance and credit are being phased in over four tax years, so that the full effect of the restriction will not be felt until tax year 2020/21. There is a view that HMRC could have gone further here and not applied the restriction to let properties already bought by budget day, after all these would have been bought on the basis of a tax treatment which is now being altered. Sadly, the chances of any further relaxation to the restriction are highly unlikely.The restriction is likely to significantly increase tax liabilities on rental profit and decrease the net rental profit after tax. In slides presented at the CIOT's recent webinar on the subject (see note below for further detail), I showed an example where the net rental profit decreases from 21% of gross rents in 2016/17 to 9% of gross rents in 2020/21. The disallowance of finance costs also increases taxable income, so could have a knock on effect greater than the restriction of relief to 20%, e.g. loss of personal allowances, tax credits, savings allowance etc. Some trusts may be in the position of having insufficient money to pay all of interest, expenses and tax.

What can a highly geared "buy to let" residential landlord do, other than simply liquidate their business at fire sale prices? They could move into commercial property renting, but that is a more specialised field. They could incorporate their letting business, because the restriction covers only individuals, trustees and partnerships (also including limited liability partnerships). The subject of possible incorporation is a whole technical article in itself. However, incorporating a residential property letting business is not exactly without difficulty, including:

- SDLT on the market value of properties transferred into a company,
- possible CGT on properties transferred (depending on the level of involvement in the business the individual may be able to claim incorporation relief under s 162 TCGA 1992),
- increased tax on profit extraction (in view of the increase of tax on dividends from April 2016 also announced in the summer budget),
- possible double charge to tax on exit.

Not exactly slam dunk planning is it? Members will need to consider carefully all their clients with geared residential property letting businesses and provide tailored advice to each.

The Property Taxes Sub-Committee has had a busy year. Whilst we can hope 2016 is a year more of consolidation and less of upheaval the announcements by the chancellor in his Autumn Statement of a change to SDLT and the acceleration of CGT payments in April 2019 (see CIOT / ATT press releases: http://www.tax.org.uk/StampDutyincreaseswillhikebuytoletcostssignificantly.php and http://www.att.org.uk/RisktotaxpayersinchangestoCGTpaymentssaystaxbody.php) do not augur well.

Brian Slater
Chair

SPRING CLEANING

Ximena Montes Manzano discusses recent changes to only or main residence relief

The capital gains tax exemption on the disposal of a person's only or main residence (which is in most cases automatic), had been fairly settled and subject to few changes since the consolidating Taxation of Chargeable Gains Act of 1992. This "settled" state of the law came to an end with FA 2014 – which introduced a narrowing of the deemed periods of occupation – and was considerably overhauled by FA 2015. This article will explore the amendments made by, and the implications of, the Finance Acts of 2014 and 2015 in relation to only or main residence relief ("main residence relief"). For the purposes of this article a working knowledge of the relief is assumed. For a detailed analysis of the conditions and mechanics of the relief please refer to my book Main Residence Relief by Claritax Books .

FINANCE ACT 2014 AMENDMENTS

Deemed periods of residence

With effect from 6 April 2014, s 58 of FA 2014 amended section 223(1) of TCGA 1992 in order to halve the period at the end of an individual's period of ownership which is deemed to be a period of actual occupation as the individual's only or main residence. The deemed period of residence changed from the last 36 months in the period of ownership to the last 18 months. This change is accompanied by an exception which covers owners who are disabled or who are long-term residents in a care home. In those cases, the deemed period of occupation will be extended to the last 36 months of ownership if the following conditions are met:

1. The individual (or the individual's spouse or civil partner) has a mental health disorder which prevents them from managing their own affairs or is in receipt of a disability benefit or allowance; or
2. The individual is a long-term resident in a care home (already resident or reasonably expected to be resident for at least three months); and
3. The individual does not have any other relevant right in relation to a private residence at the time of the disposal of the dwelling-house.

An individual is deemed to have "any other relevant right in relation to a private residence" if:

1. he owns or holds and interest in a second dwelling-house (or part) which is not the main residence disposed of; or
2. he is entitled to occupy the dwelling-house under the terms of a trust and the trustees own or hold an interest in a second dwelling-house which is not the main residence in question; and
3. main residence relief would have applied to any gain accrued on the disposal of the second dwelling-house or would have done is an election had been made.

It is clear from the amended provisions that the exception excludes unmarried couples even in cases where all the conditions for the exception are met. It is also clear that mere ownership of (or an interest in) a second home could mean that the extension of time is disapplied. It seems that this would be so even in circumstances where the second home is unsuitable for the disabled person's occupation (for instance a third-floor flat without a lift) and where there has never been an election.

FINANCE ACT 2015 CHANGES

Disposals of UK residential property by non-UK residents

New s 14B of TCGA 1992 introduced a charge to CGT for non-UK residents (individuals, trustees and personal representatives) on the disposal of any UK residential property.

Individuals will benefit from the annual exemption and from main residence relief only in certain cases:

Determination of main residence

For disposals made on or after 6 April 2015, an individual's dwelling-house (or grounds) will not be eligible for main residence relief for a tax year unless

a) the individual making the disposal was resident for tax purposes in the same country as the dwelling-house for the tax year (or for a partial tax year) or

b) the individual spent at least 90 midnights in that dwelling-house or another qualifying house ("the day count test") (ss. 222A – 222B).

The day count test is generous in that the 90-days required do not need to be consecutive; any days spent by the individual's spouse or civil partner count towards the total (double counting excluding) and any days spent in different qualifying houses (i.e. owned by the individual or spouse/ civil partner) within the same country may be aggregated.

Amount of relief and period of ownership

When calculating the amount of main residence relief due to an individual, s 223(7) of TCGA 1992 provided that the period of ownership did not include any period before the rebasing date. Changes to 223(7) and the insertion of new 223(7A) and (7B), mean that where a capital gain (or part thereof) on the disposal of a main residence is a non-resident CGT disposal ("NRCGT"), the "period of ownership" does not include any period before 6 April 2015 (unless the individual makes an election to apportion).

Any chargeable gain will be on the growth from 6 April 2015 and, therefore, there are two possible bases for computing relief: the first is by rebasing at 6 April 2015 and the second by an express election by the individual to apportion.

Elections

According to s 222(6A) of TCGA 1992, if an individual occupies two or more residences for a period and has made an election for one of them to be treated as his main residence, that election is not disturbed just because during the same period another of his residences is treated as not being occupied as a residence by virtue of the restrictions for NRCGT.

Similiarly, if an individual wishes, he may nominate which of two or more residences (of which one is the NRCGT residence) was his main residence for any period within his period of ownership of the NRCGT residence (s 222A(2), (3)). A notice of election may vary any notice previously given to elect another residence within the individual's ownership period.

When an individual makes a disposal whilst non-UK resident, any main residence election must be made in the non-UK resident pages of a self-assessment tax return. Such an election is irrevocable and cannot vary a previous election made on a residence that has already been disposed of, in other words, the provisions do not have retroactive effect (s 222A(5), (6)). If the election affects an interest held by a spouse or civil partner, the election must be made by both parties either in the same election notice or by written notification agreeing to the terms of the notice (s 222A(7)).

Finally, a taxpayer subject to the NRCGT charge must report and pay within 30 days of the UK residence disposal unless they already file a UK tax return.

Profile

Ximena Montes Manzano is based in Temple Tax Chambers and was instructed by the CIOT, the ATT and the Joint Professional Bodies' Working Party on Professional Conduct to review and advise on the legal implications of the guidance on "Professional Conduct in relation to Taxation". She practises and advises in all areas of taxation and may be contacted at 0207 353 7884 or MontesManzano@templetax.co.uk

GREAT EXPECTATIONS

Caroline Fleet reviews recent case law on main residence relief

The Principal Private Residence relief ('PPR') provided to individuals on the disposal of their main residence is probably the most commonly claimed and known of reliefs within the capital gains legislation – sadly, it is also one of those reliefs that many taxpayers are not always fully aware of the internal subtleties and requirements for the relief to be available. Too often, taxpayers have the impression that just living in a property is sufficient to qualify for the relief.

Looking at some of the recent cases that have been heard by the tax tribunals, it is clear to see that it is often the quality of occupation and the expectations regarding the residency when the property is occupied, that is the focus of attention firstly by HMRC and then by the courts, in determining whether the relief should be available.

It is generally considered that the quality of occupation goes hand in hand with the length of that occupation - the longer you lived in a property, the more likely it is that that property was your main residence. However, there have been a few cases recently where this has not been the case and the quality of occupation has been sufficient to qualify for the relief, even though the time spent living in the property was actually quite short. Often the underlying reasons for the change of residence arise because of the breakup of a marriage or changes in personal relationships.

Richard James Dutton-Forshaw v HMRC [2015] UKFTT 478 was one such case.

Richard Dutton-Forshaw (RDF) lived with his wife and daughter in Lymington but worked in London. He would stay in London during the week and go back to Lymington at weekends. When his marriage broke down in 2002, the couple divorced. A few years later in June 2006, RDF purchased another property in Lymington with the intention of moving in with his new girlfriend while continuing to work in London. However the relationship ended prior to moving in and he then decided that he wanted to be based in London and purchased 32 Cornwall Gardens, moving in there on 5 August 2006. He retained the property in Lymington and commenced renovation work on it with the intention of selling it on completion.

During this time, RDF's ex-wife had remarried. Her new husband had been offered work in Spain and was due to move out there. RDF did not want his daughter to move to Spain and was therefore compelled to move back to Lymington to look after her. RDF duly moved out of 32 Cornwall Gardens on 26 September 2006 and took up residence in the recently renovated Lymington property. 32 Cornwall Gardens was then rented out until it was sold in November 2009.

RDF had claimed PPR on the disposal of 32 Cornwall Gardens on his 2009/10 Tax Return but HMRC disagreed and issued an assessment, claiming that the quality of occupation was not sufficient to qualify as his residence.

RDF appealed against this decision to the First-tier Tribunal (FTT).

The key point at issue was therefore whether RDF's occupation of 32 Cornwall Gardens was sufficient to qualify as a "residence". In determining whether this was the case, regard had to be given to ''the nature, quality, length and circumstances of his occupation of the property''.

In this case, there was clear evidence presented that RDF had intended for the property to be his main residence, including:

- He applied to the Royal Borough of Kensington and Chelsea for a parking permit, which required the property to be his main permanent house for the application to be successful. Once his circumstances changed, he returned this permit.
- He joined a London based dating agency.
- He attended Church there.
- Declarations of his intention to his ex-wife.
- In addition, if the property was not his "home" then, there was no other property available to him at that time.

Due to circumstances beyond his control, his occupation was shorter than expected. He had hoped to live there on a continuous basis but this was not to be.

It was the expectation of continuity and permanence at the outset which swayed the FTT. They drew from earlier cases, stating that the need for permanence and continuity should not be overstated and it is important to look at the full circumstances to determine whether the property qualifies as residence. Therefore, despite living in the property for just over 7 weeks, the FTT ruled in RDF's favour and his claim for PPR stood.

This case was similar to that of *David Morgan v HMRC [2013] TC02596*. In this case, Mr Morgan had purchased a property with his fiancé but 2 weeks before they were due to complete and move in, the engagement was called off. Regardless, Mr Morgan moved into the property but found that a combination of high running costs and unhappy memories forced his hand and he moved back in with his parents.

He rented out the property from 31 August 2001 to 15 March 2006 and then moved back in to the property with a view to selling it, the property being sold on 28 July 2006. During the entire period of ownership, his actual occupation amounted to two separate periods totalling around 30 weeks.

Again, the FTT found in favour of Mr Morgan and despite the short length of actual occupation in the property, there was clear evidence of expectation of permanence and continuity. For example, at the time the offer was put in and accepted on the property, Mr Morgan was already engaged and had no idea that the engagement would be broken off before the purchase was completed.

Contrast these two cases with that of Sus*an Bradley v HMRC [2013] TC02560*. This also involved the breakdown of a relationship whereby Mrs Bradley moved out of the marital home into a rental property she owned. At the same time as she moved into this rental property, she put it on the market and stayed there until it was sold. She reconciled with her husband shortly after moving in and the rental property was sold less than a year after she moved in there.

She had claimed PPR on the disposal but this was denied by HMRC. The FTT also dismissed her appeal on the basis that there was never any intention to live in the property permanently and it was only ever going to be a temporary home and not her residence.

The common theme here is continuity, or the expectation of it. While the length of time spent living in a property goes some way to demonstrating the quality of occupation, it is not conclusive and should be considered alongside the rest of the facts pertinent to each individual case.

Crucially, the onus is on the taxpayer (and their advisers) to be able to provide evidence, if subsequent challenge by HMRC that their occupation of a property ''shows some degree of permanence, some degree of continuity or some expectation of continuity." Where the period of occupation is relatively short, obtaining this evidence is even more vital.

Profile

Caroline Fleet, Director at Gabelle LLP has, for the last eight years, specialised in advising clients within the real estate industry with particular focus on trading vs investment considerations, permanent establishment and holding structures. Caroline can be contacted at caroline.fleet@gabelletax.com or on 0203 805 7470

CAPITAL RELIEF

Ian Mackie considers the capital tax reliefs on residential investments

The Government is under increasing pressure to improve the availability and quality of housing in the UK. Against this background, if you were to canvass opinion of property investors, or even tax professionals, most would probably say there is confusion surrounding the tax reliefs available to investors in residential property. This confusion arises from a combination of legislative complexity and the changing policy of successive governments.

This article looks at the different types of residential investment and the capital reliefs that may be available, SDLT, VAT and other taxes and reliefs associated with transactions are not discussed here.

WHAT IS RESIDENTIAL FOR TAX PURPOSES?

The table below summarises some of the incentives available for a range of property types, all of which could be described in one way or another as residential.

Spectrum of residential accommodation and reliefs

	Hotel	Residential Care home	Aparthotel	Furnished Holiday Let	Student Accommodation	House in Multiple Occupation
Capital Allowances including ECAs & AIAs	✓	✓	✓	✓	✓/×	✓/×
Wear and Tear allowances	×	?	×	×	?	?
Land remediation Relief	✓	✓	✓	✓	✓	✓

Key

✓ Allowance available, × Allowances not available , ? Awaiting result of consultation

CAPITAL ALLOWANCES – RESIDENTIAL ACCOMMODATION

Plant and machinery allowances are not generally available on residential accommodation but what exactly is residential accommodation for capital allowances purposes? To help to understand this it is helpful to look at the legislation and HMRC's manuals.

Legislation expressly prevents landlords from claiming capital allowances on expenditure on plant and machinery for use in a 'dwelling –house' as part of a UK property business .Specifically for CAA2001, Part 10 the term "dwelling-house" is given the same meaning as in the Rent Act 1977 (CAA2001 s531).

In 2001*, Uratemp Ventures Ltd. V Collins [2001] UKHL 43*, the court examined the Housing Act 1988 definition, found that a hotel room without cooking facilities comprised a dwelling house.

Some years later in 2008, because of the Uratemp Ventures ruling, HMRC changed their interpretation of the law to mean that in student accommodation, individual study bedrooms could comprise separate dwelling houses, leaving only the communal dining, kitchen and lounge areas not being part of the dwelling house.

The new guidance led to much confusion and as result, HMRC published further guidance in HMRC Brief 45/10 in 2010 which revised their definition and updated the Capital Allowances Manual at CAA11520 which now states that a 'dwelling house is a building, or a part of a building; its distinctive characteristic is its ability to afford to those who use it the facilities required for day-to-day private domestic existence.'

It goes on to say that '….cluster flats or houses in multiple occupation that provide the facilities necessary for day-to-day domestic existence…..are dwelling houses. The common parts (for example stairs and lifts) of a building which contains two or more dwelling houses will not, however, comprise a dwelling house.'

Communal areas

Therefore Capital Allowances are available on plant and machinery and integral features in residential properties and including but not limited to:

- Lifts
- Heating and lighting in corridors and stairwells
- Fire alarms
- Access control

Currently, hotels, aparthotels and residential care homes are unaffected by the guidance in CA 11520 and capital allowances are available for qualifying expenditure on all parts of these properties.

Enhanced capital allowances (ECAs)

Where registered environmentally beneficial equipment is installed that qualifies for capital allowances a 100% first year allowance may be available through the enhanced capital allowances scheme.

Annual investment allowance (AIAs)

In addition to ECAs, investment is being encouraged by the recent changes to the Annual Investment Allowance. AIAs give businesses a 100% deduction from taxable profits for expenditure on machinery, equipment and plant.

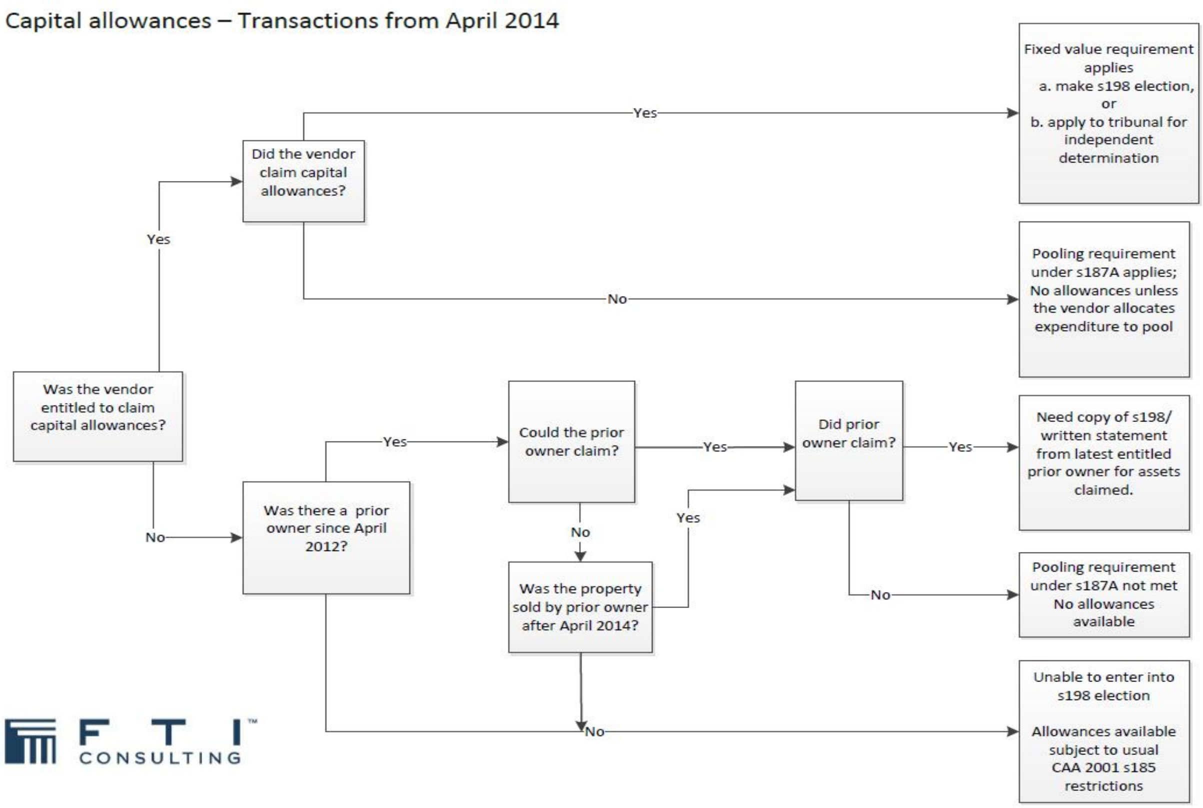
The AIA limit has changed recently and has been announced as:

- 1 January 2013 to 31 March 2014 (*) – £250,000
- 1 April 2014 (*) to 31 December 2015 – £500,000
- 1 January 2016 onwards – £200,000

(*) For sole traders, partnerships and LLPs, the changeover dates are 5/6 April 2014.

Capital allowances and fixtures - by way of a reminder

The Finance Act 2012 introduced major changes to the requirements for claiming capital allowances on fixtures when there is a sale and purchase of a property. The flowchart below highlights the key features of the regime from April 2014



WEAR AND TEAR ALLOWANCES

Landlords of fully furnished residential properties can currently claim an allowance for notional wear and tear on furnishings equal to 10% of the net rent received. HMRC are currently consulting on the withdrawal of this allowance and are proposing a new relief on the actual cost of replacing furniture which will be available on unfurnished, part furnished and furnished properties, it is expected that this will apply from 2016 onwards. Under the new replacement furniture relief landlords of all residential dwelling houses, excluding Furnished Holiday Lettings (FHL), will be able to claim a deduction for items provided for the tenant's use in the dwelling house. However there are concerns around transitional provisions and the narrow definitions proposed could exclude relief for anything that constitutes an improvement.

LAND REMEDIATION RELIEF (LRR)

Another often overlooked relief that is available is land remediation relief. In 2011 the Government decided not to withdraw this tax relief as it would risk "plans to support the housing and construction sectors through planning reforms and the release of large areas of publicly owned land for development".

Land Remediation Relief ("LRR") is available as a 150% tax deduction in the period the expenditure is incurred for any costs in relation to the remediation of contaminated or derelict land.

Remediation of land in a contaminated state is defined as causing significant adverse impact on the health of humans or animals or damage to buildings and includes removal of asbestos and for derelict sites, the removal of building foundations.

TAX CREDITS

For loss-making companies the utilisation of capital allowances and land remediation relief to reduce tax paid is of no benefit. However these companies can claim a **19% or 16% cash tax credit respectively** in return for surrendering any additional losses created by the relief, subject to certain conditions.

SUMMARY

Residential development is a politically topical and an evolving area, with UK plc clearly committed to a significant expansion of the current housing stock. The difficulty for advisers lies in determining the true nature of any residential development and applying the correct tax treatment to maximise all reliefs.

Profile

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CIOT & ATT WEBINAR SERIES

Residential Let Property report by Lakshmi Narain

The latest in a series of webinars was delivered on the 9th November. The event was hosted by John Whiting, Director of the Office of Tax Simplification, who set the scene by highlighting the immense complexity of property taxation and reminding participants that the CIOT had held a round table discussion on the issue. Unsurprisingly, this had concluded that there was no clear policy but a lot of confusion and complexity.

Megan Shaw, HMRC policy lead for the Finance (No.2) Act 2015 changes to residential let property, set out the key features of the changes. The Chancellor had announced, in the summer budget, that "The government will restrict the relief on finance cost that individual landlords of residential property can get to the basic rate of tax..." Clearly, key questions that need to be addressed are:

- what are finance costs?
- what do we mean by residential property?
- are individuals the only people affected?
- how does the restriction operate in practice?

Megan proceeded to answer these questions. However, the legislation is complex (isn't it always?) and runs to over 5 pages. Questions remain as to how it will operate in practice as there are practical issues that HMRC intend to address in guidance.

Brian Slater of Howard Kennedy and chair of the CIOT's Property Taxes Sub-committee set out a number of issues that advisers are or should be doing. Quite simply, a key starting point is to prepare financial models and then to consider the impact of changing the business model. As the restriction does not apply to companies, incorporation is a possible solution - that, no doubt, is where the difficulties are likely to begin.

The final session was delivered by Karen Griffin, director at Deloitte. Karen considered some of the issues that arise in relation to trusts. In particular, the basic rate reducer does not apply for interest in possession trustees or personal representatives - it applies to the life tenant or legatee. The practical consequences include difficulties where the additional tax liability creates a deficit and the extra detail that will be required on the R185.

The slides accompanying the webinar contained a number of clear and useful numerical examples to illustrate the way the restrictions will operate. A large number of questions were submitted: many were covered by the presentations others included:

1. Where a husband and wife own a property jointly on say a 99:1 split and have submitted form 17 will the 20% finance charge tax credit mirror that apportionment?
2. Farmer buys land including a derelict barn with borrowed money. Converts barn to dwelling and lets it. How would loan interest be apportioned?
3. How do you approach purpose of borrowings where mixed residential and commercial letting? Can you allocate to residential, rather than commercial?
4. What is the position with properties held by an LLP?
5. Does the tax reducer work in the same way for settlor interested trusts
6. Although buying new properties through a limited company sounds appealing, what are the commercialities of arranging a mortgage?
7. Do you not also have to worry about ATED if property value exceeds £500K
8. Are overseas FHLs excluded?

There was insufficient time for these questions to be addressed but brief set of responses to these questions are set out below, subject to the general comment that in each case the detailed facts will need to be established and the legislation may change before the rules come into effect in April 2017, the following observations may be made:

1. The finance charge credit should broadly follow the charge to income - see new s274A, ITTOIA 2005
2. The loan interest should be apportioned on a just and reasonable basis. Further detail will be required on the use of the funds - see new s272B, ITTOIA 2005.
3. As in 2 above, finance costs will need to be allocated on a just and reasonable basis - see new s272B, ITTOIA 2005.
4. Where an LLP is tax transparent then it is generally treated in the same way as a general partnership.
5. The income of the settlor interested trust is deemed to be that of the settlor and the restriction will be applied at that level.
6. There is no simple or general answer to this - each case will be different.
7. This will certainly be a further issue depending upon the availability of reliefs.
8. The exception for FHLs does not limit it to UK properties - see s272B ITTOIA 2005 and s399A ITA 2007

Overall, an excellent webinar that provided an opportunity to look at a major change at an early stage. If you did not see it the webinar can be viewed via the members' section of the CIOT & ATT websites where the slides can also be found.

The CIOT raised concerns on the implementation of the financing restriction and a note summarising the submission was published in the Technical Newsdesk section of Tax Adviser (http://www.taxadvisermagazine.com/technical/personal-tax) and ther ATT made the following comments:.

ATT COMMENTS ON CLAUSE 24 OF THE FINANCE BILL

The ATT's comments on clause 24, submitted to HMRC and to the Finance Bill committee, covered these points:

The legislation will create situations where the tax liability on the rental activity exceeds the actual amount of the profit. By 2019/2020 this will result in effective rates of tax well in excess of 100%.

The legislation has potential implications for recipients of child benefit and other state benefits. The ATT included in its submission examples to illustrate the impact on an individual's effective rate of tax where the legislation will lead to an increase in taxable income and trigger the high income child benefit charge.

The legislation will provide a disincentive for landlords who own commercial premises with a flat above to make it available for residential accommodation because to do so would result in a restriction in the finance costs allowable as a deduction against profits. Many landlords may decide to keep the flat vacant and use it as storage for the business below.

A clarification is required to new clause ITTOIA 2005 s 274(a)(2) to state clearly that the N% calculation is only of relevance if the finance costs relate to a share in a rental partnership. Otherwise, it might be considered that N% of profits assessable to tax is less than 100% in a non-partnership situation if the rental income is the only source of income received and the personal allowance is used to reduce the taxable element to less than 100%. This has (unintended) consequences when calculating the allowable tax reduction.

Overall, the ATT's view was that the legislation adds unnecessary complexity to the tax system. Many basic rate taxpayers will have to go through a series of complicated steps to arrive at the same answer they would have arrived at under the current system. The ATT believes that the new provisions should be triggered only if someone is a higher rate taxpayer on their rental income, so as to avoid this unnecessary complication for many taxpayers.

The ATT's response to HMRC can be read in full on the ATT website.

- See more at: http://www.taxadvisermagazine.com/article/fb-2015-%E2%80%93-relief-finance-costs-related-residential-property-businesses#sthash.r6mXkq3w.dpuf

YOUR NEW PROPERTY TAX VOICE

Property Tax Voice is also published on the Tax Adviser website

Members will be able to access Property Tax Voice, together with its related articles at taxadvisermagazine.com . Initially the site will not require a password but in due course you will need login details to access it.

Publishing on the web will allow us to provide more information to members as well as reaching a wider audience but we would really like to hear your feedback. What do you find useful? What do you want more (or less) of? – please email us at technical@ciot.org.uk

The taxadvisermagazine website has undergone a revamp recently and now has an easy to search function for Personal Tax content under the 'Feature' and 'Technical' tabs. You can also access Tax Adviser magazine via the NewsStand app on a variety of smart devices. The app can be found on the Apple Store (under Tax Adviser online) and the App Store via Google Play.

CONSULTATIONS AND SUBMISSIONS

Finance Bill clauses – non-residents CGT on residential property (4 February 2015)	Detailed commentary on the draft clauses following consultative meetings
Proactive submission on SDLT seeding relief for REITs (12 February 2015 and 2 October 2015)	The Government intends to introduce a seeding relief for property authorised investment funds (PAIFs). We looked at the case for a similar relief for REITs.
Land and Buildings Transaction Tax multiple dwellings relief and sub-sale development relief (19 February 2015)	The CIOT sent comments to the Scottish Parliament
FB15 Clauses: ER on associated disposals joint ventures and goodwill (25 March and 2 June 2015)	The CIOT commented on the unintended consequences of the FB15 clauses restricting ER on associated disposals joint ventures and goodwill.
Tax Devolution in Wales: Land Transaction Tax (LTT) submission (6 May 2015)	Joint Response by the CIOT and the Stamp Taxes Practitioners Group
Welsh Landfill Disposals Tax consultation (19 May 2015)	CIOT made a submission (which included ATT input).
Annual Tax on Enveloped Dwellings (ATED) (30 September 2015)	The CIOT corresponds with HMRC regarding ATED to companies owning the reversionary interest of a block of flats, whose shareholders are the lessees.
Scottish Land and Building Tax – first period of operation	The CIOT responded to the Finance Committee of the Scottish Parliament's call for evidence on the initial operation of LBTT.
Wear and tear consultation (October 2015)	Both CIOT and ATT submitted responses
Finance (No 2) Act 2015 section 24	The CIOT and ATT attended two HMRC workshops and made submissions on the clause.
Definitions of residential property	The CIOT met HMT in the summer. Ongoing.

SDLT ISSUES

The CIOT's engagement with HMRC on behalf of members in respect of SDLT

The CIOT is represented on two HMRC stakeholder forums concerned with SDLT. The SDLT Working Together Forum (this forum also includes the Annual Tax on Enveloped Dwellings (ATED)) meets quarterly; its objective is to identify and find solutions for significant operational issues with SDLT and ATED. A second forum, the SDLT Technical Forum, upon which the CIOT is also represented, aims to examine significant technical issues with SDLT that are hampering commercial transactions. We welcome issues from members that fall into either category that we can raise with HMRC on members' behalf. In future issues we will report back on issues raised by members. Two current issues are considered below.

PARTNERSHIPS – AN UNINTUITIVE EXIT CHARGE (FA 2003 SCHEDULE 15 PARA 17A)

The anti-avoidance provisions of paragraph 17A impose a charge to SDLT if, during the three years after a transfer of land to a partnership the transferor or a partner connected with the transferor either:

- Makes a withdrawal of money or money's worth from the partnership (other than income profit) or
- reduces their interest in the partnership share; or
- ceases to be a partner.

A withdrawal of money or money's worth would include the withdrawal of capital from the capital account and the repayment (to any extent) of a partner's loan.

The Office of Tax Simplification's interim report on partnerships had this to say on para 17A:

6.79 One point raised on more than one occasion was the different approaches on selling property between partners and partnerships. There could be an entry charge but there could also be an exit charge. The latter seems to be the effect of paragraph 17A sch 15 Finance Act 2003 and has no time limit. It is therefore necessary for advisers to warn of this even though it does not seem to be applied by HMRC. This is in fact an anti-avoidance provision which is nonetheless capable of catching commercial transactions. It was suggested that paragraph 17A is, in fact, redundant in the light of later anti-avoidance legislation in s75A Finance Act 2003, and could be disposed of

The interim report may be found at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/274278/PU1619_OTS_Partnerships_Interim_report.pdf.

Para 17A potentially gives rise to double taxation, where, for example, a property is transferred into a partnership , the partnership sells the property to a third party (on which SDLT is paid) and the partners withdraw the proceeds within a three year period, the withdrawal is treated as a land transaction and SDLT is due. The occasion of the death of a partner or divorce could also trigger the charge. Questions arise around its operation where land is transferred in tranches potentially creating new three year periods.

The CIOT understands that HMRC are considering the para 17A as part of their work on the OTS recommendations. If members have particular instances of this provision causing difficulties, we would like to hear of them.

THE EXCHANGE PROVISIONS (FINANCE ACT 2003 SCHEDULE 4 PARA 5)

For SDLT purposes where interests in property are exchanged, there are two land transactions. Finance Act 2011 made significant changes to the SDLT exchange provisions. It introduced a 'higher of' test for determining the chargeable consideration if the subject-matter of any of the relevant transactions is a major interest in land. Prior to the change, assuming that one of the interests transferred is a major interest, SDLT was charged on the market value of the interest acquired by each purchaser. For transactions with an effective date on or after 24 March 2011 (subject to transitional provisions), SDLT is charged on the higher of the market value of the subject matter of the transaction or the value of the consideration given by the buyer.

It is understood that the intention behind the FA 2011 change was to prevent the manufacturing of an exchange of interests to take advantage of the cap at market value in circumstances that would otherwise take place as a cash sale for a higher amount. However the changes gave rise to inequitable results particularly where there is an exchange of interests between connected parties for no other consideration other than the interest transferred. In recognition that this change would give rise to unfair results HMRC confirmed in guidance that the new provisions are not expected to change the SDLT payable on transactions 'on innocuous transactions (other than some involving VAT)' and provide examples at SDLTM04020a.The difficulty in practice is a recurring one of whether, and to what extent, it is possible to rely on the guidance in a situation where the strict terms of the legislation imposes a charge that is ameliorated by guidance ('taxed by law, untaxed by concession').

We would welcome examples in practice from members of the situations where the operation of the SDLT exchange rules give rise to problems in practice, particularly where it is necessary to rely on the terms of the guidance to mitigate what appears to be an unintended consequence of the strict application of the law. Please send all comments to the CIOT technical officer dealing with the CIOT's response to HMRC's review, Kate Willis at kwillis@ciot.org.uk

DEFINITION OF RESIDENTIAL PROPERTY AND THE MEANING OF A DWELLING FOR SDLT PURPOSES

Background

In June of this year, the CIOT wrote to HMT to reiterate the case for considering residential property taxes holistically as it has been a long-held concern of the CIOT that when piecemeal changes or reforms are made to one aspect of property taxation without adequate consideration of the operation of inter-related taxes, the consequences are invariably undue complexity, disproportionate costs of collection for business, unintuitive results and, occasionally, a failure to achieve policy objectives. Our letter was followed by a meeting in July with the HMT policy advisers responsible for residential property taxes policy.

Residential property definitions

One aspect of this overall goal is to consider the definitions of residential property across the taxes with the ultimate aim of achieving greater core consistency in definitions of residential property across the board. Currently there are subtly different definitions of residential property for SDLT, ATED, FA 2004 Schedule 29A (investment-regulated pensions), CGT, CGT-related ATED, Business Investment Relief for non-domiciliaries, capital allowances, VAT and no doubt other areas. Subtle variations between definitions of residential property depending upon the tax or context make it difficult to discern the underlying policy and set traps for the unwary.

SDLT

We have therefore welcomed a recent initiative by HMRC Stamp Taxes to undertake a project to invite input from practitioners on the current issues surrounding the main statutory definition of residential property for SDLT purposes in FA 2003 section 116, and the associated HMRC guidance. The section 116 definition begins by defining residential property as meaning 'a building that is used or suitable for use as a dwelling, or is the process of being constructed or adapted for such use,'(FA 2003 s 116(1)(a)). Some of the existing guidance in the HMRC SDLT manual on the meaning of 'use as a dwelling' relates to the now withdrawn Disadvantaged Area Relief and generally the guidance is not always easy to follow or comprehensive. In addition there is further guidance on the meaning of a dwelling in other contexts and for other taxes (for example in HMRC's Capital Allowances manual at CA11520 and VAT Information Note 02/14). It is not always clear to what extent there is a read across from guidance for other taxes that may have a different policy intent.

The CIOT will be responding to the invitation from HMRC to identify problems encountered in practice with the definitions of residential property for SDLT and specific circumstances that cause uncertainty. In addition views are sought on the current guidance in the SDLT manual to identify areas of the manual that are unclear, misleading or need further development. Please send all comments to the CIOT technical officer dealing with the CIOT's response to HMRC's review, Kate Willis at kwillis@ciot.org.uk.

EVENTS

Stamp Taxes Practitioners Group annual conference report from Lakshmi Narain

The Stamp Taxes Practitioners Group (STPG) now has in excess of 170 members nationally and holds meetings bi-monthly. It held its annual conference on the 4th November at the very pleasant facility of etc.venues in Aldersgate. It contained the usual mix of technical presentations, case studies and reports from leading practitioners and the tax authorities.

The current Chairman of the STPG, Gordon Keenay, a former Stamp Taxes Business Director with HMRC and currently head of stamp taxes at FTI Consulting, set the scene before introducing the first speaker, Simon McKie, of McKie &Co (Advisory Services) LLP. Simon gave a talk based on an excellent article that he had written jointly with Sharon McKie entitled 'Constructive Abdication: an analysis of the decision in Project Blue Limited v HMRC [2014] UKUT 0564 (TCC)'. The article, dissects the legislation and the irrational basis of the decision and may be accessed at http://www.mckieandco.com/Publications/Rudge_Revenue_Review/rudge_revenue_review.html. The major problem with the legislation is the failure to provide a clear basis for identifying the purchaser (P) and the vendor (V) in the notional transactions. The article notes the ten different possible choices of P and V. Further problems relate to the lack of a tax avoidance motive / purpose test to determine whether the legislation is at all relevant in a case, such as this, where the taxpayer has structured the transactions so as to use reliefs that have been clearly provided.

Simon was followed by Michael Thomas of Gray's Inn Tax Chambers. Michael provided an update on case law and a telling feature were the series of slides entitled 'SDLT noteworthy cases'. For 2003-2010 it read: Elizabeth Court v RCC, for 2010-2013: Vardy Properties v HMRC, Orsman, Pollen Estates , DV3 and Allchin, for 2014: Project Blue, Portland Gas Storage, and R (on the application of St Matthews West). But for 2015, Michael had a blank slide! There are a number of possible reasons for the lack of activity and these were discussed. Interestingly, the goodwill challenge (trade related property), that was expected in 2010 is now expected to be heard in 2016.

Roger Thomas QC, Pump Court Tax Chambers, followed the case law update with a detailed examination of the legislation on pre-completion transactions. With a number of tax planning structures, put in place before the introduction of SDLT in 2003, being unwound, the lack of transitional provisions in Schedule 2A, FA 2003 presents a number of particular problems.

Paul Clark, consultant at Cripps LLP, has written extensively on the problems of applying the SDLT legislation to lease renewals. His presentation ran expertly through the myriad of problems arising where a lease comes to an end but the tenant stays on.

The conference ended with presentations from Revenue Scotland (on the Land and Buildings Transaction Tax - LBTT) and the Welsh Government (on the proposed Land Transaction Tax - LTT). Dr Colin McHardy, Head of Tax Operations & Compliance for Revenue Scotland provided an interesting insight to the progress made with LBTT since it came into effect on 1 April 2015. Andrew Hewitt, formerly with HMRC, set out the progress being made in Wales with the Tax Collection and Management (Wales) Bill and, in particular, the proposal to create of a Welsh Revenue Authority.

South Wales Branch report by Lakshmi Narain

The South Wales Branch held an extended afternoon session on Property Taxes on the 20th October 2015 that was chaired by the Branch Chairman, Lakshmi Narain.

The Branch was most fortunate in having three Technical Officers, Kate Willis (Property and CGT&II) , Will Silsby (ATT) and Jane Mellor (Professional Standards) deliver sessions. Kate Willis and Will Silsby ran through a range of property related issues that the CIOT and the ATT have been working on. The range of issues is most impressive, as most members will be aware of by simply looking at the Technical pages of Tax Adviser. It is easy to see how much the tax system will have benefitted from the expertise offered by the Technical Officers and the hundreds (300 or so for the CIOT and over 30 for the ATT) of volunteers engaged in the technical work of the CIOT and the ATT. Both Kate and Will have contributed extensively to the efforts of the Welsh Assembly Government to ensure that the taxes to be devolved are done so in a way that meets the needs of the 21st century.

The core of the event was a technical analysis of a case study that examined the client's needs over a period of some 13 years. Starting with the basic decision as to whether to acquire a residential property in a corporate vehicle or in the ownership of an individual to its transfer into an LLP, it dealt with the impact of the changes to s 75A, FA 2003 to partnerships in 2010, the introduction of ATED in 2013 and to corporate members of LLPs in 2014. The case study highlighted the need to consider the finer points of both tax and property law and most importantly, to the simple need to be aware that change happens - change in law as well as change in client circumstances. The simple take-away was that an essential feature of tax planning is to be aware that there may be a need to unwind or finesse the structure.

The increasing focus on anti-avoidance over recent years has resulted in close attention on the action of tax practitioners. Jane Mellor led the delegates through a range of topics including:

- Professional Conduct and Professional Rules & Practice Guidelines
- Anti-money Laundering
- Engagement Letters
- Mortgage Lenders

- Other Professional Standards projects

It was interesting to note the activities of Professional Standards. In 2014/2015, among other matters they worked on

- Powers of Attorney
- High Risk Promoters
- Accelerated payments
- Fit and proper tests for charity trustees
- Tax Transparency
- Annual return and PII
- Use of designated title Chartered Tax Adviser
- AML compliance
- Attended CFE and liaised on CFE submissions to EC

Future branch events

Harrow & North London 4 February 2016

Capital allowance treatment of Fixtures

East Midlands 9 February 2016

Property - capital allowances and SDLT

Sheffield 1 March 2016

Taxation of Property

Scottish Borders 10 March 2016

Working with the District Valuer

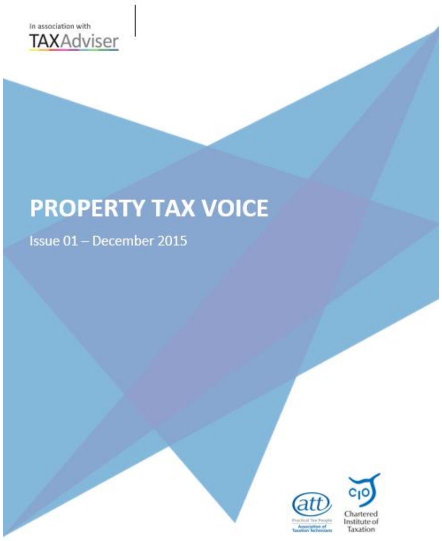
East Anglia 15 March 2016

CGT - land transactions & property tax update

Thames Valley - Oxford 25 April 2016

Private Residences

CONTACT US



Suggestions?

If you have any suggestions for further articles, please let us know: technical@ciot.org.uk

To contact the Property Taxes technical officer, Kate Willis, please email: kwillis@ciot.org.uk.

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