HAZLEWOODS LLP
BUSINESS ADVISERS & CHARTERED ACCOUNTANTS

developments

The magazine for property people

inside...

A Potentially Costly Mistake - Trading Stock or an Investment Property?

See page 4 for the full story

The New Construction Industry Scheme

See page 5 for the full story

Welcome you to the second issue of our property newsletter 'Developments'.

'Developments' is aimed at those in the property sector - developers, investors, the construction industry, and property owning businesses.

The aim is to keep our coverage of the issues relevant, topical and above all practical. You won't be drowned with science!

For more details please visit our website. It sets out in a lot more detail the areas we are specialising in. It also contains interactive tools and useful links. The web address is: www.hazlewoods.co.uk/property

The Hazlewoods Property Team

Over the years Hazlewoods have been advising an ever increasing number of clients involved with property. Recognising the importance of delivering best advice in a complex area we have now put together a specialist team of property advisors. They cover all aspects of personal and corporate taxation, VAT, SDLT (Stamp Duty Land Tax), and commercial advice as well as providing good links to relevant lenders.

We are here to help provide advice and solutions.

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The importance of planning

We act for a number of developers. One thing that is curiously striking is how deal led they are. They focus on life on a deal by deal basis. Whilst the emphasis is on profitability there often seems to be no overall strategy for ensuring that they maximise the wealth that they derive from their developments. And retain it.

To make and retain substantial sums of money you need to have a plan. Without some proper advice you'll sell yourself short. At the most basic level you should never go into a development without knowing what you want out of it. Is it short or long term and what do you want to do with the money once you've made it. Do you want to spend it? Do you want to reinvest it? This will help determine the type of vehicle you use to undertake the project. A lot of the thought that should go into a project should be tax focused.

Minimising your taxation liabilities will go a long way to helping you maximise your wealth. A good starting point is to ensure that you have the correct trading structure. There are many reasons why developers would want more than one company but often one sees a developer with far more companies than he or she actually needs. 'Keep it simple' is not a bad maxim. It could be as straight forward as ensuring that you don't have too many SPVs trading at any one time; an additional company could cost you over £20,000 extra in corporation tax a year, and you might not even need the company concerned!

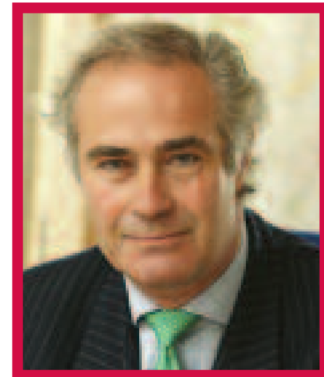
Avoiding the myriad taxation traps is also another key to ensure that as much of your profits as possible are retained. Believe me there are SDLT, VAT, income tax and corporation tax traps lying in wait for the unwary or those badly advised.

The extraction of profits also needs to be looked at carefully. Under certain circumstances it could be preferable to wind up a development company and obtain business taper relief rather than extract the profits.

You also need to look at sheltering your profits. I know most people begin to yawn when pensions are mentioned but with the post 'A' Day rules a new area of opportunities is opening up.

Last but not least you need to look at succession issues and, having admitted you are only mortal (!), make sure you minimise your Inheritance Tax liabilities.

While you beaver away making the cash it helps to have someone who can help you see the big picture, and that's where we come in.



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A Potentially Costly Mistake - Trading Stock or an Investment Property? Part 2...

In the last issue of Developments I recounted the tale of the property developer who nearly faced a large tax bill without selling the property, because he had decided to retain the building as an investment rather than sell it on. But what about the reverse position?

Suppose you have owned a property for a number of years as an investment, but the business tenant moves out. After considering your alternatives you come to the conclusion the best option is to apply to redevelop the site for residential housing.

Surely there are no tax implications until I sell? I hear you say. Unfortunately, for the unwary, there could be tax to pay before the sale of the residential units. Why? Because the property's nature has changed from being one of investment (which is a capital asset), to one of trading stock (which is revenue). The consequence is you could be treated as having sold the property at its market value, before it is redeveloped, with tax payable on any capital gain. There will also be tax payable when the redeveloped properties are sold, with the cost of the building for that purpose being the value used in the capital gains calculation. If there has been a significant capital gain during your ownership, then you will need to consider the cash flow implications of this tax payment before any sales have been realised.

So, how would we overcome the problem?

Thankfully, there is an easy solution to the problem if you are a company, because an election can be made to transfer the property to trading stock at market value, less any gain which would have arisen. This means no tax at that stage, and all the tax is paid when the redeveloped property is sold. The effect will be that you will pay tax you would have paid on the capital gain, but only when the residential units are sold.

Unfortunately, if you own the investment property personally and then trade as a developer in your own name, whilst you can still make the election to avoid any capital gains tax, the decision as to whether to do so is not so simple. Imagine you have been letting the property to an unquoted trading company and as a result your effective tax rate on the capital gain is 10% because of taper relief. If you made the election, the benefit of the taper relief is lost and you could effectively pay 40% on the gain, rather than 10%. In those circumstances, you probably do not want to make the election. One solution would be to think carefully about your timing, as it may be possible to arrange your affairs so that the capital gains tax is not payable until you have sold the property.

If you operate as a group of companies and have an investment company and a property development company, and they transfer properties between each other, then you need to be aware that any transfers may give rise to tax liabilities if not properly planned because again the nature of the property is changing from investment to trading or vice versa.

For more details, contact David Pierce - 01242 680000, e-mail: drp@hazlewoods.co.uk

The New Construction Industry Scheme - the good, the bad and the ugly!

First, the good news

The implementation date for the introduction of the new scheme has been deferred from April 2006 to April 2007. According to the Government announcement, this extension has been "agreed" with the construction industry. No reason has been given, but the suspicion is that the necessary IT systems are behind schedule and the Government wish to avoid another IT fiasco. It remains to be seen whether this potential problem will be avoided or merely delayed!

Then, the bad news

The Financial Secretary to the Treasury, John Healey, said that 'during this period, HMRC will step up its level of advice and compliance activity with the industry, including new interactive software and up to 70 telephone advisers to provide help with employment status from November 2005.'

Somehow, I do not find this statement reassuring. I am sure the industry will generally dread compliance visits. In my experience, builders and developers are often ill-prepared to deal with these.

Finally, the ugly news?

Interactive software and telephone advisers? You must be joking!!

The chances of HMRC being able to provide unbiased and accurate advice on status issues must be very slim. This is a complex area of law, based on case law rather than specific legislation and I just cannot believe that interactive software or telephone advisers will be able to cope with the intricacies. A few cases will be straightforward, but as for the rest I can guess what 'advice' will be given - and it will not favour the taxpayer. In fact, why would a contractor even risk highlighting the issue if he is unsure - it might be an invitation to HMRC for a compliance visit the following month.

Graham Cook, specialises in the Construction sector. He can be contacted on 01452 634800 or e-mail: gbc@hazlewoods.co.uk.

Residential Conversions - A New Interpretation of "Absurd" VAT Law?

The conversion of a non-residential property which contains a residential element (such as a public house with living accommodation on the upper floor) into a number of dwellings has always been fraught with VAT pitfalls for the unwary!

The developer will be seeking to zero-rate the sale of the newly-created dwellings in order to recover his input tax on the project. However, the relevant VAT legislation states that, where a non-residential part of a building is converted to residential, *"the result of "that conversion" must be to create an additional dwelling or dwellings"* if zero-rating is ultimately to apply - Customs have always interpreted this to mean that the only sale that can qualify for zero-rating is that of a new dwelling created entirely in the previous non-residential area. If any element of the previously residential part is included in a new dwelling, that sale has been treated as entirely VAT-exempt, with the consequent problems for input tax recovery.

In one tribunal case, the Chairman, whilst upholding Customs' interpretation of the law, commented on what he felt was the "absurd" example of a four-storey office block with a caretaker's flat on the top floor. If this was converted "vertically" into four new dwellings, the sale of every one of those dwellings would be VAT-exempt, whilst a "horizontal" conversion into four apartments would result in three of the sales being zero-rated!

However, a recent Court of Appeal ruling in the case of Ivor Jacobs (concerning a claim under the DIY scheme) may offer a way out of this absurdity. The taxpayer bought a former boarding school (which included a headmaster's flat) for conversion. The building was regarded as a mixture of residential and non-residential parts before the project began. After conversion the building became a family home which included three staff flats on the first floor, each of which was regarded as self-contained.

It was found that the staff flats were created entirely within a part of the building that had previously been residential. Customs therefore argued that these flats could not be taken into account in determining whether the conversion of the non-residential part of the building had created additional dwellings - as far as they were concerned, there was one dwelling in the building previously (the headmaster's flat), and subsequently only one dwelling had been created from the non-residential part i.e. there was no additional dwelling. The Court disagreed - in interpreting the phrase "the result of "that conversion"" (see above) the taxpayer was entitled to consider the conversion of the entire building. In this case, four dwellings existed where there had only been one previously. Mr Jacobs was therefore entitled to a refund under the DIY scheme (although only in relation to his costs of converting the previously non-residential parts of the building).

Customs may well try to appeal the Court of Appeal ruling to the House of Lords. However, in the meantime, developers are entitled to apply the principles of the Court of Appeal ruling, which essentially means the following two-stage test:

- Has a non-residential part of a building been converted?
- Are there now more dwellings in the entire building than previously?

If the answer to both questions is yes, the developer is entitled not only to zero-rate the sale of new dwellings created entirely from previously non-residential elements (as was always the case), but now also to treat the proceeds from the sale of a dwelling created from both residential and non-residential elements as partly exempt (re the previously residential element) and partly zero-rated (re the previously non-residential element). This will produce a more favorable result in terms of input tax recovery than treating the entire sale as exempt, as Customs have insisted previously.

Any developer who has suffered a restriction on reclaiming input tax in the past three years in the circumstances described above should contact us to discuss the possibility of submitting a repayment claim.

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IN, OUT, SHAKE IT ALL ABOUT!!! Gordon Brown's Stamp Duty Land Tax Hokey Cokey

New Stamp Duty Land Tax (SDLT) rules concerning partnerships came into force on 23 July 2004. From this date there are some wide ranging implications with any partnership that owns property or uses property owned by partner(s) outside of the partnership.

This articles aims to give a general outline of what will be caught under the new rules and how the tax will be calculated.

There are three different scenarios which could give rise to an SDLT charge in a partnership:

1. Property (including land or leases) is transferred into a partnership or initially provided by a partner(s) for use by the partnership,

2. In a partnership that holds property or uses property held by a partner(s), there is a change in the Income sharing ratios of the partners (e.g. a new partner, a change in profit sharing ratios or an outgoing partner),

3. Property is transferred from a partnership, or held by partner(s) and ceased to be used by the partnership.

Note that the first anomaly under the new regime is that the rules are only concerned with changes in the income profit sharing ratios of the partnership and not with capital sharing ratios as is the case under capital gains tax.

Under the first scenario the rules state that the deemed value on transfer of a property into a partnership is calculated by adding a proportion of the market value of the property (based on the element relating to the transferees) to a proportion of the consideration paid (based on the element relating to the transferor). If this exceeds the SDLT threshold, a charge to tax arises.

Under the second scenario the deemed value is calculated by multiplying the market value of the property by the percentage increase in the individual's share. Again, if this exceeds the SDLT threshold, a charge to tax arises.

The calculation under the third scenario is similar to that in the first. However, credit is given for any SDLT paid when the property was transferred into the partnership.

The new rules bring a whole new range of transactions into the charge of SDLT that have never been taxed before. It is now important to carefully consider the potential SDLT implications of any movement of property used by a partnership, together with the implications in a partnership changing its income profit sharing ratios.

Be warned that we have already seen some large liabilities to SDLT resulting from normal partnership transactions, so ensure you seek professional advice when considering any partnership changes or property transactions.

For more details, contact Nick Haines, SDLT specialist - 01242 237661 or e-mail: nmh@hazlewoods.co.uk

'A' Day why pension planning could make more sense than ever!

Most of you will be aware of the changes to the pensions legislation coming in on 6 April 2006.

Many of you will have ignored it. Pensions planning is boring old hat I hear you say!

Not a Bit of it!

The new rules open up the possibility of some serious pension funding. If you have a development that's really profitable you could use your company scheme to fund a significant contribution to your fund, up to £215,000 or maybe more in a company environment.

Even better, now you won't need to take an annuity, so your fund when you get to retirement won't get 'swiped' by an insurance company and die with you.

Best of all, investment companies will be able to make pension contributions.

There is now the prospect of some intergenerational tax planning. As before, if you die before drawing a pension, the fund can be left free of taxation to your nominated beneficiaries. But now there is also the prospect of being able to leave those beneficiaries the fund if you die having started to draw a pension. There will be a tax charge of some sort (to be advised) but if the fund was in your estate you would have had to pay Inheritance Tax - and you will have had tax relief on all the contributions to the fund.

Using Hazlewoods Financial Planning LLP we can help you take advantage of the new regime.

For more information contact
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More information

Should you wish to obtain further details of Hazlewoods LLP and the other services we provide including our Property Services Brochure please e-mail Jonathan Harvie jh@hazlewoods.co.uk or telephone 01452 634800

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