Winter 2011/12

Property Focus

Laying the foundations for future prosperity

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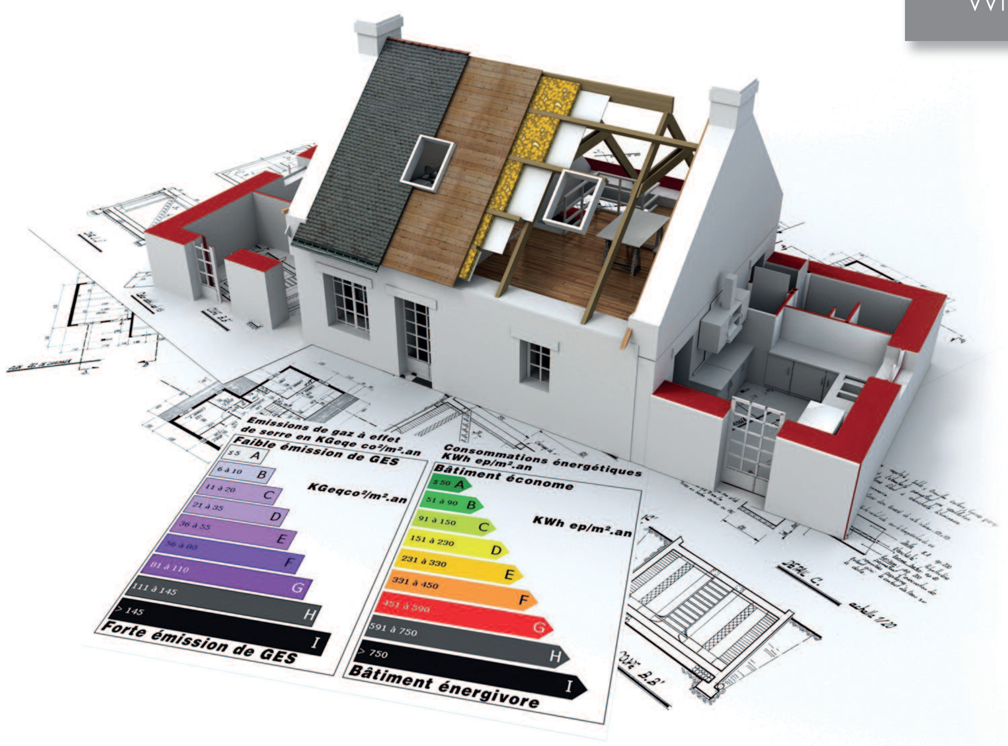


HAZLEWOODS

DRIVING LIFELONG PROSPERITY

Continued slowdown in new homes

Since the general election in 2010 there has been much publicity on proposals to free up the planning process and to make more land available. A number of the proposals have proved contentious, and even the National Trust has thrown its comments into the pot. The final plans are still far from clear.

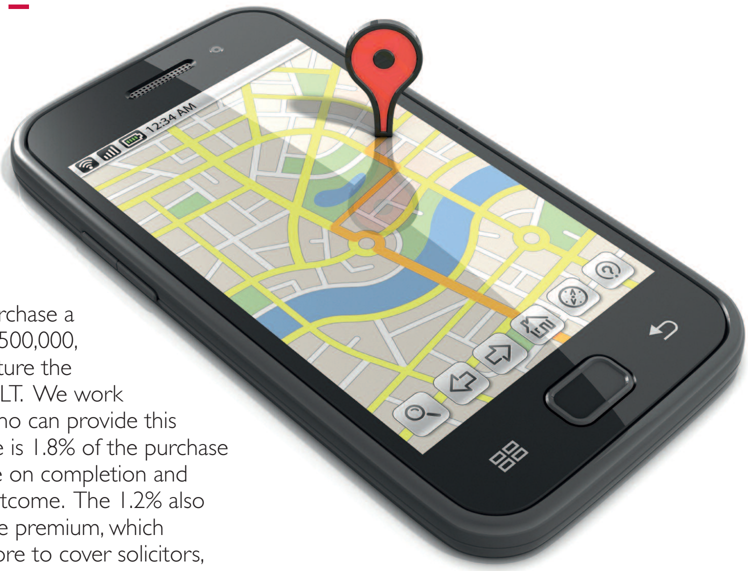
The second quarter of 2011 saw the permissions for residential development tumble. The Home Builders Federation report showed just 25,171 approvals were granted in England in the quarter. This is half the levels for the same period in 2006 and only a fraction of the 60,000 approvals per quarter which are estimated to be needed to tackle the housing shortfall. Understandably the figures will further inflame the debate on planning reforms.

House building and construction are seen by both the Chancellor and Shadow Chancellor as being key parts of plans to help economic growth. This is seen in the proposals to ease planning approvals; the reduction in Stamp Duty Land Tax on lower value properties and the Labour Party proposals to reduce VAT on repairs. All of these may have merit in helping both the construction sector and the economy but the fundamental issue still seems to be the state of the property market.

Recent mortgage figures have shown that whilst the number of mortgage applications and approvals are increasing, borrowers are consistently paying down net debt, rather than increasing their loans. This is understandably related to concern over the economy, wages and job security. Until that situation changes it is difficult to see the planning reforms, whatever form they ultimately take, or other tweaks to taxes on property, having a dramatic effect on the house building and construction sectors.

Our experience is that those developers and builders who have identified their strengths and unique selling points, have made progress in a competitive market. Those who do not have a clear strategy have failed and will continue to fail. The message, therefore, has to be to continually review your business strategy and developments in your sector.

Stamp Duty Land Tax - where are we now?



Stamp Duty Land Tax (SDLT) has been with us now for almost eight years. Since its introduction, there have been numerous changes, such as the overly complex partnership rules the increase to 5% on residential properties over £1m and the introduction of what was perceived at the time to be a general anti avoidance rule (s75A) to stop SDLT planning.

The anti avoidance rule has proved to have flaws within it, enabling SDLT mitigation/planning/avoidance (you decide what word to use!) to continue to be available.

HMRC have tried their best to discourage such arrangements, issuing various "Spotlights" giving their view that such planning does not work, although there is never any real substance to back up these statements. With SDLT raised to 5% on residential properties over £1m, the appetite to mitigate the tax is increasing.

It would appear that HMRC have a battle on their hands for years to come.

If you are looking to purchase a property valued over £500,000, there are ways to structure the transaction to avoid SDLT. We work closely with planners who can provide this service. The general fee is 1.8% of the purchase price with, 1.2% payable on completion and 0.6% on a successful outcome. The 1.2% also includes a fees insurance premium, which returns this fee (and more to cover solicitors, disbursements and interest) should HMRC be successful in any challenge.

For more information, please contact Nick Haines on 01242 237661 or nick.haines@hazlewoods.co.uk

Pensions changes will add costs

Over many years we have seen HMRC trying to treat more sub-contractors as employees. This had undoubtedly increased costs for businesses involved in the construction industry. New legislation originally introduced by the last Labour Government, but only effective in the next couple of years, is potentially going to increase costs again. There have been attempts in the past to encourage employees to make pension arrangements with, for example, Stakeholder Pensions. Now another attempt is being made by an auto-enrolment plan for pension contributions. Whilst one supports the need for pension provision, these provisions can increase costs.

Pensions and Auto-Enrolment - what is this and what does it mean?

There has been an intention for sometime for all employees to have a work-based pension and to save money for their retirement. However, this has not yet been achieved and new pensions requirements for employers are now coming in on 1 October 2012 to work towards this goal. This date applies to the largest employers (those with over 120,000 employees) only but there is a gradual introduction of auto-enrolment which will affect you, as will be explained below.

What do you have to do?

- Enrol eligible workers into a qualifying workplace pension arrangement; and
- Choose a qualifying scheme and make contributions into it.

What happens to existing pension schemes?

- Employers will continue to have an ongoing duty to maintain qualifying pension provision for workers who are already members of qualifying schemes.
- If you do not already have a pension scheme in place that meets the Government requirements, then the Government "NEST" (National Employment Savings Trust) scheme is a new low cost scheme that all employers can use. Other schemes are expected to also become available and we can advise you of these once details are available.

Gradual introduction of "Auto-Enrolment"

Requirements for employers are to be introduced gradually over the next six years and will be based on the size of the employer. Auto-enrolment will be staggered depending on the number of employees you have. The Government recently announced a change in the timetable for implementation and the new timetable should be released early in 2012.

We do know that:
- Businesses with more than 4,000 employees will come under the new rules by June 2013.
- Half of all workers will be enrolled by May 2015; and
- Even the smallest employers will have to comply by 2018.

Which employees must be included?

- You must enrol those employees aged between 22 and state pension age (an increasing 65+ for men and an increasing 60+ for women) who earn above the income tax personal allowance (£7,475 in 2011/12).
- Employees will be able to opt out of their employer's scheme but the Government is likely to make this very difficult.

Minimum contributions

- Contributions become payable on earnings within a defined band, which according to the Pensions Advisory Service is between £5,035 and £33,540.
- The minimum contribution will be 8% of earnings of which the employer must pay a minimum of 3%.
- For example: if the employer chooses to pay 3%, the employee will pay a net 4% with a further 1% paid as tax relief by Government, totalling 8%.
- The level of contributions is being phased in as follows:
  - from October 2012 to September 2016: total contribution of a minimum of 2% of earnings including at least 1% from the employer;
  - from October 2016 to September 2017: total contribution of a minimum of 5% of earnings including at least 2% from employer; and
  - from October 2017, total contribution of a minimum of 8% of earnings, including at least 3% from the employer.
- The employer contributions should be deductible for tax purposes.

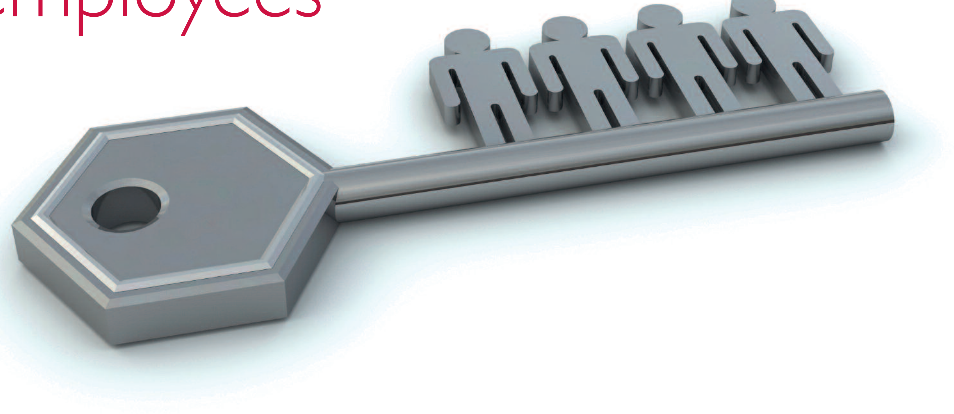
What can I do to plan for auto-enrolment?

- Employers should plan ahead for an increase in costs.
- Employers should consider the implementation of salary sacrifice in conjunction with pension contributions. This way employment costs can be reduced as a result of the national insurance savings available. At the time of writing the saving will be at least 13.8% of the salary sacrifice.

Where significant pension costs may be anticipated going forward, the introduction of a salary sacrifice arrangement sooner could help reduce the increased costs.

If you have any questions on the impact of these new requirements, please contact David Pierce on 01242 680000 or david.pierce@hazlewoods.co.uk

Retaining key employees



One of the significant tax negatives of working in the property industry is the non availability of the most tax efficient method of incentivising and locking in key employees, Enterprise Management Incentive (EMI) Options.

This is because certain trading activities are excluded from qualifying for EMI which include dealing in land and property development.

This can cause a problem when you want to incentivise staff by providing them with some shares because, in the absence of an approved Share Option scheme, such as EMI, what different routes are available?

One of the first obvious ones is gifting shares to the employee. The problem here is that the employee ends up paying income tax on the market value of the shares being issued, which could be up to 60%, so not particularly tax efficient.

The employee could pay market value for the shares. The beauty of EMI is that employees don't have to pay for shares until they want to, or they have the cash coming in from a future sale to cover the financing of them. However, if you were to issue shares to employees and insist they pay market value, they somehow have to finance that, which certainly in the current climate, when the investment is going to be made into a property company, will not be the easiest finance to obtain!

You could consider an Unapproved Share Option Scheme. The problem with this is that the employee still receives an income tax charge based on the difference in market value from the date of grant to the date when the shares are actually purchased through an exercise of the Option. As with gifting shares to an employee, this is not particularly tax efficient.

So are there any other options?

There is another route that could be explored, which revolves around partly paid shares. Take a situation where an employee is issued with shares for their market value which, let's say, is £100 per share. However, the company only calls up the nominal share capital of £1 per share, leaving the remaining £99 per share "uncalled".

By doing this, the employee receives the shares for a nominal payment and, because they are committed to paying the full market value at the date they are issued, they are not subject to income tax.

As to the uncalled part, HMRC have confirmed that this does not constitute a loan and therefore avoids the 25% tax charge imposed on companies lending money to shareholders in close companies. It may be considered a loan for benefit in kind purposes, however, as it is in connection with an investment into shares of a trading company, the benefit in kind interest charge is negated by tax relief for interest on a qualifying investment!

There is another benefit with this route. If the employee holds these shares for a year before disposal, providing the other qualifying conditions are met, the employee should only have a 10% Capital Gains Tax rate due to the availability of Entrepreneurs' Relief. This is a benefit even over EMI, where often the shares are only acquired on a disposal, in which case the one year qualifying period will not have been met.

The shares issued may not meet the qualifying conditions for Entrepreneurs' Relief, because they do not constitute 5% of the share capital and 5% of the voting rights. If that is the case, you may be able to create a separate class of shares that only have capital rights equivalent to the nominal share capital (£1 per share, say) but give voting rights. These could be issued in addition to the partly paid shares to give the employee sufficient share capital and votes to qualify for the 10% rate!

As with everything, the documentation is key and it is incredibly important to get the right advice to ensure you don't fall into any tax traps along the way.

For more information, please contact Nick Haines on 01242 237661 or nick.haines@hazlewoods.co.uk

Visit our new website!

Hazlewoods have launched a brand new website with many exciting features.

We are regularly updating our property page with helpful and sector relevant news. Why not see the changes we have made for yourself at www.hazlewoods.co.uk

When is a house not a house?

Adam Lloyd, VAT Director at Hazlewoods, explores the challenges and pitfalls surrounding the VAT zero rating of new residential accommodation.

There are not many things you can buy these days that are not subject to VAT. Cars, computers, phones and adult clothes all come with an involuntary donation to HMRC. However a new house is one exception. The zero rating of new residential accommodation means that the person constructing the house can reclaim VAT on all related expenses whilst not having to charge VAT on the onward sale.

Thankfully the relief also extends to DIY house builders, for whom there is a VAT refund mechanism that enables them to reclaim the VAT they incur, thus ensuring it does not become an additional cost to people who chose to build for themselves.

In both instances, the relief is pivotal on the building qualifying as zero rated residential accommodation. However, the definition of residential accommodation is tightly worded and a number of people, including builders, developers and acquirers, have failed to secure zero rating because the building has not met the criteria.

One of the biggest problems centres on the terms of the planning consent. The terms, timing and works permitted can all have an effect, and the courts have been busy considering particular cases over the last few months.

A number of recent cases have looked at restrictions in the planning consent. In one case a farmhouse had been built with a stipulation in the planning consent that the house could not be sold separately and would always be ancillary to the agricultural use of the land. As a result the court concluded the house did not qualify as its separate use / disposal was prohibited. In a similar case accommodation was acquired from a developer that was subject to a planning restriction, limiting its use to holiday accommodation and not permanent residential accommodation. The acquirers appealed against the developer's decision to charge VAT but the appeal was dismissed as there was no scope for the accommodation to qualify as a private residence.

Both of these cases show that restrictions on the use to which a property is put can have an effect on zero rating. However, a different case shows that restrictions on the activities of the occupants should have no such effect. In this case a second house was built on a site operated as a holiday chalet business. The terms of the planning permission stipulated that the new house must be occupied by persons involved in the business and their families. In this instance the court ruled that the restriction was on the activities of the occupants - not the use of the house. The appeal was therefore successful.

Other cases have centred on the timing of the planning consent and the building itself. In one such case the claimant demolished and rebuilt a house in its entirety but only had planning permission for a conversion and extension. Having gained retrospective planning consent, claims for VAT were made for works carried out before the new consent had been granted. The court refused the claim on the grounds that no correct consent was in place when the works were carried out. In a particularly harsh case, the claimant had sought and received planning permission to (partly) demolish a building and construct a replacement dwelling. However, the court ruled that too much of the previous property had been retained, meaning the new property was not sufficiently "new" (one is allowed to retain one facade but not two unless it is a corner site).

It does however work both ways. HMRC has tried unsuccessfully on a number of occasions to use a time lag to try and "split" the building of a house from the construction of ancillary buildings. In one case a garage and games room that were constructed two years earlier than a house were all subject to one planning permission and therefore all zero rated. In another case the construction of new kitchen and laundry facilities at a nursing home was held to be zero-rated despite the fact that work did not begin until two years after the new home which the facilities served had been occupied

What all the above tells us is that the terms of the planning consent are pivotal in determining whether a house can be sold or built without VAT being a cost. The strict rules regarding residential use must be applied and any restriction on use can lead to problems. Similarly, the terms of the consent affect all works built under that consent, regardless of any time lag between building one part or the other. It is also clear that it is the use to which the property is put that affects zero rating – not the activities of its occupants.

It is therefore essential that the potential for zero rating be considered at an early stage, ie when making and negotiating an application for planning consent. It is at this stage that any terms will be discussed and it is these terms that can affect zero rating. It is also essential that all works be included under the terms of the planning consent and, of course, that it is sought or received prior to works commencing. Getting it wrong can cost a lot of money.

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Services

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- Management accounts
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- Raising finance
- Sage advice and training
- Financial planning
- Payroll assistance to include bureau service
- VAT
- Stamp Duty and SDLT mitigation
- Inheritance Tax and estate planning
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