Property Focus

DRIVING LIFELONG PROSPERITY

Winter 2017

SPOTLIGHT ON CLOUD ACCOUNTING

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INSIDE

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Cloud accounting – the spreadsheets' successor

Spreadsheets were designed for desktop computers and have been a staple of business life for decades. For every PC and laptop, it was a 'must have' application which has stood the test of time. It's been THE financial management tool for businesses for years, often since before the business was launched, used for business plans and financial projections. So, it's easy to see why business owners/managers have stuck with their tried and trusty friend and why they may be reluctant to leave them behind.

But time and technology do not stand still, this is a digital world of cloud based software and connected devices. The spreadsheet and PC based tools are being overtaken by these advances in technology. Spreadsheets are definitely not designed for small, mobile, touch screen devices.

So, what is there to consider?

COST

Cloud accounting allows business owners to access accounting solutions via the internet. You simply pay as you go and enjoy a subscription-based solution that is kind to your cash flow and the environment too. When your cloud needs fluctuate, your server capacity scales up and down to fit, so you only use the energy you need.

FLEXIBILITY

One of the biggest advantages of switching from spreadsheets to cloud accounting is the flexibility to access data on the move. Long gone are the days where files are sat on a single computer. It allows small business owners to make quicker and better-informed decisions based on real-time information. If you have access to the internet then you can be at work, wherever and whenever you choose. Users can get an instant snapshot of cash flow, capture expenses on the go, pay an outstanding supplier's bill or send a customer invoice from wherever you may be and from any device you've got to hand – phone, tablet or computer.

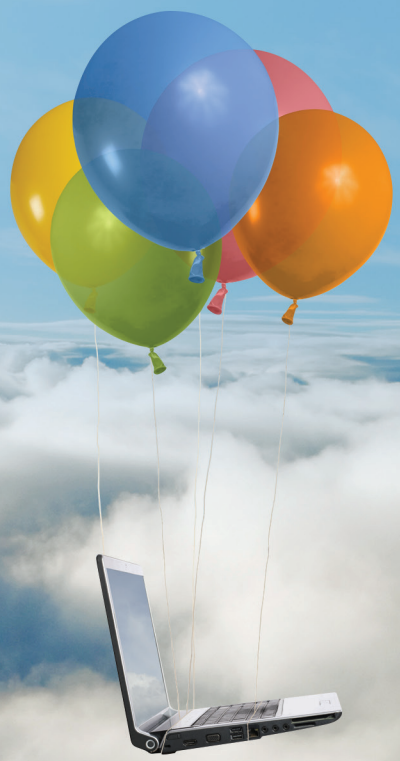
SECURITY AND PEACE OF MIND

For a small business owner, the cloud also offers a more secure way to store information especially compared with saving spreadsheets onto desktops and laptops. The servers are out of sight and are maintained by your cloud based solution provider. If you lose your laptop or it gets stolen, or your computer is infected by a virus, your data is not compromised, you simply switch to another device and it's business as usual.

MAKING THE TRANSITION AND HOW WE CAN HELP

If you're checking your bank balance from your phone, you're already using the cloud. If you're using social media, you're in the cloud again. Most of us have been in the cloud for quite some time, possibly without realising, so you're not a stranger to it after all.

The cloud is fast becoming the 'norm' and we are here to help you make the transition. The ability to access cloud accounting from any internet-connected device and any location will allow you, the business owner, to collaborate more effectively with us, your dedicated accountants and advisers.



SDLT and MDR – confused already?!

Stamp Duty Land Tax (SDLT) is payable on the purchase of properties; the amount paid and applicable rate depends on the value of the property. Sounds simple, right?

Unfortunately, it is not always quite as straightforward as multiplying the purchase price by certain rates, particularly when there is more than one property being purchased. In addition, the introduction of a 3% surcharge on the purchase of second homes has complicated matters further.

THE BASICS

SDLT is calculated in bands so, for residential property, 0% on the first £125,000 of consideration and 2% on the next £125,000 etc. (see tables for further details).

Stamp Duties

Residential Property	SDLT rate#
Up to £125,000	Zero
Over £125,000 to £250,000	2%
Over £250,000 to £925,000	5%
Over £925,000 to £1,500,000	10%
Over £1,500,000	12%
Over £500,000 if bought by a non-natural person e.g. a company)*	15%

*15% rate applies to the entire consideration, subject to certain exemptions.
#3% surcharge applies for additional residential property.

Non-residential or mixed use property	SDLT rate
Up to £150,000	Zero
Over £150,000 to £250,000	2%
Over £250,000	5%

However, where the 3% surcharge applies this is calculated on the entire purchase consideration.

Example: Fred purchases a second home for £250,000.

The SDLT charge would be £10,000 calculated as:
£125,000 x 0%
£125,000 x 2% = £2,500

Plus the 3% surcharge on the whole consideration:
£250,000 x 3% = £7,500

MULTIPLE DWELLINGS RELIEF

Multiple Dwellings Relief (MDR) 'does as it says on the tin' – it is a relief, which is available on the purchase of more than one residential property. Essentially, it works by calculating the mean price of the properties purchased, working out the SDLT charge on one property and then multiplying by the number of properties purchased.

Example: A block of three flats are purchased for £900,000.

Under the normal calculations, the SDLT charge would be £62,000 .

Calculated as:
£125,000 x 0%
+ £125,000 x 2% = £2,500
+ £650,000 x 5% = £32,500
+ £900,000 x 3% = £27,000
(SDLT surcharge)

With MDR, the mean value of the properties would be £300,000 (£900,000/3) and the SDLT charge would be £42,000 calculated as:
£125,000 x 0%
+ £125,000 x 2% = £2,500
+ £50,000 x 5% = £2,500
+ £300,000 x 3% = £9,000
(SDLT surcharge)

The SDLT charge would therefore be £14,000 per property and £42,000 in total when applying MDR. This is a saving of £20,000.

FURTHER SAVINGS TO BE HAD?

On close inspection of the legislation, the additional 3% surcharge may not apply on certain multiple dwelling purchases.

In our above example, even if the individual did not own a residential property before the purchase of the block of flats they would still be liable to the 3% surcharge on the whole consideration.

There is an exception, however, for purchases of dwellings with self-contained annexes, or outbuildings that are also dwellings if they equate to less than one third of the total price paid. Examples could include a house with a self-contained granny annexe or a farmhouse which also has a cottage on the same plot. Bear in mind though this exemption would only apply where the purchaser does not already own a residential property or if they are purchasing this property to replace their main residence. In all other cases the 3% surcharge would still apply.

SIX OR MORE DWELLINGS

There is another option to consider when six or more properties are purchased together in one transaction. In this case it is possible to treat the purchase as a commercial one and apply the non-residential rates. The highest rate for non-residential property is 5% compared to 12% for residential purchases so the savings can be significant The 3% surcharge will also not apply as it is not classed as a residential purchase.

Suppose that our earlier example was instead for the purchase of six flats for £1.8million. This leaves you with three different ways to calculate the SDLT payable. We will not bore you further with the calculations but it could bring about three very different results i.e.

1. Following normal rates and rules - £183,750
2. Claiming MDR - £84,000
3. Electing as commercial and applying non-residential rates - £79,500

In this case, therefore, it would be more beneficial to elect to treat the purchase as a commercial purchase with savings of over £100,000 compared to calculating under the normal rates for residential purchases.

CRYSTAL CLEAR?

Calculating the SDLT charge is not as simple as multiplying a few numbers together and there are ways to minimise your bill. The legislation is complex and detailed and it is advisable to speak to a tax professional to ensure that you are taking full advantage of any reliefs and minimising your liability as far as possible.

FAMILY INVESTMENT COMPANIES

In our Autumn 2017 Talking Tax we looked at the changes to the taxation of residential property from April 2017. This included the restriction of relief on mortgage interest costs to the basic rate of tax for landlords.

We have been working with a number of our clients to assess the impact of these new rules. In some cases, it could render their property business to be no longer viable with effective tax rates of over 100% of the rental profits.

One option we have implemented for some clients is the transfer of the properties to a company. This has also provided the opportunity for our clients to look at the succession of the property business to the next generation. Using a family investment company (FIC) as an alternative to a trust to hold the properties could result in inheritance tax (IHT) savings.

WHY USE A FAMILY INVESTMENT COMPANY?

An FIC is formed as a limited company which is a well known and understood vehicle and, with currently low corporation tax rates, it can be more tax efficient than holding investments or properties directly.

An FIC tends to have different classes of shares with different rights attached to each class. This allows the properties to be passed on to the next generation whilst retaining some control. For example, the parents may have the voting rights in the company but only a small percentage of the capital rights, the majority held by the children.

Any growth in the value of the company would be sheltered from IHT as the children would own the capital rights.

The company will receive full corporation tax relief for interest charges on the property mortgages; however, on transferring the properties to a company it may not always be possible to obtain as favourable rates as when held personally.

WHEN A FIC MIGHT NOT BE THE WAY TO GO

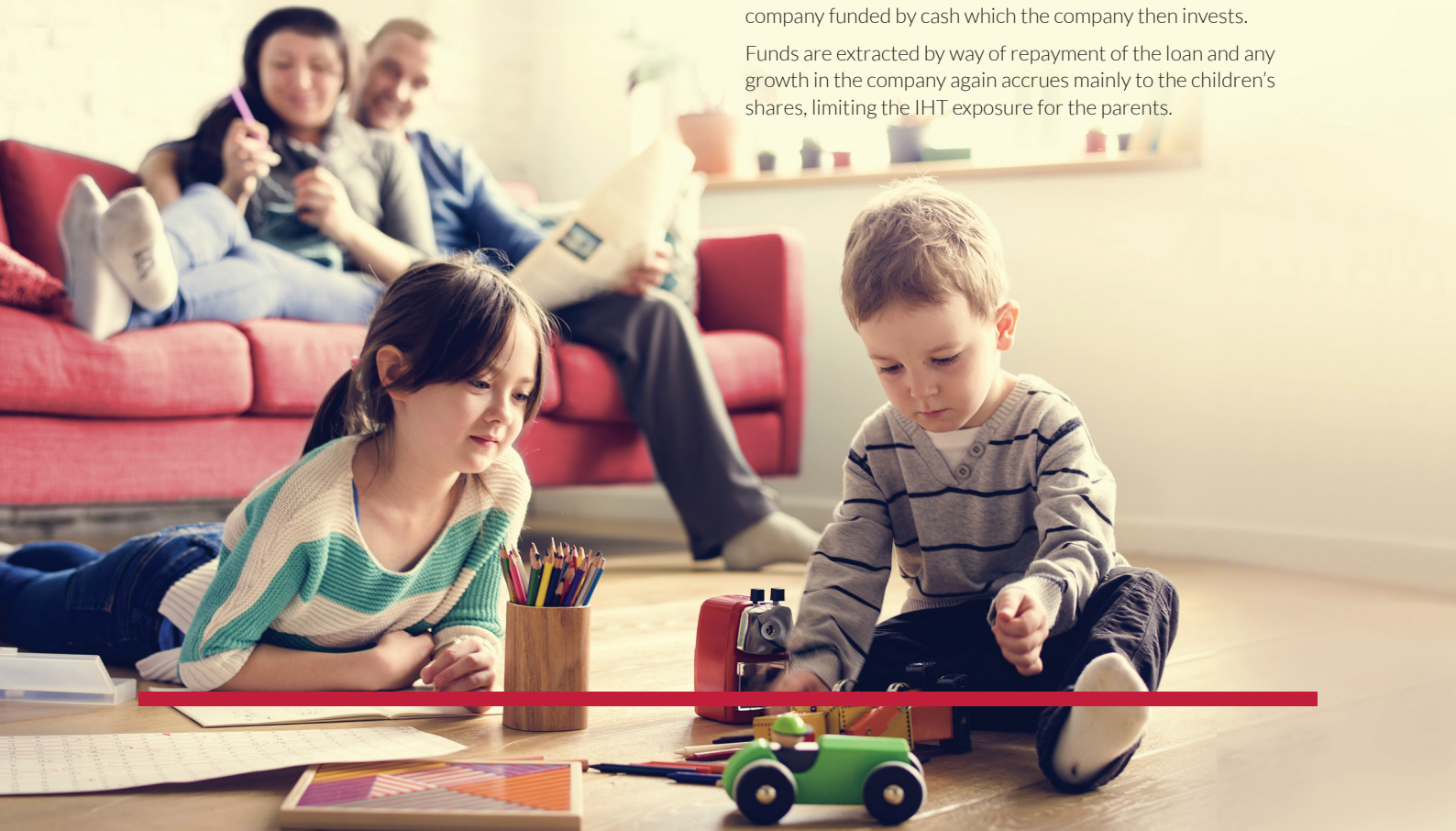
Some points to consider:

- There could be significant SDLT and/or capital gains tax charges on transferring the properties to a company. In some cases these can be mitigated, but this would be dependent upon the facts and circumstances of the existing property business.
- On transfer to the company there could potentially be an IHT charge if the properties are gifted in and there is a reduction in the value of the parents' estate. This would depend on the specific facts, however, and in some cases an IHT charge may be avoided on transfer.
- The ongoing costs of operating via a company should be considered including;
  - annual filing obligations and costs;
  - potential charges under the ATED regime (Annual Tax on Enveloped Dwellings) which applies for residential properties held by a company with a value of £500,000 or more, although there is an exemption for rental properties; and
  - overall tax cost of operating via a company with corporation taxes and income tax on distribution.
- As mentioned, the loan interest rate offered by the banks may not be as preferential when held by a company.

NOT JUST PROPERTY

An FIC does not just have to be established to transfer in property. In fact, due to the upfront taxes which may be levied on transferring properties into a company, the typical structure is to establish a company funded by cash which the company then invests.

Funds are extracted by way of repayment of the loan and any growth in the company again accrues mainly to the children's shares, limiting the IHT exposure for the parents.



THE LOTTERY OF VAT LEGISLATION AND PROPERTY CONVERSIONS

The complexity of VAT legislation affecting property transaction is well illustrated by the number of tribunal decisions in this area that are seemingly completely at odds with the rulings of earlier tribunals. Creating new dwellings by the conversion of an existing commercial property, where there is also an existing residential element, is an excellent example of this complexity, and is a situation we are frequently called upon to advise.

Consider the example of a developer converting a building comprising a shop on the ground floor, with a storage area plus two flats above. The property is to be converted such that it will ultimately contain three dwellings. The conversion can be done either:

1. horizontally (such that the former shop area now becomes one of the dwellings and the upstairs flats are each extended to include part of the former storage area); or
2. vertically, so that each of the dwellings contains a part of the previous shop and a part of one (or both) of the previous flats.

Traditional wisdom would say that, if route 1. is followed, the grant of a long lease in the ground floor dwelling will be zero-rated (enabling the developer to recover input VAT on the conversion costs for that dwelling) because the dwelling has been created in an area that was previously 100% non-residential. However, the grant of a long lease in the upstairs dwellings will be VAT-exempt (preventing recovery of input VAT) because part of the area that they each occupy was residential previously.

But if route 2. is pursued, the grant of a long lease in any of the dwellings will be VAT-exempt, hence the developer recovers no input VAT.

This difference in VAT treatment between the horizontal and vertical conversion was recognised as being a ludicrous consequence of the legislation by the tribunal in the *Calam Vale* case in 1999. Nevertheless, the tribunal considered that the legislation forced it to conclude that the VAT treatment would indeed be different for the two scenarios.

This anomaly was seemingly remedied by the subsequent tribunal decision in *Alexandra Countryside Investments Ltd* in 2013, where the taxpayer converted a pub containing a flat into two houses, each of which included part of the flat and part of the previous commercial area. Here, the tribunal ruled that, the starting point was to recognise that the number of dwellings in the entire building had increased as a result of the project, and based on its interpretation of the legislation, the tribunal considered that this meant the sale of each of the new dwellings could be zero-rated.

Based on this decision, the developer in our example would be able to zero-rate the long lease in each of the three dwellings.

Unfortunately, this seemingly good news for our developer has been short-lived. In considering the cases of *MacPherson and Languard New Homes Ltd* earlier this year, the Upper Tribunal ruled that, not only must the number of dwellings in the building be increased as a result of the project, but also a new dwelling must be created **entirely** from an area that was previously non-residential, if zero-rating is to apply to the sale or the grant of a long lease.

Therefore, as far as our developer is concerned, the VAT position has been returned to how we had traditionally assumed it to be, with the differing VAT treatment for the horizontal and vertical conversions. But now that is not quite the end of the story – suppose when converting the shop area, our developer decides to also convert the top floor into a single flat. Because the entire building originally contained two dwellings, and will continue to do so after the conversion project, no additional dwellings have been created; hence the long lease in the new ground floor flat can no longer be zero-rated, thus meaning the developer now cannot recover the VAT on any of his costs! Purely from the VAT perspective, he would be well advised to carry out the ground floor conversion first as a separate project, so that there will be three dwellings in the property, at least for a short time.

It is therefore perhaps little wonder that the Upper Tribunal stated in *MacPherson and Languard New Homes Ltd* that it had reached its conclusion *"with some hesitation"*, given the arbitrary way in which the legislation seems to apply in this area.

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