Property update

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VAT & domestic service charges – are you exposed?

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On 7 September 2018 HMRC issued a business brief and information sheet in relation to the VAT position on domestic service charges.

Who is this relevant to?

- Domestic landlords who use managing agents
- Managing agents

What is the issue?

Domestic service charges are exempt from VAT when provided to a tenant or leaseholder by a landlord but standard rated when provided to a freeholder (because there is no landlord/ tenant relationship).

In 1994, to create parity, HMRC introduced a concession so that mandatory service charges could be exempt from VAT even where there was no landlord/ tenant relationship. Most property companies utilise the concession.

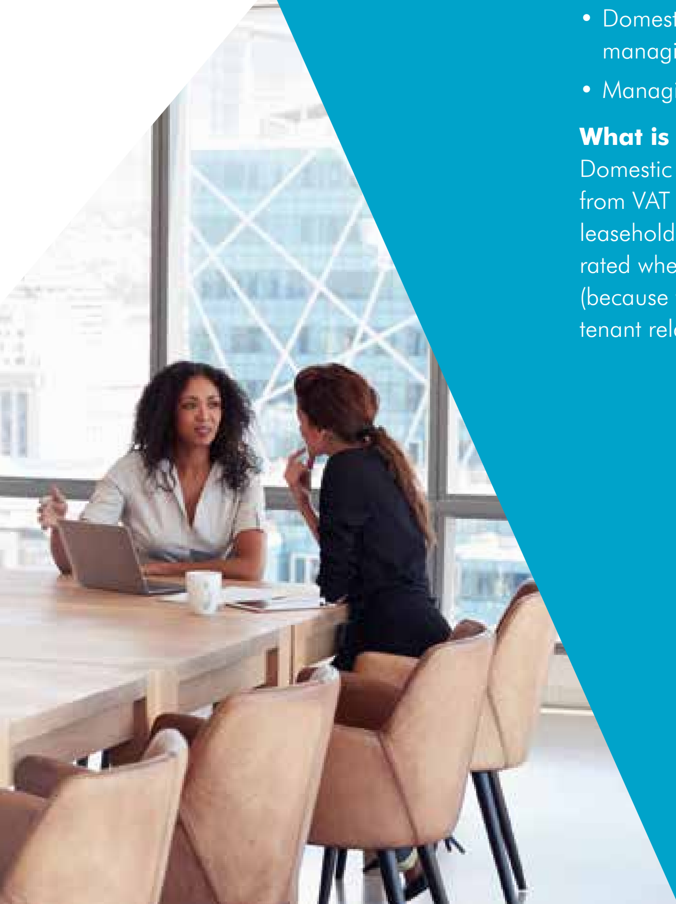
HMRC advises that it is aware that where the service charges are provided through a management company the concession is being used incorrectly in some cases with charges being treated as exempt from VAT when, in fact, they should, in HMRC's opinion, be subject to VAT.

The business brief and information sheet are designed to clarify HMRC's position but it is clear they will be looking to challenge arrangements if they consider the concession does not apply.

What should you do?

- For managing agents it is important to review the arrangements to ensure that they are charging and accounting for the correct amount of VAT. If not there is a risk of additional VAT due to HMRC plus the threat of penalty action.
- For landlords, as the rent is exempt from VAT, any VAT incurred is a cost to them. It is important therefore to understand the correct VAT treatment to prevent any nasty VAT bills.

If you have any concerns about your VAT treatment of domestic service charges please get in touch.



Housebuilders and the Option to Tax

The default VAT position for selling or letting land and property is that it is exempt from VAT. Whilst this means no VAT is chargeable, it also means VAT cannot be reclaimed from HMRC on related expenditure.

Exemption can also have an impact on a business's overhead VAT recovery. This issue can, however, be solved where land and commercial properties are concerned by 'Opting to Tax'. This turns a VAT exempt supply into a taxable one, at 20% VAT, allowing VAT incurred on construction, refurbishment, maintenance and sale costs to be recovered from HMRC.

In considering Options to Tax there are some basic points to keep in mind. The Option is a formal decision which cannot be revoked for 20 years. It is taken by each entity exploiting the property or land-just because an owner Opts does not mean that the property is 'Opted' by all that subsequently acquire an interest (except in most cases for transfers between 'VAT group' members).

For the Option to be valid there is a formal two stage process. A decision is made to Opt at a point in time, and then the decision must be notified in writing to HMRC.

Timing of the notification can be important, especially where transfers of property rental businesses are concerned. HMRC will not allow retrospective Options, although a belated notification may in certain circumstances be accepted by them, (but not for 'going-concern' transfers).

The notification process can itself be problematic. For instance, if forgotten it isn't possible for a seller to provide evidence of the Option to a buyer's solicitor, leading to delays or aborted transactions. This is surprisingly common when housebuilders are buying land with existing properties. In addition, prior permission to Opt from HMRC may be required, due to exempt use of the property within the last 10 years (unless complex 'automatic permission' criteria are met). Failure to obtain permission where needed could invalidate an Option and lead to a later exposure, being any VAT claimed, with potential penalties.

Housebuilders buying property subject to an Option to Tax to convert or to replace with new builds should consider a number of issues. The VAT incurred should be recoverable in most instances as the sale or long lease over 21 years in newly built dwellings (or those converted from commercial) is zero-rated. But the addition of VAT will increase the Stamp Duty Land Tax cost and create a cash flow issue whilst a refund is awaited from HMRC. Housebuilders should therefore consider if the Option by the seller can be 'disapplied' (for example, where commercial property is bought for conversion into dwellings). But the effect on the seller also would need some thought.

Issues with the construction of commercial areas are less common, especially where these are to satisfy Section 106 planning gain requirements. The dedication of these areas/properties to management companies would not give rise to a VAT charge and VAT on construction would be recoverable, assuming their relationship to the (taxable, zero-rated) development of new homes.

However, there can be circumstances where commercial properties are retained by developers with an intention to rent. Two catches can apply. One is for charitable, non-business use, where notification to the developer would 'disapply' the Option, meaning that rental income would be exempt and VAT on construction works would become a cost. The second 'disapplication' is less common. It is where a tenant (connected or otherwise) makes a contribution to its landlord's capital works and is unable to recover most of its VAT. The latter test is an automatic provision and not optional. This is why developments with any unusual aspect should be reviewed by a property VAT specialist, ideally in the planning phase.

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My property is my pension

Utilising your commercial property

Whilst most of us are aware of the need to save monies on a regular basis for when we retire, for those who have their own businesses and who utilise commercial property, pensions can be a very sophisticated and useful vehicle.

You will have heard the saying "my property is my pension" and now it can be as it is possible to purchase commercial property within a self invested personal pension (SIPP) or a small self administered scheme (SSAS) with the pension subsequently letting this commercial property to the business.

It is usual for a valuation to be carried out both for the purchase price and the rent especially if this is a connected transaction such as a business owner renting from his own pension. A lease agreement is put in place and rent is then paid to the pension fund which is a deductible expense for the business and is a tax free payment into the pension. This is in effect a return on capital, the same as it would be if you used the more traditional pension investments of stocks and shares.

The usual benefits are available at retirement whereby tax free cash is payable at 25% of the fund value and income can be generated from the remaining value. If the property is then sold, there is no capital gains tax on this value.

So, when we add in the fact that pension benefits can now be accessed flexibly and passed on to beneficiaries on the death of the owner without inheritance tax being charged, pensions become a superior type of investment and should therefore not be ignored.

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Buy-to-lets and second homes: shortening of the tax payment window

HMRC are planning to introduce new rules in relation to the sale of residential property and the date to which Capital Gains Tax will be paid.

A payment on account system is to be introduced which will include the submission of a new payment on account return.

Currently Capital gains Tax is payable by 31 January following the end of the tax year in which the relevant disposal takes place. This means that it can be up to 22 months from the disposal date that any Capital Gains Tax has to be paid.

From April 2020 any Capital gains Tax due on the disposal of residential property will have to be paid within 30 days of the completion date. For example, if contracts are exchanged on a sale on 1 May 2020 and completion takes place on 1 June 2020. Any Capital Gains Tax due will have to be paid by 1 July 2020.

When calculating the tax due, capital losses brought forward from earlier years can be taken into consideration. However, if any losses are realised in the same year as the residential property disposal, only those losses actually realised prior to the completion date can be taken into consideration when calculating the payment on account. Losses realised after the completion date will be taken into consideration when the self-assessment tax return for the year is filed. HMRC are currently looking into a way of achieving a 'year-end reconciliation' where the individual concerned does not complete a self-assessment tax return.

Interest will be charged on any late payments of tax and penalties may apply in relation to the late submission of the relevant return.

Any tax that is paid under the new rules will be treated as a tax credit when the relevant self-assessment tax return is filed.

No return will be required where the residential property being disposed of is fully covered by private residence relief. Likewise, no return will be required for a disposal at no gain/no loss such as a transfer to your spouse or civil partner.

The effect of the new rules is that taxpayers will have a very narrow timescale in which to bring together not only the information necessary to calculate the gain but also those details that may relate to available losses. It is, therefore, more important than ever to ensure that your paperwork is kept as orderly as possible and that all information relating to the properties are held since the property was purchased.

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GOING FOR GROWTH

Join us to explore the growth strategies that companies like yours are adopting for the next three years. We will look at the opportunities and challenges facing UK private businesses trying to grow in the modern economic climate. The events are based around insights drawn from our research among more than 500 companies, company case studies and from our expert speakers.

Topics will include:

- The top growth strategies – research highlights
- The emerging economic context
- Strategies
- Obstacles
- Opportunities

We will be holding the following events 08:30 – 10:30:

London, Wednesday 31 October

Etc Venues, 200 Aldersgate, St Paul's, London EC1A 4HD

Kent, Thursday 8 November

Bridgewood Manor Hotel, Near Bluebell Hill, Kent ME5 9AX

Sussex, Tuesday 13 November

South Lodge Hotel, Nr. Horsham, Sussex RH13 6PS

To register to attend, for more information or for a copy of the report please visit **krestonreeves.com/goingforgrowth**

Cash basis for landlords

With effect from 6 April 2017 (individual) landlords are required to report their rental income and expenditure on a cash basis.

Prior to this, landlords had to report their rental profits on an accruals basis unless their gross receipts did not exceed £15,000.

Under the accruals basis, a landlord has to recognise the income that is due to them and the expenses that relate to the tax year under review, irrespective of whether or not the income has been paid or the expenses met. This is different to the cash basis which means you only recognise the income and expenditure when it is physically received or incurred.

From 6 April 2017 the cash basis must be used unless:

- The property business is carried on by a company, an LLP, a partnership with a corporate member or a trust
- The gross property income exceeds £150,000 for the tax year
- If the property is owned jointly by spouses or civil partners, where one has made an election to account for the income on an accruals basis
- You make an election not to use the cash basis

The date in which income is received when letting your property through a letting agent is deemed to be when the letting agent receives the rental income, not the landlord.

Under the cash basis, the receipt of a tenancy deposit should, strictly speaking, be treated as income in the tax year it is received. However, HMRC recognise that this is unfair and instead only the amount retained at the end of the tenancy is taxed as income under the simplified cash basis.

Under the simplified cash basis, the capital / revenue divide is removed. Instead, all expenditure, even capital expenditure, incurred wholly and exclusively for the purposes of the property business is allowed as a deduction from income unless it relates to a number of types of expenses, the most common ones being:

- Acquisition or disposal of a property business or part of a property business
- Education or training
- Provision, alteration or disposal of land
- Provision, alteration or disposal of cars

It is important to note what capital expenditure has been deducted against your rental income as if you later receive any money for this, i.e. you sell it or you receive insurance proceeds then this income also needs to be recognised.

Finance costs are deductible on a paid basis but where you have interest and arrangement fees relating to residential letting then you will be subject to the new mortgage interest relief restrictions on these costs which came into effect on 6 April 2017 also.

When preparing your 2017/18 Tax return care needs to be taken to ensure you do not double count any income and expenditure. Switching between the accrual basis and cash accounting can mean that income and costs received/ incurred in this tax year were already recognised in 2016/17.

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