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property matters

A property sector publication brought to you by Moore and Smalley Chartered Accountants and Business Advisors

Option to tax – common errors and misconceptions

Commercial premises are exempt from VAT

The letting or sale of commercial premises is exempt from VAT by default. However by 'opting to tax' the VAT liability changes from exempt to taxable at 20 per cent. Although simple in theory, it can become a very complex process. In addition, if an error is made then the sums involved can be very large. This article doesn't deal with the mechanics of opting to tax, but considers errors and misconceptions which may arise.

1. When an option to tax is made, or is already in place, it is only relevant to the opter and their VAT number, not to anyone else who may take an interest in the property

When purchasing a property that has been 'opted' by the seller, the purchaser does not inherit the seller's option. If required the purchaser needs to elect and submit their own option. This is especially important when buying a tenanted property as a transfer of a going concern.

2. If a business de-registers and it has an opted property, VAT is due based on the value of the property at the point of de-registration

This often happens when a business ceases to trade or when the only activity relates to the letting of the premises and can come as a nasty surprise. After requesting to de-register HMRC will enquire about opted properties. It is often best to keep a registration open to avoid this charge until it is known what the property will be used for in the future.

3. The sale of a commercial property less than three years old is standard rated, but not its lease

This is an important consideration to make when selling a property which isn't opted. It is always important to establish if it is less than three years since the completion of the property.

4. HMRC's records aren't perfect

It may be that no record of whether a property owned by a business has been opted exists. HMRC can be contacted to see whether they hold details of any option made, however their records are not perfect and they acknowledge this fact when responding to requests. As such, it is important to check available records to see if there is one sitting on a file somewhere. This is most relevant regarding properties that may have been opted in the earlier days when the option to tax was introduced.

5. An option to tax can be revoked in certain circumstances

There are several circumstances when this may occur, for example when sold to a housing developer or if anti-avoidance legislation is appropriate. When selling land or property the revoked applications need to be considered. Otherwise, if applicable and a sale becomes exempt the seller may find themselves in a position of owing VAT incurred on the land or property back to HMRC.

If you have an interest in property and wish to generate additional income or dispose of the property, whether or not an option to tax should be made will be a matter requiring consideration. In every case professional advice should be sought before taking action.

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Buying a commercial property through

A self invested personal pension is exactly the same as a 'normal' personal pension except that it offers a wider range of investment choices not typically found in an insurance company plan (i.e. the self invested bit). The maximum contribution limits, retirement and death benefits for a SIPP are the same as with a 'normal' personal pension.

SIPP – an effective way of taking commercial property in hand

Investment options

The introduction of SIPPs allowed investments into a wide range of assets including:

- Stocks and shares listed on a recognised exchange
- Futures and options traded on recognised futures exchange
- Authorised UK unit trusts and OEICs and other UCITS funds
- Unauthorised unit trusts that do not invest in residential property
- Unlisted shares
- Investment trusts subject to FSA regulation
- Unitised insurance funds from EU insurers
- Deposits and deposit interests
- Commercial property (including hotel rooms)
- Ground rents (as long as they do not contain any element of residential property)
- Traded endowments policies
- Derivatives products such as a contract for difference (CFD)
- Structured investment products
- Gold bullion

As well as these investment options the other significant benefit available to SIPPs is the ability to borrow to fund investment purchases. In practice, as lenders will want a tangible asset to secure any borrowing against this is virtually restricted to commercial property purchases.

Commercial property purchase

The maximum borrowing rules have changed over the years and now the maximum borrowing is 50% of the net asset value of the SIPP. The value of the building being bought is irrelevant for calculating maximum borrowing (although it remains an important issue for the lender of course).

The most common property purchase we arrange via a SIPP is where the client wishes to buy the property from which they operate their business. In most cases the property is owned either personally or via their company, however it could also be bought from an unconnected third party.

The following example assumes the client owns the property personally and operates his limited company from the same property which has been independently valued at £300,000 with rental value of £24,000. All property valuations for SIPP purchases have to be current and provided by a qualified independent chartered surveyor.

As well as the property value there are other costs you would expect with a property transaction. The following are provided as a rough guide only– cost will vary from case to case:

Purchase price	£300,000 not subject to VAT
Stamp Duty	£ 9,000
Valuation Fee	£ 882 (incl. VAT)
Solicitors Fees	£ 1,469 (incl. VAT)
Search Fees / Disbursements	£ 950
Provider fees	£ 1,810 (incl. VAT)
Our FP fees	£ 3,525 (incl. VAT)
	£317,636

You will note that in this example I have assumed that the property is not subject to VAT on the sale, however if it was then the SIPP would have to fund an additional 20 per cent.

Should VAT be payable then the SIPP can reclaim this when the first VAT return is completed, as pension arrangements are exempt from VAT. The reclaimed VAT would be paid back to the SIPP only and not to the client or his company.

Irrespective of whether the property purchase is VATable or not, we would usually register the scheme for VAT so that any VAT on the rent and fees could be reclaimed by the SIPP.

I have also assumed that in this case the client has £62,000 accumulated in previous

your pension

pension arrangements that are available (and it is suitable) to transfer into a SIPP, the client's company has net profits of £250,000 and sufficient cash for a pension contribution. (It should be noted that it is not always the case that transferring existing plans to a SIPP would be the best course of action).

With the total purchase cost of £317,636 the property would be funded as follows:

Estimated Funding Required

Existing Pension Fund	£ 62,000
Employer Gross Pension Contribution	£150,000
Bank Borrowing	£106,000
Total	**£318,000**

The employer contribution assumes that the client has sufficient unused annual allowance (including carry forward) to enable the employer contribution to be paid.

Once the property purchase transaction has been completed then the main benefits would be:

1. The company will have offset the pension contribution as a business expense against profit saving £30,000 corporation tax (at 20 per cent).
2. The client having sold the property will have received £300,000 into his personal account – this will of course be subject to CGT on any gain made.
3. The client's net retirement fund will have increased from £50,000 (the old arrangement) to £194,000 (i.e. property value less loan / set up costs).
4. The client's company will pay rent of £24,000 pa to the SIPP for the use of the property, which again is a business expense saving £4,800 corporation tax each year.
5. The rent is used to repay the bank borrowing so that after circa 5/6 years (depending on interest on loan and ongoing SIPP charges) repays the loan. Additional pension contributions can be paid in future years to repay the loan at a faster rate.
6. The rent would then continue to be received by the SIPP and can be invested in alternative assets.
7. When the loan has been repaid the asset value of the SIPP would be circa £300,000 which could then support borrowings of £150,000 to fund another property purchase if wanted.

There are of course disadvantages with using a SIPP for property purchase, which include, among others:

1. Being an illiquid asset – it could be possible that there will not be sufficient cash available at retirement to provide benefits and the client is forced to sell during a downturn in the property market.
2. A pension invested in a single investment carries more risk than a diversified investment portfolio
3. The company has to maintain the rental payments even if the company has a significant setback / cashflow problem

This article merely provides a simplistic overview for a property purchase through a SIPP. If you are considering taking such a step then professional advice is essential.

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No respite from CIS

HMRC have considered the building industry's tax over the years with, some may say, a jaundiced eye and they have introduced several schemes to more tightly control tax due in from the whole sector. The most recent is the Construction Industry Scheme (CIS).

This scheme, (the launch of which was itself delayed by a year due to last minute tidying required by the tax authorities), is very similar and runs parallel to, PAYE Schemes. Because of this, many of the regulations sat more comfortably with businesses which had been running payrolls for some years.

For new or existing businesses whose trade involves construction the initial problems that can arise are:

- Not recognising you should be within the scheme
- Failing to register for the scheme
- Mistaking registration as a subcontractor with the separate registration required as a main or deemed contractor
- Failing to make nil returns for the months when no subcontractors were paid
- Failing to obtain the necessary information from subcontractors
- Paying your subcontractors before verifying them

Errors

Errors on CIS returns submitted cannot be corrected later in the tax year, and all errors will count against all construction related businesses, not just those with gross paid status in the form of tax recovery and penalties.

Those gross paid subcontractors will receive letters outlining their compliance "failures" which might lead to loss of their gross paid status.

On reviewing such letters from HMRC, many had been caused by HMRC's own misallocation of PAYE payments received or other of their internal system errors.

No respite from CIS ...continued from page 3

More were the result of the agreements for time to pay not being noted on the Revenue and Customs CIS database. Despite letters being generated by computer and sent out unchecked, and many problems being caused by their systems, it remains the taxpayer's responsibility (and cost) to follow the appeals process and advise HMRC in writing, even of their own mistakes.

Penalties

The changes to the tax penalty regime also impacted on CIS and now RTI has involved further changes to the CIS administration. Consequently, it has never been more important to ensure businesses quickly identify their involvement, ensure accurate and timely compliance and continue to monitor their involvement, particularly where there have been changes to either your business plan, your customer needs or even the staff preparing the returns.

To ensure accurate compliance and avoid penalties, which may be charged even in cases where it can be shown there is no loss of tax, it is essential to:

- Regularly review all construction related work undertaken by your business
- Check the CIS relevance of each type of work done
- Ensure your business is correctly registered with HMRC as subcontractor and/or contractor
- Never pay without first verifying each subcontractor
- Check the information provided by your subcontractors at intervals to ensure it is still current
- Check the monthly returns are made by the deadline whether they are populated or are nil returns
- Ensure (if you are incorporated) that the CIS deductions your business suffer are submitted on the EPS returns under the RTI payroll requirements.

Despite the recession there has been no respite from the constant review of CIS compliance by HMRC, with investigations, tax recovery and penalties all being aggressively pursued.

Should you have any concerns regarding the scheme, its relevance to your business or its operation, please do get in touch.

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