

Impact of the 2010 Emergency Budget on the Property sector

The unavoidable budget that provides prosperity for all.

These are the words of George Osborne who after only seven weeks in office has commenced to take measures the new government consider essential to recover the excesses of the past. Spending cuts are the main thrust with wide ranging reductions being anticipated averaging 25% across departments. These represent 77% of the revenue raised from the budget with the balance of 23% coming from increases in tax. Speculation was rife regarding the measures that would be introduced to raise the tax take with capital gains tax and VAT being high up the list and an initial reaction is that the increases are considerably less draconian than many were predicting.

A rise in capital gains tax for high income earners of 10% to 28% still leaves considerable opportunity for tax planning with the differential between the top rate of income tax and national insurance of 51% being 23% higher than the highest rate of capital gains tax. An increase of £3 million to £5 million in the lifetime allowance for entrepreneurs relief was unexpected and for those high earners hoping to make an eligible capital gain in the future there is no increase in the total capital gains tax liability until gains exceed approximately £7.5 million.

A rise in VAT to 20% was somewhat inevitable and the issue of changes in the tax rates at midnight on New Years Eve are avoided by the change being on 4 January 2011. This singular measure is the most substantial revenue raiser amongst the various measures introduced and is in common with other European countries.

The theme of the budget is paying for the past and providing for the future with the economy no longer being reliant on the financial services sector. The measures introduced are seen as a first step to transforming the economy to sustainable growth led by the private sector.

Capital Gains Tax (CGT)

General Description

Changes to CGT have been announced as follows:

- A new rate of CGT for individuals, trustees and personal representatives of 28% has been introduced effective from 23 June 2010. For individuals the CGT rate remains at 18% to the extent that total gains and income are less than the upper limit of the income tax basic rate band which is currently £37,400. For trustees and personal representatives the rate is increased to 28%.
- The lifetime limit for entrepreneurs relief on which the effective rate of CGT remains at 10% is increased from £2 million to £5 million effective 23 June 2010. For those that have previously claimed relief further relief to take the total eligible gains in a lifetime up to £5 million are available.

Comment

The increase in entrepreneurs relief will be welcomed by property developers, property traders and others operating a trade that qualifies for the relief. Investors will be hard hit by the 10% increase in CGT and there is now a small incentive to hold onto chargeable assets to the extent that they can be taxed at the lower rate of 18% post retirement or to transfer them to a spouse who may have lower income. The differential in tax rates remains such that a limited liability partnership will potentially remain the vehicle of choice for many property owners.

Income tax and national insurance

General Description

From 6 April 2011 the personal allowance will be increased for those aged under 65 by £1,000 to £7,475. The intention is to increase the personal allowance over the life of the coalition government to £10,000. Higher rate tax payers will not benefit from this increase as the basic rate limit will be reduced accordingly.

The threshold at which employers start to pay Class 1 National Insurance is to be increased by an extra £21 per week from 6 April 2011.

Comment

The increase and proposed increases in the personal allowances are welcomed and will take approximately 880,000 of the lowest paid out of income tax altogether.

Corporation Tax

General Description

The main rate of corporation tax for companies with profits in excess of £1.5 million will reduce from 28% to 27% after 1 April 2011 and will further reduce by 1% per annum until it reaches 24% from 1 April 2014.

The small profits rate for companies with profits under £300,000 will reduce from 21% to 20% effective after 1 April 2011.

Comment

The lower rates of corporation tax are intended to incentivise business as the economy climbs away from recession. Together with maintaining interest rates at low levels they will be welcomed by the property sector.

VAT

General Description

The standard rate of VAT will increase from 17.5% to 20% on 4 January 2011. Anti-forestalling legislation will be introduced to prevent the current 17.5% rate of tax being applied to supplies of goods or services to be performed on or after 4 January 2011.

Comment

This much heralded increase will create significant administration work for those in property management. The additional cost will be a burden to all in the

property sector who cannot recover the tax.

Capital allowances

General Description

There are proposed changes to capital allowances for businesses effective for periods ending on or after 1 April 2012 for companies or 6 April 2012 for businesses chargeable to income tax, as follows:

- To reduce the rate of writing down allowances for new and unrelieved expenditure on plant & machinery from 20% to 18%.
- To reduce the 'special rate' pool allowances from 10% to 8%. This includes integral features such as lifts and electrical systems, thermal insulation and expenditure on long life assets.

Furthermore it is also proposed that from April 2012 the annual investment allowance will reduce from its current limit of £100,000 to £25,000. This is the amount for which a 100% allowance on capital expenditure is available as a deduction against taxable income.

Comment

Whilst the Chancellor stated the proposed amendments above only delay tax relief on capital expenditure for businesses, this will do little for encouraging businesses to invest, and the further delay in obtaining tax relief for capital investment will put an increased strain on cash flow for property businesses.

Anti Avoidance

General Description

Measures have been introduced under the heading of Tackling Tax Avoidance although a number of the announcements remain very general in that they indicate an intention rather than specific legislation.

- General Anti-Avoidance Rule

The government is to examine whether a general anti-avoidance rule will strengthen its defences against tax avoidance.

Comment

This has been talked about for years and is nothing new but it is extremely difficult to produce general rules that will be effective.

- Stamp Duty Land tax Schemes

Further changes to the rules on stamp duty land tax on high value property transactions will be examined.

Comment

HM Revenue & Customs have been trying for years to stop these schemes but the lawyers seem to keep one step ahead and many of the available schemes succeed unchallenged. It will be interesting to see if they finally succeed.

- Employee Funded Retirement benefit Schemes

To legislate against the use of Employee Funded retirement benefit schemes, where such schemes are designed to save income tax or national insurance contributions, or avoid restrictions on pensions tax relief.

Comment

The closing of a scheme.

- Employee Funded Retirement benefit Schemes

Amend the Loan Relationship rules to prevent profits falling out of account, from the derecognition of a loan or derivative.

Comment

The closing of a scheme.

Furnished Holiday Lets (FHL's)

General Description

The Furnished Holiday letting rules will not be withdrawn from 6 April 2010 and there will be public consultation over the summer to change the tax regime from 6 April 2011.

The proposals will consider how relief for furnished holiday lettings is given. They will specifically consider the extension of the furnished holiday letting rules to properties in the EEA (which has been effective from 22 April 2009) as well as considering an increase to the number of days that qualifying properties have to be available for, and actually let as, commercial holiday lettings.

Comment

Hopefully these changes will continue the beneficial tax treatment of holiday lets as a trade.

Real Estate Investment Trusts and Authorised Investment Funds

General Description

Measures will be introduced to allow Real Estate Investment Trusts to issue stock dividends in lieu of cash distributions, in order to meet their requirement to distribute 90% of their profits.

Measures will also be introduced to ensure that a corporate investor cannot make use of an Authorised Investment Trust to create a credit for UK tax where no UK tax has been paid. Two measures will be introduced, the first to restrict a corporation tax deduction to the extent that the interest distribution

is derived from dividends exempt from corporation tax. The second, where foreign tax is suffered by an Authorised Investment Fund, to treat the receipt of the distribution in the corporate investors hands as foreign income (that carries the right to an underlying foreign tax credit).

Comment

This relaxation will provide Real Estate Investment Trusts with the flexibility to manage their distribution policy.

Consortium relief for losses

General Description

Consortium relief allows losses to pass from a corporate consortium member to a member of its own group. The consortium member in the past had to be UK resident.

The proposals will enable losses to be passed through the consortium member, even where that Company is established elsewhere in the EEA.

There will also be amendments to alter the definitions of the extent of losses that can be surrendered. The amendments will alter the tests of ownership of a consortium company, and prevent a consortium member accessing relief for a greater share of the losses, than their actual involvement entitles them to.

Comment

The relaxation of the requirements for the Consortium member to be UK resident, are welcome. However the amendments to the ownership definition, has added another tier of complications to the computation of the losses that can be surrendered through a consortia. The devil is in the detail and will apply to property groups.

Capital Distributions

General Description

It is proposed that any distributions made by a Company will generally be treated as exempt from corporation tax (provided the conditions for exemption are otherwise met).

Anomalies had arisen, as a result of change in legislation with effect from 1 July 2009, as to whether the distributions, if received by a corporate taxpayer, were otherwise chargeable to tax as chargeable gains, because they were of a capital nature.

Comment

The clarification on this important issue is welcome and is to be given retrospective effect though not for all tax purposes.

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Kingston Smith is a top 20 firm of Chartered Accountants. Our property team have considerable experience in the property sector and work with clients in property development, construction, investment and management. We help clients run their businesses more successfully by providing practical advice such as planning ownership structures to minimise their tax exposure. We provide accounting services ranging from bookkeeping and management accounts to the preparation and audit of year end financial statements, as well as helping to improve financial efficiency and source alternative methods of funding.

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