Tax Secrets for Property Developers and Renovators

By

Lee Sharpe

Publisher Details
This guide is published by Tax Portal Ltd. 3 Sanderson Close, Great Sankey, Warrington, Cheshire, WA5 3LN.

'Tax Secrets for Property Developers and Renovators' – First published in July 2006. Second edition April 2007.Third edition May 2008. Fourth edition May 2009. Fifth edition August 2010. Sixth edition May 2011. Seventh edition April 2012. Eighth edition May 2013. Ninth edition April 2014. Tenth edition April 2015. Eleventh edition April 2016.

A CIP Copy of this guide is available from the British Library.

978-0-9932513-5-1

Disclaimer

1. This guide is produced for General guidance only, and professional advice should be sought before any decision is made. Individual circumstances can vary and therefore no responsibility can be accepted by the author, Lee Sharpe, or the publisher Tax Portal Ltd, for any action taken, or any decision made to refrain from action, by any readers of this guide.

2. Tax rules and legislation are constantly changing and therefore the information printed in this guide is correct at the time of printing – April 2016.

3. Neither the author nor Tax Portal Ltd offer financial, legal or investment advice. If you require such advice, then we urge you to seek the opinion of an appropriate professional in the relevant field. We care about your success and therefore encourage you to take appropriate advice before you put any of your financial or other resources at risk. Don't forget, investment values can decrease as well as increase.

4. To the fullest extent permitted by law, Lee Sharpe and Tax Portal Ltd do not accept liability for any direct, indirect, special, consequential or other losses or damages of whatsoever kind arising from using this guide.

   The guide itself is provided 'as is' without express or implied warranty.

5. Lee Sharpe and Tax Portal Ltd reserve the right to alter any part of this guide at any time without notice.

Contents

About Lee Sharpe

Lee is a Chartered Tax Adviser and tax consultant with over twenty years' experience in helping individuals, families, businesses and advisers with their tax affairs.

Lee writes extensively on tax matters for taxpayers and their advisers, including through the Tax Insider publications, Bloomsbury Professional and the TaxationWeb website. He also lectures taxpayers, accountants and other financial advisers on tax issues.

While he has appeared on TV to comment on tax matters, it was only long enough to establish that he really has a face for radio, and to give fellow members of his local CIOT branch sufficient ammunition with which to embarrass him at committee meetings.

When he is not giving tax advice or writing about tax matters, he is busy looking after his two small children – not because he likes them, but because he wants to make sure that his office is not used exclusively for business purposes…

1 About This Guide

In recent years, there has been a great increase in interest in the property market, and this guide offers advice on the tax pitfalls and opportunities for those who are involved in this dynamic sector.

In particular, it is aimed at:

1.1 Homeowners

All of us who own our own homes hope we are sitting on a goldmine! For many people, their home is their most valuable asset – for some, it is their pension fund!

This section of the guide looks at the tax breaks available to homeowners, and how to get the maximum benefit from them. It also warns of the traps for the unwary!

It is not unusual for a homeowner to find themselves becoming a property developer, perhaps by building another property on their land, or by receiving an offer from a developer to buy their home. We will look at the (sometimes unexpected) ways that such projects are taxed by HM Revenue and Customs (referred to in this guide from now on as HMRC).

1.2 Buy to Let

It seems that these days, everyone is a landlord! In this section, we shall look at the tax treatment of buy to let investors, both on the income from their properties, and on the sale of those properties. We shall cover the letting (and selling) of residential and commercial properties, and that interesting hybrid, furnished holiday accommodation.

1.3 Buy to Sell

Not everyone buys property in order to enjoy the rental income – many intend to turn the properties over quickly by selling them again at a profit.

This sector can be subdivided into three broad categories, all of which we shall look at:

- “**Turnarounds”** These work on the basic commercial principle of “buy cheap and sell dear”. A property is bought for a bargain price, perhaps at an auction, and sold on almost immediately, with little or no work done on it to increase its value.

- **“Refurbs”** As the name implies, in a “Refurb”, a run-down property is bought, refurbished, and sold – or a large property is bought, converted into smaller units such as flats, and sold.

- **“Property Development”** This can be more or less the same as a refurb, or it may involve buying a vacant plot of land and constructing a new building on it for sale.

2 A Word about Limited Companies

This guide looks at the taxation of individuals who own property, or trade in property, as sole traders or as members of a partnership.

In some cases, it can be advantageous to use a limited company as the vehicle for investing or trading in property – the two commonest examples being:

- If you intend to plough the profits from a rental business back into buying more rental properties, rather than to draw them out for personal expenditure
- If you are a property developer

The decision whether to use a company or not can be a very difficult one, and it is beyond the scope of this guide.

If you would like detailed information and advice about whether a limited company would be the best way forward for your business, our guide "**Tax Dos and Don'ts of Property Companies**" is available from www.property-tax-portal.co.uk. Between the two of them, they offer a comprehensive guide to tax for the property investor or the property trader.

3 What This Guide is Not About

All of the tax strategies in this guide are legitimate ways of planning to minimise your tax liabilities.

In some cases, they involve "grey areas" of the tax legislation, where there is more than one way to interpret the law, and where this is the case, it is clearly indicated in the text.

This guide is not about complicated tax avoidance schemes, many of which do not work, or are vulnerable to retrospective legislation.

It is most emphatically not about ways to <u>evade</u> tax – that is, to reduce your tax bill dishonestly by telling the taxman less than the whole truth.

The above may seem obvious, but we mention it because we have sometimes been quite surprised by the advice taxpayers tell us they have received from other sources – in some cases, if they had followed that advice, they would have been straying over the line that separates (legal) tax avoidance from (criminal) tax evasion – a line that was famously described by Dennis Healey, the former Chancellor of the Exchequer, as having "the thickness of a prison wall!".

This distinction is so important that we will begin by looking at what separates tax planning, tax avoidance, and tax evasion.

4 Staying on the Right Side of the Prison Wall

"The thickness of a prison wall" – the difference between tax planning, tax avoidance, and tax evasion, and why it matters!

Taxation has rather murky origins – arguably, it began when a party of Norman soldiers rode into an English village, and stole all the chickens.

Perhaps one of the earliest examples of tax planning (or maybe tax avoidance, depending on your point of view) would have been hiding some of your chickens when you heard the approaching hoof beats.

As things got more sophisticated, both the way taxes were charged and the ways they were avoided became more complicated.

You can still see the bricked-up windows on old houses (done to avoid the 18th century Window Tax). It has been suggested that the first Lurchers (a delightful breed of dog: a cross between a greyhound and a pastoral breed such as a Border Collie) were bred to avoid the luxury tax on Greyhounds – in 1823, for example, the annual tax on a Greyhound was £1, whereas for any other breed of dog, it was only 8 shillings (40p).

If we fast forward to the present, the way the law now stands on trying to reduce your tax bill works like this:

4.1 Tax Planning and the Duke's Gardener

In 1935, the House of Lords gave their judgement in the case of the Duke of Westminster, who had set up a tax planning scheme involving his gardener (and other employees) and a Deed of Covenant – the details do not matter, as sadly that particular scheme no longer works.

Their lordships said the Duke's scheme successfully reduced his tax bill, and added that:

"Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be"

This remains true today, though there have been developments since that have chipped away at this principle.

4.2 Anti-avoidance Legislation

One of the reasons that the specific scheme used by the Duke of Westminster no longer works is that legislation was passed to prevent it from doing so in future.

For many years, this was the only way that the Government could counter tax avoidance schemes – by identifying how a specific scheme worked, and passing legislation to ensure it was no longer effective.

One of the problems with this approach (from HMRC's point of view) is that it is always a couple of years or so behind the times, and by the time the law is on the statute book, a way round it has been invented.

The other problem (from the taxpayer's point of view, this time) is that the anti-avoidance legislation can catch quite innocent transactions, or can apply in circumstances where the average taxpayer is simply unaware that the law exists, much less that it applies to him!

There are several examples of this type of legislation in this guide – to take two:

- The "Construction Industry Scheme" which requires property developers to deduct tax from certain payments to tradesmen, and keep records of payments to others

- Section 752 ITA 2007, which can turn what you thought was going to be a small capital gains tax bill into a large income tax bill

4.3 The "Ramsay" Doctrine

Since the early 1980s, the Courts have developed a new way of interpreting tax legislation (the name comes from one of the earliest cases on the subject, and has nothing to do with bad-tempered TV Chefs). The Ramsay doctrine says that:

If a tax planning scheme involves a series of preordained steps, and one or more of those steps has no commercial purpose except to avoid tax, then that step can be ignored, and you look at the commercial reality of the transaction rather than the form it has been given by the scheme.

This way of looking at the law came about as a result of a number of highly artificial and complex schemes to avoid tax that were being marketed at the time.

The Ramsay doctrine is still evolving, and it is something that cannot be ignored when considering tax planning ideas. In the course of this guide, you will find several examples where I warn that the Ramsay doctrine might be used by HMRC to attack a particular tax planning strategy, and how to minimise the risk of this happening.

4.4 The DOTAS Disclosure Rules

In the last few years, legislation has been passed that requires those who market certain types of complex tax avoidance schemes to disclose the details to HMRC.

Anyone who then uses one of these schemes has to disclose the fact in their tax return. There are severe penalties for failure to comply with these rules.

This requirement to disclose such schemes has two consequences for those who decide to use them:

- They can be sure that HMRC will look very closely at the scheme to see if it is technically effective, and if it is not, they will have the names of everyone who is using the scheme

- Even if the scheme works, it is likely that legislation (sometimes retrospective) will be introduced to block the scheme.

None of the tax planning strategies described in this guide falls into this dangerous category of tax planning scheme, and none of them requires to be disclosed to HMRC in this way.

4.5 Tax Evasion – The Other Side of the Prison Wall!

Tax planning and tax avoidance are both entirely legal. Tax evasion is a criminal offence. Tax evasion always involves dishonesty in some form or other.

For example:

- In the days of the window tax, some houses were built with "dummy" windows made of bricks, or the windows in existing houses were removed and bricked up – the tax only applied to glass windows. That was tax planning.
- In other cases, houses were designed with one very large window where previously there might have been two or more small ones.

  We have heard of a case where an entire course of bricks made of glass linked all the windows on one wall of a house, and it was claimed they were all one window for the purposes of the tax.

  The tax commissioners refused to accept this argument and the tax had to be paid. That was tax avoidance, though unsuccessful.
- Some people bricked up their windows only when the "Surveyor" from the Inland Revenue was due to inspect the property.

  There was no mortar holding the bricks in place, and they were removed after the Surveyor had gone, to reveal the glass window behind. That was tax evasion, and if you were caught doing it, your window tax was doubled!

Tax evasion is not confined to the "black economy" where payment is in cash and the taxman is never told about it.

It is likely that any "tax planning" scheme that relies on HMRC not knowing the full facts about a transaction is in fact an example of tax evasion.

Obviously, none of the strategies described in this guide involve tax evasion in any form, but in some cases (typically those involving tax planning for your home) we shall be pointing out the danger of crossing the line between avoidance and evasion.

4.6 GAAR

Since the 2013 Finance Act we have also had a "General Anti-Abuse Rule" or "GAAR".

Essentially, this enables HMRC to take action against artificial tax-planning schemes that seek to achieve results not intended by the tax legislation. It is most unlikely to have any effect on the sort of tax planning described in this book, if HMRC are to be believed, because they claim the GAAR is aimed exclusively at the sort of highly artificial tax schemes that would typically fall under the "Disclosure Rules" described in 4.4 above.

4.7 2014 Finance Act

This contained two other measures that took effect from Royal Assent to the Act in the summer of 2014:

- “Accelerated payment” will allow HMRC to serve notice on a taxpayer using a scheme disclosable under DOTAS (see above) or being countered by the GAAR, requiring them to pay the tax in dispute immediately rather than waiting for the result of the dispute with HMRC

- “Follower notices” can be issued by HMRC to those using avoidance schemes “similar” to any scheme HMRC win their case against in court. A “follower notice” requires the taxpayer using the “similar” scheme to amend their tax return to give up the tax saving from the avoidance scheme, or face a penalty.

These measures are again aimed at what HMRC might term “artificial” or “contrived” arrangements, such as might be found in “disclosable” schemes as above. We do not expect anything that we recommend in this book to fall foul of these measures, either.