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# A changing ecosystem

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*David Hannah* explains how the complex world of property tax is making its mark on the residential ecosystem

### What is the issue?

The arena of property tax is becoming increasingly complex, with professional, legal and financial services often finding themselves disagreeing on the amount of tax owed for individual transactions.

### What does it mean to me?

Such complicated reforms mean that it's more important than ever that consumers ensure that they are seeking the correct advice, in terms of the elaborate new legislation in place. It's vital that those dealing in property are able to navigate the system, in order to allow the market to prosper.

### What can I take away?

It is the responsibility of tax, legal and financial professionals to work on building a stable partnership, in which they collaboratively pursue legitimate solutions for clients, ensuring that they feel confident in their investments, and that their assets are protected from a rapidly changing landscape.

Following the decision to leave the European Union this summer, the property market is a swiftly changing landscape, but not necessarily for the worse. There are advantages to be had in the current economic and political climate, with advantageous deals to be made at the luxury end of the market, for those with the confidence to see what's available. There is also a greater selection of stock to consider, creating a buyer's market with plenty of options. London remains a highly attractive prospect to both domestic and international buyers and investors, with strong capital returns, and a stable economic outlook.

However, in light of HMRC's recent consultation, it's clear that the already convoluted waters of the property tax market have become even more complex. It is now more important than ever that consumers ensure that they are seeking the correct advice, in terms of the elaborate new legislation in place. The sector is incredibly complicated, and every day we see the pressure increasing on property buyers, conveyancers, and other professional services to act as seasoned tax advisors for transactions, which can often confuse matters even further.

If we take a look back at the numerous tax reforms that have been made over the last 15 years or so, it's no wonder that consumers and professionals alike are scratching their heads in confusion. We saw the introduction of SDLT in the early 2000s, but these days, legislation has become so intricate that even hardened practitioners are reaching for the paracetamol when reviewing transactions.

In 2008, we had the targeted anti avoidance rule for SDLT section 75A FA 2003 – which is essentially the *Ramsay* principle written into law – and it has taken nearly eight years to get a court ruling as to exactly how it should be applied. Thankfully, the Court of Appeal seems to have come down on the side of rationality in this case.

Solicitors, professional services and consumers alike are finding themselves especially uncertain as to how best to navigate the new 3% surcharge, highlighting its complexity. From a tax perspective, the details of these reforms still remain somewhat unclear – the ways in which the rules should be applied lack clarity, especially in terms of the classification of property types. The number of enquiries from solicitors, seeking strategic, regulated, advice on the new reforms, demonstrates not only how complicated the system has become, but the legal profession's recognition that this new SDLT path is one best trod with caution.

Over the past few months, we have seen a huge amount of confusion surrounding connected transactions, where either the market value has been incorrectly calculated, or where multiple dwellings relief was not claimed where it could have been.

We recently had a client who bought a property for £3.5m – not exactly a small amount – and paid residential SDLT. Upon further inspection, it became clear that she should have claimed for mixed use relief on the dwelling – in this case, the difference in tax in this case was £170,000. In reassessing her claim, she reduced her tax bill by 50%, which is an enormous sum of money to lose by receiving the wrong advice.

Another prime example of how the SDLT reforms are causing miscalculations is the new 3% surcharge legislation's treatment of married couples. Homeowners are finding themselves liable for staggering amounts of tax that would not be enforced were they merely cohabiting. If, upon entering matrimony, both parties retain their properties, then the couple as an entity would need to pay SDLT on their main residence if they ever needed to remortgage it, and if the mortgaged amount came to more than £80,000.

It is also often overlooked by solicitors that the law states that if a main home has been sold before November 2015, then the vendor is free to purchase a new property before November 2018, without paying the surcharge. This concession was introduced to ensure that parties would not find themselves paying the surcharge for a property that would be classified as a main residence where they had sold one prior to the 3% surcharge being announced, but it is one that solicitors, and even HMRC, fail to take into consideration when advising clients, and another opportunity for buyers to pay far more tax than they should.

Such cases, in which consumers have found themselves assessing conflicting advice from solicitors, conveyancers, and even HMRC, demonstrate the need for a stable partnership, in which tax and legal professionals collaboratively pursue legitimate solutions for clients. Such a relationship would de-risk the conveyancing process – since liability for error will sit with the solicitors, it is in the legal services' best interests to align their readings of the new reforms, limiting uncertainty wherever possible.

To look at the most recent reforms – the Finance Act 2016 will see a charge placed upon any profit generated from land and property in the UK. The legislation involved is especially tortuous as well as being underpinned by a strong theme of anti-avoidance.

These reforms demonstrate how complexity within the property tax arena can ultimately defeat itself, and how a rush to counter what some might see as tax avoidance can have unintended – if beneficial–consequences for those that the measures are targeted at.

The reasons for which an individual might own land have been succinctly split into four separate categories: those who have purchased land to make a profit by selling it on; those who have bought a property for its plot, to sell the land on; land that is held as trading stock; and land that has been developed on, to make a profit.

This means that even if assets are held by offshore accounts, if the land is in the UK, then the owners will be obliged to pay either Corporation Tax, if they are registered with a company, or Income Tax, if held by an individual.

Why is this good news for consumers and businesses? The legislation surrounding the Annual Tax on Enveloped Dwellings (ATED) contains a relief specifically for ‘property traders’, and under the new Income Tax and Corporation Tax legislation, any offshore owner will meet the criteria for this definition as given. Therefore, from July 2016, there are no ATED qualifying properties owned by offshore entities anywhere, and the effect of the ATED legislation on those entities has in effect been wholly neutralised.

So – gone are the days of annual ATED returns, and in come the days of calculating Trading Profit instead of Capital Gain. Conceivably, given the way in which the new reforms are phrased, it may even be open to Non-UK Companies to reclaim ATED charges already paid!

It’s also important to note that since the legislation back dates to the date the property was first acquired, ATED-related Capital Gains can also no longer apply – and since corporation tax profits are taxed at only 20%, rather than the previous 28%, many could find themselves welcoming a significant tax cut as well.

Although it is clear that HMRC and the Treasury intended to ‘level the playing field’ as regards non-residents owning and dealing in UK land, it would appear that they eliminated the opportunity to tax ATED related gains.

Such confusion caused by a complex, intricate system is, in some cases, enough to put homebuyers off the process altogether, thus countering the initial intentions of the legislation. Although the reforms seemed like a good idea at the time, what the market needs now is a boost. It is vital, for the continued growth of the market, that confidence is stimulated, so that buyers can feel secure in their transactions – and what tax is owed.

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