

# IF I WERE CHANCELLOR: PRE BUDGET REPORT 2009 / BUDGET 2010 AND BEYOND...

## BACKGROUND

Whether you are buying, selling, leasing, developing, constructing or investing in commercial property, numerous (and often competing) tax issues will arise, including SDLT, VAT, direct tax and capital allowances.

Especially in the area of commercial property, it is easy to understand why even Albert Einstein admitted, *“the hardest thing in the world to understand is income tax.”*

Given the current economic climate, one could not have expected the Chancellor to announce a reduction in taxes in December's Pre Budget Report (PBR). However, he could have made an attempt at simplifying the tax system and thus eased the burden of administration of taxes for taxpayers, potentially freeing up management time to run the business.

## SDLT

As anticipated, the PBR has sought to improve the Disclosure of Tax Avoidance Schemes (DOTAS) rules. They now require the disclosure of SDLT avoidance schemes that concern residential property with a value of at least £1 million, and also that users of SDLT avoidance schemes will have to report their usage to HMRC by way of a new form which is yet to be published.

However, despite fears regarding the PBR, SDLT planning mechanisms are still being used for both commercial and residential property. Do not assume that 4% SDLT must be paid: instead seek advice before agreeing any heads of terms.

If I were Chancellor, I would move to block these SDLT schemes with effect from Budget Day 2010 (probably late March), and I would also introduce a new 5% rate for properties above £1 million.

Although, I would make SDLT stepped, so that selling a property at say £500,010 would not invoke SDLT at 4% on the whole of the consideration, but only on the element above £500,000.

But, I would also introduce an exemption from SDLT on the transfer of property between married couples and civil partner - at present there are only exemptions on divorce or separation.

Furthermore, I would extend some of the reliefs, for example over-lap relief. This relief is available where SDLT has been paid on the consideration for a lease, which is subsequently surrendered and regranted over the same or substantially the same premises (typically due to some fault in the lease). Relief is available from SDLT for that part of the old lease which overlaps the new lease. This relief does not apply, however, to leases granted under the old stamp duty regime, and in my opinion should be extended to incorporate these.

## VAT

VAT is a European tax and changes cannot be made unilaterally by one member state.

In the context of commercial property, VAT is a complex area. Land (or supplies in respect of land) can be:

- exempt; or
- zero rated; or
- reduced rated; or
- standard rated.

In addition, the consequences of not correctly assessing and budgeting for VAT cash flows can be very costly.

The basic rule (although in tax there are always exceptions) is that land is an exempt supply i.e. no VAT is charged; thus it follows that the supplier cannot recover any VAT charged to him. It is therefore usual for an owner to opt to tax (OTT) (that is, to charge VAT in respect of his land and allow him to recover any VAT which he incurs on legal fees, development costs, capital assets etc).

Where, for example, a tenant carries on a VAT registered business from an opted building the exercise of the OTT by the Landlord is not an issue.

In these straitened economic times, many tenants are defaulting on rental payments. Guarantors and former tenants might be paying the tenant's rent plus VAT. The payer of the rent should be allowed to treat the VAT element as allowable input VAT even if that payer has not acquired a lease over the relevant land by way of either an overriding lease, assignment or vesting pursuant to a court order etc.

I suspect that, relatively soon, we will see the VAT standard rate rise to perhaps 19% or 20%, in line with other EEC countries.

## DIRECT TAX

If an individual sells property that is a trading asset then after April 2010, he may potentially pay income tax at the rate of 50%. Whereas, if that asset were a capital asset he would only be liable to pay capital gains tax at 18%. This difference in rates will inevitably lead to taxpayers seeking to categorise their activities as being of a capital nature i.e. investments and not income. The usual "cat and mouse" response will undoubtedly follow, with HMRC drafting anti-avoidance legislation to recharacterise activities as being income generating and/or taking test cases before the Tax Tribunals to re-set the boundaries.

I fear that this difference in tax rates cannot last and that we will see CGT rates rising.

Perhaps a way of simplifying the tax system would be to have a flat rate tax that applies to all types of income, profits or gains. Just after the 1987 Wall St crash, Nigel Lawson, the then Chancellor, commented:

*"In principle there is little economic difference between income and capital gains, and many people effectively have the option of choosing, to a significant extent, which they receive. In so far as there is a difference, it is by no means clear why one should be taxed more heavily than the other."*

## CAPITAL ALLOWANCES

Businesses depreciate capital assets, i.e. they write off the expense of that asset over broadly the useful economic life of the asset. That depreciation charge is not, however, allowed as a tax deductible expense in calculating the profits that are chargeable to tax. Instead the business is allowed to claim capital allowances.

One of the primary motives behind the capital allowances regime is that HMRC fears that businesses would find it easier to manipulate the depreciation charge rather than the capital allowance regime and would thus accelerate their tax deductions and decrease their tax liabilities.

Capital allowances also enable the Government to attempt to influence business behaviour, which is perhaps why we have a 150% allowance in respect of expenditure on cleaning up contaminated land and also 100% allowances (i.e. the whole deduction is taken in the year of expenditure) for expenditure in respect of:

- research and development;
- designated energy saving and/or environmentally beneficial plant and machinery;
- buildings in enterprise zones (this is to be withdrawn with effect from April 2011);
- business premises renovation allowance (BPRA).

By contrast, ordinary plant and machinery attracts usually only a 20% writing down allowance (unless they are integral features on which only a 10% writing down allowance can be claimed). This is subject to temporary first year allowances (FYA) of 40% and the 100% annual investment allowance (AIA) on £50,000 of qualifying expenditure.

In addition, amongst other allowances there are long life asset (LLA) allowances at 10% (but only if you spend over £100,000 within a chargeable period) and industrial building allowances (IBAs) currently at 2% (due to be phased out completely by April 2011).

In my view it would be simpler to abolish the capital allowance rules entirely and allow businesses to claim the depreciation that they show in their accounts.

## GENERAL

HMRC now have powers to “name and shame” persistent tax defaulters, but surely it would be better to give publicity to persons who comply willingly with their tax obligations which could be useful for business’ corporate responsibility agenda? Indeed perhaps, better still, HMRC could give a reduction in tax rates for taxpayers who had an unblemished relationship with HMRC for, say, a 10 year period.

A change heralded by the latest PBR but little commented upon, is that from 1 April 2010 taxpayers will have to pay the disputed tax liability before they can appeal the decision of a tribunal or court. This is particularly harsh and will probably result only in wealthy taxpayers appealing decisions.

It is understood that approximately 130 tax offices (on top of 93, more than a year ago) will be shut as a cost saving exercise by the Government with the inevitable result that taxpayers will have reduced access to HMRC Officers. Taxpayers will not be able to discuss issues with someone who has known them and their affairs for a length of time, but rather with a faceless call centre.

## FINALLY

But if I were Chancellor I would do something even more radical: I would privatise the collection of tax (so as to reduce still further the cost of staffing HMRC) or perhaps even adopt the approach of the Roman Empire and introduce “tax farming”. I wonder just how much someone might pay for the right to collect the taxes of their neighbours?

This article offers general guidance, it reflects the law as at February 2010. The circumstances of each case vary and this article should not be relied upon in place of specific legal advice.

For further information, please contact:

[Elizabeth Small](mailto:elizabeth.small@forsters.co.uk) on 020 7863 8380 or [elizabeth.small@forsters.co.uk](mailto:elizabeth.small@forsters.co.uk)