Property Focus

DRIVING LIFELONG PROSPERITY

Spring 2021

SPOTLIGHT ON LOOKING BACK AND MOVING FORWARD

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The construction industry: a 12 month overview

Understandably, the past 12 months have been challenging and the construction industry has had to adapt to new ways of working, such as social distancing and new working practices. During the first national lockdown, building sites were closed for a short period, but the second and third lockdowns allowed construction sites to remain open, with the government seeing the importance the sector has on the economy and infrastructure of the UK.

The government provided a lifeline to the sector by announcing a number of incentives, such as the coronavirus job retention scheme (CJRS) and self-employed income support scheme (SEISS), to assist businesses that had been impacted and had to keep employees at home.

CJRS statistics from the government show that in construction, furlough peaked on 14 April 2020 with 723,600 employees furloughed, with provisional estimates showing that at the end of December 2020, the number was at 193,400.

For SEISS, it is no surprise that construction was the highest sector in terms of value and number of applications. Covering the three grants provided to date for self-employed contractors and businesses working within the industry, by 31 December 2020, 659,000 claims have been made with a total cost of £2.2 billion, equating to 41% of total claims made in the scheme. Without this support, the number of businesses still operating would be significantly lower. More worryingly, there is still a significant proportion of the workforce on furlough, meaning output has not returned to pre-pandemic levels.

With sites shut and fixed overheads still being incurred, the announcement of government backed loan schemes, again, provided many with a level of borrowing to assist with initial working capital concerns to support cash flow during a period of site closures.

As COVID-19 continued to impact the UK (if that was not already an unwelcome distraction) at the end of December, the transition period for Brexit finished and the UK left the EU. Whilst the construction sector has not been impacted as much as others, the industry is seeing signs of smaller impacts such as material shortages, which is likely to have a bearing on the delivery and timing of contracts. One example of this is Sweden, which has recently seen an increase in the rate of COVID-19.

With Sweden being the largest exporter of timber to the UK, the delivery and timing of materials to the UK is likely to be impacted and businesses may have to look at alternative supply chains to source materials. Together with congestion at ports, materials are not finding their way to the builders' merchants to fulfil orders/supply chain, which is a concern. The cost of materials has increased due to Brexit, with a rise in shipping costs and demand for already scarce materials creating an uplift in material prices.

In what has been a difficult year for the sector, businesses have continued to be resilient and adapt to the new challenges they are facing, such as looking at the design phase and thinking about 'offsite' construction to cater to the need for safe working practices, as sometimes, prefabrication work can help to deliver the contract in a more efficient and timely manner. Others have looked to change working patterns to accommodate numbers on site with flexible working, something which may be with us for some time.

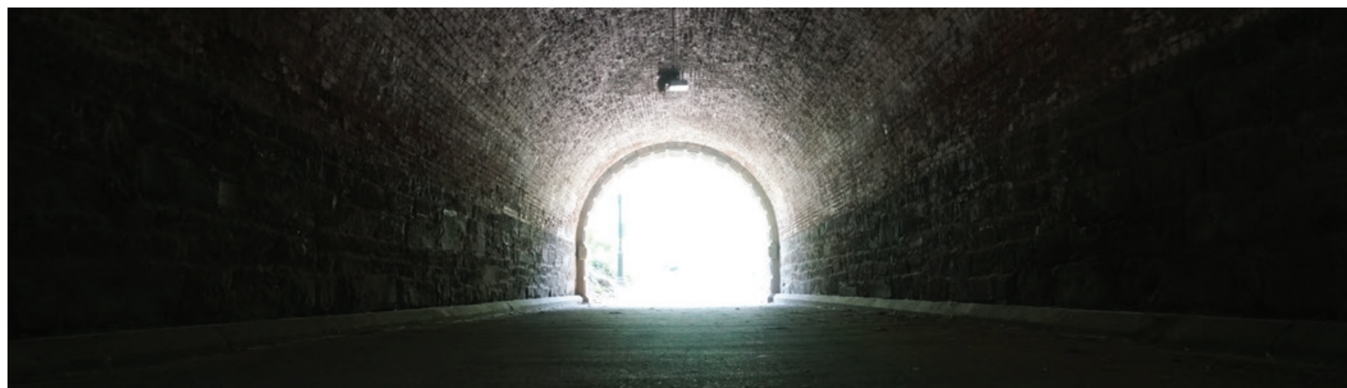
Planning ahead for a new tax year

Following the Chancellor's Budget on 3 March, we now have clarity on the tax rates and allowances for the 2021/22 tax year.

Early planning is advised, to ensure that all reliefs and allowances can be maximised during the tax year. We have set out below our top tips to consider for 2021/22.

1. As the personal allowance is reduced by £1 for every £2 of net income over £100,000, those with income of between £100,000 and £125,000 could end up paying tax at an effective rate of 60%. If your income is close to the threshold **it may be worth considering ways to reduce your taxable income**. This could be achieved by making pension contributions, charitable donations, transferring income producing assets to your spouse, or deferring income into a future tax year.
2. Taxable income exceeding £50,000 for the year could lead to a claw back of child benefit under the high-income child benefit charge. Once taxable income reaches £60,000 the benefit will be lost in full. **Reducing, deferring or transferring taxable income** as described above could help to preserve this benefit.
3. Up to £1,257 of your personal allowance can be transferred to a spouse or civil partner if neither of you are higher rate taxpayers, by virtue of the marriage allowance. This is of **benefit where one spouse has income of less than the personal allowance (£12,570 for 2021/22), with a tax saving of up to £251 per annum**.
4. The residence nil rate band (RNRB) is an additional inheritance tax nil rate band which is available on death when a residence is passed to a direct descendent. The RNRB has been set at £175,000 since April 2020, which effectively provides an inheritance tax threshold of £1million for a couple. Note, however, that for estates valued over £2 million, the RNRB element is tapered away. **We would recommend a review of your Will to ensure this, and any other tax reliefs, will be available, as well as considering any planning to reduce your estate, where appropriate.**
5. With 100% of mortgage interest relief for landlords restricted to the basic rate of tax since April 2020, you could end up with a higher tax bill than expected. **There are several ways to minimise the impact of the new rules including incorporation, spousal transfers, use of partnerships etc.**
6. If possible, you should **make full use of your ISA allowance, which is £20,000 for the 2021/22 tax year** and up to £9,000 in a junior ISA for children under 18. Although the investment itself doesn't attract any tax relief, any income or gains generated from it will be tax free.
7. If you have any surplus cash, you could look to make a tax efficient investment. There are various options which typically **offer income tax relief at 30% (but can be as high as 50%) and with tax free capital gains on disposal**. It may also be possible to carry back an investment made in 2021/22 to 2020/21 to accelerate tax relief.
8. Owner managed businesses should review their remuneration package early on in the new tax year and look to utilise their tax bands as far as possible. **A combination of low salary, high interest and dividends could result in tax free income of up to £20,570** (and double that for couples) in 2021/22 if structured appropriately and depending on the individual's circumstances.
9. **The Capital Gains Tax annual exemption for all individuals for 2021/22 is £12,300**, which you should try and use, if possible. Consideration should be given to the transfer of assets between spouses such that both utilise their annual exemptions on a subsequent disposal or deferral into later tax years where the allowance has already been used.

Consider utilising your pensions allowance, which enables you to contribute up to £40,000 for 2021/22, plus any unused allowance for the previous three tax years. Note, however, that if your adjusted income is more than £240,000, the allowance reduces by £1 for every £2 above this threshold down to a limit of £4,000. This reduction only applies where your 'threshold income' (broadly taxable income) is also over £200,000.



Domestic VAT reverse charge

After several delays in implementing the domestic VAT reverse charge for businesses buying and selling construction services, the changes have finally been implemented and are effective from 1 March 2021. From the commencement date, certain supplies of construction services will fall under the measure and will require the customer to account to HMRC for the VAT in respect of the transaction, rather than the usual position of the supplier accounting for VAT.

This will be achieved using a reverse charge mechanism. The reverse charge will apply through the supply chain where payments are required to be reported through the construction industry scheme (CIS). The reverse charge will apply until the point in the supply chain where the customer receiving the supply is no longer a business that makes a supply of a specified service and is so deemed an end user.

Companies will need to ensure they have processes and procedures in place to be compliant with the changes proposed. Cash flow management will also be a concern for some smaller subcontractors who may have previously relied on the VAT for working capital purposes. We recommend speaking with sub-contractors as soon as possible to ensure your supply chain is ready for these changes.

Financing developments: a higher cost?

In recent years, and following the financial crash in 2008, banks have become increasingly cautious with lending to property developers. Many developers are, therefore, finding banks rejecting loan applications, or offering funding for a much smaller proportion of the cost of development. As a result, developers are having to look for alternative sources of finance.

One option is seeking funding from private investors; however, this comes at a cost, with interest rates on borrowings significantly higher than typical bank borrowings. Interest rates of between 12% and 15% are not uncommon on such loans.

Rather than a traditional loan therefore, it may be worth considering alternative ways to structure the financing to reduce the cost for the developer, whilst maintaining the net income (i.e. after tax) for the investor.

There are a number of ways that this could be achieved, with the main premise of converting income into capital in the hands of the lender. With lower capital gains tax rates, the investor could receive the same net income as under a traditional financing route but at a lower cost to the developer.

As an example, a net saving of up to £15,000 could be achieved by a property developer, based on a finance cost of £100,000, by structuring as capital rather than income.

For further details on the options available to structure the financing of your property developments, please get in touch with Nick Haines on 01242 237661 or email nick.haines@hazlewoods.co.uk.

The impact of IR35 on the construction industry

The proposed changes to the IR35 rule will take effect from 6 April 2021 and are likely to have a significant impact on medium and large companies operating in the construction industry. In recent years, the number of subcontractors has increased, largely due to those operating within the construction industry scheme and providing flexibility on when and who they work for, normally through a personal service company (PSC).

The key changes for the sector will be how businesses engage with contractors, whether it be directly through a personal service company or an intermediary, for example, an agency, and whether they are deemed to be a contractor or an employee. The proposed changes are shifting the responsibility on determining the tax status away from contractors and placing the onus on the business engaging contract workers, and ultimately the decision on whether they should be paying tax and national insurance if deemed to be within the rules of IR35.

For all PSCs your business uses you will be required to:

- Make a 'status determination statement' (SDS) for each contractor.
- Pass on the SDS to the contractor in writing (and the party you are contracting with if different e.g. an agency), along with the reasons for the assessment.
- Respond to any employment status disputes within 45 days.
- Where PSCs are deemed to fall within the off payroll working rules, the entity that pays the PSC (which could be your business or an agency) will be responsible for deducting income tax and NICs from payments made to them.

Whilst the above is likely to create extra workload, there is some good news. The government has confirmed that this will not apply to small companies and are using the definition within the companies act 2006 to determine whether the business is a small company. **The limits are as follows:**

- Turnover of £10.2m of less.
- Balance sheet total of £5.1m or less.
- 50 employees or less.

One point to consider that, where the small company is a subsidiary or part of a group, the rules can be complex, so we recommend understanding your group structure and how this will impact individual entities within the group.

You should review your workforce and identify those contractors where you believe IR35 rules apply and begin to have conversations with those contractors at the earliest opportunity, to put in place processes ahead of the 6 April 2021 commencement date. It is likely you will need additional information from contractors to assess each one on its own merit. It might be the finance team is best placed to deal with the assessments but may need input from the commercial team to obtain copies of any existing agreements with subcontractors, where the contract runs past 6 April 2021.

The changes to IR35 will change working practices within the industry, and whilst change is welcome, putting the onus on the contractor only adds more risk to contractors who are already feeling the impact of COVID-19.

Stamp duty land tax: a case update

The rules and reliefs available for stamp duty land tax (SDLT) are complex and there are a number of grey areas around the correct application of the law. The rules are therefore often tested in the courts and current times have been no exception for this.

Some recent areas and cases of note include:

HOUSE WITH AN ANNEXE

Multiple dwellings relief (MDR) is a stamp duty land tax relief available on the purchase of more than one residential property. In certain cases, a house with an annexe can be treated as two separate dwellings and hence, subject to lower rates of SDLT.

The first tier tribunal (FTT) in the case of Fiander v HMRC, held that the purchase was not of two separate dwellings, as there was no lockable door separating the main house from the annexe. Although the annexe could be accessed via a separate entrance, it could also be accessed by a corridor from the main house which could not be physically closed off.

This decision was supported by another FTT decision this year, in the case of Partridge v HMRC. Although the annexe had a separate entrance, kitchen and garden, the bathroom to the annexe could only be accessed via the entrance hall of the main house.

In summary, in order to be treated as a separate dwelling and qualify for MDR, the annexe must be entirely self-contained, with all of the required facilities.

Interestingly, a recent civil case, Chappell & Chappell v Downs Solicitors, went further and held that an annexe which was entirely separate to the main building could not qualify for MDR as there was a planning obligation in place (s.106), which did not allow the annexe to be used independently from the main property. This premise, however, has not yet been tested in the courts with HMRC but it is worth bearing in mind, when considering whether the relief could be available.

UNINHABITABLE PROPERTY

The SDLT rates for residential property are, in general, higher than non-residential property and in particular, for the purchase of a second home or an additional residential property. In the case of Bewley v HMRC, the taxpayer successfully argued that a dilapidated bungalow was not a dwelling and that the non-residential SDLT tax rates should apply.

The bungalow had no heating, pipes or floorboards and asbestos was found in a demolition survey. HMRC argued that the bungalow could be brought back into use following renovation and, therefore, the 3% SDLT surcharge on residential property should apply.

The FTT found in favour of the taxpayer on the basis that the property was not suitable for use as a dwelling at the point of completion. The FTT decision highlighted that the future intentions of the purchaser are irrelevant and that the test is whether the property "is used or is suitable for use as a dwelling", at the point that SDLT becomes chargeable.

When reviewing the rates and any reliefs to apply, it is therefore also important to consider any relevant case law as well as the legislation itself. If you are unsure of the correct SDLT treatment for a particular transaction, we would recommend that you take specialist advice to ensure you are minimising your liability whilst remaining within the scope of the rules.

Restructuring: make your business fit for purpose

Recent times have been difficult for many businesses due to COVID-19, whilst others are doing fantastically well, despite the current challenging circumstances. The last year has made business leaders think carefully about their business risks and whether their current structure is actually 'fit for purpose'. It may be the time, over the next few months, to put a new structure in place that will assist in growing your business, whilst mitigating the risks of a future downturn.

RISK OF PROPERTIES AND TRADE IN THE SAME COMPANY

Hazlewoods has helped a number of clients move their property assets out of their existing trading company. The risk is if there was a downturn in trade which resulted in, for example, a significant supplier not being paid, they may seek to claim their debts by pursuing a claim against the assets of the company. This could result in a property potentially having to be sold (and at a 'fire sale' price), in order to pay this outstanding debt. It may be possible to mitigate this risk by moving the property into a new holding company that sits above the current trading company. Clearly, there are tax issues involved (and potential commercial issues if a bank has security over the property) in introducing a new holding company but, in our experience, it should be possible to carry out this exercise tax-free.

DIFFERENT BUSINESSES IN THE SAME COMPANY

Sometimes a company will have set up separate businesses/ trades over time, which may be run by the same or a different management team in the company. One may be valuable whilst another may not, or it may be desirable to sell one of the businesses before the other. A company selling one of its businesses whilst retaining another can be very tax-inefficient and commercially more difficult. Furthermore, in a similar situation to the potential separation of property, there is also a risk that if one of the businesses fails, then this could adversely impact on the valuable business.

It is possible to restructure the company by moving out one of the businesses, in a tax-efficient manner, into a new company formed for that purpose (and this could also be carried out at the same time as moving the property as discussed above). There can also be significant tax and commercial advantages of carrying out what is known as a 'demerger', so the individual businesses (whether they are trading or investment businesses) become held directly by the individual shareholders.

Care needs to be taken to carry out the restructuring in the correct way, to avoid falling into tax traps.

CREATE A NEW GROUP STRUCTURE

There are other instances where the shareholders may wish to consider bringing companies together within a group, as this can enable tax losses to be offset between the companies in the future and allow tax efficient transfers of assets around the group. If a company joining the group is valuable, there will be tax implications on the transfer of ownership of the shares which would need to be considered.

SOLVENT LIQUIDATION OF A COMPANY

If a company has sold its business, or ceased to trade, then it can often be worthwhile to carry out what is known as a 'members' voluntary liquidation', to distribute the remaining assets (often significant cash balances) of the company. By distributing the funds in this way, they are treated as 'capital' so there are likely to be significant tax benefits compared with taking the funds out as dividends or salary. However, this option needs to be considered carefully since if the shareholder(s) are going to continue with a similar business in the future, the potential tax benefits of this route may be eradicated.

Hopefully, the above gives you a flavour of some of the options for restructuring your business to mitigate risk and create additional value. The potential tax implications of carrying out such restructuring need to be considered and the tax cost of doing things the wrong way can be significant. We will ensure that any restructuring fits with your commercial requirements whilst being carried out tax efficiently.

Accounting for COVID–19 CJRS grants

Since the pandemic started, there have been a raft of measures introduced by the UK government to support businesses including coronavirus job retention scheme (CJRS) grants.

The accounting treatment for government grants, in relation to furloughed staff costs, is that the income is recognised in the profit and loss (as other income), to match the related staff costs.

The key here for recognising the CJRS claim, is when the claim actually becomes receivable. The key condition is the placing of an employee on furlough. So, once that has happened, a business is entitled to the grant as the period of furlough progresses, irrespective of when the CJRS claim is processed and the payment received.

The income however is income and should not be netted off the related cost. It should be a separate credit to the profit and loss account as part of 'other operating income'.

The reporting requirements are set out in detail in Section 24 of financial reporting standard (FRS) 102, although no disclosure apart from the accounting policy is required for small entities applying Section 1A of FRS 102. However, thought needs to be given as to whether additional disclosures should be made to ensure that a true and fair view is presented.

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