Spring 2015

haysmacintyre
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PROPERTY BRIEFING

LETTER FROM THE EDITOR

Welcome to the Spring 2015 edition of our Property Briefing in which we cover a number of issues currently facing the property sector.

Pensions, for many a word that invokes thoughts of "tomorrow" or "I can't afford to be saving now for my retirement". However, the introduction of Auto Enrolment will change this as employers and employees are forced to address the subject. With property companies typically having few employees, it is likely many are only now getting to their staging date. In our first article we look at the implications and costs that will arise.

The property sector has had new and extended taxes to contend with in recent years. In two different articles we look at the implications of the restriction to entrepreneurs' relief introduced in Budget 2015 and summarise some additional property taxes that have been introduced, including the extension of Capital Gains Tax to UK residential property owned by non-UK resident individuals.

VAT is often the man-trap waiting to catch the unwary. A recent VAT case has highlighted the risks that can arise when trying to engineer a transfer of a going concern; our article explains more. Staying with the VAT theme, we look at the Advocate General to the European Court of Justice's opinion that might enable VAT groups to be constructed with members other than corporate bodies. Although just an opinion for now, this may give planning opportunities in the future.

Finally, accounting for interest free loans used to be easy, but for those of you facing the transition to FRS 102 this may be about to change. Our FRS 102 article shows how even a relatively straightforward situation will create new issues to consider.

If you are interested in finding out more about the issues raised, please contact your usual haysmacintyre adviser, me or Katharine Arthur, our head of tax. Our contact details are on the final page.

I hope you find the briefing useful and I look forward to hearing from you.

Ian Daniels, Head of Property

PENSIONS AUTO ENROLMENT

Private sector pension scheme take up has typically been approximately 40%. Private retirement savings are therefore insufficient, particularly when life expectancy continues to increase and state benefits are under pressure.

In an attempt to increase this rate and ensure that individuals (and their employers) provide for their own retirement Auto Enrolment was introduced, which it is hoped will increase the take up to 90%.

In a move, much heralded by the Government, between 2012 and 2017 every employer in the UK must designate a qualifying workplace pension scheme into which they must enrol all eligible workers and make contributions on their behalf. The date you are required to operate an Auto Enrolment is the "staging date". With the largest employers being made to go first, it was only 1 April 2015 when employers with 50 employees might have staged; those with fewer than thirty employees will stage between 1 June 2015 and 1 April 2017.

Property companies frequently have relatively few employees such that their staging date may only now be being reached and, if not yet reached, will be in the next two years.

WHAT'S REQUIRED?

Employer duties vary for different classes of workers: you will need to assess your workforce to identify all eligible workers and maintain detailed records. Each employer will require a default pension fund. Even if you already have a pension fund for staff, you must ensure that it complies with the new rules.

Minimum contribution rates until September 2017 are 1% for employers and 1% for employees. These rates will gradually increase until October 2018 when the minimum total contribution will be 8%.

Period	Minimum employer contribution	Minimum total contribution
Employer's staging date to 30 September 2017	1%	2%
1 October 2017 to 30 September 2018	2%	5%
1 October 2018 onwards	3%	8%

The difference between the actual employer contribution and the minimum total contribution will need to be met by the employee who will be eligible to obtain income tax relief on their contributions.

WHO IS ELIGIBLE TO BE ENROLLED?

All employees who are:

- aged between 22 and State Pension Age;
- working in the UK; and
- earning £10,000 or more per year;

must be identified and auto-enrolled by their employers.

Employees have the option to opt out of auto enrolment, if they choose to do so. For some employees, particularly if they have large pension pots elsewhere, opting out maybe the right action but specific advice should be sought on individual circumstances. Employers must repeat the auto enrolment process every three years and, should they choose to do so, the employees must opt out again.

STAGING DATES

Since February 2014, employers with 250 or fewer staff have been meeting their "staging dates" for auto enrolment, and working with pension providers to ensure that all deadlines are met. If you haven't already received notification of your staging date from the Pensions Regulator, it will arrive with you in due course - and probably shortly. Alternatively, you can check your staging date by entering your PAYE reference on the Pension Regulator's website (http://www.thepensionsregulator.gov.uk/employers/know-your-staging-date.aspx).

Fines for non-compliance exist and the Regulator has already imposed its first fines on non-compliant employers (£400 plus escalating daily penalties).

Staging dates cannot be altered, but employers can choose to postpone for up to three months, although application to postpone must be made before the staging date. However, some employers are embracing the concept and choosing to bring forward their adoption of auto enrolment.

CALL TO ACTION

With a huge number of employers "staging" over the next two years, capacity in the pension market will be limited. It is estimated that 45,000 employers will "stage" in 2015, with a further 450,000 to follow in 2016.

Employers have significant responsibilities: determining the staging date, identifying eligible workers, reviewing any existing pension arrangements, selecting a qualifying pension scheme, selecting a default investment, providing information to employees, deducting contributions through the payroll and paying them over to the pension provider and completing the declarations required by the Pension Regulator. It is not something that can be done "overnight".

Auto enrolment is a challenge for many employers, both in terms of time and cost, but the best advice that can be given is do not leave its implementation to the last minute. Seek advice and seek it early; the Regulator advises a six month minimum lead time. There are also fixed cost advisory and online solutions available to assist you fulfil your obligations which we can refer you to.

RECENT CHANGES IN PROPERTY TAXATION

Last year the Organisation for Economic Co-operation and Development's analysis showed that property in the UK generated more revenue, as a percentage of GDP, than any other developed nation, with taxes on commercial and residential property accounting for 3.9% of GDP, compared to the OECD average of 1.8%.

The UK has seen a mix of property tax increases in the last decade, such as Stamp Duty Land Tax, as well as new taxes, such as the annual tax on enveloped dwellings. In this article we look at some of the newer taxes and the impact they will have in the next year.

EXTENSION OF CGT

In a significant change, with effect from April 2015, Capital Gains Tax ("CGT") now applies to UK residential property owned by non-UK resident individuals, close companies, trusts and partnerships. However, the charge will only apply to gains accruing from 6 April 2015 and taxpayers will be able to choose whether to:

- time apportion the whole gain over the whole period of ownership, with the pre 5 April 2015 proportion not being subject to CGT; or
- to value the property as at 6 April 2015 and to compute the gain or loss over the period of ownership from then.

Non-residents will be subject to CGT as follows:

- individuals will be taxed at 18% or 28% on the gain, depending on the level of their UK income and gains. The Annual Exemption, of £11,100 for 2015/16, will be available;
- trusts will be taxed at 28% with half of the Annual Exemption available; and
- close companies will be taxed at 20% but, unlike individuals, will also be able to claim indexation relief but will not be eligible for any Annual Exemption.

Those already registered for Self-Assessment with HMRC will report gains and losses on their tax return and pay the CGT within the usual time limits which will mean, for individuals, by 31 January following the end of the tax year of disposal. This will apply to those registered with HMRC's Non-Resident Landlord scheme.

However, those not registered for Self-Assessment will be required to pay the CGT due within 30 days of the disposal of the property.

Losses will only be available to offset against gains on UK residential property, unless the taxpayer becomes UK resident, in which case the ring-fenced losses become part of the general losses available for offset against other chargeable gains.

ANNUAL TAX ON ENVELOPED DWELLINGS

When the Annual Tax on Enveloped Dwellings ("ATED") regime started in April 2013, it also introduced CGT on the disposal of "high value" residential properties by companies and other "non-natural persons". To the extent that a gain is ATED related, "ATED CGT" will continue to apply at 28% in priority to the newly introduced 20% CGT charge for companies discussed above. Any non-ATED related gain will be subject to the new charge at 20%. Those companies which benefit from an exemption from ATED, such as those carrying on a rental or development business on a commercial basis, will be subject to the new CGT charge at 20% on all post April 2015 gains.

The value of properties caught by ATED has also been widened. When it was introduced a "high value" residential property was defined as one with a value of more than £2 million at 1 April 2012 or at the date of acquisition, if acquired after 1 April 2012. However, an additional ATED band has been introduced for properties valued at between £1 million and £2 million from April 2015 with a further band for properties valued between £500,000 and £1 million coming from April 2016.

PRINCIPAL PRIVATE RESIDENCE RELIEF

Significant consequential amendments to the Principal Private Residence ("PPR") rules, which exempt an individual's main residence from CGT, have also been made. These changes affect non-UK residents with property in the UK and UK residents with property outside the UK.

With effect from 6 April 2015, an individual's residential property will not be eligible to be treated as an individual's PPR unless the individual:

- is tax resident in the country in which the property is located; or
- meets a new 90 day rule for a property in a country in which he/she is not tax resident.

To satisfy the 90 day rule, an individual must have spent 90 midnights in the property. However, this could be a trick question as ninety midnights in a UK property may, of course, affect an individual's UK tax residence under the Statutory Residence Test!

The modified PPR relief will continue to be available to non-resident trusts, where the beneficiary meets the requirements.

WHAT NEXT?

For many years, property owners have been familiar with the "March 82 valuation" concept and for those individuals affected by the above changes "April 2012 valuation" and "April 2015 valuation" will need adding to common terminology. Although there is no requirement to do so, property owners should consider having their properties valued as at 6 April 2015 in order that they have the relevant information to assist when considering the implication of disposals in the future.

VAT GROUPS - THE OPTIONS MAY WIDEN WITH THE INCLUSION OF INDIVIDUALS, PARTNERSHIPS AND OTHER NON-CORPORATE BODIES

VAT grouping is a provision which allows two or more separate taxable persons to be registered as a group for VAT purposes and then be regarded as a single taxable person.

The key advantage of VAT grouping is that no VAT is chargeable on supplies between members of a VAT group, as such supplies are disregarded for the purposes of VAT. In addition, only one VAT return is prepared for the group as a whole, which reduces the administrative burden of VAT.

In order to qualify for group registration, each person must be established in the UK and certain control criteria must be met. The control criteria are that:

- one party must control each of the others; or
- one person, whether a body corporate or an individual must control all of them; or
- two or more individuals carrying on a business in partnership must control all of them.

In addition to the above conditions, there are anti-avoidance provisions which must be met before a VAT group can be formed. The other key condition that must be met, at present, is that UK law says even though a VAT group can be controlled by an individual, or a partnership, the members of the group must all be bodies corporate.

CHANGE ON THE HORIZON?

However, a recent opinion of the Advocate General ("AG") of the Court of Justice of the European Union ("CJEU") has cast doubt on this last condition.

In the joined cases of Beteiligungsgessellschaft Larentia + Minerva mbH & Co.KGh and Marenave Schiffahrts AG, the AG has opined that German VAT legislation which, like in the UK, restricts VAT groups only to corporate bodies goes too far. The AG has said that there is nothing in the EU VAT legislation which limits VAT groups to a specific form of company or entities which have a legal personality. The Opinion goes on to say that such restrictions could be imposed only where it is necessary and proportionate to prevent tax avoidance, evasion or other abusive practices.

The way that the CJEU works is that the AG's opinion is given prior to the hearing and judgement of the CJEU itself. It is not binding on the Court but it usually gives more detailed answers to the questions put to the Court and, more often than not, the opinion is followed by the Court.

If the CJEU follows the AG's opinion then the UK's blanket restriction on individuals and partnerships joining a VAT group is ultra vires. The ability to include individuals or partnerships in VAT groups, provided the other conditions are met, could be hugely significant.

With property groups typically incorporating a number of different types of entity, the CJEU judgement, when it comes, may open up opportunities for grouping that reduces the administrative burden and/or improve overall VAT recovery.

Watch this space...

FRS 102 AND INTEREST-FREE LOANS - MUCH ADO ABOUT NOTHING?

As previously discussed in our property briefings, the reporting framework for unlisted UK companies is undergoing a comprehensive overhaul with the existing suite of United Kingdom Financial Reporting Standards being replaced by the significantly briefer FRS 102.

Whilst the new standard is shorter than the "old" standards, with 3,000 pages of standards and interpretations being replaced by 300 pages, the accounting requirements are not necessarily simpler. Some transactions and balances, which were once easily accounted for, have become more complicated. One such area, which we consider in more detail in this article, is the concept of interest free loans between group companies.

INTEREST FREE LOANS

Under the "old" GAAP, interest free loans had no profit and loss impact – there was no interest to account for. Issues might arise when the borrowing company was in financial difficulty, when impairment needed to be considered, but interest free loans tended to make for "simple" accounting. The same does not necessarily apply under FRS 102!

FRS 102 recognises two types of financial instruments, "basic" and "other". FRS 102 requires that basic debt instruments, including loans, to be measured at amortised cost using the effective interest method. These terms will be familiar to those that currently have an understanding of International Financial Reporting Standards ("IFRS"); FRS 102 even refers to the option to adopt the recognition and measurement provisions of IAS 39 and IFRS 9. However, as the overwhelming majority of UK companies do not follow IFRS, these terms may be new to some.

In short, where a debt instrument has a market rate of interest, applying the effective interest rate method will not result in any differences to the current accounting treatment. Unfortunately, this is not necessarily the case where a debt instrument is interest free, or indeed, at a below-market rate.

DEBT REPAYABLE WITHIN ONE YEAR

Where the debt is payable or receivable within one year, the debt is measured at the undiscounted amount of the cash or other consideration expected to be paid or received. So, no different to current practice.

DEBT REPAYABLE AFTER MORE THAN ONE YEAR

However, where debt is repayable after more than one year the accounting potentially becomes more interesting and involved. FRS 102 requires preparers of financial statements to account for these transactions on initial recognition at the present value of future cash flows, discounted at a market rate of interest that would apply to similar debt instruments.

This is quite a change and will impact many, particularly in group situations or where a shareholder has contributed a loan to a company at a favourable rate.

AN EXAMPLE

Let us assume that £1m has been lent interest-free by a holding company to its subsidiary for three years and that the market rate for such a loan is 5%. At the start of the loan its present value would be £863,838 (being calculated as £1m x $1/(1.05)^3$).

A common question is what happens to the "difference" of £136,162. For all the benefits of FRS 102 being briefer and shorter than its predecessors, a drawback is a lack of guidance in some areas. The treatment of the "difference" above is one such instance and it becomes necessary to consider the particular transaction in order to determine the accounting treatment of this "difference".

In the probably unlikely, but possible, scenario that a third party has advanced a loan at less than market rate, the "difference" is interest income when the loan is made which then reverses as interest payable as the discounting unwinds. In summary, the following entries arise.

	Yr 0	**Yr 1**	**Yr 2**	**Yr 3**
Dr/(Cr)	£000	£000	£000	£000
Profit and loss				
Interest received	(136)	-	-	-
Interest payable	-	43	45	48
Balance sheet				
Liability	(864)	(907)	(952)	(1,000)

The more common example of a less than market interest rate loan would be where a parent makes an interest-free loan to a subsidiary. In this example the "benefit" of the loan being provided at less than market rate is initially accounted for as an increase in the cost of investment by the parent and as a capital contribution by the subsidiary. Interest is recognised in future years as the 'benefit' unwinds. This is summarised below.

	Yr 0	Yr 1	Yr 2	Yr 3
Dr/(Cr)	£000	£000	£000	£000
In subsidiary				
Profit and loss				
Interest payable	-	43	45	48
Balance sheet				
Liability	(864)	(907)	(952)	(1,000)
Capital contribution	(136)	(136)	(136)	(136)
Dr/(Cr)				
In parent				
Profit and loss				
Interest receivable	-	(43)	(45)	(48)
Balance sheet				
Investment in subsidiary	136	136	136	136
Loan to subsidiary	864	907	952	1,000

In the scenario where a subsidiary makes an interest-free loan to a parent, the "difference" given to the parent is akin to a distribution by the subsidiary, or a dividend in other words, which then appears as income for the parent. The effect of this on the subsidiary and parent is summarised in the table below.

	Yr 0	Yr 1	Yr 2	Yr 3
Dr/(Cr)	£000	£000	£000	£000
In subsidiary				
Profit and loss				
Interest receivable		(43)	(45)	(48)
Distribution (shown in equity)	136	-	-	-
Balance sheet				
Loan to parent	864	907	952	1,000
Dr/(Cr)				
In parent				
Profit and loss				
Interest payable		43	45	48
Distribution from subsidiary	(136)	-	-	-
Balance sheet				
Loan from subsidiary	(864)	(907)	(952)	(1,000)

As you can see from the tables, no interest being charged does not, necessarily, mean there is nothing to record under FRS 102.

LOANS WITH DIRECTORS AND SHAREHOLDERS

The same principles also apply to interest-free loans between a company and its shareholders. A "cheap" loan from a shareholder should be accounted as a capital contribution and a "cheap" loan to a shareholder as a distribution.

Where there is a loan with a director who is not a shareholder, the shortfall to a market rate of interest should be accounted for as interest income or interest expense as appropriate.

EXCEPTIONS

As with rules there tend to be exceptions and FRS 102 is no different.

Under FRS 102 interest free loans which do not have formal repayment dates, i.e. those which are payable on demand, short term liabilities or those that arise from inter group trading, are not required to be fair valued. Management therefore may face choices when passing funding to subsidiaries at favourable rates: are those loans to be classified as current liabilities with negative impacts on current assets, or, are those loans to attract notional interest following fair value adjustments? However, there may be a trade-off between wanting to formally defer loan repayments to improve the commercial presentation of the balance sheet and the added complexity of fair valuing loans.

CONCLUSION

As with many impacts of FRS 102, the effect on the look of financial statements and reported results will need to be considered carefully by finance teams and management, particularly with respect to factors such as covenant compliance, bonus calculation and KPI reporting. With companies reporting to 31 December now having passed the start date of the first year of mandatory adoption (i.e. 1 January 2015), management should review their plans for transition to FRS 102 at their earliest convenience, if they have not already done so.

WHEN IS A TOGC NOT A TOGC?

INTRODUCTION

In the past, it has been well recognised that the, so called, Transfer of a Going Concern ("TOGC") is outside the scope of VAT; accordingly consideration payable on the purchase of a trade and assets, so transferred, did not attract VAT. However, as is often the case with VAT, the reality is not as black and white as it might seem and a recent Upper Tribunal judgement reinforces the difficulties businesses can face when dealing with TOGCs.

HMRC's own document, "VAT Notice 700/9: transfer of business as a going concern", seeks to explain whether or not a business is a TOGC for VAT purposes and even contains two sections dedicated to property transactions. This Notice includes a number of scenarios where it accepts that the transfer qualifies as a TOGC for VAT purposes and others where it does not. One of the examples given as a transaction that qualifies as a TOGC includes the following:

> *"own a property and have found a tenant but not actually entered into a lease agreement when you transfer the property to a third party (with the benefit of the prospective tenancy but before a lease has been signed) there is sufficient evidence of intended economic activity for there to be a property rental business capable of being transferred."*

This sounds clear enough but care is needed, especially in light of the recent Upper Tribunal case which is explained below.

BACKGROUND TO THE CASE

The case that emphasises the need to read the statement above with a degree of caution is the decision of the Upper Tribunal judgement relating to the Royal College of Paediatricians and Child Health.

The Royal College acquired the freehold of a building in Theobalds Road, London from a company called Coleridge (Theobalds Road) Limited ("Coleridge") which was treated as a TOGC and, accordingly, VAT was not charged on the sales price of £17,445,000. However, two years after the sale, HMRC formed the opinion that the transaction did not qualify as a TOGC and, since Coleridge had previously opted to tax the building, VAT was due on the purchase price.

With the Royal College's activities being such that it could not recover most of the input VAT it incurred, this opinion created an unexpectedly large additional cost to acquiring the freehold. In view of the College's VAT standing, it had been extremely important to the Royal College that the transaction qualified as a TOGC in order that it did not incur VAT it could not recover.

Prior to moving to Theobalds Road, the Royal College had occupied premises at Hallam Street in London where, apart from occupying the premises for its own use, it had sub-let the premises to two other organisations, the British Association of Perinatal Medicine ("BAPM") and the British Association for Community Child Health ("BACCH"). Following a major refurbishment, Coleridge placed Theobalds Road on the market and the Royal College expressed an interest in purchasing the building. BAPM and BACCH also expressed a wish to move with the Royal College and remain its tenants.

As mentioned previously, the Royal College could not recover most of the VAT it incurred, so it was extremely important that the transaction qualified as a TOGC. The Royal College's advisers suggested that if BAPM were to enter into a lease with Coleridge prior to the sale, then Coleridge would be carrying out a property rental business and the transfer would be capable of qualifying as a TOGC in line with HMRC's published guidance.

BAPM duly entered into such a lease with Coleridge but the agreement was conditional upon Coleridge exchanging an unconditional contract for sale of the property to the Royal College. The rent due from BAPM to Coleridge only became payable after completion of the sale and the premium paid by BAPM to Coleridge was also repayable if the sale to the Royal College did not go ahead.

THE ARGUMENTS

The Royal College challenged HMRC's decision that the transaction was not a TOGC at the First Tier Tribunal and won. HMRC then appealed to the Upper Tribunal.

The Upper Tribunal held that for TOGC treatment to apply two things had to happen: firstly, an asset had to be transferred; and secondly a business, or part of one, also had to be transferred. The Upper Tribunal test was therefore one of substance, not of form.

It went on to say that BAPM wanted to become a tenant in the new building, but that was because of its pre-existing relationship with the Royal College, who had introduced BAPM to Coleridge. The Upper Tribunal considered that, in no sense, was BAPM transferred as a tenant or putative tenant to the Royal College by Coleridge, as it was already a tenant in the old premises.

The Upper Tribunal commented that BAPM's agreement with Coleridge was not what had caused it to become a tenant of the Royal College, but had the lease (or agreement to lease) been a part of Coleridge's business then the transaction would have been capable of being a TOGC. In this case, the agreement for lease was not a part of Coleridge's business as the putative tenants came from the Royal College. The agreement arose directly from, and was simply part of, the sale transaction and that, since no part of the seller's business was transferred to the buyer, the transaction could not be a TOGC.

It is possible that had BAPM actually paid some rent to Coleridge prior to the transaction, the judge would have found differently.

THE LESSON

It is clear from this decision, that in any situation where the purchaser is attempting to engineer a TOGC, such as by putting prospective tenants in touch with the seller, then it will be very difficult for the seller to argue that such tenants are part of its business for the purposes of determining whether the transfer qualifies as a TOGC.

Since the decision as to whether to charge VAT is a decision of the seller, then no matter how much purchasers may wish to assist a buyer it is wise to exercise caution in paying attention to the substance of the transaction and not just its legal form.

ENTREPRENEURS' RELIEF AND PROPERTY JOINT VENTURES

Entrepreneurs' relief has provided for many a favoured 10% tax rate on capital gains (compared to the full rate of 28%), albeit with a lifetime limit of £10 million.

Since the relief is directed at trades and trading companies, its relevance to the property sector is largely restricted to property development trades, including those carried on by way of joint ventures. However, its applicability to property tax planning has been restricted as a result of Budget 2015.

COST OF ENTREPRENEURS' RELIEF

Late last year, a National Audit Office report on the cost of tax reliefs to the Exchequer indicated that entrepreneurs' relief was costing significantly more than originally anticipated in the impact of policy changes approved by Parliament. For instance, in 2013-14 the estimated cost of entrepreneurs' relief was £2.9 billion against an expected cost of £901 million - more than three times that anticipated. This level of discrepancy was also seen in each of the years after 2009-10 such that some restriction of the relief was likely, given the need to address the Budget deficit.

THE CHANGES

Entrepreneurs' relief focuses on the gains realised by an individual on the disposal of an interest in a trade or partnership carrying on a trade, but also extends to gains realised on a disposal of shares held in a trading company, or holding company of a trading group. The restriction in entrepreneurs' relief, announced in Budget 2015, removed the relief from most shareholders who indirectly invested in trading companies. However, this change also, effectively, withdrew the relief for joint ventures, which was neither an obvious target nor a source of abuse.

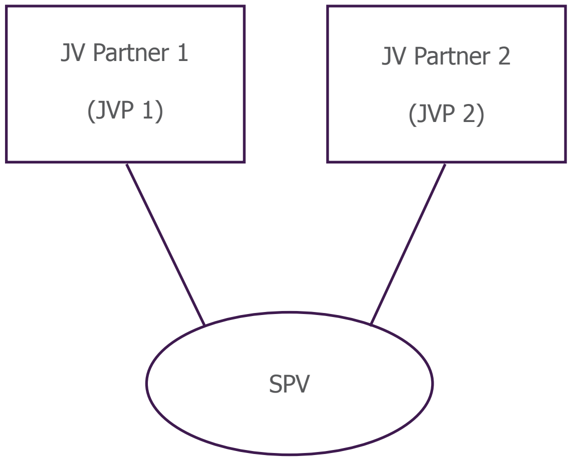
The changes may to some extent be seen and explained away as "collateral damage" arising from HM Revenue & Customs' recent efforts to restrict the tax advantages of partnerships and particularly Limited Liability Partnerships. Certainly the other significant amendment announced at Budget 2015 provides for the exclusion of corporate members of a trading partnership from the benefit of entrepreneurs' relief and it is this thought process that seems to have initiated a similar restriction for joint ventures.

JOINT VENTURES

What is the significance of the changes to the treatment of joint ventures? It is twofold: one presumably intended and the other perhaps not foreseen.

One condition of entrepreneurs' relief is that the shares disposed of, on a sale or liquidation, are shares in a trading company or the holding company of a trading group. Accordingly, a company carrying on a trade of property development (or a holding company where all its subsidiaries carry on such a trade) potentially qualifies for the relief.

A property development carried on in a corporate joint venture would typically involve a corporate SPV undertaking the development with the joint venture parties holding shares directly in the SPV. This structure is illustrated below.



Where the joint venture parties (JVP 1 and JVP 2 above) are themselves corporates, the trade carried on in the SPV was attributed to each party in accordance with their interests in the joint venture. Individuals may structure their ownership in the SPV through their own company, such as JVP 1, which would take on its share of the attributes of the SPV. It is this attribution that is perceived to give unwarranted relief and is to be withdrawn. An individual who arranged to hold his interest in the SPV through a company was treated as holding shares in a trading company (by virtue of the deemed trading) and accordingly had access to entrepreneurs' relief on a sale, or more frequently, the liquidation of his, or her, joint venture company.

The fully distributed profits of the development would therefore have borne an effective 28% tax rate: corporation tax of 20% on the profits in the SPV and then, taking advantage of entrepreneurs' relief, a further 10% capital gains tax on a liquidation of the individual's joint venture company. The share of the profits usually being extracted as a tax neutral dividend into the individual's joint venture company, say JVP 1 above. With the 10% rate applying to 80% of the pre-tax profits in the SPV this gives an effective additional rate of 8%, or 28% in total.

The benefit of this structuring has been removed by the simple expedient of "switching off" the deeming provisions. The individual's joint venture company is no longer deemed to carry on a trade by virtue alone of its interest in the SPV and entrepreneurs' relief is denied. The effect is to tax the fully distributed profits at an effective 42.4% (as a result of the capital gains tax element increasing to 28% with the removal of entrepreneurs' relief).

AN UNFORESEEN CONSEQUENCE?

The removal of the qualifying joint venture rules has a wider impact and perhaps one that was not foreseen. For a trading company (or holding company of a trading group) to qualify for entrepreneurs' relief, no significant non-trading activities may be undertaken by the company or in the group. What is "significant" is a question of fact and degree having regard to such measures as the income or profit derived from such non-trading activities or the assets or management time employed in these activities.

A property developer (whether a single company or group) carrying on a property development trade consisting of a mix of own developments and others conducted through joint ventures, structured as SPVs, will now find that their shareholding, strictly viewed, represents an investment (and therefore non trading) activity, being the simple holding of shares.

Following the changes to the joint venture rules all the taxing rules now recognise is a minority shareholding in a portfolio investment (the previous rule which provided that the holding of shares was ignored and the trading activity of the SPV attributed to its shareholders is now, of course, switched off). Clearly, if a substantial part of the company or group's activities are conducted as corporate joint ventures, and thereby are treated as an investment activity, then entrepreneurs' relief may no longer be available.

It is to be hoped that HM Revenue & Customs will take a realistic view and accept that an interest in a corporate joint venture in these circumstances is no more than an extension of the development trading activity of the company or group. However, at best, this is going to be an arbitrary line to be established on the facts of each case and will inevitably lead to uncertainty as to the entrepreneurs' relief status of a company or group.

The forthcoming Budget in July would be an opportunity to clarify the reach of the rule changes but we suspect this will not be case; instead there is likely to be a period of uncertainty before Revenue practice and interpretation is established.

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