(H)ATED! Further Problems For Limited Companies

Julie Butler looks at the increasing tax problems associated with residential property ownership through a company.

This article provides a timely reminder about the recently introduced 'property tax' (or the 'annual tax on enveloped dwellings' (ATED), to be precise) for those who own property in a limited company. There will probably be many advisers and owners who are not even aware of its powers and impact.

The ideal trading structures for various businesses (e.g. farms), has been given much consideration over the decades. For various historic reasons, some operations are owned by limited companies, which can include ownership of residential property, possibly even a farmhouse in some agricultural businesses. This can result in a multitude of problems, not least the now wide-ranging ATED charge.

The Introduction of ATED

Since 1 April 2013, non-natural persons (NNPs) holding UK residential property valued at more than £2 million on 1 April 2012 have been liable to pay the ATED. NNPs buying residential property of that value have also had to pay SDLT at 15% on the price of the dwelling. Both of these tax changes were introduced as part of a series of measures announced in the 2012 Budget, with the aim of discouraging the ownership of UK residential property through 'corporate envelopes', which was seen at the time as an advantageous tax avoidance strategy.

At the same time, the charge to capital gains tax (CGT) was extended to NNPs that are within the scope of ATED for disposals of high value residential properties. Before this measure, companies would have paid corporation tax (with current rates of 20% or 21%) on chargeable gains, rather than the normal CGT rate of 28%.

ATED 'casts a wide net'

Finance Act 2014 has extended ATED and SDLT at 15% over the next two years, to apply to residential properties owned by NNPs valued at above £500,000. For ATED particularly, two new taxable bands will be created:

- residential properties worth more than £1 million but less than £2 million will fall within ATED from 1 April 2015 (the annual charge will be £7,000); and
- residential properties worth more than £500,000 but less than £1 million will fall within ATED from 1 April 2016 (the annual charge will be £3,500).

As with existing bands, the annual charge for each of these will increase in line with the rate of inflation.

The ATED-related CGT charge of 28% payable by NNPs on the disposal of property interests will also be extended to include these lower valued properties. Again, the extension to lower values will be in two stages:

- disposals of enveloped properties with a value over £1 million up to £2 million will be subject to CGT from 6 April 2015; and
- disposals of enveloped properties with a value over £500,000 up to £1 million will be subject to CGT from 6 April 2016.

However, CGT will only apply to gains that have accrued on or after those dates.

For all limited companies (e.g. those that own stately homes, farmhouses and farmworkers' cottages), now is the time to seriously evaluate options of how to mitigate any possible penalty and to consider disclosure requirements.

Agricultural property relief on limited company ownership

Residential property owned in the limited company has suffered tax disadvantages besides the ATED, and there are more problems to consider and plan for. First, there is the question of benefits-in-kind (BIKs) for directors, and the potential income tax and National Insurance contribution expenditures to allow for. Secondly, within the agricultural market sector, there is the complex issue that farming operations owned in a limited company do not achieve agricultural property relief (APR) for inheritance tax (IHT) on minority shareholdings (i.e. shareholdings that do not control the company). It would therefore seem essential to review all properties held, to ensure tax efficiency and compliance are achieved.

How can an ATED charge be mitigated?

The new rules may result in significant compliance costs for those 'genuine' businesses that own property that are eligible for relief from ATED, but regardless of this currently there is an obligation to file an ATED return. In recognition of this problem, the Government is consulting on simplifying administration for such businesses.

The ATED extensions to lower value properties have been announced well ahead of the new rules coming into force. There should be time for NNPs who may be affected to consider restructuring their residential property holdings. However, it is important to seek advice prior to 'de-enveloping' regarding available reliefs, and the tax impact of removing residential properties from current structures.

Relief for farmhouses

In the agricultural sector, farming companies who may be affected by the extension to the ATED charge must consider the availability of the various reliefs. There is a specific relief (calculated on a daily basis) available in respect of farmhouses occupied for the purposes of a farming trade if:

- the farmhouse forms part of land occupied for the purposes of a farming trade carried on commercially with a view to profit: and
- the person carrying on that trade, or a person connected with him, is entitled to an interest in the single-dwelling farmhouse.

For a farm that is owned in the limited company, there are problems of the ATED charge when the land is let and the property is not 'occupied'. The compliance consideration of IHTA 1984, s 117 has to be considered. This could have the advantage that the 'occupation' test for IHT qualification is reviewed at an earlier stage.

A relievable day for the purposes of ATED is defined as a day that the farmhouse is occupied by either:

- a farmworker (that is, an individual substantially involved in the day-to-day work of the trade, or the direction and control or its conduct) occupying for the purposes of the trade; or
- a former long-serving farmworker (an individual who previously had been a farmworker for a period of three years or more, or periods totalling three years or more in a five year period) or the surviving spouse or civil partner of such a worker.

Substantial involvement in the day-to-day work, or the direction and control of the conduct of the farming trade equates to spending 20 hours a week (on average) throughout the year on those activities. The relief is primarily concerned with the time spent by a specific individual; this does not include the time spent by a group of individuals occupying the farmhouse. There is also relief for houses held in a limited company, such as stately homes, which are open to the public for 28 plus days per year.

Joint property

As the legislation applies to single dwellings, it is necessary to look at the position on joint property.

Occupation of part of the dwelling is to be regarded as occupying the whole of the dwelling for establishing the extent of the relief. That is to say, where only part of a single-dwelling interest is occupied for purposes that would qualify for farmhouse relief, then the whole interest will be treated as qualifying going forward.

Action plan

- All companies will have to question the tax treatment of residential properties contained therein and the ability to obtain exemption from the ATED charge.
- Where there are concerns over the disadvantages of BIKs, together with APR and now ATED, a total restructure might be reconsidered, mindful of the tax downsides and how they may impact the business.
- All legal and tax structures for operations with some corporate interaction must now be reviewed (e.g. within agriculture where the corporate partner has become de rigour for a number of businesses).

Examples: Potential reconstruction:

1. For those in a partnership with a 'corporate partner' (i.e. mixed membership), an updated partnership agreement must be actioned together with a shareholders' agreement. This must be tied into the December 2013 'corporate partner' legislation. Coupled with the loss of the annual investment allowance for capital allowances purposes, many would say the corporate partner has no future.
2. For those farms owned by a limited company, a total review of ATED, benefits in kind and APR for non-controlling needs to be undertaken with considerations for a total restructure as appropriate.

Practical Tip:

The current tax planning 'favourite' is for a 'stand-alone' limited company that runs alongside a partnership, taking advantage of the fiscal benefits of the incorporation but not complicating matters with mixed membership or farm ownership.