HMRC campaign to solve tax leakage on property

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In the first of a series of new style interventions, HMRC have begun a campaign of compliance checks into property income. The campaign targets people who receive income from property but have not disclosed it to HMRC. The recent announcement of the HM Revenue & Customs (HMRC) property campaign, i.e. that there will be compliance checks, was presumably planned before the current "credit crunch". The reality is the review will be in the aftermath of Capital Gains Tax (CGT) reform.

I. Introduction

Many small investors in property have been aiming for capital growth and have been oblivious to the disclosure requirements regarding income and the claim for expenses, e.g. interest paid often exceeded the rent received and many property owners did not see the need to disclose.

For various reasons in the current property and mortgage climate there could be some dynamic activity in the property sector with interesting tax consequences:

- Forced sales due to mortgage problems by property owners.
- "Buy to let" entrepreneurs "snapping up" properties resulting from the above point.
- Increased and planned sales due to the improved 18 percent CGT rate – but are the buyers and mortgage lenders there?

II. HMRC compliance checks

So what was planned by HMRC with regard to property compliance checks and increased tax collection?

The campaign may be part of a wider information gathering exercise as HMRC state that, "the engagement will also provide an opportunity to inform HMRC about the potential for future capital gains tax liability". Recipients should not ignore these intervention letters, even if they have not made profits on their letting or profits on property sales. The rental sector produces lots of information to which HMRC has access. Information from the Land Registry and stamp duty details are freely available. Voters lists and local authority records are often reviewed.

HMRC have said that, where the taxpayer has authorised an agent to act for him, they will send the query to the agent, with a copy going to the taxpayer.

III. Property disposals

When a property is sold there could be a CGT liability. Many taxpayers might be unable to sell their property when they planned to due to the credit crisis and they may be forced to let out the property. There are a number of taxpayers who are unaware of the "main residence letting relief".

So how does the relief work?

Provided that at some time during the period of ownership, a particular property has been the only or main residence (by fact or election), the gain attributable to a period of letting is relieved, up to a limit under section 223(4) of the Taxation of Chargeable Gains Act 1992.

The amount relieved is the lower of the amount protected by owner occupation relief and £40,000. The lettings relief is given to both the husband and wife provided that at the time of the letting he/she had an interest in the property. This does provide an opportunity for future planning points.

IV. HMRC looking to solve tax leakage

There have been press reports following a number of meetings between professional bodies and HMRC, at which HMRC expressed its concern about what it perceived to be substantial tax leakage in the area of property.

In the last decade there has been a large rise in the number of people owning more than one property. Some properties are purchased as holiday homes or to help children onto the property ladder. Many more investors look to let-out the additional property and, in due course, realise a capital gain on their investment. There has been a large amount of non-disclosure which is often through ignorance.

V. Accountants looking to provide a support structure to the property market

Perhaps most firms of accountants would benefit from a "property helpline" to deal with all the problems that are facing clients and potential clients.

It would appear that there are a large number of potential new clients needing help and advice on both the property tax compliance and planning and then everything will run much smoother if the property owner makes a "proactive" visit to a firm of accountants for help as opposed to a "reactive" visit once HMRC have contacted the property owner with a number of questions.

VI. Empty property and VAT

It might seem all doom and gloom for those with a property empire but there is some good news to present. Should the property have to stay empty for two years then there is a VAT advantage. Regulations have been published to amend paragraph 3 of the Notes to Group 7 of Sch. 7A, Value Added Tax Act 1994. The effect of the change reduces from three years to two years the period of time for which qualifying residential premises must be empty before supplies of qualifying services and building materials used in their renovation or alteration may be charged at the reduced rate of VAT of five percent.

Phew! What a relief for all those landlords who might have property that they want to let out, stand empty whilst the mortgage interest racks up. When the property has to be renovated/altered there will be a reduced rate of VAT. Thank heavens!

VII. Sympathy with HMRC

HMRC must be faced with quite a dilemma. Property is clearly an area of potential extra "tax take" (someone has to pay for the hospitals and schools) and one that must be featured regularly on the HMRC "shop online" service, i.e. neighbours and contacts who know some property owners are escaping the "tax net" and the tax compliance. However, there is financial suffering by families in the current climate and a sensitive approach will be required.

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