



## 'Opt to tax' – action! Last year as a teenager!

On 1 June 2008, HMRC introduced changes to the 'option to tax'. The main purpose of these changes is to give clarification to the first revocations on 1 August 2009, 20 years after their introduction on 1 August 1989. The VAT regulations of 'opt to tax' are currently 'teenagers', but from 1 August 2009 some of the original elections can be revoked, which needs planning and possible action.

With so many farm buildings that have been converted into 'commercial lets' over the last 20 years, the opt to tax election and an understanding of the regulations have become regular work for the farm accountant/adviser. The following are the basic rules.

- The option cannot be made in relation to a residential property.
- An option to tax election can be made by writing to HMRC, so that all future income generated by a property becomes taxable (standard rated) rather than exempt. This election then enables input tax recovery to be made on related costs.
- Rental income from property is exempt from VAT in most cases – the disadvantage of this is that any related input tax on costs incurred on the property (overheads, refurbishment or the cost of the property itself) cannot be reclaimed for input tax purposes as the input tax relates to an exempt supply, hence the advantage of the option.
- Once an election has been made, it cannot be revoked for 20 years, except through an initial 'cooling-off' period.
- The 'cooling-off' rules have been amended as part of the June 2008 changes.

## The rule changes from 1 June 2008

It will now be possible to revoke the election, causing all rents and any sale of the property to be exempt. The following are the changes (see Tax Faculty article below for further changes).

- Introduction of rules governing the revocation of an option to tax after 20 years.
- Introduction of a new way to opt to tax (a real-estate election), which does not require individual notifications of each option.
- Provision that, in future, an option to tax applies to land and buildings on the same site – with a special transitional rule for existing options.
- Automatic revocation of an option to tax after six years if no property interest has been held during that time.
- Introduction of certificates to 'disapply' an option to tax for buildings to be converted into dwellings and for land to be supplied to housing associations.

## Planning opportunities

Just like teenagers, buildings are expensive to maintain, and it might be sensible to consider a repair plan prior to revocation. This is a good opportunity to warn clients of the changes from 1 June 2008 and the planning opportunity provided by the 1 August 2009 birthday. With the current housebuilding collapse and the development land bank value crisis, this is a time to be reviewing all property opportunities – is commercial property the way forward?

## Revocation conditions

What are the revocation conditions as from 1 August 2009?

- **Valuation condition.** In the 10-year period before the option to tax is revoked, there must have been no relevant interest in the building that was made at less than open-market value (e.g. undervalued rents).
- **No input tax adjustments needed under the Capital Goods Scheme.** The Capital Goods Scheme mainly applies with regard to the purchase of certain buildings and building works that exceed £250,000 – input tax is adjusted over a 10-year period;
- **The 20-year time period.** The taxpayer must have held a relevant interest in the building or land at the time when the option first took effect, and provided that 20 years have now passed.

It is important to plan for all forthcoming applications.

## Automatic revocation

- The new regulations make it clear that an option to tax land applies equally to a building upon the land (including a building that has yet to be built). This revokes HMRC's previous policy of allowing land and buildings to be separately opted.
- An option to tax election is treated as automatically revoked where the opter has held no relevant interest in a building for six years. For example, if a building was sold by the 'opter' in May 2002 (and no other use or occupation of the building has been made since then), the option to tax is automatically revoked in May 2008. (There are some exceptions to this clause in relation to group companies.)

## Summary

With the well-publicised property market dilemma, a large number of tax advisers will be working with their clients on how to survive the next few months and years. Consideration of commercial property cannot be reviewed without the understanding and interaction of the opt to tax rules.

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