

Practical issues relating to ATED (Lecture B1310 – 16.42 minutes)

The Annual Tax on Enveloped Dwellings (ATED) is an annual tax charge which is levied on owners of residential properties valued in excess of the threshold amount which are 'enveloped' ie held by non-natural persons. There is an associated 15% SDLT charge on the same properties.

It is important to acknowledge that these are anti-avoidance provisions which often work in a very punitive way but this was in response to widespread avoidance of tax, particularly SDLT, by use of overseas property holding structures and HMRC are unapologetic about the way the provisions work. We are also seeing an increase in the compliance work being done by HMRC on ATED, mainly in relation to SDLT.

Here we are going to look at some practical issues, including areas which HMRC are challenging. However, we will first look at the basic principles.

The basic principles of ATED

ATED is charged where the following conditions are met:

- There is a chargeable interest which is a single-dwelling interest;
- The asset is beneficially held by a company, partnership with a company member or collective investment vehicle;
- The asset has a taxable value over the threshold.

It is payable for each year, or part year, for which the conditions are met. The current threshold value is £500,000.

This value is applied to each individual dwelling or property which is in the process of being constructed or adapted for use as a dwelling. Land occupied as part of the dwelling as garden or grounds is also taken into account in the valuation. Valuation issues are discussed below.

Some properties are specifically excluded from being treated as dwellings such as residential accommodation for school pupils, care homes, hospitals (and others).

ATED is levied according to a banding system based on the value of the dwelling. The current charges are as follows:

| Value of property | 2022/23 | 2021/22 |
|---------------------|---------|---------|
| £500,001 to £1m | 3,800 | 3,700 |
| £1,000,001 to £2m | 7,700 | 7,500 |
| £2,000,001 to £5m | 26,050 | 25,300 |
| £5,000,001 to £10m | 60,900 | 59,100 |
| £10,000,001 to £20m | 122,250 | 118,600 |
| Over £20m | 244,750 | 237,400 |

These charges apply for the whole year but can be pro-rated where the charge applies for only part of the year. So if a property is only acquired part way through the year, the charge will only apply for the period when the property is held.

Since this is an anti-avoidance provision, HMRC acknowledged that there must be reliefs and exemptions from the charge in (what they consider to be) genuine commercial scenarios and so genuine businesses should be exempt from ATED.

The following are exempted from the charge:

- Property rental businesses;
- Rental property being prepared for sale;
- Dwellings opened to the public;
- Property developers;
- Property traders;
- Financial institutions acquiring dwellings in the course of lending;
- Regulated home reversion plans (from 2016);
- Occupation by certain employees or partners (changed in 2016);
- Caretaker flats owned by management company (from 2016);
- Farmhouses;
- Providers of social housing;

Each of these have their own conditions and it is important to be aware of the pitfalls, some of which are discussed below.

Returns

Where tax is charged on a person for a chargeable period will respect to a single-dwelling interest, the person must deliver a return for the period. A claim for relief must be made in the return or by amending the return, although there is a simple claim form for reliefs.

A return must be made within 30 days of purchase and then each year, even if no liability arises because there is a relief being claimed. For new builds the return has to be made within 90 days of completion (being completion for local authority purposes so when adopted for council tax purposes) or the date occupied if earlier.

Not surprisingly, many returns are filed late and normal penalties apply even if no tax is due. The Tribunal have been reluctant to allow appeals against penalties for failure to submit returns in those cases which have reached the First Tier Tribunal other than cases where there had been a procedural failure by HMRC (Heacham Holidays Ltd [2020] TC07883 being the most recent). Several appeals on the basis that penalties were disproportionate (because no tax was due) have been dismissed and arguments of ignorance of the law have not succeeded here as they would be unlikely to in relation to other compliance obligations.

Identifying the 'high value interest'

Mixed use property will need to be separated out. If a dwelling is part of a larger property, only the residential part is subject to ATED and the ATED-linked SDLT charge. This may be easy in some cases. For example, a shop with a flat over can be easily separated out into its constituent parts. However, a large residential property which is part of an agricultural holding might be more difficult as it could be problematic to work out where dwelling starts or finishes.

If there is more than one dwelling in a property (ie a main dwelling and an associated dwelling standing within the garden or grounds of the main dwelling) and they are owned by a person connected with the chargeable person, they are added together and looked at as a single dwelling where there is no separate access. Two dwellings in the same dwelling are treated as one dwelling for ATED purposes where there is private access between them. This would apply to property in a terrace, semi-detached houses or flats in a single building.

Valuations

The valuation of land for ATED purposes is not very logical. At the point at which ATED was introduced, being 1 April 2013, any existing dwellings had to be valued as at 1 April 2012. The value then has to be re-evaluated every 5 years from that initial date. The value that we are looking at in all cases is the market value, being the price that could be expected to be achieved between a willing buyer and a willing seller.

Property was therefore revalued at 1 April 2017 and there will need to be another revaluation of property at 1 April 2022 which will impact rates of ATED from 1 April 2023. If the property is acquired after any of these dates, then it is valued at the acquisition value at the time of purchase and then revalued at the same dates.

Those to whom the charge applies will need to self-assess the value of the property. There is no obligation for the value to be established by a professional valuer but, of course, HMRC can challenge any ATED return and this includes being able to challenge the valuation.

It is possible for a taxpayer to ask HMRC to agree the valuation before the return is submitted by asking for a Pre-Return Banding Check. However, this is only available for those who believe that their property valuation falls within a 10% variance of a banding threshold. In fact, HMRC will only agree to the banding proposed and not comment on any formal valuation. It is also stressed by HMRC that this confirmation cannot be used for any other purpose by the taxpayer. HMRC can still also enquire into a return which is based on the PRBC.

Use of property

The reliefs from ATED focus on the use of the property. However, the SDLT provisions look at the purpose for which the property is purchased. If the conditions for relief are breached in the first three years of ownership, then there may be additional SDLT to pay on the purchase.

Use of property issues were discussed in *Hopscotch Ltd v R&C Commrs* [2020] BTC562. The company, resident in the BVI, had acquired a property in London in 1993 for £1.25m but then did nothing with it. They tried to sell it for £13.5m in 2011 but then decided to renovate it so as to improve the chances that a sale could be achieved. It was remarketed in 2017 at £15.9m but was unsold at the date of the hearing even though the price had again been reduced. Relief had been claimed from 2016/17 year from ATED (even though it had been paid in previous years) on the basis that it was carrying on the trade of property development.

HMRC dismissed this argument having considered the badges of trade and this view was confirmed by the FTT and then the UT. There was simply insufficient evidence to support a view other than the work was being done to facilitate a sale and this was not a trading activity.

Another case which addressed this point was Pensfold [2020] TC07609.

Pensfold was a company registered in the Cayman Islands. On 12 January 2017 the company acquired Pensfold Farm, including 27 acres of land previously used for grazing for £2,825,000. The plan was to develop the property at Pensfold Farm into an eco/agritourism venture. The intention was to add a tennis court and changing facilities in an existing barn, to create a new lake, introduce alpacas as well as rare breeds of sheep, pigs and cattle and provide facilities for ponies and an entertainment barn. The project was delayed after purchase while the state, and possible uses, of the land considered. The return was made on the basis that this was non-residential property but HMRC believed it was residential and that the 15% rate was due.

Relief is available if the property was acquired “with the intention that it will be exploited as a source of income in the course of a qualifying trade” with “reasonable commercial plans” in place to carry out that intention without delay, “except so far as delay may be justified by commercial considerations or cannot be avoided”. HMRC had challenged the extent of realistic plans for the site.

The First Tier Tribunal was satisfied that the trade exemption was in point as there was a clear intention to carry out their trade; the law only required 'reasonable commercial' plans to be in place, rather than the detailed plans suggested by HMRC. There was no requirement for the trade to actually be carried on for the relief to apply. Further, The Tribunal confirmed that the delays, to draw up detailed plans and to await the outcome of HMRC's enquiry, were clearly for commercial reasons.

The most problematic of the reliefs is that which relates to property which will be used in a qualifying property rental business. This is because the relief is not available if there is occupation of the property by a 'non-qualifying individual' although it is important to note that the definition of this term includes non-individuals. It is a very wide definition.

In the case of Fish Homes Ltd [2020] TC07666 the company acquired a two-bedroom flat in a block in Greenwich to add to an existing property portfolio. However, it transpired that the flat was in a block with cladding similar to that used in Grenfell meaning that the property could not be let out on a formal tenancy agreement. Whilst work was going on to rectify the problem, the property was occupied by the shareholders' eldest daughter and a friend of hers. The initial SDLT return had been completed without payment of the 15% charge because the property was intended to be used in a property rental business but HMRC opened an enquiry on the basis that either that was not the intention at the time of purchase or that the daughter's occupation within 3 years meant that the relief claimed was clawed back. The appellants tried to argue that the property was not a dwelling (following a judgement in the case of P N Bewley Ltd [2019] TC06951 which related to the 3% supplement but which hinged on the status of the property) because of the failure of the building to comply with building regulations due to the cladding. However, the FTT found that this in itself does not render a building being incapable or unsuitable to be used as a dwelling since many people live in houses built under earlier regimes which would not comply with current regulations. On that basis the claw-back of the relief was correct.

This was reinforced in the case of Waterside Escapes Ltd [2020] TC07881.

Waterside Escapes Ltd ran a holiday property rental business.

In June 2015, the company bought a property from Bewl Holiday Homes LLP for £1,250,000 and paid SDLT totalling £68,750 on the basis that it had acquired the property exclusively for the purposes of its holiday letting business. The LLP's members were a married couple, each holding a 50% interest in the partnership. The wife also held 50% of the shares in Waterside Escapes Ltd, with the remaining shares being held by a trust whose shares were acquired on the day that the property was bought.

The First Tier Tribunal rejected Waterside Escapes Ltd's argument that the 15% rate did not apply, as the property was not acquired exclusively for use in a rental business. The Shareholders' Agreement allowed shareholders to use the property for up to five days per annum. The Tribunal concluded that the 15% rate should have been paid as a non-qualifying individual was permitted to occupy the property for up to five days a year.

There was a partial victory relating to the chargeable consideration but the principle was established that the small entitlement to occupation brought the ATED provisions into play.

The very prescriptive nature of the reliefs was highlighted in the case of Sequence Care Group Holdings Ltd [2018] TC06475 which purchased a large residential property which was to be converted into a care home. Relief from the ATED linked SDLT charge is only available where it is intended that the residential property is to be exploited as a source of income in the course of a qualifying trade. A care home is not a residential property for these purposes so the intention to convert denied the relief although the legislation has now been amended to allow this to occur.

Contributed by Ros Martin