

Welcome

Welcome to this special edition of the **wkproperty** in which we take a look at some of the current burning issues faced by the industry.

After the recent mixed Budget, house builders could be some of the biggest winners. The £600 million extra finance earmarked for 10,000 additional affordable homes this year is not in itself a massive boost, but taken with the underwriting of mortgages and the albeit limited stamp duty concessions, it might help the property and construction industry to begin to see the 'green shoots of recovery' that everyone is talking about.

Indeed, house starts, sales and mortgage lending increased very slightly in March and April of this year. Could these be the start of a slight recovery in the industry?

What is 'impairment' – and how could it affect your business?

Impairment is a term used within UK accounting standards and is defined as "a reduction in the recoverable amount of a fixed asset or goodwill below its carrying amount". It is used to ensure that these types of assets are recorded at no more than their realisable value to the business. In summary, fixed assets or goodwill are regarded as impaired when either the net realisable value or the "value in use" is lower than the book value of the relevant assets.

The applicable accounting standard is Financial Reporting Standard No. 11 (FRS 11). The subject of an impairment review is of particular relevance to property companies in the current economic climate but assessment can be quite an arduous and time consuming process. Accordingly, FRS 11 suggests that evaluation of assets and goodwill should only be undertaken if there is evidence of impairment.

What are the normal indications of impairment?

Depending on the industry in which you work, signs of impairment can include:

- > **a current period operating loss in the business in which the fixed asset or goodwill is involved;**
- > **a significant decline in the market value of the asset during the period;**
- > **evidence of obsolescence or physical damage to the asset;**
- > **a significant adverse change in the business or in the market in which the asset is involved, or a reorganisation, such that the asset can no longer be used for any reason or has become surplus to requirements;**
- > **a major loss of key employees in the business;**
- > **changes in interest rates and other assumptions used to calculate the asset's future "value in use".**

Identifying the true cost

FRS 11 is designed to ensure that fixed assets and goodwill are recorded at no more than their recoverable amount. It considers how you should treat any impairment loss which becomes apparent, and tries to ensure that sufficient disclosure is given to enable users of financial statements to understand the impact of impairment.

So for example, if you are intending to dispose of an asset on a planned date, the depreciation charge should be adjusted so that the asset is written down to its expected net realisable value on the planned sale date. The asset's net realisable value is the amount for which an asset can be disposed of, less any direct selling costs. Direct selling costs include legal costs and the costs of removing a sitting tenant but they do not include reorganisation costs e.g. redundancy costs linked to the sale of a property.

'Value in use' and future cash flow

FRS 11 defines 'value in use' as the present value of the future cash flows from the asset's continued use. However, it adds that, where a fixed asset is not held for the purpose of generating cash flows, an alternative measure of its service potential may be more relevant.

Individual assets should be reviewed where possible, but it will often only be possible to test groups of assets. The review should compare the carrying amount (the book value after depreciation) with net realisable value, or value in use if higher. The latter can be difficult to calculate, involving prediction of future cash flows and use of a suitable discount rate. Note however that it will only need consideration if net realisable value is less than carrying value.

Save time and stress by calling in an expert

An impairment assessment can sometimes be quite complex, involving individual assets and groups of assets which can be difficult to calculate. Some assets, such as property, will usually need the help of an expert to provide a formal or, at least, a "desk-top" valuation to assist in identifying current values. Other assets that do not have a readily ascertainable market value may need the assistance of your accountants to produce calculations to produce the "value in use". If you suspect that any of your company's fixed assets or goodwill have been impaired in recent years, it could make good financial sense to call on the help of Wilkins Kennedy specialist advisors who will be pleased to assess the possibility of impairment and its effect on your business.

To find out more, contact contact Steve Golder on 0207 403 1877 or email steve.golder@wilkinskennedy.com. Or simply put a call in to your nearest Wilkins Kennedy office.

In this issue New 'gold standard' to see off cowboy letting agents
Can't sell a new-build house? Take care before you rent it out
 Thinking about a bank loan? Watch out for loan covenants?

Can't sell a new-build house?

Take care before you rent it out

If you're a house builder having trouble selling a new home, you might, quite logically, be tempted to rent it out until house prices pick up again.

However, under HMRC regulations, you might be letting yourself in for some complex potential VAT problems.

Due to the current slowdown in the residential property market, some house builders are deferring their intended sales of dwellings and temporarily letting instead, and so becoming partly exempt.

As you're probably aware, if a new house is sold freehold or on a long lease (over 21 years in England; 20 years in Scotland) you can reclaim all of the VAT incurred on your Property costs.

However for short leases or lettings HMRC can insist on a claw-back of some of the VAT incurred on building and development costs.

Put simply, the reason for this is that VAT on freehold sales is rated as zero, so you can recover all the VAT, whereas short lettings of new property are VAT exempt – so you have no right of VAT recovery.

How to check your position

For many house builders the amount of 'exempt input tax' related to their temporarily lets is small (known as de minimis) and as a result they can continue to recover all of their input tax; but they must check to avoid VAT mistakes.

If you are in a large building firm you may already be partly exempt and familiar with operating a partial exemption method. However smaller building firms may not be so aware of the intricacies surrounding the whole area.

The 'de minimis' is a simple check which is based on the expected time period you will be letting your property as a proportion of the economic life of that Property, which for VAT purposes is ten years.

How de minimis works

Your exempt input tax is determined by applying the proportion to your total input tax. Provided your exempt input tax does not exceed £625 per month on average (up to £7,500 per year) and is not more than half of your total input tax, then your exempt input tax is de minimis and you can recover it in full. What's more, the 'de minimis' test applies to the total input tax incurred – including for example any input tax on general overheads such as bookkeeping costs.

However, if your building or buildings do not qualify for de minimis exemptions, you will almost certainly have to do one or more of the following:

- > **adjust the VAT previously recovered on your submitted VAT returns**
- > **restrict the VAT to be recovered on your current and future VAT returns**
- > **both adjust your past VAT recovery and restrict your future VAT recovery.**

So, for example...

Let's assume you have recovered £20,000 input tax on a house that you originally expected to sell for £300,000. Because of market conditions, at the end of the tax year you decide to defer the sale by letting for two years and so become partly exempt. A simple check for de minimis is:

$\text{£20,000 input tax} \times 2 \text{ year lease} \div \text{a 10 year expected economic life of the Property (the standard)} = \text{£4,000 exempt input tax}$

The £4,000 of exempt input tax is de minimis because over the tax year it does not exceed £7,500 or 50 per cent of your total input tax. So there is no need to adjust the VAT previously recovered on your VAT returns. If the input tax was incurred over more than one tax year, the de minimis test should be applied to the input tax incurred in each of the tax years separately.

A word of warning

The starting point for the repayment of VAT when you rent a house is the moment you decide to rent it – not when you sign leases – so you could be liable to VAT even though there is no rental yet coming in.

It's well worth seeking advice

Naturally this article is only an outline of the VAT situation on letting new houses. If you are not familiar with all the complex issues that lie behind the legislation, contact Peter Salter on 0207 403 1877. Or simply put a call in to your nearest Wilkins Kennedy office.



Most people complain about tax – but **are you claiming all your allowances?**

Many businesses and people complain about the seemingly increasing tax burden in the UK. But how can you be sure your business is claiming everything it is entitled to? The following brief guide might highlight some areas where you could be entitled to claim valuable refunds from the government.

There are a large number of areas where businesses can reclaim tax on buildings, plant and machinery – and even up to 150% of land remediation costs if that is included in your sphere of operations!

The various capital allowance schemes mean that when you buy certain new equipment or invest in buildings or research and development, you can deduct a proportion of the cost from your taxable profits and reduce your business tax bill. All of which is good news for your business, especially if you need to invest to fund growth.

Here we give a brief overview of the main areas where you could claim.

Fixtures within Properties

Whenever you purchase a property, a certain part of the cost will be attributable to fixtures which will qualify for capital allowances. This is often forgotten and can lead to large potential refunds being due to your business.

Since April 2008, certain integral features (such as lifts, heating systems and thermal insulation) will benefit for a 10% allowance per annum. Plant and machinery which is not an 'integral feature' will be available for relief 20% per annum.

If you have purchase a building within the last few years, we would recommend that you review the level of capital allowances which were claimed.

Contaminated Land

If your company has acquired land which is contaminated, then you should be able to claim tax relief for 150% of the costs incurred in cleaning of the land. If the company is in a lossmaking position, it is possible to surrender the loss for a repayable tax credit.

Annual Investment Allowance (AIA)

From April 2008 businesses are now able to obtain tax relief for the full cost of plant and machinery up to £50,000 per annum.

In addition, from April 2009 for one year only, your business can claim a 40% first year allowance on the cost of additions in excess of the AIA.

Furnished Holiday Lettings (FHL)

The favourable tax treatment for FHL will be withdrawn from April 2010. This does create a window of opportunity to obtain tax relief for certain expenditure under the AIA. Until April 2010 FHL treatment will be extended to properties in other EEA countries. Therefore, you may want to consider amending previous tax returns to obtain tax relief.

Enhanced Capital Allowances (ECA)

There is a 100% first year allowance for expenditure on 'energy-saving' plant and machinery. Most manufacturers will now advertise their products which comply with the ECA rules, but if you are not sure you can check at www.eca.gov.uk. This allowance will provide a cash-flow boost when it is most needed.

Industrial Buildings Allowance (IBA)

A key factor in any renovation or refurbishment is the allocation of expenditure between repairs, fixtures or plant, and property improvement. Previously property improvements in certain buildings would qualify for 4% IBA, but from April 2011 there will be no such relief. This makes negotiation with the Revenue a crucial factor and the WK Property team are well versed in such matters.

If you need help identifying the capital allowances your business could be eligible for, simply contact your nearest Wilkins Kennedy office, or contact our Property & Construction team on 01689 827 505

- > 150% relief for land remediation
- > Window of opportunity for holiday lets



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At last, an end to bad practice

For years, the private residential lettings industry has had something of a poor reputation caused by unprofessional and unethical letting agents. The root problem was that whilst the large majority of letting agents are extremely professional, a small number of rogue agents has tarnished the image of the profession.

In order to offer assurance and protection to consumers and landlords, the Association of Residential Lettings Agents (ARLA) has just launched a Licensing Scheme for its members, thus ensuring the highest standards for letting agents in the UK.

Ruth Lilley, Head of Membership and Professional Development of ARLA, said: "ARLA has lobbied the Government for 10 years to assist us in establishing higher industry standards. For too long the rental sector has been seen as the black sheep of the property market with a lack of regulation of and a requirement for redress to protect the consumer when the agent's failings are to the financial detriment of that consumer.

"The ARLA Licensing Scheme will create the gold standard for letting agents in the UK, offering consumers best practice service and advice – as well as a commitment to the protection of their money."

Put simply, the effect of the new legislation will mean that all ARLA members will need to be licensed as part of their membership, which includes the following implications for every member who will have to:

- > **hold a gold standard professional qualification relating to lettings;**
- > **undertake Continuing Professional Development;**
- > **ensure they have client money protection schemes in place to protect all tenant and landlord funds held by their office;**
- > **undertake an annual independent audit;**
- > **have professional indemnity insurance in place;**
- > **sign up to an independent redress scheme;**
- > **abide by a strict code of practice.**

Until this new legislation was introduced early in May 2009, none of the above was compulsory for letting agents. ARLA's sister organisation, the National Association of Estate Agents (NAEA) will follow suit with the launch of its own licensing scheme later this year.

A move warmly welcomed by many organisations

Adam Sampson, Chief Executive of Shelter, said: "It is high time the government acted to introduce statutory licensing for all letting agents, something that Shelter has been campaigning about for some time. We welcome ARLA's new licensing scheme and its commitment to raising standards in the sector. All consumers should have the right to expect a professional letting service, and have access to redress when problems arise."

Simon Gordon, Head of Communications, National Landlords Association said: "We very much welcome this latest development as another push to raise standards within the private-rented sector. Letting agents are in a particular position of trust between landlords and tenants and their practices must be above reproach. The ARLA Licensing Scheme should go a long



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Letting agent and ARLA President David McMaster commented: "As an agent, this is something I have been campaigning for for years. Having a license helps me to set my business apart from all the unscrupulous, untrained and unethical agents who I hope will one day be ousted from the market because of this scheme."

Richard Beamish, Chief executive of Asset Skills, the Sector Skills Council for the property industry, said: "Letting agents often suffer unfairly with their public image despite most being honest, well run businesses. We have long pushed for minimum standards in estate agency and fully support ARLA's licensing scheme for letting agents. We believe it will go far in improving public perception of the profession."

Even the Trading Standards Institute is delighted

Paul Ramsden, Deputy Chief Executive, Trading Standards Institute, commented: "The absence of Government regulation of letting agents has long been a concern for TSI. We have in the past, and continue to, call for tighter controls of this sector. In general, but even more so during these difficult times, people will leave themselves vulnerable to letting agents intent on reaping the benefits of the regulatory gap in which they operate".

And finally...

Richard Capie, Director of Policy and Practice, the Chartered Institute of Housing, said: "The UK housing market needs far-reaching wide-scale, holistic reform to deliver fair, affordable and flexible housing in the future. The Chartered Institute of Housing believes the Private Rented Sector is an essential part of the mix with huge potential to meet the aspirations of many people currently unable to access suitable housing. The licensing scheme represents a major step forward and will give greater confidence to tenants and housing professionals alike."

If you would like to know more about how this new ARLA protection scheme can benefit you, simply contact your nearest Wilkins Kennedy office who will be pleased to help.

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Thinking about a bank loan?

Watch out for loan covenants?

If you think you can see the green shoots of recovery and are attracted by the current low interest rates the banks are offering, take care. Not only are most banks especially slow to lend in this tough economic climate, almost all of them will insist on a series of loan covenants which put special responsibilities on your business.

The reason banks will insist on this measure is that it wants your business to protect its collateral and ensure that if there is a catastrophe of some sort, your company can still repay the loan. Not only that; it makes good sense from your point of view as well.

Make sure you understand the details

If your bank insists on a loan covenant, make sure you read and fully understand each part of the contract completely. And if there is something you don't understand – or if you want to negotiate any of the conditions before signing, don't be afraid to ask. The lender probably wants business as much as you do.

What is a loan covenant?

Put simply, a loan covenant is a condition or series of conditions with which your business must comply in order to adhere to the terms in the loan agreement. If you do not act in accordance with the covenants, the loan can be considered in default and the lender has the right to demand payment (usually in full).

Basically, the reason the banks do this – especially today – is to protect themselves in a number of ways:

- > **to maintain loan quality;**
- > **to maintain steady cash flow;**
- > **to preserve equity;**
- > **to keep an eye on the borrower's financial performance and condition.**

Read the covenants carefully – and comply with them

Typically, a loan covenant will consist of a number of conditions which must be adhered to throughout the whole period of the loan. Typically, these may include any or all of the following:

- > **insurance cover on the plant, equipment or inventory in order to safeguard against the catastrophic loss of collateral;**
- > **life insurance for the indispensable owner or manager without whom the company could not continue. In many cases, the lender will ask for an assignment of the policy;**
- > **guaranteed payment of taxes, fees, licenses. You will be asked to keep those expenses up to date as failure to pay would result in the assets of the company being encumbered by a lien from the government, which would take precedence to the one from the bank;**
- > **financial information on borrower and guarantor. You will normally be asked to submit financial statements for the continuing assessment by the bank. These are usually submitted yearly, while account receivables can be required every month.**

You might also be required to maintain a certain level in key financial ratios such as:

- > **minimum quick and current ratios (liquidity);**
- > **minimum Return on Assets and Return on Equity (profitability);**
- > **minimum equity, minimum working capital and maximum debt to worth (leverage).**

In addition, the conditions of your loan covenant might stipulate things that you cannot do such as:

- > **changing your management structure of management or arranging a merger without prior approval from the bank;**
- > **no more loans without prior approval. This is to reassure the bank that you do not take on excessive debt affecting the quality of the original loan.**

In situations where the net worth is being eroded by the extraction of capital in the form of dividends or stockholder's withdrawals, the lender might find it necessary to restrict the amount of money that can be taken out of the company.

Keep the lender up to date.

It is important that if you do anticipate problems during the period of the loan, make sure you prepare a realistic plan for getting your company in compliance and discuss it with your banker as soon as possible.

Finally, keep track of your key financial ratios on a monthly basis so you know your business is healthy and in a position to thrive.

To find out more, contact Nick Parrett on 01689 827 505 or email nick.parrett@wilkinskennedy.com. Or simply put a call in to your nearest Wilkins Kennedy office.



CIS returns: play safe by being on-time

If you're a contractor registered under the Construction Industry Scheme (CIS) make sure you send your returns in on time each month. Failure to do so without good reason can result in quite harsh automatic penalties.

Your monthly returns tell HMRC about any payments you've made to your subcontractors during the last tax month.

When late returns penalties apply

Under HMRC rules, you must get each monthly return to them no later than 14 days after the end of each tax month it is for.

And since each tax month runs from the sixth day of one month to the fifth day of the following month, it means you'll need to get your returns to HMRC by the 19th of each calendar month.

For example, if your next return is for the tax month from 6 June to 5 July, you'd need to get it to HMRC no later than 14 days after 5 July. So the deadline for that return would be 19 July.

Most importantly, if you make your returns by post, try to ensure you send them in good time to allow for any postal delays. And always make sure you sign the return. If you don't, HMRC will send it back for you to sign. But they can't give you any extra time to return it to them.

Even if you didn't pay any subcontractors during the last tax month, you'll normally still need to make a 'nil return' to tell HMRC because the same deadlines apply to nil returns.

How much do late returns cost you?

If you send HMRC a monthly return late – whatever the reason – you'll automatically get a penalty.

What's more, the basic penalties for late returns are incremental and can be quite severe.

The basic penalty for a late return with fewer than 50 subcontractors on it is £100.

If your return has more than 50 subcontractors on it then the penalty goes up by another £100 for each additional block of up to 50 subcontractors on the return.

In addition, there are extra penalties for each extra month late (continues up to 12 months) – plus an extra final penalty where a return is over 12 months late.

As you'll see from the chart below, the penalty keeps increasing with the number of subcontractors on the return. So if there were 500 subcontractors, for example, the late return penalty would be £1,000 per month – and so on.

But remember, even returns with no subcontractors on them – nil returns – also get a £100 penalty if they're late.

No. of subcontractors on the return	Penalty for late return (inc. 'nil')	Additional penalty per month	Extra penalty after 12 months
0 – 50	£100	£100	£3,000
51 – 100	£200	£200	£3,000
101 – 150	£300	£300	£3,000
151 – 200	£400	£400	£3,000

HMRC charge these penalties for each month a return is late. So if a return with 50 subcontractors on it was two months late, for example, then the total penalty would be £200. And if HMRC still haven't received it after three months, this would go up to £300 – and so on for up to 12 months.

If HMRC still haven't had a return after 12 months they add an extra final penalty charge of an amount up to £3,000.

What to do if you disagree with penalties you have been charged

Mistakes do happen and it may be that if you appeal, HMRC might agree with the reason why you're appealing. If they do, they may drop the penalty.

The penalty notice they send you will include details about how to appeal if you think the charge is unfair or not warranted. Your dealings HMRC should normally be routine but there may be occasions when you disagree with a decision made by HMRC. If this happens, you may be able to challenge the decision by appealing.

In most cases your appeal will be settled by reaching an agreement with HMRC. But if you can't agree, you can ask for either of the following:

- > a review by HMRC;
- > your appeal to be heard by an independent tribunal.

Take extra care over your returns

You might have sent them a late return with 51 subcontractors on it. Because there were more than 50 subcontractors, they would have charged you the basic £100 penalty plus an extra £100 – £200 altogether. If you later realised you'd included two subcontractors by mistake you'd need to tell HMRC about the error so they could update your return. Because the amendment reduced the number of subcontractors below 50, you should write to HMRC and ask them to reduce the penalty to £100.

But be warned, this can work both ways. If your original late return showed 49 subcontractors but you later updated it to 52, for example, they would have to increase your penalty.

If you've got any questions about a penalty notice, or you want advice on managing your returns, just call your nearest Wilkins Kennedy office who will be pleased to help.