



Law Society
of Scotland

Consultation response

Residential Property Developer Tax

July 2021



Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

We welcome the opportunity to respond to HM Treasury's consultation on *Residential property developer tax: consultation on policy design*¹ (the consultation) We have the following comments to put forward for consideration.

General comments

Overall, we consider that a sales tax model may be more appropriate than a profit-based model which excludes deductions and losses, and which will in some cases, (for example, build to rent) create a tax point before there is any realisation of an asset, which could create funding issues for developers and is not usually considered the most convenient point at which to impose a tax. This could adversely impact on build to rent developments being instigated and therefore distort supply of housing in that sector. Further, a sales tax would not require the potentially complex profit calculations and compliance by developers nor the detailed drafting of new concepts that would likely be required for the proposed models. We note that the proposed disallowance of deductions and losses in the calculation of profits for testing the £25m+ annual profits threshold may bring more developers into the scope of the tax than just those who fall within the £25m+ profits headline and this could mean greater compliance costs (with potentially complex rules) for more companies than the Government initially intended.

In considering the models set out in the consultation, it appears that the criterion for the tax is based on a two-part test of: (i) the relevant level of absolute profit; and (ii) the nature of the activity being undertaken. However, we consider there is a lack of clarity as to whether there is a third component to the test, based on the type of company or business activities which is involved. The consultation states third party contractors not connected to developers are to be excluded, and there is reference in the joint venture section to institutional investors. To consider this in the context of an example, Housebuilder A employs Contractor B to build flats; Housebuilder A enters into a golden brick contract with a housing association (land is transferred mid construction, and then Housebuilder A build out for housing association). The principle which treats Housebuilder A and Contractor B differently for the purposes of the tax is not clear.

¹ <https://www.gov.uk/government/consultations/residential-property-developer-tax-consultation>

Consultation questions

Chapter 3: Scope

1. Question: Is this definition a reasonable basis for identifying residential property in scope for the tax? Will companies be able to identify profits in scope using this definition?

We note that there are a number of definitions of residential property already in use in the tax sector. In the interests of certainty and clarity, we very strongly support using a definition which exists already. We would broadly favour use of the definitions currently used in stamp duty land tax and land and buildings transaction tax (in Scotland) which focus on the property, rather than the capital gains tax definition which is connected to a person. HMRC guidance is already available in respect of the SDLT definition.

We note the reference in the consultation document to the government's proposal to include undeveloped land or land undergoing a change in use within scope of the tax where planning permission to construct residential property has been obtained. The lifetime of residential development is often measured in decades. We favour the tax point having a clear connection to the point at which planning permission is granted, as, if property is included in scope before a grant of planning permission, it is likely to be difficult in many cases to assess the particular point at which land moves from having no residential component to having a residential component.

Residential development often involves arrangements where a developer secures some control over land through an option or a suspensively conditional contract, and so at the point in time at which planning permission is issued, it is common for the land not to be owned by the developer, and the actual purchase of the land may be contingent on other issues, such as the availability of services, including drainage, and the impact on viability of ground conditions or contamination. At the point of grant of planning permission, the allocation of an uplift in value between the landowner and the developer, and the effect on profits of the developer, is uncertain. On this basis (i) we cannot see how RPDT could properly apply to land not yet owned by a developer, and (ii) we would recommend testing the proportion of such planning permissions which then be within the net for RPDT.

We question whether the definition is to be based on use or design of the property. If it is to be based on use, it may be difficult to have certainty as to whether profits will be in scope. In addition, there may be a possible impact on market value. Such an approach is likely to make it very difficult for developers to calculate land value.

In this regard, we favour a simple definition to which certain inclusions or exclusions could be added as required.

2. Question: Do you agree with the approach to affordable housing? What are the implications for housing associations and to what extent would their taxable activities fall in scope?

No comment.

3. Question: Do you agree with this approach to communal housing?

In relation to purpose-built supported housing, we note that it is commonplace for large funds to be developed in connection with such projects and the specific flow through the fund of the tax treatment requires consideration.

There is potential that some developers may bear the costs of others if a blanket exclusion is made in this regard, for example for certain type of tax-exempt investors.

Careful consideration and definition/guidance will be required in relation to what is to be considered sufficient to meet the requirement for 'communal facilities'.

4. Question: Do you agree with this approach to student housing?

We consider that there is an overlap between the issues arising in connection with student housing and with supported housing as to what is considered sufficient to meet the requirement for 'communal facilities'.

We note the increasing use of "cluster flats" for student accommodation i.e. standalone bedroom and bathroom flats which all also have access to a communal kitchen and living space, which may or may not be connected. We anticipate issues around this and also consider that variations on this model (such as different designs) could become points of difficulty if an exclusion for student accommodation was too narrowly worded, such as the proposed "self-contained" wording.

5. Question: Is there an alternative to the approach described for retirement housing, which considers provision of care and allied services, that should be considered?

We note that the suggested approach draws a distinction between retirement housing where care and allied services are provided as an "integral part of a communal dwelling, as in a residential home," and retirement communities that "offer accommodation and communal facilities that are not reliant on care provision". In practice, we consider that the situation is much more nuanced than this. For example, while retirement communities offer accommodation and communal facilities, one of the key tenets for later living housing-with-care is that care is integral. As such, residents of retirement communities will often sign up to a minimum amount of care which can then increase according to need. We understand that this provision of care commonly determines planning use class in England and Wales.

Detailed consultation with those operating in this sector should be carried out in order for these issues and common build structures to be fully explored and understood.

An alternative would be to include all communal, student and all retirement housing and split out an amount to represent market value of income for provision of care from the ambit of the tax, or, alternatively, to include all of these types of properties and not have any split of income, but instead to impose a lower rate on such properties. Taxing all such income, albeit at a lower rate, may mean there is less of an attraction to companies to attempt to re-characterise development income as for something else. However, if such approach were to

be followed, the tax may impact on supply of such accommodation, and this may run counter to Government's intention not to affect housing supply.

6. Question: Are there additional forms of communal housing that you believe should be excluded from the definition of residential property activity for the purposes of the RPDT?

No comment.

7. Question: How should income from the development stage of build-to-rent activities be measured for the purposes of the tax? Do groups already recognise build-to-rent income in their development profits? On what basis?

The proposal to tax a notional profit (the Government's proposal being fair value of the building less development costs) at the time the building is brought into use for letting will mean tax will require to be paid despite there being no immediate income to the developer (unless a lease premium was paid). This is not usually considered a convenient or appropriate way to design or impose a tax charge.

If it is the case that the Government's interventions to support the residential property market, such as SDLT/LBTT temporary raised thresholds and cladding remediation funding, have not benefitted the build to let developers in the same way or to the same extent as the build to sell market, then it may be appropriate to simplify the proposed tax charge on these developments. For example, consideration could be given to imposing tax on only, say, the premium and/or first five or ten years rent. This brings the benefit of not needing to calculate and tax a notional profit.

We also note there would appear to be scope for disputes regarding valuations (used to establish the notional profit) to arise, and this to take up a lot of HMRC and taxpayer time.

8. Question: What are the implications of models 1, 2a and 2b for businesses?

We note that the proposal under model 1 is that "...where a company's activity includes more than an insignificant amount of residential property development activity then all of its profits would be subject to the tax.". We would be concerned that this could restrict new entrants into the residential development sector, and could result in some organisations removing themselves from this sector.

In addition, depending on the detail of any proposed significance test, the impact on a group of triggering a liability for RPDT could be disproportionate. If the application of the tax was complicated or uncertain, this could reinforce the barriers to entering the residential property development sector and increase pressures to leave it.

We consider that models 2a and 2b potentially make it difficult for an entity to calculate the tax that it is due to pay as the profit modelling is artificial and will require extra work, however, an activity-based approach (as opposed to a company-based approach per model 1) would seem to be a fairer way of introducing the tax.

Given the potential complexities, it may be appropriate for the costs involved in calculating the tax to be deductible against profits.

A surcharge on corporation tax on trading profits which arise from residential development, based on profits already calculated for corporation tax purposes (without the adjustments proposed to disallow deductions and losses) would be a simpler model to operate and the return filing obligations would not require anything additional – it would simply be a higher rate payable on such profits. We recognise that for ‘mixed’ companies, an apportionment between residential and other profits would be required.

Overall, we consider that a sales tax model may be more appropriate than a profit-based model which does not take account of deductions. The tax point in the proposed models may be before there is realisation of an asset (for example, before there is a property sale). We consider it would be appropriate for the tax to be focussed on realisation of developed assets, although appreciate that this would lower the tax base. This would allow entities to transparently pass on the tax burden to the eventual purchaser if desired. We recognise that consideration would be needed as to how this would work in the build to rent sector.

In light of the proposed 10-year period for the tax, we consider that a number of sites that will generate tax revenue will have been purchased pre-introduction of the tax. In addition, those sites which are purchased in the years leading up to the end of the proposed 10-year period are unlikely to generate a lot of revenue within the lifetime of the tax. These factors may impact tax revenues depending on how profit is calculated. In the event that a sales tax model is followed, we consider it unlikely that developers will seek to avoid taxation by delaying sales where work is already in progress.

9. Question: Which approach is preferred?

As referred to above, out of the available models, we consider model 2 is preferable, however, we have a stronger preference for a sales-based tax.

10. Question: Which of these would be administratively easier for major residential property developers to operate?

No comment.

11. Question: Where should the significance test be set for model 1?

No comment.

12. Question: What would be the best approach to achieving an apportionment for income and expenditure that is fair without being unduly burdensome?

No comment.

13. Question: To help inform the design, what are the sector’s expectations for future losses?

No comment.

14. Question: Do you consider there is any method of allowing carried forward losses, which can provide both fairness and minimal administrative burden?

No comment.

15. Question: What are the implications of excluding interest and funding costs from the measure of profits for RPDT purposes?

This will potentially involve more companies in having to perform calculations to test if they are within the scope of the tax (once their profits are recalculated leaving out certain deductions), therefore resulting in compliance-type costs even for those companies which, in the event, are not in scope.

Chapter 4: Allowance and rate

16. Question: Do you agree that the same approach regarding treatment of carried forward losses for the calculation of the profits for the tax should apply for the calculation of profits for the allowance?

No comment.

17. Question: Do you think it is more appropriate for the definition of a group for the purposes of this tax to be based on a tax rule or an accounting standard?

We consider that the tax rule seems appropriate, and taxpayers are generally familiar with this.

18. Question: Which existing definition of a group for tax or accounting purposes do you think would be most appropriate for this purpose?

No comment.

19. Question: What rules, in addition to your preferred group definition, do you consider would be required to ensure that the threshold is applied to a single economic entity?

No comment.

20. Question: What would you consider to be appropriate measures of economic participation in a joint venture?

No comment.

21. Question: What would you consider to be an appropriate hurdle for a participator becoming liable to tax in respect of the joint venture?

No comment.

22. Question: Do you have any other observations regarding the use of joint venture structures in the UK residential property development sector?

We note the proposed approach in relation to taxing joint ventures as a transparent entity. This diverts from the usual and accepted method of taxing joint ventures (where the joint venture is taxed, and credit given to the members). We consider that this will bring complexity to the legislation. As referred to above, we consider a sales tax model would be more appropriate and would help to resolve some of the complexities in this regard.

23. Question: Do you agree that these principles should guide the decision on the rate of the tax?

We consider that it is hard to see how the tax will be reflected in the market value of property. CT is not generally captured in costs of property on a residual market value basis. If the RPDT becomes relevant for calculating land value, then having a tax model which is predictable would be of greatest value. Where there is a straight-forward sale, the tax burden is likely to be able to be estimated with reasonable certainty by considering projected sales revenue and sales costs. However, we consider that there is a potential to create a two-stage market where the tax burden is theoretically reflected in the market value.

While we broadly agree with the principles:

(i) we note that the administration costs involved to establish the RPDT for a revenue of £2 billion appear disproportionate;

(ii) we are unclear as to the underlying principle which results in the figure of £2 billion as being the required tax revenue to be generated.

Chapter 5: Interaction with the Gateway 2 levy

24. Question: Do you have any initial views on the cumulative impact of the RPDT and the Gateway 2 levy?

Not applicable.

Chapter 6: Reporting

25. Question: Do you agree that the RPDT should be reported using the same periods as for CT?

We consider that it would be sensible to tie reporting for RPDT with the same periods as for CT. That said, some affected parties may be exempt from CT. It will be important to consider the interaction with greater immediacy around CT payment plans, including the development of Making Tax Digital and estimations of tax.

It is important that reporting, and if required, payment can be made efficiently. We favour adding reporting and payment to existing reporting mechanisms for CT so as to reduce the administrative burden and risk of payments being lost.

26. Question: Do you see any difficulties applying the CT rules for accounting periods to any of the models and if so, how could they be overcome?

No comment.

27. Question: For models 1 and 2a would there be any difficulties for a given company in knowing that the group's thresholds for the RPDT have been satisfied?

We consider there could be challenges here, particularly in respect of model 2a, given the artificial nature of the requirements. This could give rise to complexity around the calculation.

28. Question: If there is a requirement for separate registration, is 90 days from the end of the accounting period a reasonable timeframe?

We consider that separate registration should not be required as this creates greater complexity.

Chapter 7: Payment and Compliance

29. Question: If possible, would including RPDT amounts within quarterly instalment payments be preferable? Or would this create any issues?

See our comments at Q25 above.

30. Question: Do you agree that allowing a nominated company to act on behalf of the group would reduce the compliance burden?

No comment.

31. Question: Do you foresee any difficulties with the nominated company calculating and reporting RPDT liability on behalf of the whole group?

No comment.

32. Question: Are there any practical issues around the nominated company accessing information from the rest of the group?

No comment.

33. Question: Would specific rules be needed for companies whose AP does not coincide with the nominated company's AP?

No comment.

34. Question: Do you have any comments on the proposed commencement date?

Where the tax applies to sales this will be taxing a real gain, however for buy to rent (a tax on notional gain) this is a dry tax charge and so the developers may not have funds or financing in place to fund the tax, given these developments will likely have been commenced and finances arranged years previously. The sector may address this by slowing down completion/ build out rates, for example, to utilise multiple £25m allowances).

35. Question: Do you have any views on avoidance risks generally, and how these should be minimised?

No comment.

36. Question: Do you have any observations on the proposed anti-avoidance provisions, or other avoidance risks?

No comment.

37. Question: Do you think it would be necessary to introduce additional rules to ensure compliance or to make administration of the tax easier?

No comment.

Chapter 8: Assessment of impacts

38. Question: Would you adjust your development plans, build out strategy, or land acquisition strategy in response the implementation of this tax? If yes, how?

No comment.

39. Question: Are there other ways you would adapt your development plans in response to the implementation of this tax? If yes, how?

No comment.

40. Question: Are there other potential impacts on housing supply?

If the tax burden from the RPDT is significant, this is likely to result in development being more expensive for some companies as compared to others. This is, in turn, likely to have an impact on the housing market, and costs are likely to be passed on to consumers. It would also be possible, that the final form of RPDT and any complexities or uncertainties in its application would reinforce the barriers to entering the residential property development sector and increase pressures on companies to leave or reduce their activities in that sector.

We note that there appears to be tensions between the proposals for RPDT and other government policy around supply of housing, including the repurposing of surplus commercial property due to COVID-19. We suggest that further consideration is merited in this regard.

41. Question: Is there anything further the government might want to consider in relation to the design of the tax which would help minimise the impact on housing supply? Or other housing policy objectives?

No comment.

42. Question: Is there anything the government might want to consider with regards to the impact of the tax on the supply of affordable housing?

Fully understanding affordable and supported housing is important in the context of the design and delivery of the RPDT. The consultation refers to most affordable housing being developed at a cost-only return, however, the landscape is generally more complex than that. Affordable housing is often a loss-making part of a development site. The complexities need to be properly understood to enable appropriate activities to be within scope of the tax.

43. Question: Do you have any comments on the summary of impacts?

No comment.

For further information, please contact:

Alison McNab

Policy Team

Law Society of Scotland

DD: 0131 476 8109

alisonmcnab@lawscot.org.uk