SQUIRE PATTON BOGGS

United Kingdom: Residential Property Developer Tax

7 October 2021

Updated: 13 October 2021 to reflect revised guidance relating to build-to-rent and affordable housing provided by non-profit companies

Still Time to Have Your Say

Although no rate has been announced, the march towards the introduction of the Residential Property Developer Tax (RPDT) continued with the publication of draft legislation late last month. However, despite still not containing the hoped for specific exemption for the sector, it is understood that HM Treasury has confirmed that build-to-rent developers will fall outside the scope of the new tax[1]. In addition, following an unheralded revision to the draft legislation (published during the early evening of 8 October), registered non-profit housing companies providing social housing have been specifically excluded from being liable for RPDT. As a result, alongside developers of student accommodation and senior living care facilities, non-profit providers of affordable housing and build-to-rent developers can now breathe a cautious sigh of relief. Nonetheless, all developers of residential land in the UK will be interested to consider the detail published in the draft legislation. Comments on the draft legislation can be submitted before 15 October 2021.

Another New Tax

The proposed RPDT is part of the government's five-point plan to bring an end to unsafe cladding as a response to the Grenfell disaster. When enacted, RPDT will be a new tax on the UK residential property development sector and will apply as a surcharge in addition to corporation tax. It will take effect in April 2022, alongside a new "Gateway 2 levy" (which will be applied when developers seek permission to develop certain high-rise buildings). It is intended to help ensure the largest corporate property developers make a fair contribution to the government's remediation work costs.

During the summer, HM Treasury consulted (the Consultation) on the broad policy design of the RPDT.[2] On 20 September 2021, draft legislation for the RPDT was published, which is now the subject of a short technical consultation. The final design of the RPDT (including, crucially, the rate of the tax) will be announced at the Autumn Budget, which is scheduled to take place on 27 October 2021.

Be Prepared

- Identify whether you will be caught
- Consider any exemptions that may apply
- Ensure that you are familiar with the reliefs

Key questions remain unanswered even though we are just weeks away from the Autumn Budget, when the final design is expected to be announced. There is still time to comment on the draft legislation by emailing RPDT.mailbox@hmrc.gov.uk.

If you would like to discuss any aspect of this new tax, please contact your usual contact at the firm, or one of the contacts named at the end of this alert.

Read on for more detail on how RPDT is expected to work.

1 Our original version, issued prior to the reported confirmation referred to the failure to exclude build-to-rent from the RPDT in the draft legislation.

2 See our previous update UK Residential Property Developer Tax: What Is Your Fair Share?

What Is Missing?

Two vitally important aspects of the design are yet to be determined, namely:

- **Rate of the RPDT** – The Consultation did not give any indication of a likely rate but did state that "while the rate may be amended once the tax is in force, it is not intended to fluctuate year-to-year."
- **Annual allowance** (that is, the level of relevant profits above which the RPDT will apply) – The Consultation envisaged an annual allowance of £25 million, but this has not carried through to the draft legislation.

Since the government has stated its intention is for the new tax to raise at least £2 billion (over a 10-year period), it is reasonable to conclude that HM Treasury is currently modelling the likely impact of the tax to determine both rate and allowance in order to ensure the tax "affects only the largest residential property developers".

Much has been made of the £2 billion revenue target, the singular justification for its introduction and the possibility that, as a result, the RPDT will be time-limited (to the decade envisaged in the Consultation). However, the draft legislation provides for no time limit, or even a review, of the new tax. There is merely a reporting obligation on RPDT payers, which is primarily intended to ensure HM Revenue & Customs (HMRC) can monitor its effect. Indeed, the Consultation was quite clear that if the RPDT does not achieve its aim over its anticipated life, "the government would consider whether to extend the duration past a decade."

If introduced, repealing the RPDT will require positive action by a future government. Subject to any adverse economic distortion (that is, any unwelcome detrimental impact the RPDT might have on property development or housing supply in the UK), the history of taxation suggests that if RPDT is successful, and raises the revenue hoped for (or more), the government may be more reticent to withdraw it than might currently be hoped. This is likely to be especially true in the period following the COVID-19 pandemic and the UK's withdrawal from the EU, and as the enormity of the financial challenge presented by tackling climate change emerges.

Proposed Structure: Will You Be Caught by RPDT?

The draft legislation is structured into three main parts, namely:

- **Key concepts** – that is, the definitions that will determine the scope of the new tax
- **Profits and losses** (including the annual allowance) – that is, the "tax base" that the RPDT would be applied to
- **Administration and enforcement**

The current design of the RPDT broadly follows the Model 2a (activity-based) approach considered at the time of the original Consultation.

Each part is examined in more detail below.

Key Concepts

The RPDT would only be charged on activities related to **residential property**.

Alongside this fundamental concept, there are three other key definitions that run through the draft legislation and that would fix its scope. These additional definitions are drawn from the head of charge, which provides that if introduced in its current form, the RPDT would be charged on:

- **Residential property development profits** (the RPD profits, as discussed in more detail in the next main section) of a
- **Residential property developer** (the **RP developer**) that undertakes
- **Residential property development activities** (the **RPD activities**) in a chargeable accounting period ending on or after 1 April 2022.

Residential Property

What is "residential property"? For the purposes of RPDT, residential property is defined broadly, and so means any:

- Building that is designed or adapted (or is in the process of being constructed or adapted) for use as a dwelling
- Land that is or forms part of the garden or grounds of such a building
- Interest in, or right over, land that subsists for the benefit of such a building or land
- Land in respect of which planning permission is being sought, or has been granted, such that it (or a building on it, or any interest in or right over it) would fall within one of the three categories listed above

Limited, specific, exclusions are set out in the draft legislation. The listed exclusions in the draft legislation cover property that is used (or will be used) as (or for) communal dwellings. That would include residential care homes, hospitals and hospices, accommodation for the armed and emergency services, prisons, hotels, temporary sheltered accommodation and (perhaps most notably since its treatment was uncertain at the time of the Consultation) student accommodation.

As currently drafted, therefore, with the one notable exception of registered non-profit housing companies (as discussed below), most of the exclusions relate to the type of residential property being (or to be) provided, and not to the type of business model adopted by the RP developer. For example, as currently drafted, there is no general exclusion for a Real Estate Investment Trust (REIT) that carries on a RPD activity. In addition, there is no *specific* exclusion for the build-to-rent sector, despite robust representations by the British Property Federation (BPF). However, since the draft legislation was first published, it is understood that HM Treasury has confirmed that build-to-rent developers will not be caught by RPDT because of the requirement that the property being developed must be held as 'trading stock' (which is unlikely to be the case for build-to-rent developers). It can be hoped that confirmation is contained in future published guidance to accompany the final legislation for inclusion in Finance Bill 2021-22 (if not the final legislation itself).

RP Developer

If enacted, the RPDT would be a tax on corporate entities, irrespective of their tax residence. An **RP developer** would be any company (or group of companies) that is within the charge to corporation tax and that undertakes any RPD activities. The government intends RPDT to target the legal entities (i.e. corporates) that undertake large-scale residential property development. In the 8 October revision to the draft legislation, the definition was narrowed to exclude non-profit housing companies providing social housing. Subject to a new provision that will impose an 'exit charge' in the event a company ceases to be a non-profit housing company (as defined), the effect should be to provide a complete exclusion from RPDT for registered developers of affordable housing, irrespective of the activities they carry on.

RPD Activities

As currently drafted, the true scope of the new tax will be determined by the activities that represent **RPD activities**. All profits from all UK-based RPD activities of an RP developer form the tax base for RPDT; there is no *de minimis* exception or exclusion. This would ensure the tax cannot be avoided by fragmenting development activity between different group companies.

RPD activities are initially defined (intentionally) very widely in the draft legislation. They represent anything done by an RP developer "on, or in connection with, land in the United Kingdom … for the purposes of, or in connection with, the development of residential property".

The draft legislation expressly includes the following activities (and any activities ancillary to any of them) as RPD activities in relation to residential property:

- Dealing
- Designing
- Seeking planning permission
- Constructing or adapting
- Marketing
- Managing

Importantly, the RP developer (or, extending the scope further, a company related to the RP developer) will need to have (or have had) an interest in the relevant land.

An "interest in land" for these purposes is, again, broadly drawn by the draft legislation to cover any circumstance where the developer has (or had) a beneficial interest, right or power in or over the land. However, the interest, right or power will need to be held as trading stock of the developer's trade, which includes the relevant RPD activity (or activities). It is this requirement that (as HM Treasury has reportedly confirmed) will have the effect of excluding build-to-rent developers from the scope of the new tax. Interests represented by a mortgage over, or a licence to merely occupy or use, the land are also excluded.

As it currently stands, pure property investors (i.e. those that do not hold their interests in land as trading stock) will fall outside the scope of the new tax. However, certain types of property investor, with trading entities in their group, may find that they are caught by the wide scope of RPDT. Such entities are advised to assess their position and closely follow further developments as the final design of RPDT is unveiled.

RPD Profits (and Losses) and the Allowance

RPD Profits

An RP developer will need to calculate its RPD profit (or loss), in respect of the applicable accounting period, according to a basic formula set out in the draft legislation.

An RP developer's RPD profit (or, as the case may be, loss) for an accounting period would be:

A. The RP developer's **adjusted** trading profits (including any joint venture profits attributable to the RP developer)

   Less

B. Any available allowable RPDT loss, group, or carried forward group, reliefs

   Notably, the normal corporation tax loss relief provisions are excluded from applying for the purposes of RPDT by the draft legislation but then substantially recreated such that they apply **solely** in respect of RPD profits and losses. This would mean, for example, in relation to loss carry forward, that it would be subject to the same rules that restrict the carry forward of losses. In essence, the maximum available set off of carried forward RPD losses will be an amount equal to 50% of the RPD profits of the relevant future accounting period.

Under the draft legislation, the adjusted trading profits simply means the company's trading profits, as calculated for the purposes of corporation tax, but ignoring the following items:

- Any profits, losses and capital allowances that do not relate to RPD activity (with any apportionment to be made on a just and reasonable basis)
- Any profits of a charitable trade carried on by a charitable company to the extent such profits are applied to the charitable purposes of the charitable company – i.e. charitable housing associations carrying on a RPD activity that make profits that are not used for charitable purposes will be liable for RDPT

- Any loss relief and/or group relief (as already noted)
- Any amounts included in the company's trading income under the loan relationships and/or derivative contracts rules

Basic computation rules would apply, meaning that the critical determinate of whether an amount ought to be included or ignored would be the type of activity to which it relates. There are no special computation or adjustment rules for different types of activity or business models.

Under the proposed legislation, special rules will apply to accounting periods that straddle the commencement date, 1 April 2022. Very broadly, profits and losses will be apportioned such that RPDT is only chargeable (and relieved) in respect of profits arising after 1 April 2022. Anti-forestalling provisions are included in the draft rules to counter tax avoidance arrangements that purport to recognise RPD profits in the accounting period ending before 1 April 2022.

Allowance

If enacted in its current form, RPDT will only apply to RPD profits arising from RPD activities in excess of an, as yet unspecified, group-wide, annual allowance. Where the applicable accounting period is shorter than 12 months, the allowance would need to be reduced on a pro rata basis. In addition, in applicable cases, special rules would be applied to ensure the available allowance is allocated between group members (with the default being it is shared equally) and between parties to a joint venture arrangement.

Payment, Administration and Enforcement

If introduced, RPDT would be charged as if it were a charge to corporation tax. This means that HMRC would be responsible for its collection and that all of the normal rules for the calculation, management, administration and payment of corporation tax would apply equally to RPDT.

As a result, RPDT will operate as a surcharge – i.e. it will be a charge additional to, and will not be an allowable deduction for the purposes of, corporation tax.

Subject to the complexities of the interaction of computation rules, amounts representing RPD profits will already have been brought into account for the purposes of a RP developer's normal corporation tax computation.

The same profits will then be brought into account again, this time for the purposes of calculating RPDT liability. As already discussed, RDPT will be charged on the amount of RPD profit that exceeds the annual allowance.

In order to ensure receipts of RPDT are closely monitored, the draft legislation imposes an obligation on RP developers that make a payment of RPDT to notify HMRC of that fact, in writing, on or before the date the payment is actually made. The "responsible company" for making the notification would be the RP developer unless a group payment arrangement exists. Where a group payment arrangement is in place, the "responsible company" would be the company making the payment on behalf of the RP developer. HMRC's full information and inspection powers would apply to any failure by a company to comply with any of its reporting obligations.

Finally, the draft legislation also affords HMRC and HM Treasury full powers to make regulations to enhance and refine the regime. The areas specifically identified in the draft legislation for further regulation include:

- For the purposes of the annual allowance:
  - The nomination and replacement process for the allocating member of a group
  - A requirement for the submission of an allowance allocation statement for the allocating member of a group
- Specific rules necessary in relation to joint venture arrangements

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