Residential Property Developer Tax

HM Treasury consultation on policy design

G15 response

About the G15

The G15 is the group of London's largest housing associations. Our members house one in ten Londoners and own or manage more than 600,000 homes across the country. We're independent, charitable organisations and all the money we make is reinvested in building more affordable homes and delivering services for our residents. Each G15 member is different, but we're all striving towards the same goal – to solve the capital's housing crisis and improve the lives of Londoners.

https://g15.london/

Summary

Our position

We strongly support government's intention to levy a time-limited tax to fund building safety works on existing high risk and high-rise developments. The problem of making existing buildings as safe as reasonably possible is the most pressing issue in housing today, and, assuming funds are made available to do this work, it is a problem that is time-limited, so a time-limited tax is a suitable way to address part of it.

Making homes safe

This tax in isolation is not a silver bullet to fixing the entirety of problems associated with building safety. This intervention is a welcome addition to, but not a substitute for, the most desirable ways government could act to arrive at a comprehensive solution as fast as possible, namely:

- Providing suitable guidance to ensure action on the least safe buildings is prioritised
- Continued support to enable leaseholders to sell and remortgage
- Allocating additional funding to protect leaseholders from high bills and ensure that sufficient resources are available for housing associations to continue to invest in building new homes.

Protecting the supply of affordable homes

With national waiting lists for social housing well in excess of one million households and a housing affordability crisis that is yet to be controlled, it is more important than ever to deliver as many affordable homes as possible. The increased funding for the 2021-26 Affordable Homes Programme is welcome, although the reduction in the share of this allocated to London – the city where affordability pressures and affordable housing need are the most pressing – means that every step must be taken to remove barriers to increasing the supply of new affordable homes.

We are clear that the final residential property developer tax (RPDT) arrived at must ensure the delivery of the affordable homes we need is not jeopardised. As the policy is laid out in the consultation document, government will unintendedly prevent the building of new affordable homes.

We recommend that there should be a blanket exemption for corporate entities that are one of the below:

- **Non-profit registered providers of social housing**
- **Companies that are wholly owned by non-profit registered providers of social housing**.

Non-profit registered providers are prohibited from distributing profits and all profits are retained to fund the building of affordable homes. Similarly, the profits and assets of a wholly owned subsidiary company will only be capable of being distributed to its non-profit registered provider parent. It follows that **if any RPDT is payable by non-profit registered providers or their wholly owned subsidiaries it will inevitably reduce the funds available build new affordable homes**.

This exemption would be straightforward to apply, because the Regulator of Social Housing maintains a list of registered providers. It would be almost inconsequential to government's ambitions to raise £2bn over ten years, because even large housing associations' non-charitable subsidiaries tend not to get far beyond the £25m per year profit threshold.

And it would protect the delivery of affordable homes, because many quirks of the way housing associations go about the business of meeting housing need could be mistakenly caught by this tax, directly or indirectly, if it's not implemented sensibly.

Our feedback

We thank government for the opportunity to comment on these proposals, and share their ambition to ensure all reasonable steps are taken to make homes safe.

Our answers to specific questions posed in the consultation document follow. Although the G15 comprises largely London-based housing associations, our answers pertain to beyond London. Although the G15's core specialism is developing homes and managing social housing, our answers pertain to beyond this remit. This is because we are committed to meeting housing need, and national and extra-sector policies can contribute to this aim.

Scope

Q1: 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?

Yes, broadly. Government says the tax should:

> *"…include any undeveloped land or land undergoing a change in use, for which planning permission to construct residential property has been obtained."*

We note that one does not need to own land, have an interest in land, or be a developer of any kind to apply for (or obtain) planning permission. It will, therefore, be necessary to fully define "undergoing" as it is used above.

Even only considering land that is realistically to be used for residential development, the inclusion of profits from undeveloped land with planning permission, if implemented as written in the consultation document, will catch land promoters and investors who buy land without planning permission, gain planning permission, then sell the land on to a developer. This could make it harder for developers to continue to ensure they have a pipeline of land to continue building homes. As over half of new affordable homes are delivered through developer contributions, this might also affect the supply of affordable homes.

Q2: 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.

Protecting affordable homes delivery

It's essential that this policy be implemented in a way that exempts non-profit developers of affordable homes, so that housing associations can continue to deliver low rent and low cost homeownership homes for those whose needs aren't met on the open market. At present, the policy doesn't do this.

Government's proposals as they stand in the consultation document appear to assume that a charitable exemption is enough to ensure housing associations developing affordable homes won't be caught by the tax:

> *"The government understands that there are large housing associations that focus wholly or mainly on the development of affordable housing. It is recognised that a large proportion of these activities are deemed to be charitable and therefore exempt from corporation tax. The government does not intend to disturb the existing tax exemption for charitable activities and would not be seeking to tax such activities under the RPDT."*

While it is true that a large proportion *are* charitable, this is not universally true, and it becomes less true the larger the organisation (and the larger the organisation, the more affordable homes they tend to deliver).

Many charitable or other non-profit housing associations have set up wholly owned non-charitable subsidiaries, which build market homes as well as affordable homes, and subsequently send profit back to the parent company for the development of more affordable homes overall. This is how the model of cross-subsidy works in practice, especially for the largest housing associations building the most affordable homes.

Furthermore, in many cases the subsidiary doesn't immediately gift profits back to the parent group, because a stronger balance sheet for the subsidiary allows it to attract more private finance, protecting the parent organisation (where the management of existing social housing stock is undertaken) from the financial risks associated with new development. The larger the organisation, the more affordable homes they deliver, the more likely this is to be the case.

Even in cases where the subsidiary *does* gift all profits back to the parent group soon after making them, "soon" does not mean "immediately," and may not even mean in the same tax year, or even the year after. Decisions of this nature are commercial decisions made for a plethora of reasons, and any constraint in this manner will hurt housing associations' ability to deliver affordable homes, given that housing associations' core purpose is to meet housing need and that delivering affordable homes is a substantial subset of that core purpose.

The preceding two paragraphs mean not only that the proposals outlined in the document are insufficient, but also that **an exemption on gift-aided profits is insufficient**, (which we note because it seems a likely knee-jerk reaction to the proposals), particularly as it will not be possible to gift aid interest payable.

For this reason, we recommend a **blanket exemption for:**

1) **Non-profit registered providers of social housing**
2) **Companies that are wholly owned by non-profit registered providers of social housing**.

Despite being for-profit on paper and as far as Companies House might understand the term, wholly owned subsidiaries of housing associations are *not* for-profit in a truer understanding of the idea of profit and who it is *for*. The profits of wholly owned subsidiaries can only be distributed to their non-profit registered provider parent, which in turn is prohibited from distributing profits to shareholders. The profits of subsidiaries never leave the social housing group. They are always, axiomatically, eventually reinvested into affordable homes.

Why is an entity-level exemption the best approach?

An entity-level exemption of this sort is far more workable a solution than any kind of activity-based exemption. If a social landlord owns an ostensibly for-profit subsidiary that develops a scheme of fifty market homes and fifty affordable homes, all profit generated by the one hundred homes, without exception, is intended for and will support the maintenance and development of affordable homes (these fifty, or others). Any attempt to tax these fifty market homes will not only be complex administratively, but will absolutely adversely affect the maintenance of existing affordable homes and the development of new ones.

Our proposed exemption would be very straightforward to apply. The Regulator of Social Housing is required by section 111 of the Housing and Regeneration Act 2008 to maintain a register of all registered providers of social housing. Companies House maintains a list of which companies are limited by shareholder and which are limited by guarantee. So there is an accurate, explicit, publicly available set of companies to whom this exemption would apply.

In the case of private developers who sell affordable homes built as part of a section 106 agreement to a housing association, the consultation document rightly points out that these won't actually increase the tax burden for developers. When a private developer buys land, their residual land value calculation has already built in the affordable homes contribution required, and so effectively the section 106 requirements have meant the developer has spent less on land than they otherwise would have. To carve out the revenue the developer receives from a housing association as tax exempt would be double counting it for tax purposes – it would be deducted once indirectly in the form of a smaller cost, and then would be deducted again in the form of a tax break.

Could private developers pass on this cost to housing associations via the price charged to associations for homes delivered through section 106?

Some G15 members have expressed this as a concern. The mere fact that this tax does not imply a tax burden for private developers' section 106 contributions does not self-evidently imply that they will be unable to act differently in a manner that will move the *ostensible* cost of the tax to housing associations.

If the tax is to be levied on entities, a given specific development scheme is not caught by the tax except insofar as it contributes to overall entity-level profit. The profit achieved by developers already accounts for the price they paid for land, and the price they paid for land should account for the section 106 contribution (at least in theory – one of the problems of section 106 is its negotiability and resulting incomplete impact on land prices).

It follows that whether the RPDT is economically able to be passed on to housing associations depends on a) whether or not the price the developer paid for the land accounts for this additional cost, and b) whether or not there is a sufficiently free, competitive market in the buying and selling of section 106 homes. We note that (a) means transitional arrangements are necessary, and (b) means that there may be issues that arise where in a particular locality, there are few developer sellers and few housing association potential buyers.

Why should some housing association groups pay corporation tax but not the RPDT?

While it is true that explicitly exempting the gift-aided profits of subsidiary companies would mitigate much of the impact, there would remain instances where this would still hurt the development of affordable homes. Firstly, not all housing associations are charities. Secondly, not all subsidiaries gift aid profits immediately, because they want to grow the financial independence of the subsidiary and protect the parent company from development risk. In addition, even if gift aid is used by a subsidiary to mitigate corporation tax profits, the consultation document proposes that interest payable and certain group relief would not be deductible for RPDT purposes (see below).

As illustrated above, there are reasons why subsidiaries of housing associations and non-charitable housing associations may pay corporation tax on their profits. There is a strong case that they shouldn't pay the RPDT in addition to this.

- Corporation tax is a permanent tax paid to fund all government services, and so has a very broad and indiscriminate base. RPDT is a temporary tax to raise a predetermined amount of revenue to fund a specific undertaking, and so its base is rightly targeted too. The consultation document implicitly uses this reasoning throughout.
- The tax could affect housing associations' ability to finance safety work – the very work that this tax is intended to support. This is salient as an argument to exempt non-profit registered providers and their subsidiaries over and above the symmetrical argument for exempting private developers because profit taken from private developers reduces private developer profits, whereas surplus taken from housing associations reduces the delivery of affordable homes.
- Most housing associations are likely to pay no or little tax under the RPDT regime. However, proving this is likely to lead to a significant amount of administrative burden which could be avoided via an exemption from the tax.

Q3: Do you agree with this approach to communal housing?

Yes, insofar as "communal housing" means the things listed on p9 of the consultation document. But we do not preclude the possibility that there are some forms of communal housing that are not included in this list.

Q4: Question: Do you agree with this approach to student housing?

It's unclear from the consultation document what the proposed approach to student housing is.

Student housing is often a social good above and beyond the development of market price owner-occupied homes. Encouraging education is a good, relieving the impact of student demand on traditional housing in university towns/cities is a good, and helping to make costs to students as low as possible is a good.

We do not recognise the distinction in the consultation document between whether a dwelling was built for and occupied by a student and has basic functions/amenities that are private, versus a dwelling with these basics characteristics but where these functions/amenities are not private. All the social goods remain the same, and, much as with our thoughts on section 106 above, they ought to have been entailed in the land cost paid by the developer.

Q5: Is there an alternative to the approach described for retirement housing, which considers provision of care and allied services, that should be considered?

We stress the need for a full and coherent view on the inclusion of retirement housing in the scope, and on the definition of retirement housing. Government says:

> *"…there is a need to consider the treatment of different forms of retirement accommodation where varying levels of care provision may be included. Where care and allied service functions such as catering and cleaning are provided as an integral part of a communal dwelling, as in a residential home, then the government intends profits from such developments to be out of scope of the RPDT."*

We note that the overall desirability of this approach is highly sensitive to the definition of "retirement housing." Depending on what types of development are in scope of the RPDT, there could be an incentive for retirement housing providers to divert provision from sheltered housing to extra care housing (or, at the very least, to provide the minimal additional service to residents which would qualify for tax exemption). Such services would need to be paid for through service charges, which would make homes less affordable, reduce actualised demand, encourage under-occupancy of general needs family homes (and non-social homes), and increase demand on health and social care services.

Q6: 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?

In addition to our answer to Q3, we note that even if some kind of communal housing type *is* exempt from the RPDT, a method must be implemented so that developers (as defined by this policy, which is not the ordinary definition of the word) must not show they are exempt if they are obviously not in fact in scope. We cover this in qq8-11.

Q7: 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?

There is fundamentally no difference arising from the tenure of the homes, so long as the developer is a for-profit developer. The basic argument for the scope of the tax and who ought to pay it does not change. As a residential property developer, one may make profits on the development of homes; if they are to be offered to consumers on a market-price basis, to buy or to rent, this profit ought to be achieved in a manner that is viable, and viability is a scheme-level phenomenon rather than an entity-level phenomenon.

That said, there are clear reasons that, as a society, we might prefer build-to-rent over development for owner-occupation: faster absorption rates mean that homes are delivered faster; a relatively (and undesirably) large proportion of England's private rented sector owned by buy-to-let landlords, or accidental landlords, or landlords otherwise less able or willing to follow regulations.

Achieving the outcomes implied by a greater prevalence of build-to-rent should be arrived at via continuous taxation and regulation rather than this tax.

Qq8-11: What are the implications of models 1, 2a and 2b for businesses? Which approach is preferred? Which of these would be administratively easier for major residential property developers to operate? Where should the significance test be set for model 1?

The key trade-off here is simplicity versus fairness. Model 1 would be a simple system that would mean some organisations pay more than they *should* do based on the current narrative around the intended scope of the tax. Model 2 would arguably be fairer, as it would only capture what is presently intended to be in scope, but would be harder for organisations to administer.

Whichever is chosen, there should be a preliminary test – perhaps based on turnover from all activities – that would exempt any organisations who would clearly not be in scope, so that the administrative burden doesn't hurt a vast number of businesses who would never end up paying anything anyway.

We propose any organisation with less than £25m (or whatever level the profit threshold is determined to be) in profit over a given tax year be categorically exempt, and therefore need offer no proof whatsoever that their profits in scope do or do not make them liable to pay the tax.

Q15: What are the implications of excluding interest and funding costs from the measure of profits for RPDT purposes?

One of the complications here is linked to accounting policies. If organisations capitalise interest costs, the cost of sale will be higher and taxable profit smaller, unless organisations would need to *un*recognise the capitalised element. This was not clear in the proposals in the consultation document.

Furthermore, excluding interest and funding costs would mean that the RPDT will inevitably be paid on interest costs. This in turn could tip the company into being liable for corporation tax.

Consider this:

It is only possible to make gift aid payments to the extent that a company has distributable reserves. Suppose a company with no reserves achieved profits before interest of 100, interest costs of 80, and profit after interest of 20. The company would be able to make a maximum gift aid payment of 20. This would mean that RPDT would be payable on 100-20 = 80, even though it has zero profits after gift aid. In fact, the RPDT itself would further reduce the distributable reserves, meaning a gift aid payment of 20 will not even be possible, which might result in additional corporation tax liability as well the RPDT.

It should be noted that this result would not arise if there were no financing costs in the subsidiary. In that case a gift aid payment of 100 could be made which would ensure that no RPDT or corporation tax liabilities arose. It would be a very anomalous result if a subsidiary with borrowings had RPDT and corporation tax liabilities, but the same subsidiary, with the same operating profit, with no borrowings and interest costs, and larger pre-tax profits, did not.

Allowance and rate

Qq20-22: What would you consider to be appropriate measures of economic participation in a joint venture? What would you consider to be an appropriate hurdle for a participator becoming liable to tax in respect of the joint venture? Do you have any other observations regarding the use of joint venture structures in the UK residential property development sector?

As well as land-led or section 106 affordable home development, housing associations are increasingly undertaking joint ventures to supply affordable homes to create diverse neighbourhoods, and generate profit to cross-subsidise their affordable home pipeline.

To supply these homes at a viable build cost, and to diffuse the risk of volatility in the market, many associations have entered into joint ventures on a scheme-level basis with other developers. These partners are most often building contractors, but there are other configurations, such as association-association, or association-council. Joint ventures tend to be split 50-50, but other splits exist. These arrangements usually involve the association getting first refusal of the affordable homes delivered on the site.

Housing associations viability test each joint venture, considering any subsidy required for affordable homes and potential profit from any sales when determining whether to enter the arrangement. In most cases, the non-profit entity will contract to develop the affordable homes, and a subsidiary, normally a for-profit development vehicle, will take on the development risk of the market sale homes.

To retain this method of delivering new homes, housing associations will need to be able to extend any tax exemption to their share of the venture. Failing to do so would make joint ventures unviable, reducing the opportunities available to the sector. This would mean that associations are less able to access lower build costs, and are more reluctant to take on the risk associated with larger opportunities.

We suggest that:

- Any entity-level RPDT for non-profit registered providers covers each type of joint venture arrangement (entity, contractual arrangement, and more) while being robust enough to extend the benefit to the association party only.
- For entities exempted on this basis, there should not be a distinction between the affordable homes and the market sale homes within a joint venture. Profit form market sale homes is used to finance affordable homes, as discussed in q2. Any exemption should be applied to the association’s entire interest in the venture.

Ideally the tax should be exempted rather than taxed and then reclaimed, in order to avoid unnecessary bureaucracy and spikes of capacity resulting from reclaiming tax. However, we note that a publicly available attribution of interest in the joint venture may not be commercially desirable, and that could become more problematic if the attribution of profits pushes one partner into the scope of RPDT but not the other. So there may be a risk of a dry tax charge.

Q23: Do you agree that these principles should guide the decision on the rate of the tax?

Yes. Designing the tax subject to responses showing how it should best be designed subject to government’s intention, then setting the rate based on what would deliver £2bn over ten years, seems like a reasonable approach.

Interaction with the Gateway 2 levy

Q24: Do you have any initial views on the cumulative impact of the RPDT and the Gateway 2 levy?

We note that the question answers itself insofar as the impact is, in some sense, cumulative, even though one is levied on entities and another on schemes. While taxes levied on entities should theoretically not directly affect the viability of schemes, the fact of an additional Gateway 2 levy in addition to an increased general rate of corporation tax does place some strain on this claim.

Payment and compliance

Q25: Do you agree that the RPDT should be reported using the same periods as for CT?

Yes.

Q30: Do you agree that allowing a nominated company to act on behalf of the group would reduce the compliance burden?

Yes.

Q35: Do you have any views on avoidance risks generally, and how these should be minimised?

Exempting entities rather than activities, as we propose, will minimise avoidance risks.

Assessment of impacts

Q41: 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?

There is a question as to the extent this tax will impact on supply overall. The answer to this depends largely on whether developers seek to maximise post-tax profit versus post-tax return on capital employed. If the former, the RPDT should have little impact on new supply. If the latter, it's possible developers may respond to the RPDT by increasing their operating margin, so that they develop *fewer* schemes (because for developers, operating margin is a *cost* insofar as it pertains to viability calculations), but their return on capital employed *increases* despite lower overall entity profit.

The question is broadly similar to the question of whether changes in corporation tax affect developers' propensity to build. Even if we suppose developers care about profit rather than return on capital employed, and therefore don't change their operating margins at all, there will be some development that would have happened in years subsequent to introducing the tax that would not have happened otherwise, because more reserves means more funds available to invest, which means less borrowing requirements, which means less interest costs, which means more viability.

If we suppose instead that developers care more about return on capital employed, and therefore increase their operating margin and build fewer homes, this would not only result in fewer homes, but a lower overall tax base (or at least a tax base which is somewhat lower, offsetting some, if not all, of the revenue from the RPDT). Less homes means less entity-level profit, which means less profit that is in scope for corporation tax.

However, we believe whichever of the two eventualities above materialises, this is unlikely to be so significant as to make the cost-benefit analysis of introducing the RPDT shift in favour of it being a net bad. The RPDT is time-limited, and remedial building safety works on existing buildings is also, in some sense, time-limited, as there are only so many buildings that are in scope for remediation, and there will be no additions to this set once the new building safety regime comes into force.

Overall we consider the RPDT, so long as it protects the delivery of affordable homes, to be a sensible way to raise funds for the work needed to make buildings safe.

For further information, please contact

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