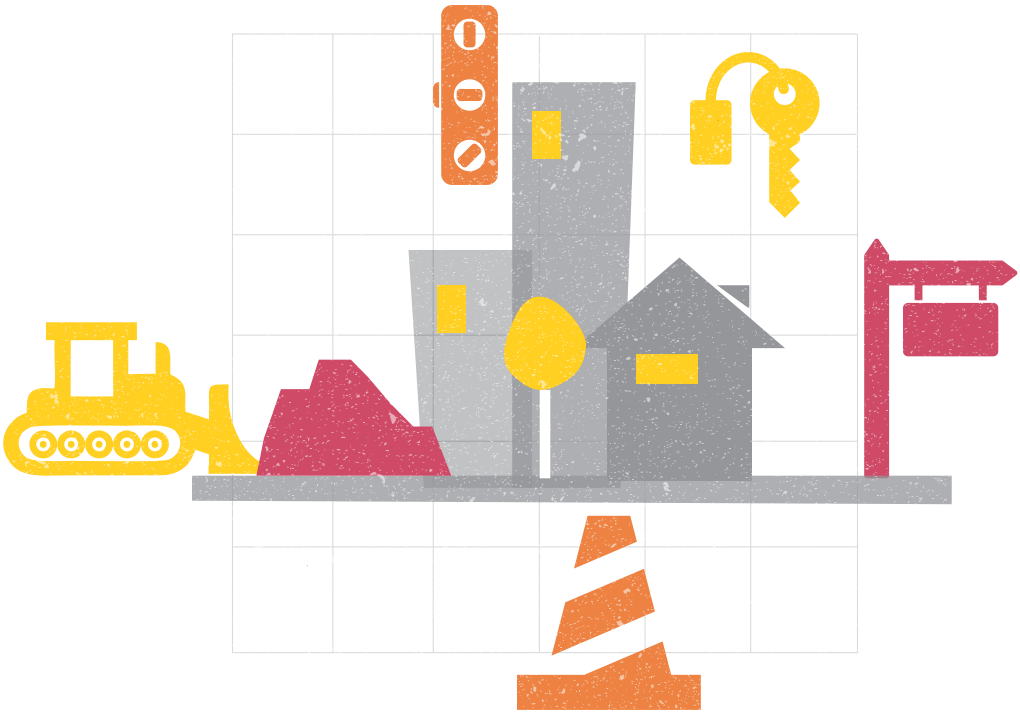
Property & Construction

PKF FRANCIS CLARK
Shared Ambition

NEWSLETTER
ISSUE 01



Property Developer Tax
CIS - how it impacts investors and developers
Stamp duty land tax - overage on land
Capital gains tax: 60 day reporting - could this affect you?
Land remediation relief - Q&A

Welcome

Welcome to our Winter 2021 property and construction newsletter. Included in this edition is a range of articles looking at property developer tax, land remediation relief and annual investment allowance as well as other topics we hope you find interesting.

It is pleasing to see that the sector is still surviving after a difficult 18 months or so for us all, but it is not yet clear the impact of supply chain availability and cost issues is having on holding up projects. Hopefully a better year lies ahead.

The recent Budget did not produce any significant surprises or measures that were not expected and certainly none which had a major impact on this sector. One might say that for once it really was a rather dry Budget for us financial people, who sadly look forward to it with much more anticipation than the wider public!

One thing I would like to bring to your attention is that the Spring Budget this year saw the launch of a consultation document into various aspects of the UK Research and Development (R&D) tax relief. The recent Budget saw the first announcements driven by that consultation paper and the responses which will see an overhaul of the R&D tax regime with effect from April 2023. I have commented further on in this newsletter about R&D in property and construction but this really is a sector that does not make full use of the tax breaks available. If you take nothing else away do please have a read.

If you have any queries arising from any of the articles or issues more generally affecting either your business or personal affairs, please do not hesitate to get in touch with us.

Paul Bray
Partner, Head of Property & Construction
paul.bray@pkf-francisclark.co.uk

Property developer tax

After the earlier announcement that a residential property developer tax (RPDT) would help pay for remedial cladding work, the Chancellor confirmed the tax will take effect from April 2022. The new tax will be levied on the profits that companies and corporate groups derive from UK residential property development, to ensure that the largest developers make a fair contribution to help pay for building safety remediation.

The tax will be charged at 4% on profits exceeding an annual allowance of £25m.

This is expected to raise £640m by 2024-25, with annual tax take averaging around £220m a year.

Why is this new tax being introduced?

Earlier this year the proposal to introduce a new tax on property developers was announced as part of the Government's Building Safety Package in order to ensure that the largest developers make a fair contribution to help fund cladding remediation costs. The draft legislation follows the conclusion in July of consultation on the design of this proposed new tax.

It followed the Housing Secretary's announcement in February 2021 of plans to bring an end to unsafe cladding through a multi-billion pound intervention, with the aim of raising £2 billion through the RPDT over the next decade.

Which companies and activities are affected?

The legislation introduces a tax charge on residential property developers from 1 April 2022, with profits from periods straddling that date being apportioned. The RPDT will be charged on residential property development profits calculated according to a formula set out in the legislation, and subject to an annual allowance.

The tax will apply to companies without restrictions in regards to the residence of the company, simply that the developer, or a related party must have an interest in the land. It will apply to profits arising from the development where the land/property is held as trading stock by the developer or a related entity. Property investors are however currently excluded.

The following would not be subject to RPDT:

- *groups exclusively carrying on activities as a third-party contractor in relation to residential developments of an unconnected developer*
- *commercial development*
- *residential development outside the UK*

In addition, the final legislation confirmed the exclusion of build-to-rent or affordable housing activity and other removals from the definition of "residential property".

The tax will apply to companies within the charge to corporation tax which undertake residential property development (RPD) activities and have profits above £25m, the tax will be calculated at the applicable rate on the company's RPD profits so far as they exceed its allowance for the relevant accounting period.

RPD profits for these purposes will be calculated in accordance with a formula, essentially adding together a company's 'adjusted trading profits' (or losses, as the case may be) and its joint venture profits (or losses) - so far as in each case they relate to its RPD activities - then deducting allowable loss relief, group relief and carried forward group relief.

However, RPDT is not a supplementary corporation tax. Collection and management of the tax will be the responsibility of HMRC, but it will be run as a separate system.

Residential developer companies (with certain exemptions) will be required to include in their company tax returns a statement of RPD profits, losses and reliefs. It is worth noting these further points:

- *the measure of profits which attract the tax is calculated without deduction for finance costs - including third party financing - so the £25m threshold might catch more companies than was first envisaged*
- *RPDT will be ignored and no allowance made when calculating mainstream corporation tax liabilities*
- *the consultation does not announce the rate of tax. Indications are this will be 'proportionate', taking into account the proposed 25% rate of corporation tax coming in from 2023*
- *any unused amount of the annual allowance will not be capable of being carried forward*

R&D tax relief

One thing we would like to flag further as mentioned in the introduction is that the Spring Budget this year saw the launch of a consultation document into various aspects of the UK Research and Development (R&D) tax relief. The consultation period ran up to June 2021 and the recent Budget saw the first announcements driven by that consultation paper and the responses which will see an overhaul of the R&D tax regime with effect from April 2023.

The Chancellor announced an increase in funding to Innovate UK which supports private R&D investment. It has also proposed that the qualifying expenditure categories to which R&D tax reliefs apply is widened to include data and cloud computing to update the relevance of the relief for modern research techniques which have changed significantly since the relief was first introduced in 2000.

You might wonder the relevance to this sector?

Well for many years advisors like me have been trying to engage the property and construction sector more into the extremely valuable tax reliefs that R&D brings.

It really is simply about having something new and innovative which has been produced by an advance in a process - not just white coats in labs.

Are you doing something new and more efficiently from a process created in house?

In terms of numbers, a qualifying spend of £100,000 can produce a tax benefit of £33,000 under the SME scheme. It really doesn't hurt to explore the possibility.

Budget update

Autumn Budget 2021: New and previously announced business tax changes

While some may have been surprised by the lack of major new tax announcements in the Autumn Budget, it's important to remember that a number of previously announced measures affecting businesses have yet to come into force.

Here we roundup what upcoming changes businesses need to be prepared for and when:

April 2022

- *National Insurance increases by 1.25% for employers until the new Health & Social Care Levy becomes a separate tax in April 2023 (announced in September)*
- *Dividend income tax rates increase by 1.25%*
- *Residential property developer tax introduced, bringing in a 4% tax on companies with profits above £25m*

April 2023

- *Temporary increase in the Annual Investment Allowance to £1m ends, reducing to £200k, instead of happening at the end of December 2021 as originally planned*
- *Corporation tax increases from 19% to 25%*
- *The super-deduction and 50% first year capital allowances comes to an end*
- *Business rates multiplier is unfrozen and 50% relief for retail, hospitality and leisure sectors ends*

Paul Bray
Partner
paul.bray@pkf-francisclark.co.uk

CIS

How it impacts investors and developers

I am often asked the question whether a property developer or property investor would be caught under the Construction Industry Scheme (CIS). The question carries more risks and implications when it is asked after the development work or investment has already commenced and it then needs to be unravelled and may lead to an HM Revenue and Customs (HMRC) disclosure being needed.

To answer the question, we often need more information so that we can establish whether this is an Investor or a Developer. We also need to go back to the basics of CIS and the starting point is often to consider why CIS would not apply.

Any business or individual must understand the differences between a property developer and a property investor when determining their responsibilities under CIS. Failure to operate the scheme correctly will leave a business/individual open to a possible HMRC compliance check, resulting in HMRC seeking any under-deducted CIS tax and imposing penalties.

CIS background

CIS is a scheme whereby Contractors in the building industry are required to deduct tax at source from payments made to subcontractors working for them. Some subcontractors are entitled to be paid without any tax deduction as they hold what is known as Gross Payment Status, others at 30% as per HMRC's instructions, but in the main CIS deductions require 20% tax withheld before payment. The scheme requires registration as a Contractor and administration in the form of monthly submissions; the penalties for non and/or late submission can add up to a significant amount.

Who is a Contractor? HMRC's Construction Industry Scheme guide (CIS 340) defines a mainstream contractor as 'a business or other concern that pays subcontractors for construction work. Contractors may be construction companies and building firms, but may also be ... many other businesses.'

What is construction work? This is again widely drawn and is often referred to as construction operations, which includes the construction, alteration, repair, extension, demolition or dismantling of buildings and/or work - although there are exceptions. A business set up to undertake such construction work is obviously required to operate the scheme. Private householders paying for work on their own homes should not fall within the CIS regime's scope.

Property Developer v Property Investor - what is the difference for CIS?

Property developers are 'mainstream contractors' for the purposes of CIS because their principal business activity is the creation or renovation of buildings or other civil engineering works. Therefore, property developers are required to register and operate CIS as soon as they engage subcontractors to carry out construction work.

Property investors - their business has a principal activity that is the acquisition and disposal of buildings for capital gain or the holding of property for rental income. Its CIS position can be less clear and extra care needs to be taken to decide if or when the CIS applies. If a property investor is purchasing a property to hold as an investment or for rent and arranges for the property to undergo minor refurbishment before being ready for occupation, these activities will not be considered those of a mainstream contractor. However, if they hold a portfolio that leads to a larger spend on construction operations then they could be classed by HMRC as a 'Deemed Contractor'.

A Deemed Contractor is a business that is not usually associated with being in the construction industry (e.g. a restaurant chain, supermarket or a landed estate) but can be treated as a contractor if its expenditure on construction operations over the previous 12 months are more than £3m (the basis of this calculation changed in April 2021). This is a rolling 12 month period, so a property investor needs to monitor their spend to ensure the limit is not reached. There is an exemption where a business can ignore expenditure on property such as offices or warehouses which are only for their purposes and not used by a third party and also where construction operations total less than £1,000, what HMRC refers to as small payments, excluding the cost of materials. However, this arrangement does not apply to mainstream contractors.

Property investors should also consider if they take on a large project that required significant construction work or they may invest in multiple properties which require work to be undertaken, may be moving their trade from one of investment to that of developer. HMRC might then consider them to be a mainstream contractor. HMRC do confirm within their guidance that "where a business that is ordinarily a property investor, undertakes activities attributed to those of 'property development', they will be considered a mainstream contractor and caught for CIS during the period of that development" and this could be the case even if it is only for one property.

Summary

When looking at the construction work being undertaken by a property developer or investor you should always consider whether CIS might apply. Advice should be sought at the earliest opportunity, because If you make the wrong decision it could lead to a significant liability were HMRC to undertake a CIS Compliance Check with interest and penalties.

If you would like any additional information or to discuss this in more detail, please contact me.

Steve Ashworth
Director
steve.ashworth@pkf-francisclark.co.uk

Stamp duty land tax

overage on land

It is not uncommon for overage agreements to be placed on land, particularly where it is felt there could be development opportunities in future and the vendor does not wish to miss out if these come to fruition. But how does this impact on stamp duty payable by the purchaser and are there any opportunities or pitfalls?

When land or property is purchased, many people are aware that stamp duty land tax (SDLT) is due on chargeable consideration, which is in money or money's worth. Care should be taken where there are any overage clauses to ensure the correct amount of SDLT is paid and to consider whether it would be advantageous to make an application for deferral.

For example, what happens if land is sold for £1m plus an extra £500,000 if planning permission for development is obtained? The £500,000 element is contingent and the amount is known. It can be uncertain if planning consent will be granted. SDLT would be due on the full £1.5m if no further action is taken. We would normally recommend that application for deferral of payment of SDLT is made on the £500,000 where the uncertainty is likely to last at least 6 months. There is a cashflow advantage of not having to pay SDLT on an element when it may never become due, but also protects the interest position.

In many cases we see, the overage is uncertain. If no deferral application is made the chargeable consideration is calculated to include a reasonable estimate of the final consideration with no discount for future value. There are again advantages with making a SDLT deferral application which is illustrated in the example below.

In 2015, a retiring farmer sells green belt land to another dairy farmer for £2m, imposing an overage clause. The clause includes that if, within the next 25 years, planning permission is granted for the development of land for any use other than agriculture, the dairy farmer will pay 30% of the uplift in value as overage.

- *Fast forward to 2021 and the land is unexpectedly zoned for residential development, resulting in the arable farmer getting planning permission*
- *The overage land is now worth £20m, so £6m is payable to the retired farmer as overage*
- *SDLT is now due on £8m (being £2m + £6m overage) based on the rates applicable in 2015*
- *SDLT on the £6m element was due in 2015 so interest is charged on the additional tax, backdated to 2015*
- *If the dairy farmer had applied for deferral of overage, even of £0 of overage, as the development was thought to be so unlikely, interest would have been payable only from the date when payment of overage (and therefore the extra tax) is triggered*

There are tight deadlines for making deferral applications for SDLT purposes, but these normally have significant cashflow benefits as well as protecting the interest position should any overage become payable in future.

PKF Francis Clark have an experienced SDLT advisory team who would be pleased to assist. Contact me or your normal Francis Clark contact for more information.

Heather Britton
Director
heather.britton@pkf-francisclark.co.uk

could this affect you?

Capital gains tax

60 day reporting

The short turnaround reporting on residential properties by UK residents has been effective since 6 April 2020, and this is something that could affect you if you are considering selling or gifting an interest in a UK residential property. Until the Autumn Budget Day on 27 October 2021 the time limited was just 30 days, but this has now increased to 60 days with immediate effect as recommended by the Office of Tax Simplification. It is a change welcomed particularly by accountants and tax advisers and whilst still a tight turnaround time does provide a little longer to assist their clients.

When is the capital gains tax payment due and how is it reported to HMRC?

Since 6 April 2020, a capital gains tax (CGT) return had to be filed with HMRC within 30 days of completing on a disposal of an interest in residential property if certain criteria are met. This has now increased to 60 days from 27 October 2021. The resulting tax liability must also be paid within 60 days of completion. This timescale can prove challenging for cash flow as well as reporting. Unfortunately, penalties will be imposed if the filing is submitted late and interest will accrue for late paid tax

A 60-day CGT return is not required if the disposal has not resulted in a capital gains tax liability, for example if:

- *The residential property disposal has resulted in a capital loss*
- *The gain (together with other residential property gains that have already happened in the same tax year) is within the annual capital gains tax exemption*
- *Reliefs are applicable to the property disposal which reduces the taxable gain to nil*
- *Capital losses are available to be used against the gain to reduce it to nil, either from previous tax years or from disposals in the current tax year, before the completion date*

There are slightly different rules for non-residents which are not covered in this article. Any non-resident disposing of a direct or indirect interest in UK residential property should seek tax advice well in advance of the disposal taking place as the 60-day filing will apply even if no tax is payable.

Even if a 60-day CGT return has been filed and capital gains tax has been paid, the disposal will still usually need to be reported on the annual self-assessment tax return completed after the end of the relevant tax year. A credit will be given for the tax paid during the year. In most cases the 60-day return will have been filed on an estimated basis as income affecting the CGT rate will not be known until after the end of the tax year.

The disposal may be a mixture of residential and non-residential property. If the property is sold with land, it will be important to determine whether that land is regarded as forming part of the residence or if it is non-residential. Where there is a mixture, only the gain on the residential property part is required to be repoqwrted within 60-days, so this will need to be valued separately.

The cost of any improvements or extensions to the property are normally allowed as an addition to the original acquisition cost/value when calculating the gain/loss on disposal so it is important to hold on to records of this sort of expenditure.

If the property is being sold by more than one owner, each owner will need to consider if they need to file a 60-day CGT return. Companies are not subject to the 60-day CGT reporting.

When might a capital gain arise other than on a sale?

It is important to note that it is not just the sale of a property that will trigger a capital gains tax liability. It could also occur when a property is transferred by way of a gift or a transfer at undervalue. Spousal transfers are normally treated as made at nil gain/loss so would not need to be reported. However, a transfer between spouses following permanent separation may give rise to a capital gains tax liability and advice should be sought. If the disposal is a transfer or gift at undervalue of the property, a valuation of the property will be required to calculate the potential gain and tax at stake. It is important to identify if a valuation is needed at an early stage in proceedings to allow sufficient time to arrange for one to be undertaken.

Main residence relief

Relief from capital gains tax is available when somebody sells their only or main residence. The rules for this relief can get rather complicated for farmhouses or cottages with large gardens, paddocks or outbuildings or where the property has not always been used as the main residence or an election has been made in favour of another residence. If there is any doubt as to whether main residence relief would fully negate the gain, advice should be taken as soon as possible in case there is a reporting requirement. Even with a 60 day time limit it can take some time to properly identify and investigate main residence relief.

How to report next steps

Before you make a 60-day CGT return, you need to have a Government Gateway account and a Capital Gains Tax account online – we are unable to set these up for you. As soon as they are set up, we can complete the capital gains report on your behalf as your agent. HMRC will not issue a payment reference number to enable you to make the necessary tax payment until your CGT return has been submitted. We can provide you with step by step instructions on how to set up your Government Gateway account and Capital Gains Tax account should you need them, but we would recommend that you allow a few days to set everything up, just in case there are any problems.

The disposal of UK residential property is now something that requires advice ideally before or as soon as possible after the transaction has completed. The tax implications of a disposal may not be straightforward and the penalties for late filing can add up quickly. If you have any questions or would like to discuss things further, please contact us.

Sam Chapman
Partner
sam.chapman@pkf-francisclark.co.uk

Annual investment allowance

Budget 2021 date extension to £1m limit

In the Chancellor's Autumn Budget Speech 2021 he announced a further date extension of the £1m annual investment allowance limit from 31 December 2021 to 31 March 2023, but what does that mean for businesses?

Businesses often need to make capital investments in order to improve efficiencies, expand or simply keep up with the latest technology.

When the level of the Annual Investment Allowance (AIA) was first introduced in 2008 it was to encourage investment and allowed businesses to write off 100% of the cost of qualifying assets against their taxable profits, up to a certain limit.

This limit started at £50,000 and has been as high as £1m since 1 January 2019. This £1m temporary increase to encourage investment was due to come to an end on 31 December 2021 where it was to revert to the previous 'permanent' rate of £200,000, which is a significant reduction.

Many businesses may have been planning to incur significant capital expenditure by 31 December 2021 in order to achieve 100% tax relief before the limit is cut. The recent Budget announcement takes some of the timing pressure off as the £1m limit will now remain until 31 March 2023 which is welcome news.

Since 1 April 2021, many companies have been able to benefit from the 130% super-deduction or 50% first year allowances that were announced in the Spring Budget. However, these new first year allowances are not available to unincorporated businesses who rely on AIA to get 100% tax relief on a significant amount of expenditure.

Whether the AIA does eventually reduce back down to the 'permanent' rate of £200,000 from April 2023 remains to be seen. When there is a reduction in AIA rate then care is needed to ensure that capital expenditure is not left until too late to achieve full relief due to the complex way in which the relief is time apportioned and restricted.

If you have any questions regarding obtaining tax relief for capital expenditure please do contact me or your local PKF Francis Clark adviser.

Ben Lee
Director
ben.lee@pkf-francisclark.co.uk

Land Remediation Relief

Are you missing out on a claim?

Many property developers and landlords may be missing out on an opportunity to claim significant tax relief under land remediation relief (LRR). What are the key opportunities and who can claim?

Q What tax relief is available?

Expenditure incurred on remediating land or buildings that were contaminated at the time of purchase can qualify for a 150% deduction against taxable profits. This would mean a £150,000 tax deduction for every £100,000 of qualifying land remediation expenditure.

Land or buildings would be in a contaminated state if present as a result of industrial activity such that it is or could be causing harm or may pollute groundwater, streams, rivers or coastal waters.

Q Who can make the claim?

- *LRR is only available to companies and not unincorporated businesses*
- *The company may be carrying on a trade or a property investment business as a landlord*
- *LRR is available for both capital and revenue expenditure*
- *Property developers will achieve relief when properties are sold (i.e. in the same period as the actual expenditure is charged to the profit and loss account)*

Q What can be included within qualifying expenditure?

Expenditure can include the cost of establishing the level of contamination, removing the contamination or containing it. No relief is available if the remediation work is not carried out.

LRR can also apply to arsenic, radon and Japanese knotweed. Another area we see regularly is in relation to asbestos.

Q My company is loss-making so is it worth making a claim?

If claiming LRR gives rise to a loss, your company can surrender the loss and instead claim a land remediation tax credit equal to 16% of the loss. This would mean a £2,400 cash payment from HMRC for every £10,000 of qualifying expenditure.

Q Are there any key exclusions?

Relief is not available where the company, or a connected party, was responsible for causing the pollution (known as the 'polluter pays' principle), for cleaning up nuclear sites or, for landlords, where the contamination was caused by the tenant.

Q Are there opportunities when bringing derelict land back into use?

Yes – there are opportunities for expenditure incurred by companies bringing long-term derelict land back into use. The land must be out of productive use and not be capable of being used productively unless buildings or structures are removed.

To count as long-term derelict the land must have been derelict since the earlier of when the site was acquired by the company (or a connected party) or 1 April 1998.

Qualifying expenditure includes the cost of establishing what redundant structures are present and the cost of removing a specific list of structures, including building foundations, machinery bases and below ground redundant services.

Q How can I find out more information?

Please contact me or speak to your normal PKF Francis Clark contact to discuss whether there may be opportunities to access this additional tax relief.

Heather Britton
Director
heather.britton@pkf-francisclark.co.uk

Maximising the value of your business

As you may be aware there has been a lot of transaction activity in the construction sector with the pandemic boom in home improvement and general construction activity driving growth. Despite the supply chain challenges being experienced by many in the sector there remains a significant amount of interest from financial institutions in funding transactions as well as national players implementing a strategy of growth by acquisition.

At PKF Francis Clark we have advised multiple businesses in the merchant sector on their succession plans and helped to position these businesses to ensure they achieve the maximum value from acquirers. We have a number of active transactions on both the sell and buy side and therefore have an up-to-date insight into current sector valuation multiples, as well as a comprehensive list of industry contacts and prospective buyers.

PKF Francis Clark

PKF Francis Clark is ranked in the Top 10 in the UK as one of the most active Corporate Finance teams in the country. As a result, we have a breadth of experience covering all elements of a transaction, with particular experience in advising owner managed businesses and supporting shareholders in realising optimum value. Outlined below is a selection of our relevant experience:

You're invited!

Selling your business workshop

PKF Francis Clark will be hosting an informal, interactive workshop due to an increase in requests for advice from business owners who are thinking of selling their business and wish to understand the process involved and what their business could be worth. The workshop will enable business owners to prepare for and achieve a successful sale of their business.

To register your interest please email
harry.clive@pkf-francisclark.co.uk

What we've been up to...

Michelmores Property Awards

2021

From left to right: Heather Britton, Andrew Allen, Paul Bray, Ben Lee, Natassia Richardson, Steve Ashworth, John Endacott, Sophie Endacott, Rob Tough

The Deaf Academy - the winner of 'Project of the Year'

A few members of the property & construction team from PKF Francis Clark and clients were delighted to attend the Michelmores Property Awards on 4 November and sponsored the award of Project of the Year (over 5 mil).

We were delighted to present The Deaf Academy with their well-deserved award and recognition of how their project is helping improve lives of those living with deafness and hearing impairments. Congratulations to all the winners on the evening!

What's coming up...

We are looking forward to hosting our annual Property Seminars in February 2022 with updates directly from our property and construction experts on everything from tax to CIS. The seminars will run over three 45 minute sessions conveniently delivered over lunchtime in a virtual format. Further details to follow so please make sure you are signed up to our newsletters and property event invitations for further information.

PKF FRANCIS CLARK

Shared Ambition

We share your ambition

pkf-francisclark.co.uk

Bristol | Exeter | Plymouth | Poole | Salisbury | Taunton | Torquay | Truro