

## **REAL ESTATE TAX IN A TOUGH CLIMATE**

**by Michael Thomas**

In difficult times people focus on saving costs and may be prepared to be more flexible in order to get deals done. The question which then typically arises is whether there is a tax saving which can be achieved by implementing the commercial deal in a particular way. This corresponds with the trend away from 'one size fits all' tax schemes, the availability of which has been much reduced by the recent wave of anti-avoidance legislation. In addition, a situation where land often no longer stands at a gain and, for example, the shares in land-rich but debt-laden companies may be significantly reduced in value, makes now an ideal time to embark on restructuring of all kinds.

In the market where developers were racing to acquire new sites vendors were typically able to demand cash for the freehold, and the developers suffered SDLT at 4%. But there are ways in which a development can proceed without such a charge being incurred. The one which tends to work best is for the parties to undertake a joint venture into which the landowner contributes the land and the developer works. The proceeds of sale are then divided between them. No SDLT arises in this situation except to the extent that the developer pays cash up-front. However, even the SDLT charge on any cash might potentially be avoided by the developer making a loan to the landowner. An alternative route for a developer to save SDLT is to have it paid as a builder and marketing agent so that it acquires no interest in land. The problem in practice with this arrangement is that the developer inevitably wants the right to direct conveyances of units, which falls foul of s.44A FA 2003. There are ways around this difficulty, but they tend to add complications and increase the chances of an attack from HMRC. So, where appropriate, the joint venture model is preferable. One point to be aware of if either of these structures is followed is that the landowner will have some income profits.

For investors and those acquiring land for their own use, the question which I am typically asked, albeit less frequently nowadays, is whether this can be achieved without incurring a charge to SDLT. The short answer is that it should be possible to save SDLT provided that both parties are prepared to be sufficiently flexible. However, I am not aware of any planning for residential property which is to be occupied as the purchaser's home which is sufficiently robust that I would recommend it. It should be emphasised that SDLT planning is difficult, as it is necessary to overcome the general anti-avoidance rule in s.75A FA 2003. Such planning will typically involve risk and needs to be approached with caution.

Two generic ideas to save SDLT for investors are worth a specific mention. One is to use a partnership as an acquisition vehicle. This kind of planning requires the involvement of the vendor but it should not be necessary for it to do anything too onerous. There are several variations on the partnership theme. Some of these ideas are more robust than others, and all involve additional complication. Nevertheless, in a deal of sufficiently high value where there is scope for flexibility then one of them might provide an appropriate solution.

The other suggestion is for the parties to enter into a sale and leaseback with a right to repurchase, and take advantage of the Islamic finance reliefs. Again, there are

significant obstacles in the way of using this kind of arrangement as a general planning tool. First, the purchaser must be a financial institution: this definition extends to companies with suitable credit licences but it is not permissible to go out and buy such a company. Secondly, both the leaseback and the right to repurchase must have some commercial substance so that they cannot be disregarded. So, taking advantage of the Islamic finance relief certainly merits consideration if the basic transaction is a sale and leaseback. This idea may also be imported into other transactions, but care needs to be taken to ensure that the conditions for relief are truly met.

Restructuring may be driven by direct tax considerations. For example, now is a good time for an individual to consider making gifts of assets which stand at little or no gain, so as to improve his IHT position. Another idea which is currently in vogue is to remove investment properties from companies so that they are held directly by the shareholders and future gains are taxed on the individual at the favourable 18% rate rather than incurring an effective double charge. There are typically two potential difficulties with this idea. One is that such gain as there is on current market values will be taxed in the company; but often this will not be sufficiently high to prevent the planning, the aim of which is to shield future gains. The other is that SDLT will be payable if the property is sold out of the company to the individuals. However, it is possible to very easily avoid this SDLT charge by selling the property to the individuals in partnership. This is one example of where the SDLT partnerships regime produces favourable results for transactions taking place between connected parties. Others include the incorporation of a partnership business and, more generally, any sale of assets between connected persons.

Where restructuring is driven by commercial necessity then tax remains of paramount importance. Being able to put a low value on land enables tax charges to be minimised where no relief is available. However, care must be taken to ensure that the tax risks are properly managed, because any valuation is open to challenge from HMRC. So, it is important that any valuation which is relied on is sufficiently robust; if there are doubts as to the correctness of a valuation then an additional disclosure might be made against HMRC to guard against a discovery assessment being made after the normal enquiry window has closed.

Taxpayers should also beware the consequences of making guarantee payments. Such a payment is unlikely to qualify to be deductible in computing either income, because there is no concept of a group trade, or capital profits, because the payment is not reflected in the state or nature of any shareholding. In addition, the guarantor is unlikely to be able to recover any VAT as input tax because no supply is made to him. Where possible commercially then a better course is for the guarantor to subscribe for additional share capital in the primary debtor and then to have the payment made directly by the primary debtor.

More generally on the VAT front, there is less scope for more aggressive kinds of planning following the ECJ's decision in the *Halifax* case and the decisions which have followed in its wake. HMRC is also spending more time in the country and is known to be upping its level of scrutiny into shoots: claims that the shoot is not a business are strictly scrutinised and the possibility of a shoot becoming exempt as a sports club is an alternative worth considering. On a more positive note, HMRC has confirmed in RC Brief 54/08 that it accepts that unsold development stock can be

moved between connected companies so that a short-term letting does not give rise to an input tax clawback. “Golden Brick” arrangements on sales to housing associations, where a partially completed building is supplied by the developer to the housing association together with a further supply of works to reach practical completion, should also remain safe. Another positive development is that the VAT Tribunal has been taking a broad view as to what is a transfer of a business as a going concern following the ECJ’s decision in *Zita Modes Sàrl v Administration de l’enregistrement et des domaines*<sup>1</sup>. This position is yet to be reflected in HMRC’s published guidance but there is considerable opportunity for taxpayers to self-assess boldly in this area.

To summarise, in bad times as in good it is important to scrutinise the tax consequences of any deal to ensure that all potential savings are obtained and pitfalls avoided.

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<sup>1</sup> (Case C-497/01) reported in [2005] STC 1059, [2003] ECR I-14393.