

Insights

HOW WILL THE NEW UK RESIDENTIAL PROPERTY DEVELOPER TAX WORK?

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On 29 April 2021, the government published a consultation on what is to be called the [Residential Property Developer Tax](#) (or RPDT). This sets out proposals for the design of a new tax to be charged on the largest residential property developers.

The plan is for the tax to be introduced from April 2022 (through inclusion in the 2021 Autumn Finance Bill) and to raise at least £2 billion. Such funds will contribute to the cost of cladding remediation work.

Plans for this tax were [first mooted in February](#) as part of a £5 billion cladding remediation package. However, details of what was planned were sketchy at best and so it is pleasing that the consultation setting out further detail of the parameters of the tax has been so swiftly published.

This post takes a look at the consultation starting with a recap of why such a tax has been introduced. It then looks at what is being proposed, timelines for introduction and what will happen next.

Some background

Fundamentally, this is all about making sure that [Grenfell](#) never happens again.

Since the Grenfell tragedy in June 2017, the government has introduced (and is in the process of introducing) various measures in an attempt to minimise fire safety risk in high rise residential buildings. The ramifications of such measures are arguably prompting the biggest shake-up of the [building safety regime](#) that the construction industry has ever seen. This tax on developers is but one part of these measures.

The genesis of the tax stems from the government's commitment in February to fully fund the cost of replacing unsafe cladding for all leaseholders in residential buildings in England which are 18 metres and over. The idea is that the funds raised by this tax, in conjunction with a new Gateway 2 levy (which will be applied when developers seek permission to develop certain high-rise buildings in England) (the details of which are yet to be announced) will go towards the cost of such replacement.

The government describes the imposition of such a tax on developers as “industry paying its fair share”. It argues that the “largest developers in the residential property development sector” should contribute towards the cost of remediation because they will be the ones who benefit from the end result. Although interestingly, the government takes care to say in the consultation that the tax is not a punitive measure. It recognises that many developers who will be affected have had limited involvement in the development of high-rise buildings that require remediation.

What is being proposed?

The tax is time-limited

The government intends for the RPDT to be time-limited and aims to raise at least £2 billion over a decade. It warns that if it does not raise sufficient revenue over the ten-year period, it will consider extending the duration.

No rate has been set yet. This will be decided after the design has been finalised. Most likely it will be announced in the Autumn Budget.

The largest profitable corporate residential property developers will be subject to the tax

The RPDT will apply to companies or corporate groups, including companies developing through partnerships.

It will be levied in addition to corporation tax and is not itself corporation tax.

A group of companies or a standalone company will be within the scope of the RPDT if they:

- undertake UK residential property development activities; and
- generate relevant profits (see below) that exceed the £25 million annual allowance available to them.

What is a residential property development?

Building on existing definitions of residential property in other taxes, the government intends the RPDT to apply to:

“...a house or flat that is considered as a single residence, generally together with the grounds and garden or any other land intended for the benefit of the dwelling”.

The definition will be extended to include future residential use, for example by including any undeveloped land or land undergoing a change in use, for which planning permission to construct residential property has been obtained.

There are some boundary issues:

- *Affordable housing* should be in scope, although those developers developing at a cost only return or charitable developers (for which an exemption would apply, for example the large housing associations) may be unaffected by the tax.
- The usual list of communal dwellings (such as hotels, residential homes for children, prisons and so on) would be excluded, but *student accommodation* (or certain types, such as self-contained units) may not be, and could consequently be subject to the RPDT.
- Similarly, certain types of *retirement living* may be in scope.

To come within the scope of the RPDT the taxpayer must be developing and this will include:

- building a new residential property and converting an existing property to residential;
- whether for sale or rental.

As a result it would catch the build-to-rent (BTR) sector. A challenge for the sector is in determining the development profit if the property is held for investment. A couple of proposals are made. If property is sold or transferred within a group after completion of the development phase, an arm's length profit would be used for RPDT purposes. Where this does not happen, the fair value of the development upon initial rent, minus the cost of development would be taxed. This would lead to "dry tax charges" – meaning tax on proceeds not received.

What profits will be taxed?

The government is looking at two alternative models of taxation.

Model 1 would tax companies and groups of companies that undertake *any* amount of UK residential property development or support that work *provided* the residential property development activity is significant.

Under this model RPDT would be calculated on the *total profits* of the company as computed for corporation tax purposes, with adjustments (mentioned below). This would mean profits from other activities of the company such as commercial property development or on the full profits of a mixed development would be subject to RPDT. The impact of this approach of taxing the company rather than the activity would depend upon how a group is structured and whether the company in question does more than residential property development.

Model 2 in contrast is better targeted at taxing profits from UK residential property development activity only. It would apply to companies or groups of companies that undertake that activity or support others in the same group doing that work. Only UK residential property development activities would be subject to the RPDT, so this would require identifying those activities within a company. For example, on a mixed use development only residential profits would be taxable.

Under this model taxable profit attributable to the relevant activity would be calculated either using the profits computed for corporation tax purposes or using a consolidated accounting measure of profit. In either case there would be adjustments (mentioned below).

What are the adjustments to the taxable profit for RPDT?

- Interest and other funding costs will be excluded from the calculation of the profits. Adding back interest costs to profit could significantly increase profits subject to RPDT.
- Also, losses incurred pre April 2022 will not be able to reduce profits subject to the RPDT going forward. For losses incurred after that date, the government is seeking views on allowing the use of carry forward RPDT losses, recognising that profits can fluctuate year on year. Any such regime would introduce greater fairness, but is likely to be complex.
- On the models using corporation tax profits as a starting point to calculate the taxable profit for RPDT, any losses surrendered by a group member that are attributable to activities other than residential property development would be added back. The impact of this would be more severe under Model 1 (which would tax all profits, but not allow group relief for all profits) than Model 2 (which would tax only residential property development profits).

How will the RPDT impact on non-UK residents?

The RPDT is expected to apply to profits of a non-UK resident company that are already subject to UK tax. So RPDT could apply where the non-resident has a permanent establishment in the UK or falls within the scope of the UK's offshore property developer rules (without protection under a double tax treaty). Here the UK is observing the limits of its established taxing rights internationally.

Joint ventures

The government is considering a two-tier approach for taxing corporate joint ventures in order to treat development profits fairly. It notes a number of different structures can be used for corporate joint ventures and that investors could be non-UK or be exempt pension funds. It wants the joint venture to be taxed appropriately, whether the taxation is at the level of the corporate entity or the investors.

Under this approach:

- Profits would be subject to the RPDT for the JV structure as if it were a standalone group.
- The profits of the JV applicable to each JV member's ownership of the JV would also be taxed to RPDT as part of the group's RPDT profits.

Where the joint venture is liable to pay the tax, double taxation would be avoided by a participating group receiving an appropriate credit.

No additional rules for partnerships (or other fiscally transparent structures) are being considered as, if the JV partner is a corporate, its profits would be taken into account for RPDT in any event.

Sale of corporate vehicles

A rule would be introduced to stop residential property development profits falling outside of charge through a sale of a developer company that ceases to be within the scope of the RPDT.

Anti-avoidance rules

A series of rules will be introduced against:

- Accelerating the recognition of profits before the start date (in April 2022).
- Fragmenting activities across a group.
- Re-characterising residential property development profits.

When?

The tax would apply to relevant profits arising from 1 April 2022 and will be introduced in the 2021 Autumn Finance Bill.

What next?

The consultation will run from 29 April to 22 July. Groups and joint ventures undertaking UK residential property development will, no doubt, want to engage with the consultation to see how the new RPDT could affect them.

Some of the key issues for the industry will include:

- The impact on BTR, including the government's suggestions on how to tax development profit.
- What is treated as residential for these purposes. For example, considering the impact on student accommodation and retirement living.
- How the different models of taxation (taxing the corporate, in the case of Model 1, or the relevant activity, in the case of Model 2) will impact on individual groups. For example, this could differ depending upon how they organise their business into different corporate entities.
- The taxation of joint ventures. For example, considering how the tax would impact on an exempt pension fund investing in a UK development through a joint venture company.

This [article](#) first appeared on the Practical Law Construction blog dated 5 May 2021.

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