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Real Estate:UK response to VAT treatment of land intended for the construction of new social housing

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General Comments

We welcome the Government's objective of removing unnecessary VAT barriers that can get in the way of building new homes. The consultation proposal represents a pragmatic intervention which at the same time has the potential to improve both the viability and timing of housing delivery and is both low-cost and low-risk from an Exchequer perspective.

Whilst the financial benefit of the proposed relief will vary depending on the circumstances of individual transactions, the wider significance of the measure lies in reducing friction within the development process. Transactions involving land for social housing can currently require commercially unnecessary structuring in order to mitigate irrecoverable VAT costs. These arrangements increase transaction costs, extend negotiation periods and create uncertainty for all parties. A targeted zero rate has the potential to simplify these transactions considerably.

We therefore support the introduction of the proposed relief.

The consultation appropriately recognises that successful implementation will depend upon careful legislative design. We believe the legislation should seek to build upon existing VAT concepts and administrative mechanisms rather than creating entirely new frameworks. Existing certification procedures, concepts of intended use and established HMRC practice are generally well understood by taxpayers, advisers and HMRC alike. Adapting these mechanisms will produce greater certainty than introducing wholly new evidential requirements.

A recurring theme from our members' experience is that the legislation should recognise the commercial realities of modern development. Land is frequently assembled over extended periods, developments are commonly delivered in phases, and housing is increasingly delivered through partnerships between private developers, registered providers, local authorities and institutional investors. The legislation should therefore accept these structures without requiring artificial transaction arrangements solely to secure the intended VAT treatment.

Similarly, mixed-tenure and mixed-use developments have become more common over the past decade. Many development schemes include combinations of social housing, open market housing, commercial premises, community facilities and public infrastructure. The VAT rules should support these integrated developments rather than creating incentives to separate them artificially. It is for this reason – on which we elaborate further below – that we strongly feel the zero rate should be determined primarily by whether the recipient of the land is a registered provider rather than relying on a definition of social housing that risks creating unhelpful cliff edges.

Finally, we consider that comprehensive HMRC guidance will be essential to achieving the Government's objectives. Given the diversity of land transactions, guidance setting out clear principles and criteria will be critical in providing confidence to taxpayers and reducing the scope for disputes. We would strongly recommend that HMRC consults with relevant representative bodies and respondents regarding draft legislation, draft guidance and drafts of any proposed certification processes or documentation before these are officially brought into effect.

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Responses to selected Consultation Questions

Question 1
Are you responding as:

- a landowner
- a developer
- a social housing provider
- another type of organisation — please provide details (for example, a trade or representative body, charity, another type of business or organisation)
- a tax advisor
- an individual

RE:UK is a representative body for the UK's property sector. Please see the introduction above for further details.

Question 4: Does HMRC/the governments understanding accurately reflect your knowledge of what happens in practice?

Broadly, the understanding as set out in the "summary of the problem/interaction of VAT rules for social housing delivery" section of the consultation reflects (at a fairly high level) our own knowledge of the VAT-related issues faced by landowners, developers and registered providers in developing land for social housing.

That said, we have had the benefit of reading a draft of the Home Builders Federation's (HBF's) response to this consultation and would agree with and support their more detailed comments on certain inaccuracies with the way that HMRC have expressed aspects of current arrangements to do with the development of social housing.

Question 5: What is your assessment of how the current 'golden brick' rules create barriers of the construction of social housing?

The consultation rightly identifies that a zero-rated sale of (land for) social housing - indeed housing more generally - benefits all parties involved and as a result is an outcome that promotes the development of new homes. The consultation also acknowledges the point that "golden brick" is typically achieved only after substantial work and cost has been incurred in the development.

The timing of golden brick matters, because registered providers are typically required to have title to the relevant land before they are able to access Homes England grant funding to support that housing. However, the need to wait until golden brick in order to mitigate irrecoverable VAT means registered providers have to delay receipt of such funding with no obvious benefit to anyone. The ability to carry out a zero-rated sale at an earlier stage in development would be a considerable improvement.

As we have discussed with HMRC in the past, there is also considerable uncertainty regarding the point at which golden brick is reached in the context of any given development (an issue which is likely to become more complicated with advances in modern methods of construction). We of course appreciate that this will depend on the facts and circumstances of each case, but the way that this uncertainty is often dealt with in practice is to develop housing to a point where there can be no doubt that golden brick has been met. This is likely to be above and beyond the golden brick criteria, meaning that the time between development starting and a sale to a registered provider is elongated even further.

A new zero rate for development land sold to registered providers would do away with the need to consider golden brick analysis and therefore remove that source of VAT-related uncertainty.

Question 7: What is your definition or understanding of the term 'social housing'? (Please reference any statutory definitions that may be relevant including planning regulations and legislation.)

While the Budget announcement focused on social housing as the intended beneficiary of this proposed policy change, we would caution that in order to secure the intended outcome of faster delivery of social housing, the new zero rate will need to apply more broadly than purely to social housing (and indeed broader than just housing).

This is because social housing is rarely developed on a "standalone" basis. It is much more common for social housing to be but one element of a broader development scheme that may include homes let out at market rent (or at varying discounts thereof) and homes held under shared ownership. The same scheme may also include non-residential elements, such as public realm and health and educational facilities.

The important point in this context is that the financial viability of the social housing is generally contingent on the other aspects of the development and it would be economically artificial to try and separate them. The new VAT zero rate should not attempt to do so either.

Indeed, applying the zero rate strictly to the plots of land on a development scheme that are intended for social housing would give rise to significant complexity and invite questions such as:

- What do we mean by social housing? Does it include all forms of discounted rent? What about shared ownership?
- Does it refer only to the proportion of the site comprised of relevant buildings or does it include their gardens/private outside space?
- What about shared spaces (e.g. playgrounds, landscaping, parking)?
- Could a proportion of the value of supporting infrastructure be attributable to the social housing? If so, how and when to calculate it?
- Similarly with non-residential healthcare and educational amenities (e.g. new GP surgery/school)?

Attempting to address, accommodate and apportion for these would likely lead to the application of the new zero rate becoming so complicated and uncertain that it's unlikely it would get used much, defeating the object of the policy measure. We therefore do not feel that the zero-rate under consideration should feature a definition of social housing and the zero rate should apply by reference to the identity of the recipient as a registered provider (more on which in our response to Question 10 below).

However, purely for the purposes of satisfying the interest that we understand HMRC has in wanting to know stakeholders' perceptions of what counts as social housing, we would look firstly at the Housing and Regeneration Act 2008's (HRA 2008) definition of 'social housing'.

This is covered by sections 68 to 70 and in a rental context states that:

> *"Accommodation is low cost rental [i.e. "social housing"] accommodation if—*
> *(a)it is made available for rent,*
> *(b)the rent is below the market rate, and*
> *(c)the accommodation is made available in accordance with rules designed to ensure that it is made available to people whose needs are not adequately served by the commercial housing market."*

By that definition, social housing includes social and intermediate/discounted market rents (which is the context in which the term is used in this response).

The definition is slightly more complex in a sale context (section 70 of that Act), but includes shared ownership arrangements.

Planning legislation and guidance (such as the National Planning Policy Framework, or NPPF) provides another potential definition, albeit under the nomenclature "affordable housing". However, as with the HRA 2008's approach, it includes all below-market rate tenures, including social rent, discounted market rent, shared ownership schemes and discounted market sale housing.

Question 8: How would a new relief reduce the complexities in the current system and incentivise your business's ability to develop social housing quicker? (meaning accelerate the delivery of social housing to help achieve the government's objective of building 1.5 million new homes)

As noted above, the new zero-rate would – in the context of transactions in land acquired by a registered provider for the construction of new housing – both eliminate the need to assess whether the golden brick criteria have been met and bring forward the point at which a sale to a registered provider can be zero rated.

This benefits all parties involved; registered providers are able to access grant funding at an earlier stage and the developer obtains a cash flow benefit and is able to recycle the capital invested in the development into another scheme more quickly as well as improve time-adjusted rates of return on the scheme being disposed of. This all helps to make development more economically viable and get new homes built more quickly and, furthermore, may make transactions viable when they would not have been under a traditional golden brick structure.

Question 9: How would a new relief reduce administrative burdens for your business? (landowner, developer, social housing provider)

A new zero rate would do away with the need to rely on golden brick arrangements (and the associated planning, monitoring and advisory costs incurred by both parties) to achieve an economically sensible VAT outcome.

That said, the extent to which administrative burdens are eased depends on the administration of the zero rate. If it involves extensive certification, ongoing monitoring of use, detailed apportionment or retrospective adjustments, there is a risk that the administrative burden is simply replaced rather than reduced. We would therefore encourage HMRC to align the relief with terms already contained within the VAT legislation such as 'relevant housing association' and existing certification requirements.

Question 10: What types of organisations do you consider provide social housing? (Please reference any regulation of bodies mentioned if relevant.)

While there may be other types of organisation (e.g. local authorities, charities, housing co-operatives) that provide some form of below market rate housing, we are primarily aware of the role played by registered providers and would expect that the new zero rate would apply only to them – at least in the first instance.

We agree that it's appropriate to use the definition of "relevant housing association" in Group 5 to Schedule 8 of the VAT Act 1994 for the purposes of setting who can benefit from the new zero rate. It is important that the zero rate applies to both for-profit and not-for-profit registered providers as both are involved in the development of new below market-rate homes.

Question 11: Are there any issues associated with limiting relief to registered providers? (Please provide any additional detail that you feel will be relevant.)

Perhaps.

As noted in our response to Question 10, there may be other types of organisation that provide below market rate rental housing and it is arguably unfair that these should not benefit from the zero rate. However, we are not in a position to comment on how many such organisations there are nor on the scale of housing development that they commission or undertake.

From our perspective, it is better that the new zero rate is introduced quickly, even if imperfectly and for this reason we would recommend that the Government presses ahead with the zero rate being restricted to registered providers. Once the legislation for this has been introduced, it should be possible to extend its scope should there be a perceived need to do so in order to further encourage the development of social housing.

Question 12: Are there any unintended consequences or risks you foresee with the introduction of this new relief?

We do not foresee any negative VAT-related unintended consequences or risks. Registered providers are closely regulated and the activities they are allowed to carry out (particularly the extent to which they can dispose of property) is restricted by legislation.

We struggle to see how the new zero rate could give rise to significant risk to the Exchequer.

On a different point, it would be helpful if HMRC could confirm whether the occasional use of the term “bare land” in the consultation paper (as opposed to just “land”) is particularly significant.

We have assumed that - subject to meeting relevant criteria around the recipient of the supply – the zero rate would apply to sales of land on which homes are to be developed, regardless of how much has actually been built on it. In other words, the zero rate could apply to land with nothing on it but also to land that has had supporting infrastructure put in place and land where visible construction is underway.

The scenario we would wish to avoid is a new rule that zero rates sales of “bare land” (with nothing on it), is followed by a limbo period where works have commenced but not obviously reached golden brick (presumably a standard-rated sale?) and then golden brick (zero-rated again). We doubt this is what the Government has in mind, but we would appreciate confirmation of this point.

Question 13: How frequently do plans for the development of social housing change? When plans do change, in what way do they change?

Our response would depend on what HMRC means by “change” in this context. Housing development schemes can be large, complex projects involving multiple parties operating under different legal or regulatory regimes, spanning many phases and can take years if not decades to fully complete.

Obviously, given that context it is normal for the parameters of the project to change from what might have been originally submitted to the local authority for the obtaining of planning consent. Depending on evolving economic, social and regulatory conditions, almost any aspect of the development may need to change, such as:

- The number of homes – a stronger economy is more conducive to demand and therefore improves the financial viability of new construction. Conversely, increasing interest rates and cost inflation erode that viability, meaning that projects with planning consent may not be possible for the private sector to deliver.
- The type of tenure – changing economic viability could result in a different tenure mix than might have been originally anticipated. A development may need to

reduce the below market-rent component if it is the only way to ensure the scheme gets developed at all.

- The size, shape and specification of homes – changing building and environmental regulations will affect how homes are designed and operated. These changes will have a consequential impact on cost and economic viability.
- The timing of their construction – completions may be delayed if economic conditions worsen or building or environmental regulation requirements begin to apply mid-construction.
- Whether homes even get built – developers or construction contractors may go bust during the course of development, delaying or even completely stopping development.

However, these changes all reflect normal commercial responses to changing conditions. The fact that plans change should not be viewed as a source of potential Exchequer risk and the new zero rate should accommodate such changes without assuming that they arise from a desire to avoid tax.

Question 14: What evidence can be produced at the point the land is sold to demonstrate that it has been purchased by a registered social housing provider, and therefore qualify for the zero rate?

Whether or not an organisation is a registered provider is a matter of public record, so it should be fairly straightforward to compare the buyer's name on a sale agreement with the Registers of social housing in the different Devolved Administrations.

Question 15: Can you see any risks or complications with a declaration mechanism in the form of certification?

We do not see any material risks or complications with this approach.

Existing certification procedures have generally operated effectively in other areas of VAT legislation and are familiar to developers, registered providers and professional advisers. The certificate should give enough certainty to sellers that they can rely on declarations received in good faith, while avoiding the need for developers or landowners to undertake extensive verification checks into the purchaser's intended use of the land or be at risk of any change of use by the purchaser

The certification process should be straightforward, proportionate and capable of being applied consistently across different development structures. Whilst the standard position should be for a certificate to be provided before the supply of land takes place, it would be good if HMRC could consider allowing late certification or retrospective correction where the substantive conditions for relief are satisfied, but an administrative error or timing issue has occurred, so that disproportionate VAT consequences do not arise.

Question 16: Are there any unintended consequences or complications of mixed tenure developments? We are interested to understand more around practical or delivery concerns that you think may be relevant in this context.

Mixed tenure developments are common as the surplus obtained on the rental or sale of market rate housing is usually needed to subsidise the provision of below market rate homes. It is also not uncommon for homes of different tenures to be spatially mixed together, such that it is not obvious to an observer which homes are rented or owned, and which at market rates or below-market rates.

This is why we would strongly recommend against the new zero rate focusing particularly on the type of housing being delivered on a given site and rely instead on the recipient of the land supply being a registered provider, the tight regulation of which ensures that they will have a clear purpose and requirements around providing affordable homes.

Question 17: What additional support or guidance would help your organisation navigate the new VAT relief?

As ever, clear and practical guidance setting out HMRC's interpretation of the legislation would provide certainty regarding the intention and application of the new zero rate, though the zero rate is implemented as we contemplate above, the guidance should be relatively straightforward. Ideally, such guidance would illustrate how HMRC would approach the question of whether the zero rate can apply to particular circumstances and whether any relevant evidential requirements have been met.

Specific examples are generally helpful, but we acknowledge that these can never be comprehensive so it's important that the guidance gives enough insight into how HMRC thinks about the zero rate and the circumstances in which it may challenge its application.

We would strongly recommend that HMRC consult with respondents and relevant trade bodies on draft legislation, draft guidance and drafts of any proposed certification processes or documentation ahead of their coming into effect.

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Question 18: Are there any other changes that you think should be included to make the new relief easier for you to implement?

Reiterating a point made in our general comments, the proposed new zero rate presents very limited Exchequer risk. It is therefore hard to overstate the importance of the new zero rate being straightforward to interpret and operate so that it can be applied with confidence by developers, landowners, registered providers and other organisations involved in the delivery of social housing. If the scope is unclear or open to interpretation or if evidential requirements are too onerous, the policy will not have its intended effect.

In addition, the rules should accommodate common registered provider group structures and genuine intra-group movements, provided the underlying purpose for the original acquisition by the registered provider remains the delivery of additional new housing. In particular, it should be possible for land to be transferred within an RP group without creating an irrecoverable VAT cost or uncertainty where the transfer forms part of a genuine delivery structure.

Three final and more general thoughts.

Firstly, the relief should operate as an optional additional route to achieving the intended VAT outcome, rather than as a mandatory replacement for existing ‘golden brick’ arrangements.

Secondly, while it’s beyond the scope of the present consultation, the Government should consider the merits of bringing forward the point at which the sale of land for housing development more generally can be zero-rated. We have noted above that the current golden brick rules give rise to considerable uncertainty and the cost and effort that goes in to mitigating the risk of “failing” the golden brick test is not inconsiderable. We can see clear benefits (and limited Exchequer risk) if the VAT rules were more supportive of housing development in this way.

And thirdly, we reiterate comments we’ve made in the past about the perverse incentives created by a system that makes it more VAT efficient to demolish existing buildings to construct new housing (zero-rated) than to undertake the often quicker and environmentally preferable refurbishment of existing residential buildings (the rents on which are exempt and therefore input VAT irrecoverable). We’d encourage the Government to consider introducing a reduced or zero-rate for refurbishing residential buildings and would be happy to explore options for this further.