Autumn Budget 2018 – a submission by the BPF

Introduction

1. The British Property Federation (BPF) represents the commercial real estate sector. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them.

2. The real estate industry provides the infrastructure and places in which people can live, do business and relax. Indeed, it is very hard to imagine how the modern economy would work if there wasn't anyone to provide it with appropriate physical space. As a creator of that space, the real estate industry is uniquely placed to shape the UK's future and to support long-term economic growth and increased productivity across the UK.

3. The purchase, development, ownership and management of commercial real estate involves significant economic activity. The Government can leverage this economic activity – as well as the real estate industry's ability to support other sectors of the economy – to help deliver on its key objectives of maintaining jobs and growth, building economic resilience and housing the nation.

Building investor confidence through stability

4. Investors currently own £486 billion[1] of commercial property and it is essential that the sector continues to attract investment to fund new developments and regenerate existing assets. Overseas investors – who currently contribute almost a third of all investment into UK commercial real estate - will look across the global market when making investment decisions and the UK must remain a destination of choice, particularly as we leave the EU in March 2019.

5. The tax burden on UK real estate is the highest in the OECD and double the OECD average. Domestically the commercial real estate sector contributes almost 50% of its GVA in taxes, compared to 27% for the rest of the economy[2]. It should also be remembered that many property owners are investing in and managing property on behalf of ordinary people investing through pension funds or similar schemes, and a successful real estate sector will bring them benefits.

6. The sector needs a tax system that is competitive, stable and which addresses the strategic questions of the future including business rates and Land Value Capture. A sense of stability and certainty is crucial for real estate investors and developers who are typically making very long-term investment decisions. Constant changes to real estate taxation increases both the tax burden and the complexity for investors in administering the system.

7. Recent fiscal events have seen a stream of changes to real estate taxation, with the current draft Finance Bill implementing substantial new measures for non-residents on the taxation of property gains and income, and alterations to payment periods for CGT and SDLT. This has left investors uncertain about the Government's medium-term plan for property taxation - the current draft Finance Bill seeks to create a more level playing field between the property taxation of residents and non-residents although the proposed end-point is unclear. As a consequence, investors are asking whether there are further changes to

[1] Property data report 2017, Property Industry Alliance
[2] Commercial real estate taxation, Cebr, 2018

come and finding it difficult to confidently determine long term net returns from investment in UK real estate.

8. A more holistic approach to tax policy is needed. The real estate industry is now subject to some 25 taxes across the lifecycle of a property from purchase and refurbishment, through leasing and sale, to demolition and redevelopment. The BPF recommends that any future tax policy changes are made with a more holistic view of how real estate is taxed in the UK. This means considering all taxes that apply to real estate across the lifecycle of a property, rather than considering separate taxes in isolation We would welcome being part of such a discussion with Government going forward.

9. Given the number of property related tax changes already contained in the draft Finance Bill, we are not proposing any more substantial changes in the immediate term. There needs to be a focus on ensuring the Finance Bill measures are implemented effectively – through clear legislation, effective guidance (particularly for non-residents coming into the rules on capital gains and corporation tax for the first time), and HMRC being resourced to deal with the volume of calls and queries that may arise as people begin to implement the new rules.

10. Instead our submission looks at how we can start building a tax framework for real estate that remains attractive to investors and supports Government achieve its policy goals. Our comments are under three headings:

- Longer term challenges facing property taxation
- Supporting Government to achieve its policy ambitions
- Improving the operational effectiveness of the current tax system

Longer term challenges facing property taxation

11. Looking ahead there are substantial challenges within the tax system that Government and the real estate sector will need to address. It is clear that some taxes such as business rates can't continue indefinitely in their current form and that changes are needed to reflect the changing use of space by businesses in all sectors of the economy. At the same time politicians and think tanks are looking at whether a new approach is needed to taxing land and property potentially through Land Value Capture. These issues need proper consideration as any changes of this magnitude will impact on the real estate sector, its customers and the different taxes that businesses pay. Changes can't be considered in isolation but must take into account the wider impacts they will have.

Land Value Capture

12. Land Value Capture (LVC) occurs in different forms and therefore we do not have a blanket policy position, but one that considers the impact and nuances of different LVC measures. In general, LVC refers to taxes and charges that are a one-off, or for a limited period, to help capture some of the benefit that landowners derive from public infrastructure investment, or changes to the planning classification of their land. LVC seeks to capture 'betterment' and is used to support the delivery of specific local or sub-regional infrastructure.

13. By their very nature, taxes of this sort should not be used to plug gaps in local or national government current spending. Care also needs to be taken in their implementation. Land value uplifts are generally long

term and value capture mechanisms at the commencement of development, on top of on-site infrastructure costs, risk stopping that development altogether; while seeking to extract 'hope value' could also mean less land coming forward for housing at a time when the Government's ambition is to deliver 300,000 homes per annum.

14. LVC models include:

- **Infrastructure betterment taxes** – The sector has provided funding for Crossrail and in principle will support other infrastructure delivery through betterment taxes. Support will be stronger where there is a clear and direct link between the betterment tax and specific infrastructure projects. MCIL (Mayoral Community Infrastructure Levy) has worked well in London, but in other regions, land values will struggle to support such mechanisms, and therefore the Strategic Infrastructure Tariffs announced at Budget time. With infrastructure betterment taxes, little and often is better than large one-off up-front costs. That, however, raises issues about timing of infrastructure and tax receipts. We have therefore also been long-term supporters of Tax Increment Financing (TIF), where funds are borrowed to pay for infrastructure improvements, and repaid from the broader recurrent tax base that is created.

- **Planning betterment tax –** This is an area that is littered with failed policies, from the development taxes of the 1940s to 80s, to the planning gain supplement suggested by the Barker Review, and to some extent the community infrastructure levy. Government should be focusing on simplifying and improving the existing taxes in this area by, for example, taking on board the CIL Review recommendations. It should be mindful that planning betterment taxes will not work well in all parts of the country, and that large up-front costs will stifle development and stop land coming forward for much needed housing delivery.

  There is one exception to our description of failed policies, which is the New Towns, where land was bought at one use (sometimes using CPO powers), granted planning permission and sold at another by public bodies, often a Development Corporation created for the purpose. The forced sale of land without hope value is a power that Governments should only use sparingly, given the rights to property it infringes on. We can see the justification with New Towns, given the significant infrastructure spending that they require and opportunities they create, but only support this method of LVC within the defined circumstances of the New Towns Acts.

- **Development partnership models** – the sector works very effectively with public bodies to help share value capture. This often involves public sector bodies investing land in a joint venture and deriving income and/or increased capital from the activities that take place, once a place is developed. In today's environment, where local authorities are having to think carefully about current spending, such partnership models can be win-win.

15. LVC models such as the above should be distinguished from recurrent Land Value Taxes which would replace or sit alongside existing recurrent taxes, like business rates or council tax and are often used to pay for current spending. Changing the basis of local taxation so fundamentally through Land Value Taxes would raise significant political and practical challenges, and the sector believes efforts would be better spent ensuring existing recurrent taxes, such as council tax and business rates, functioned better and more equitably.

Business rates

16. The BPF welcomes steps the Government has taken in recent years to alleviate the pressures business rates can cause for property occupiers. The switch from the RPI to CPI as the basis for escalating the multiplier and introducing more frequent revaluations were the result of positive engagement with the business community. Whilst recognising the progress that has been made in reforming the current system, high-streets remain under pressure, and we would recommend that any further short-term reliefs focus on further slowing increases in the business rates multiplier over the next few years.

17. Longer term the current business rates system is increasingly unfit for purpose. Businesses of all sorts will become ever more efficient in their use of space (partly through automating operations, moving things online or staff working remotely). As a result, commercial property rents and values will struggle to keep up with inflation and this means that the basis on which rates are raised (effectively ensuring the same real terms income to government every year) is unsustainable. The rate of tax is already nearly 50% and continues to increase. It is unreasonable to expect a shrinking tax base to deliver the same amount of tax year in, year out. To force it to do so will hugely damage our economy over the next decade.

18. Instead, the Government should be brave. It should decouple business rates from inflation and it should fix the rate of tax. This would mean businesses pay more in the good times, when they can better afford it and paying less when times are tough. The Government should also - as it is already doing - consider whether the tax system is capturing an adequate proportion of the enormous amount of value that is being generated online. Economies evolve and so should the tax system.

Supporting Government to achieve its policy ambitions

19. The Industrial Strategy highlighted the importance of vibrant places and harnessing new ideas as foundations of productivity. The real estate sector can play a role as an enabler, through which Government can achieve its ambitions on productivity. Our recommendations below would:

    - Create prosperous communities by supporting the emerging Build to Rent sector to provide more affordable homes; and
    - Help the real estate sector to grasp the opportunities provided by PropTech to utilise the management of data to improve efficiency and drive innovation

Build to Rent and the 3% SDLT surcharge

20. The UK Build-to Rent Sector (BTR) is making an important contribution to UK and London housing supply. Our latest statistics (compiled by Savills – Q2 2018), show that there are 126,000 Build to Rent units completed, in construction and planning in the UK. In 2017, a quarter of all new market homes delivered in London (24%) were for BTR, and 11,300 BTR homes were under construction at the end of 2017, close to one in five of all private homes under construction in the capital.

21. The sector has evolved substantially in a relatively short period of a few years and a number of business models have developed. Some providers are developing from scratch and therefore only incur SDLT on land purchased. Some are pursuing a hybrid model of purchasing BTR units off developers as well as developing some sites themselves. Other investors, which can include UK pension funds, smaller investors and overseas institutions, are purely forward purchasing units from a developer.

22. This latter part of the market involved in forwarding purchasing is an important and growing opportunity for some of the UK's second-tier housebuilders – the likes of Bloor, Countryside and Telford. We believe this part of the sector (investors and second-tier housebuilders) could be growing faster and contributing more to housing delivery if institutions were not faced with the 3 per cent SDLT surcharge. We would advocate removing transactions of 15 or more homes from the surcharge, and therefore allowing this part of the market to contribute more homes.

Affordable Private Rent

23. The Government has a specific approach to affordable housing provision for the BTR sector – Affordable Private Rent (also known as Discounted Market Rent) - which allows sub-market rented accommodation to be retained by the investor. This allows for efficient management and means the affordable and market rented units are physically indistinguishable, the only difference being rents. It creates a homogenous community and avoids so called 'poor doors'.

24. The National Planning Policy Framework (in its glossary) now recognises Affordable Private Rent as an affordable housing tenure:

    Affordable housing for rent: meets all of the following conditions: (a) the rent is set in accordance with the Government's rent policy for Social Rent or Affordable Rent, or is at least 20% below local market rents (including service charges where applicable); (b) the landlord is a registered provider, except where it is included as part of a Build to Rent scheme (in which case the landlord need not be a registered provider); and (c) it includes provisions to remain at an affordable price for future eligible households, or for the subsidy to be recycled for alternative affordable housing provision. For Build to Rent schemes affordable housing for rent is expected to be the normal form of affordable housing provision (and, in this context, is known as Affordable Private Rent).

25. The sector could deliver more Affordable Private Rent homes if tax policy reflected planning policy and now also recognised Affordable Private Rent. For example, policy could:

    - Recognise the transacting of land and buildings for Affordable Private Rent as complying with planning obligations and provide SDLT relief in that regard.
    - Incorporate Affordable Private Rent within Registered Social Landlord relief, by adding a fourth qualifying category 'transacting of land or buildings that are classed for planning purposes as Affordable Private Rent'.

PropTech

26. The BPF has commissioned a report from the Future Cities Catapult that has examined the link between the productivity of the sector and technology adoption. It has made a series of recommendations that we will be taking forward over the autumn and into the new year, involving our members in their delivery. We are also commissioning a further SWOT analysis of the UK PropTech market and how it could be enhanced in order to propagate it and maintain its competitiveness vis-à-vis competitor markets overseas.

27. We would welcome collaboration with the Government and regulators to examine, based on our findings, how we can ensure that regulation and legislation does not fence out new entrants to the sector and can provide fertile ground for new products and services.

28. We are proposing that a property sector regulatory sandbox could be set up, akin to the FCA's current approach, involving industry and government representatives to map out regulations and regulators across the real estate cycle, and how the provision of real estate services could be made more resilient and efficient. Winning suggestions could then be taken forward with an initial round of seed funding. A potential venue for this funding could have been the Department for Business, Energy and Industrial Strategy (BEIS) Regulators' Pioneer Fund, which could perhaps be repeated in the next year.

Improving the operational effectiveness of the current tax system

29. Applying taxation in a real estate context can be complicated, given the number of different taxes and rates and the complexity that can be associated with implementing the rules. The Corporate Interest Restrictions for example were accompanied by over 500 pages of guidance. Complexity in tax and regulation not only impacts on productivity, it also has a negative impact on investor and business sentiment.

30. To support businesses apply the current property taxation rules, and the new measures coming forth in the draft Finance Bill, it is essential that HMRC operates effectively and provides the right support to businesses so that projects and transactions can be completed smoothly. However, HMRC's resources can be stretched and officials do not always have sufficient time to engage with property businesses and build their understanding of how the sector operates day to day. This can result in tax guidance not keeping pace with policy or business changes, and misunderstandings between HMRC and businesses.

31. A focus on operational efficiency will improve investor confidence and be relatively cost neutral. Areas that need addressing are outlined in the paragraphs below.

Tax Guidance

32. Ensuring the reliability of tax guidance must be a priority as it is the main source of information for businesses dealing with tax rules day-to-day. However, members' experience is that guidance can be out of date and slow to be updated following developments in case law, particularly where cases go against HMRC and therefore require a change in policy.

33. We appreciate that it can take time for HMRC to properly consider what new jurisprudence means for its policy positions and for guidance to subsequently be updated. However, as a basic principle HMRC should not be continuing to publish guidance that is factually wrong. Therefore, in the interim it would be helpful if sections of HMRC guidance that are currently under some sort of policy consideration were clearly flagged with 'health warnings' so that users know to take additional care and HMRC officials know to contact the policy team for the latest updates.

34. The BPF has been engaged with both the Office of Tax Simplification and HMRC on their separate reviews of the tax guidance system, and we would be pleased to work with officials on measures to improve the operation of the guidance process.

VAT

35. Discussions with BPF members on the operational effectiveness of the tax system often centres on VAT as a particular area of concern. Applying VAT in a real estate context can be particularly complicated. A range of different rates and exemptions can apply depending on the facts and circumstances of individual situations and the precise treatment of a transaction or project is often open to interpretation. Hundreds of decisions are taken every day on VAT - at all levels within companies - and this can be hampered by out of date VAT

guidance, delays in getting decisions from HMRC, or misunderstandings with HMRC on how the property sector operates.

36. Addressing practical issues will have a positive impact on business interactions with HMRC. Current VAT issues highlighted by members are:

    - **VAT Registrations** – HMRC rejecting registration applications either because they have not fully understood the different types of property vehicles used in the sector or for very minor details e.g. not having a 'wet signature'. The BPF has proposed creating a table which would be agreed with HMRC setting out how different entities in property investment structures should register for VAT, covering who has authority to register and which details/signatories would be required. Initial conversations with HMRC have suggested that if agreed with VAT policy teams this could form part of amended guidance.

    - **Making Tax Digital:** The April 2019 start date is fast approaching, yet many firms will not be advanced in the planning processes with further information on the MTD process and potential software providers only having been recently published.

    - **VAT Reverse Charge on Construction Services:** The VAT reverse-charge for businesses in the construction sector is due to take effect in October 2019. We remain concerned by the proposals for certification which could be administratively burdensome. The current proposal is that entities which are exempt from the reverse charge as final consumers will be required to provide written confirmation to their suppliers confirming they qualify for the exemption. This is a significant change and means that a large number of entities not directly impacted by the new legislation will need to be aware that they must provide confirmation where appropriate. The BPF believes it would be more logical for those within the reverse charge to confirm that they should not be charged VAT.

37. The Office for Tax Simplification's review of VAT published last year made welcome recommendations on simplification which are being considered within Government, and we would urge that active steps are taken to implement the OTS recommendations with a clear timetable for delivery.

Simplifying the Construction Industry Scheme

38. Alongside action to improve operational efficiency, steps could also be taken to simplify the tax system to reduce unnecessary bureaucracy. The Construction Industry Scheme (CIS) creates a huge administrative burden for real estate groups. Introducing a grouping mechanism for CIS would significantly reduce bureaucracy, by removing intra-group payments that commonly occur internally within property owning structures from having to comply with the full obligations of the CIS scheme. Such a measure would ensure officials can spend less time processing paperwork from compliant businesses, and more time tackling cases of criminal evasion. A joint and several liability approach for grouping would ensure no revenue is put at risk to achieve the significant administrative savings for business and HMRC who have to process the returns.

39. We look forward to discussing our comments with you in more detail. Please do not hesitate to get in touch if you require further information:

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