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Scottish Property VOICE

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Chairman's Column

SPF in Prime Position to Influence Key Policies

The last time I penned this column, I noted how pivotal this year would for our industry and (perhaps unsurprisingly) highlighted the new Planning Bill as chief among the raft of significant policy changes we expect to see this year. In the relatively short period time since then there have been some important developments, which I will share with you now.

The first is that we have been invited to give oral evidence to the Scottish Parliament's influential Finance and Constitution Committee on the Financial Memorandum that accompanied the Bill. I am delighted that John Hamilton, CEO of Winchburgh Developments, has agreed to represent our position. John sat on the Independent Review of Planning in Scotland and, as Chairman of the SPF's Planning Committee, is best placed to advise the committee on our concerns.

The second significant planning development is that the SPF has submitted detailed written evidence to the Local Government and Communities Committee on the main body of the Bill. Our evidence is the culmination of close to two years of input from members working with the SPF team, and comprehensively raises many the key issues and concerns that members have spoken about. We look forward to the Parliamentary Committee's debate on the Bill, which will commence soon.

Although not provided for in the Bill, I am acutely aware that the greatest concern for many members is Third Party (or Equal) Rights of Appeal (TPRA) and the possibility that Parliament may approve an amendment to the Bill to include it. On this issue, you can rest assured that the SPF will be making the case for the industry directly to MSPs of all parties and will highlight the stark risks that TPRA would introduce to the Scottish economy.

In addition to our work on the planning reform agenda, we have also been heavily involved in supporting investment into the Scottish real estate industry. Just a few weeks ago, the SPF Policy Board and I met with Benny Higgins to discuss the early work being carried out to set up the Scottish National Investment Bank (SNIB).

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Chairman's Column

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Benny, the outgoing CEO of Tesco Bank, was tasked by the First Minister to establish an early framework of how SNIB might operate and the type of projects that it might fund.

At the meeting, we were keen to promote investment into the built environment and brought up the issue of a lack of Grade A office space in Glasgow and Edinburgh. We singled this out as an area that could greatly benefit from the type of patient capital that SNIB proposes to deliver, as well as detailing the wider social and economic benefits that would flow from such investment. Infrastructure was also a key topic of discussion given its importance in enabling other development. Current examples of issues surrounding transport and utilities were highlighted, as was the potential for both to be alleviated through SNIB investment. We look forward to Benny's report, which we expect to be submitted to the government imminently.

In the meantime, a significant piece of legislation will come into force in a matter of days. From 12 March 2018 the Scottish Lobbying Act will come into operation and will put additional responsibilities on members who deal with Scottish Ministers and their special advisers, MSPs and the Permanent Secretary of the Scottish Government. I urge you to look at the dedicated webpage to find out more about how it might affect you and your organisation: **www.lobbying.scot**

With only a couple of weeks left to go, my thoughts now turn to the SPF's Annual Conference. I'm really heartened to see the first-class line up that will take to the stage on 7 March 2018. Not only will attendees hear from the person in charge of Scotland's public cheque book, Finance Secretary Derek Mackay MSP, but there will also be a wide range of other key stakeholders speaking. From Investors and planners, to developers and public officials, our contributors will be able to speak with authority on the conference's main theme of creating great places to live, work and enjoy.

To accompany this, Professor Graeme Roy of the Fraser of Allander Institute will unveil the findings of the latest in-depth report into the economic impact of the real estate sector in Scotland. Having seen the initial findings, I believe that this research will be paramount to our ability to quantify and qualify precisely the value that our industry adds to the Scottish economy. This information will be vital, particularly when it comes to working with government on issues such as the Planning Bill.

I look forward to seeing you at conference in just one week's time.

When it Comes to Dilapidations, V.A.T. Spells 'Complicated'

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The VAT treatment of dilapidations raised its rather fiendish head in a recently reported case.

In West End Commercial Limited v Trocadero there was a suggestion that a third party had badged its payments as 'dilapidations' instead of paying a licence fee (rent). The judge noted that "whereas the payment of a licence fee would carry VAT, the payment of dilapidations does not". He stated that he would be "referring the papers to Her Majesty's Commissioners for Revenue and Customs in order that they may, if they consider it appropriate, investigate these matters further".

This prompted us to revisit the VAT treatment of dilapidations and it is not as simple as one might hope…

So, when it comes to VAT, what are dilapidations?

HMRC guidance states: "The terms of a lease may provide for the landlord to recover from tenants, at or near the termination of the lease, an amount to cover the cost of restoring the property to its original condition. A dilapidation payment represents a claim for damages by the landlord against the tenant's 'want of repair'. The payment involved is not the consideration for a supply for VAT purposes and is outside the scope of VAT". This seems clear enough.

The respective VAT recovery positions of the landlord and tenant can determine which party is more likely to undertake the remedial works.

LANDLORDS' ISSUES

Where a landlord carries out remedial works after (or in anticipation of) receiving a dilapidations payment from their former tenant, the VAT incurred should be recovered either from HMRC or from the former tenant.

If the landlord is unable to recover from HMRC the VAT it will incur putting the property back into compliance, it should recognise this when preparing the dilapidations claim because the cost of irrecoverable VAT is not one that a landlord would normally want to suffer. The landlord needs enough funds to restore the property to a suitable standard and consequently it will want to include an 'allowance' for the VAT it incurs (and cannot recover from HMRC) within the dilapidations claim.

If the landlord can recover the incurred VAT from HMRC then no allowance for VAT would need to be included in the dilapidations claim made against the former tenant.

If the landlord does not carry out the works but funds a third party (for example, a new tenant) to perform them, the payment made by the landlord can be regarded as payment for a supply by the new tenant or an incentive for the new tenant to take the lease. The VAT liability of the payment made by the landlord depends on the specific terms of each agreement. However, if the sum paid to the new tenant is a VATable supply, the landlord will have incurred a VAT liability which it may not be able to recover from HMRC and, if so, should look to recover from the former tenant as an 'allowance for VAT'.

TENANTS' ISSUES

Rather than risk having to pay damages to the landlord, tenants may decide to carry out the works to remedy the breaches themselves, before the end of the lease term. Where this happens the tenant would not normally make a supply to the landlord. If the tenant is VAT registered it would recover the VAT in accordance with its normal VAT recovery position.

Tenants should consider the legal principle of 'mitigation'. Claimants (landlords in this instance) are limited to claiming the loss which they would have suffered had they mitigated the loss. Therefore, tenants should consider whether the claim made by the landlord could have been mitigated by the landlord reasonably removing a VAT liability, perhaps by opting the building for tax, or by avoiding making payments to third parties.

GUIDANCE FROM THE COURTS

In the case of Customs and Excise Commissioners v Cantor Fitzgerald International the European Court of Justice held that the assignment of a lease by a tenant was a standard-rated supply for VAT purposes.

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When it Comes to Dilapidations, V.A.T. Spells 'Complicated'

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This affects the VAT status of associated dilapidations payments. A payment by an assignor tenant to an assignee which is used to fund a future dilapidations claim by the landlord is also liable to standard rate VAT. HMRC consider the assignee is "accepting the lease" in return for the payment. The VAT position can be different when the assignor makes a payment directly to the landlord rather than the assignee.

For example; let's assume that £10,000 (net) of remedial work is required to remedy accrued dilapidations. The tenant wants to assign its lease to another party and pays the assignee £10,000 in lieu of the accrued dilapidations liability. That £10,000 is liable to standard rate VAT. The assignee has therefore received a payment of £8,334 + VAT. The VAT will have to be paid to HMRC by the assignee. The landlord will make a dilapidations claim for either £10,000 or £12,000 (depending on their VAT position) and consequently this assignee tenant would be underfunded.

This is the case despite HMRC Notice 742 stating "A dilapidation payment … is not the consideration for a supply for VAT purposes and is outside the scope of VAT."

In British Eventing Limited v HMRC a payment of £140,000 was made to an assignee, and the assignee agreed to spend that money reinstating fire damage (the assignor's insurers paid the £140,000 to the assignors). Once again this payment was liable to standard rate VAT. The payment was deemed to be consideration for the taxable supply of accepting the assignor's obligation to repair the property.

These cases highlight the importance of being clear on who the obligation for repairs falls to in the contract and payments being made in line with those obligations.

'SPLIT' APPROACHES TO VAT

In some cases, landlords' dilapidation claims include an allowance for VAT incurred on professional fees paid but no allowance for VAT incurred on the remedial works themselves. This situation could arise where the landlord is unable to recover all of the VAT incurred from HMRC, for example when the professional services are actually provided to a third party (tenant or a financier) or the services are also linked to a VAT exempt activity. It would therefore be reasonable to expect that a landlord's dilapidations claim would, in the future, include an allowance for VAT on the remedial works, but only once the remedial works have been completed.

CONCLUDING POINTS

The interaction between VAT rules, the terms of the lease and transactions between tenant, landlord and third parties can be confusing and open to different interpretations. Given the sums involved in the property sector it is important that all parties confirm their VAT position, retain evidence to support this and take appropriate advice.

Housing and Flood Risk

Elizabeth Colette Patton v East Renfrewshire Council [2017] CSOH 158

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Planning permission for 828 houses and associated development at Maidenhill, Newton Mearns was granted by the Council as planning authority on 2 June 2017. There is a well-recognised and long-standing risk of flooding in Newton Mearns, Mearns Village and the surrounding area. This had been recognised by SEPA who had designated it a Potentially Vulnerable Area. On a number of occasions in the recent past there had been flooding caused by overflowing of local watercourses and on several occasions raw sewage had flooded onto streets and surrounding gardens following heavy rainfall. The Newton Mearns Flood Prevention Group and the Mearns Village Community Association ("MVCA") had opposed the development and had submitted a detailed statement of objection to the Council. When the development was nonetheless granted permission, a challenge was brought against the Council's decision in the name of secretary of the MVCA who was also a member of the Flood Prevention Group.

The challenge was brought on a number of grounds, the general thrust of which was that the planning authority's planning committee had been materially misled regarding the danger of flooding that would be caused if the development were to proceed. In particular, it had been incorrectly stated to the planning committee that SEPA no longer had any objections to the scheme due to the information provided to it by the developers. It was also stated that due to the effect of development and the creation of hard surfaces, the proposals had not demonstrated "zero detriment" and had failed to adopt a precautionary approach to flood risk as required by national planning policy. As a matter of law, if a report to committee contains insufficient information to enable the committee to perform its function, or if it is misleading, then a decision taken on the strength of such a report may be challengeable in the courts.

To illustrate the deficiencies which the petitioner stated the report contained, she provided three specific examples. The first of these concerned a connection route known as "Option 2d". Flooding in the area of that connection had occurred as recently as August 2017 with very unpleasant consequences. The example was, however, undermined when the court was shown a Development Impact Assessment prepared by Scottish Water in August 2017 showing that the proposed route was not in fact Option 2d to the north east of the development but by an altogether different route broadly to the north west. The original basis of the objection was therefore no longer a live concern and did not support the reduction of the decision to grant planning permission.

The second example was in relation to off-site water courses and the necessary capacity to accommodate the effect of the new development. Again, contrary to what was argued by the petitioner, the planning authority was able to show that an expert assessment of the capacity and condition of the downstream culverts had been carried out. The planning committee had before it the responses of SEPA and the Council's Roads Service which had considered the question of flooding and had particular regard to the culverts. The third example dealt with the proposal to build on the water course and functional floodplain. Again, this had been a matter of study by the planning authority which was considered by SEPA. The report to committee was in fact correct in noting that SEPA was satisfied with the information provided to it.

In summary, the court did not agree that the committee was misled, nor that its decision was irrational. In refusing the challenge, Lord Glennie stated:

"it seems to me that the case for the petitioner amounts, in substance, to a disagreement with the decision taken by the committee in granting the planning application. It is well-established that the courts cannot interfere on that basis."

In other words, the bar to challenging the exercise of discretion by a planning authority to grant planning permission remains a high one. Just because a there is an argument, however honestly held, that the authority should have arrived at a different conclusion, this will be insufficient to support a legal challenge. It is essential, however, that the planning committee is provided with full and complete technical details covering all relevant matters raised by the development.

As a footnote, it had been argued that the petitioner did not have title to sue. The court disagreed with this based upon the wider concept of standing introduced by the case of *AXA v Lord Advocate* 2012 SC (UKSC) 122. It held that in a relatively small community such as Newton Mearns, it would in principle be difficult to find that any resident did not have the necessary standing to bring a legal challenge. This would still be true even if the potential flooding about which they were complaining was on the other side of the settlement.

Policy Round-Up February 2018

Some key policy developments for the industry

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Planning and Development

Planning has dominated the landscape this month. We responded to the Scottish Parliament Finance and Constitution Committee's call for comments on the financial impact of the Planning (Scotland) Bill. We made it clear that it is difficult to be precise and give detailed comments on the Bill's impacts, when final decisions have still to be made and that many of the provisions and powers in the Bill will depend on secondary legislation. We also noted our major reservations over the prospect of a Scottish Infrastructure Levy and further discretionary fees, highlighting members' concerns that there cannot be any notion of a duplicate development tax alongside S75.

We also responded to the Parliament's Local Government and Communities Committee in a similar vein following its call for evidence on the Bill. We were clear that 'third party' or 'equal' right of appeal would have a significantly negative impact on what is a generally positive package of proposals. Further strong concerns were raised at the suggestion of sheriff officers/bailiffs being in the position of seizing the property of applicants for non-payment of a levy.

Looking ahead, the SPF has now been invited to give oral evidence to the Scottish Parliament's Finance & Constitution Committee on Wednesday 28 February. John Hamilton, Chair of the SPF Planning and Development Committee and CEO Winchburgh Developments Ltd, will give evidence on the Financial Memorandum that accompanied the Planning Bill.

LBTT Update

February saw some clarity on the requirement from 1 April 2018 for certain commercial property tenants in Scotland to submit a further tax return to Revenue Scotland (RS). The additional tax return will be required on the third anniversary of the effective date on non-residential and agricultural leases. This will be the case even if there have been no changes to the lease or if no further tax is payable.

Meanwhile, a consultation on the details of the first-time buyer relief from Land and Buildings Transaction Tax (LBTT), announced in the draft Scottish Budget 2018/19, has also been launched by the Scottish Government. The consultation seeks views on the proposals in terms of eligibility and implementation of the policy and closes on 23 March 2018.

Scottish National Investment Bank

Speaking to the SPF's Policy Board, Benny Higgins, who is leading the establishment of a plan for the Scottish National Investment Bank (SNIB), said he envisages that SNIB will have 'scale, scope and ambition'. In a wide-ranging discussion, Mr Higgins highlighted that his report, detailing how the bank should be set up, will be published by the end of the February. It is expected that the report will highlight the bank's potential to offer long-term patient capital to commercially viable projects in Scotland, which otherwise might not attract sufficient funding. However, a question remains over whether Scotland will need any additional devolved powers to fully realise the potential for SNIB.

Residential Investment and Management

A new statutory Code of Practice for letting agents is now in force. The Scottish Government has said that landlords and tenants can use the code to challenge poor practice and, if necessary, enforce it through the new First-tier Tribunal for Scotland (Housing and Property Chamber). The code also sets out standards that must be met in how letting agents deliver services and includes specific requirements on how clients' money should be handled.

Elsewhere, the Scottish Parliament's Local Government and Communities Committee has supported the general principles of the Housing (Amendment) (Scotland) Bill. However, while the Committee was "broadly content" with its proposals, it has outlined some potential issues for the Scottish Government to consider. The Housing Amendment Bill seeks to reclassify RSLs as private bodies.

Scottish Energy Efficiency Programme

February also saw the SPF respond to the Scottish Government's second consultation on 'Local Heat & Energy Efficiency Strategies, and Regulation of District and Communal Heating'. The SPF welcomed the Scottish Government's attempts to promote energy efficiency and decarbonise heat generation in Scotland, however, we urged for caution over the government's proposals for district heating. Looking at the proposals more holistically, we also highlighted the need for the Scottish Government to ensure that LHEES do not slow down new development, particularly in the residential sector.