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By email

Comments by the Scottish Property Federation on Land and Buildings Transaction Tax: a consultation on Proposed Sub-sale Development Relief Regulations

Executive summary

Sub sale relief is vital to supporting a number of intricate and complex funding arrangements that enable development and investment to be brought forward for the Scottish property industry.

We recognise that sub sale relief has had a chequered history and that Scottish Ministers are concerned at the prospect of significant tax avoidance activity. However, UK SDLT has been tightened and there are now a number of safeguards in place to ensure what is now called pre-completion transaction relief is used appropriately.

The proposal for LBTT development transaction sub sale relief is targeted precisely at development activity. For this reason the scope of the relief is already more limited than its UK equivalent and this should reassure Scottish Ministers about the use of the relief.

The SPF supports a process whereby the relief is afforded to the developer immediately with LBTT being paid by the second purchaser at the point of a simultaneous sub sale transaction. This would ensure the government receives its revenue and yet still supports a developer to pull together the finance required for the development project.

We do not support a 'refund' approach to delivering development transaction sub sale relief. Our analysis is that the industry will come to discount the value of a refund relief. This would cut substantially into a developer's profit margin and would put Scotland at a competitive disadvantage compared to the same scheme being funded in the same way in England.

If we end up without sub sale relief or with an unworkable and uncompetitive sub sale relief scheme then the competitiveness of the property industry will be impaired and development activity inhibited. LBTT revenues will be negatively impacted in such a scenario.

Introduction

1. The Scottish Property Federation (SPF) is a voice for the property industry in Scotland. We include among our members; property investors and developers, landlords of commercial and residential property, and professional property consultants and advisers. We have within our membership over 150 corporate members with real estate industry interests in Scotland. The SPF is happy for the Scottish Government to publish our comments and to share our views with other public authorities.
2. We welcome this opportunity to comment on the proposals for a development sub sale relief power to be introduced to the LBTT regime. This relief is fundamentally about ensuring Scotland has a competitive tax regime that encourages development to take place in a situation where risk-aversion still dominates traditional avenues of funding. For this reason we believe it is vital that we achieve a workable form of relief if we are to retain a competitive working environment for the development industry in Scotland. **Unfortunately, we do not believe that the proposals made in the consultation paper will achieve a workable form of development sub sale relief because of the imposition of lengthy refund arrangements rather than straightforward relief.**
3. Crucially, we are advised by members that the consequence of the refund arrangement would be to create a situation where on average the developer in Scotland loses over 10% of the profit margin they would get developing the exact same site in England (we do not of course know what the LBTT rates are so we are using the existing SDLT 4% rate here for sake of ease as well as land values costing 30% of development costs and any pre-let returns coming in at an average 10% of total development costs). Clearly if profit margins are cut by this much then the project will fail to compete with similar projects in England and the ability of Scotland to attract investment and sustain economic growth will be impaired. This will ultimately hit LBTT revenue for the government of the day.

Alternative SPF View of Targeted Development Sub Sale Relief

4. Development is a vital boost to the economy as well delivering much needed homes, offices, retail industrial and leisure premises for Scottish communities and businesses. The SPF has therefore identified the following key principles required for an effective, fair and proportionate development sub sale relief:

a) We need a relief that will avoid double taxation where complex commercial development arrangements are needed in order to fund and deliver a development project. When sub sales occur simultaneously it is important that just one LBTT payment is due. This would support formal funding arrangements that can be so vital to suggest the development industry in the current funding environment.

b) Relief for development related sub sale arrangements should be timely and related to the LBTT that would otherwise be chargeable. We are informed by experienced developers that the industry is likely to discount the value of relief based on a long term 'refund' basis as is proposed. On this basis, the proposal although well intentioned would fail the acid test of supporting development in Scotland and would lose revenue through reduced development

activity as developers and investors choose to fund like-for-like schemes without 'double' SDLT elsewhere in the UK.

c) We believe that there should be LBTT liability at point of simultaneous transactions where sub sale relief is made available. This would make the ultimate investors liable for LBTT from the point of the pre-completion transaction but subject to the normal procedures adopted elsewhere under LBTT, meaning that we believe LBTT should be payable with the caveats of substantial performance and also the normal rights allowed under LBTT to delay payment where the consideration is subject to a future event. These caveats are already enabled and Revenue Scotland will already be required to make appropriate administrative arrangements. Crucially this assures the government of its revenue and we do not therefore see what risk there is to the government. Indeed, the government should be receiving the enhanced value of the land plus 'second' purchase.

5. We support of the need for a targeted form of relief that will ensure Scottish developers and their investors do not face double taxation at the point of bringing together development projects. While we commend the Scottish Government for their decision to revisit the need for sub-sale relief during the LBTT policy process (and as explained by the Finance Secretary in June 2013 to the Scottish Parliament), we are concerned that the administrative processes proposed as part of the relief may negate the benefit of introducing the relief. This would be a considerable disappointment to the industry which since the publication of the LBTT Bill has put significant time into seeking a workable, effective and targeted relief that will go some way to meeting the industry's concerns as well as reassuring and supporting the government's purpose and policy. In our remarks below we propose alternative means of ensuring the relief is effective, accountable and also transparent.

Comments on Chapter One

6. We welcome the recognition given to the role of the property industry in supporting and strengthening the Scottish economy. The property industry also has an important role in providing returns that support pension and life funds amongst other attributes. This section is also correct to accept that SDLT/LBTT are and will be key considerations applied by potential investors and developers to property development opportunities in Scotland.
7. The SPF has led industry concerns about the removal of sub-sale relief from SDLT and how this may make Scotland uncompetitive in relation the continuing SDLT regime in the rest of the UK. This view has also been advocated by the considerable professional leadership and expertise of the Law Society of Scotland who we believe have come to very similar conclusions and assessment of the government's proposals. We recognise that the Scottish Ministers are concerned that there should be a watertight LBTT regime that deters and blocks tax avoidance schemes. For our part we support a transparent and competitive LBTT regime as well. We are pleased that the Scottish Government has listened positively to these concerns and we support strongly therefore the case for a targeted sub sale relief being introduced via s27 of the LBTT Act.

8. We do have reservations about the proposed relief however which will require developers to pay up-front as well as investors and other third parties for what is effectively the same transaction. This will not be repaid until potentially five years after the payment which could be a serious disincentive for many developers and investors. Our members have reacted strongly to this proposal with a senior member describing it as 'the government borrowing from the industry' while likening the bureaucracy associated with the measure as akin to unfavourable business jurisdictions elsewhere in Europe. We find it strange that the Scottish Government is proposing to adopt claw-back regimes for certain reliefs and not follow the same procedure for targeted development sub sale relief.

What is sub sale relief?

9. Sub sale relief exists under SDLT legislation although it was referred to as transfers of rights initially. The Finance Secretary noted that this was introduced with the intention of supporting genuine complex commercial transactions. However, a number of subsequent examples found that these rules were sometimes misused to avoid what would otherwise be expected to be SDLT liabilities.

Why is sub-sale relief important for the property industry?

10. Commercial property investment and development involves risk and is capital intensive. The process will involve often complex negotiations between potential investors and occupiers. At the heart of this process is the funding and finance needed to gather the resources necessary for a development scheme to proceed. Because of the risk associated with development this is difficult to achieve. Real estate lending remains reduced following the aftermath of the financial crash and the exposures to property development and investment experienced by lenders and property businesses at that time and since. Indeed with increased regulation of bank lending for the purposes of real estate this situation is likely to continue. Property developers will therefore turn to sub sale or pre-completion transactions as it is now known in the UK in order to achieve the funding they require to be able to undertake development activity. This includes utilising the relief for the purposes of forward funding arrangements that are referred to in the consultation and raised in the course of parliamentary deliberations on the issue of sub sale relief and LBTT.
11. Developers will bring together a variety of parties to a commercial arrangement, including funders, investor(s) and occupiers. Sometimes a scheme may only be feasible with the support of third parties purchasing part of an available site in order for a substantial project to proceed. The concerns previously made about having to apply for relief and then be refunded potentially five years down the line is put in context if the government considers the multiple other costs facing a developer at the outset of a development proposal – the planning fee which could be some £20,000; various impact assessments including Environmental Impact Assessments, Transport Impact Assessments, licenses for various construction and planning aspects, various commercial title Registration Fees (£7,000), retail impact assessments if a retail development is proposed.... Suffice it to say that major development is highly expensive and risky and the imposition of a significant LBTT 'double' charge, even one that is expected to be refunded at completion at the outset of a project will be a serious cash flow issue for most developers. In

paragraph 3 we have already explained precisely how the imposition of LBTT upon the developer seeking to use sub sale relief to tie together the many interests involved in a development would be analysed by the industry – we repeat again that the only likely outcome of such analysis would be to lose development investment in Scotland to other parts of the UK.

12. Where a development and investment arrangement involves a pre-completion transaction the ‘first’ purchaser is in the position of agreeing to transfer their interests in land with either brief or no actual registration of their interest in the land in question. In this circumstance we believe it is fair and proportionate for a relief to be granted to the developer who is facilitating the transaction and investment and if at all, is only in fleeting ownership of the asset.
13. For the investor there is often little appetite for direct intervention in the development process. The preference is to allow the developer to take the lead on issues of site assembly, planning applications and conditions, community engagement and of course seeking occupiers for the new building(s). Sometimes forward funding may be available from an investor but not always.

How would we envisage sub sale relief working?

14. In line with the principles we submitted in our opening remarks, the SPF believes it is vital for the Scottish property industry to have an effective, transparent and competitive LBTT administration that will support appropriate property development and investment. Our support for a targeted form of sub sale relief for pre-completion transactions is based on the premise that we need to be able to offer developers a means of attracting funding via sub sale provisions where necessary.
15. The difficulty we have with much of the debate surrounding sub sale is that it has been characterised by government concerns, understandably, with the possibility of tax avoidance schemes. This has been an issue and one that has caused concern to many in the industry as well as government and as the Finance secretary noted, this ended up with changes to the sub sale regime under SDLT. The trouble is that the debate has been absent of hard data, so it is difficult if not impossible to quantify the problem and thus comment on the proportionality or otherwise of the measures proposed.

Comments on Chapter Two

16. The consultation rightly identifies the changes in HMRC regulations covering sub sale. The main change was to make claims for sub sale relief notifiable.
17. By contrast the consultation highlights the evidence presented to the Finance Committee (and the Scottish Government) on the consequences for forward funding arrangements of the abolition of sub sale relief. SPF among others highlighted the key importance of supporting forward funding arrangements in a continuing era of risk averse property finance where traditional lending remains firmly focused on pre-let development opportunities and alternative forms of finance from institutional funding, private equity and sovereign wealth funds is expected to continue to be an increasing feature of the property investment landscape. This

expectation is founded not just in market confidence but also in the continuing expectation of regulatory measures being applied to the traditional lenders.

Chapter 3

Question One

Do you agree that the Scottish Government introduce the relief mechanism outlined in the proposed draft sub-sale development relief regulations?

Yes / No

18. We cannot simply reply 'Yes' or 'No' to this question. We believe a relief mechanism is crucial to support the ability of the industry to finance and initiate arrangements for property development, but we do not believe the precise process and regulations proposed by the government will be seen as workable and effective by the industry.
19. The consultation acknowledges the variety and complexity of major property development arrangements, supported by the information and examples provided by the working group. The consultation goes on to note that '... the discussions highlighted that sub-sales are used in a wide range of development scenarios and are not just limited to the "forward-funding" arrangements that have been described to the Scottish Parliament. We support this wider understanding and recognition of the positive part played by sub sale relief in securing property investment.
20. The Scottish Government asserts that it believes relief from LBTT in relation to sub-sales should be available where it is linked to development and that development takes place in a 'timely way'. We agree. The consultation goes on to say that the government does not support relief where the development is not of a significant scale or where no development follows the transaction.

Question Two

Do you agree with the proposed definitions of 'development' and 'significant development' in the draft regulations?

Yes / No

21. We are pleased to note that the regulations are not limited to residential build as this is in line with the gist of the Finance Secretary's remarks to the Scottish Parliament during evidence and debates on the issue of sub-sale relief during LBTT's parliamentary process.
22. Although we would wish to answer this question with a straightforward yes because it includes the types of development we support, we cannot agree with the penultimate sentence of paragraph 3.5 (page 6) where the government insists upon evidence that the development has taken place. It is the developer and the investor taking the risk by financing a development project and the intention is to encourage businesses and investors to make the decision to take that risk. If the government has already received its LBTT at point of simultaneous sub sale

transactions then there is no risk for the government because they have already received their revenue.

23. The government may also wish to consider how its position would look in the event of a developer going into administration during the course of a development, where significant cash is tied up with sub sale 'relief' that is effectively withheld. There are plenty of examples of stalled development sites and mothballed developments over the past seven years and we do not think it would look good for the government to be holding onto tax relief while a property company struggles to keep a project going.

Question Three – Reasonable time

Do you agree with the proposal that the 'significant development' must be completed within 5 years of the effective date of the pre-completion transaction?

Yes / No

24. Although under Question Six there is scope provided for partial refunds of LBTT where completion is not fully achieved within five years we believe that the government overlooks the practical risk and management associated with long term mixed use development schemes. For example, the current Winchburgh scheme is set to proceed over a further 15 years from its present condition, so how would a five year cut off point work in this scenario for the investors and developers?
25. The uncertainty over final completion is not simply down to the developers and their contractor, or the fortunes of the market which the developer is seeking to sell into. By its nature major development is uncertain because it is democratically regulated and this may apply many conditions and reserved matters even to a successful planning application, a number of which may require significant work ahead of a formal development start (and building warrant application).

Chapter 4: Administrative considerations and revenue risks

26. The consultation document covers two main issues associated with administration and revenue 'risk'. The first issue is that of pre-clearance which is a procedure that has been adopted in the UK for its sub sale relief rules revision under SDLT. The consultation notes that initially the Scottish Government were interested in pre-clearance for this more targeted development relief. The paper argues that for reasons of administration Revenue Scotland will not be asked to perform this function. We do not see why this would add significant administrative burden – in theory it should remove the potential for unexpected administrative costs from both the private and public sector.

Question Four – Mechanism for claiming the relief and refund of LBTT

Do you agree that the relief should be claimed at the point that the initial transaction takes place and a refund claimed once the development is complete?

Yes / No

27. We agree that the relief should be claimed at the point of transaction but we disagree with the proposal that a developer should then have to wait until the end of the development process before being able to claim a refund. The consultation does not appear at this point to realise that there is also a need to reduce risks for the private sector when contemplating entering into property development arrangements. Without such risk mitigation it could be that projects become unattractive which could in itself incur a revenue 'loss' due to inactivity.
28. Alternatives to requiring a completion certificate and which would enable the relief to be genuine and timely for developers would include:
- 1) evidence of planning application within specified time period – the planning consent only lasts for 3 years so there would be an incentive for the developer to progress matters;
 - 2) a little further down the road, a building warrant;
 - 3) our preference would be a form of notice and commitment by the developer as part of the pre-completion transaction and application for relief. If coupled with claw-back powers this would provide evidence of both intent and the means to recover relief that Revenue Scotland judged to no longer be eligible in the event of a failure by the developer to pursue a development project for the land in question.

Claw back

29. The second issue is that of 'claw-back'. The consultation notes that other reliefs under LBTT have provisions for claw-back processes whereby tax relief may be withdrawn from a taxpayer should the reasons for the initial relief under certain circumstances. Again, we fail to see why this has been dropped as it appears to be perfectly acceptable to other forms of relief. If anything this would appear to be a useful tool to the Scottish Government to govern the progress of a development that has benefited from sub-sale relief. As the Scottish Government is already committed to administering a range of claw-back arrangements we fail to see how this will materially add to the administrative burden.

Evidence for LBTT to be refunded by Revenue Scotland

Completion Certificates

Question Five – Evidence of completion of the development

Do you agree that a completion certificate provides appropriate and sufficient evidence that a significant development has taken place and has been completed within 5 years?

Yes / No

30. We do not agree with the proposal to limit relief for development until a completion certificate is produced. The relief is intended to support investment in a development project and we believe requiring a developer to apply for a relief and then wait until a completion certificate is issued to be perceived as bureaucratic and unnecessary by applicants. It could also lock-up a significant cash flow for a significant period of time. Unfortunately and having consulted members, we believe that the industry would by and large discount the value of the refund

towards its development appraisals and this would negate the very benefit that the government is seeking to achieve in order to support development activity and funding.

Question 6 – Partial refund of LBTT

Do you agree that a partial refund should be given where a proportion of a significant development can be evidenced by a Completion Certificate (or Certificates)?

Yes / No

31. We will not offer a simple yes or no to the question because we disagree with the principle of a refund process at all. At the same time however, if the government is determined to go down the route of a refund process then it would only be fair for developers to be refunded as they complete long term components of a major development scheme. Indeed without such flexibility the developer might not receive any relief at all as such schemes may easily take 10-15 years to roll out.
32. Although not our preferred approach if the principle of refund upon achievement of completion of certificate is adopted then it will be imperative for developers to be able to apply for a refund of partially complete developments. This is because for major development sites it may be feasible for significant and distinctive components of the development to be completed before the full scheme is realised. As these sites become ready for occupation it would be important in our view for developers to receive the tax relief that they are entitled to.

Question 7 – Partial business and regulatory impact assessment

Do you have any comments on the draft business and regulatory impact assessment?

Yes / No

33. The restriction upon sub sale relief as it currently exists under SDLT has been targeted at a fear of allowing tax avoidance into LBTT via sub sale relief. We understand the government's concern to avoid allowing loopholes for potential exploitation for tax avoidance purposes. We do not support the establishment of elaborate structures designed to avoid tax payments to the government. However, nowhere have we seen any assessment of how prevalent and costly tax avoidance via sub sale relief is in Scotland. It is difficult against this backdrop of little evidence to make an assessment of whether the regulations are appropriate or whether the original restriction is unnecessary.
34. We would point out that we believe a competitive property tax system is beneficial to attracting investment into the built environment. This factor is not addressed within the PRIA however. In this situation the commercial property industry in particular (but not singularly in relation to residential development) has to compete for investment against similar propositions from England in particular. We are concerned that any perception of a disadvantageous property tax system under LBTT should deter potential investment from whatever source, whether Scottish based property developers or overseas/rest of UK investors. In paragraph 3 we explain the financial analysis that will prevail within the industry in the event of a refund process being

imposed. This illustrates clearly how such a process will put Scottish development at a competitive disadvantage compared to other parts of the UK.

Question 8 – Draft Equalities Impact Assessment

Do you have any comments on the draft Equalities Impact Assessment?

Yes / No

Comments on the Draft legislation

35. The main comment we have in relation to the draft legislation is to seek clarification about the definition made under the Schedule 10A, paragraph 1 (1) (c) where the term ‘takes place at the same time’. Our understanding is that this means ‘on the same day’ and if so we would welcome confirmation.
36. We believe paragraph 6 is in need of re-drafting because of our view that applying for relief and then subsequent refund potentially five years after the fact is in effect not to get a relief at all.
37. We would be pleased to explain our comments at your convenience.

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