Consultation: Fixing our broken housing market –
Changes to planning policy and legislation in relation to planning for housing, sustainable development and the environment
Response by the Chartered Institute of Taxation

1 Introduction

1.1 The CIOT responds on one aspect of this consultation (only) as set out in the extract below (page 80):

"A.48 In many countries local authorities regularly work with local landowners to assemble land for housing. In Germany it is common for authorities to use a process known as land 'pooling' or 'readjustment' to collaborate with landowners in the assembly, servicing and disposal of land and realise the benefit from the uplift in land values once the site receives planning permission and is made ready for development. This enables local authorities to bring forward new building plots for local people and for smaller builders to build homes, often at reduced prices. The Government considers that such approaches could be used more extensively in England, and would welcome views from local authorities and others on the opportunities this presents, any barriers inhibiting greater take-up, and how these may be addressed.

"**Question 6: How could land pooling make a more effective contribution to assembling land, and what additional powers or capacity would allow local authorities to play a more active role in land assembly (such as where 'ransom strips' delay or prevent development)?**"

1.2 Our comments on this question are limited to the taxation consequences that may act as inhibitors to land pooling, and possible solutions.

1.3 In terms of strategic policy it is important that property taxation is part of this wider review of how to address the housing crisis. Tax cannot be sensibly excluded from

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wider consultations such as this one, a point made in the recent CIOT, IFS and Institute of Government project report 'Better Budgets – Making tax policy better'.[1]

1.4 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2 Value of a land pooling mechanism

2.1 The value of a land pooling mechanism is to promote sustainable development by equalising values through a pooling process in recognition that all the land is integral to the development whether used for high value prime residential or for community infrastructure or green space. A further benefit is that where the land is taken in tranches, the land owner whose land is taken last still receives a proportion of the proceeds for the land taken initially thereby promoting a 'patient capital' approach rather than the need to maximise short term returns by early disposal.

2.2 By contrast the traditional (un-pooled) development model initially involves the developer securing an interest over the land while planning permission is obtained, with final disposal and full payment to the landowners following grant. Release of the land to the developer is deferred which, in turn, leads to a condensed construction phase to maximise short term returns. Landowners also have an incentive to be the last to sign-up to a development because they can gain extra (ransom) value by being the final piece that unlocks the site.

2.3 It is not our remit to fully assess the relative economic costs and benefits of the two models but it does seem to us that the tax system should in principle not operate so as artificially to promote one and penalise the other.

3 Taxation consequences for a landowner under the traditional (un-pooled) development model

3.1 Under the traditional route, a landowner should be able to secure some or all of the following tax features in relation to the gain on sale of land:

- the disposal of farm or other land for development is classified as a capital disposal taxed at the Capital Gains Tax (CGT) rate of 20%. Capturing the gain on disposal as a capital asset subject to CGT carries with it further potential tax advantages including the annual CGT exemption (currently £11,300) and valuable reliefs[2] particularly Entrepreneurs' Relief. That relief reduces the effective CGT rate to 10% for gains up to £10m (the £10m is a lifetime allowance) on a qualifying business disposal.

- The point at which the tax liability is triggered arises at the same point as the landowner receives the proceeds from the final disposal. In other words so-called 'dry' tax charges are avoided ie those triggered without any proceeds with which to settle the liability.

[1] http://tinyurl.com/betterbudgets
[2] Other relevant CGT reliefs are holdover relief and rollover relief.

3.2 Under the traditional model, developers will typically look to "option" land from each landowner, paying a modest upfront option fee to secure the land (usually by way of options), but not committing themselves to spending significant sums until the whole site is assembled. The use of options largely provides the favourable features outlined above giving rise to an effective rate of 10%, avoids 'dry' tax charges and preserves entitlement to IHT reliefs.[3] These tax consequences provide a strong incentive to a landowner to adopt the traditional route.

4 Taxation consequences for the landowner of entering a pooled development

4.1 The tax consequences of some examples of key equalisation routes are summarised in the appendix. In contrast to the traditional model, the examples indicate that achieving effective equalisation is unlikely to offer all of the tax incentives of the traditional route and, in some cases, pooled development will lead to additional tax costs when compared to the traditional model thereby acting as a significant disincentive to adopt that route.

5 A level 'tax playing field'

5.1 We suggest that ensuring a comparable tax outcome for landowners in adopting the traditional model or pooling route would remove the perverse incentive to adopt the traditional model over pooling. Comparable tax treatments would allow each route to be judged on its merits and in accordance with (or at least not in opposition to) underlying housing policy if that policy is to promote pooling arrangements.

5.2 Broadly a comparable tax treatment would mean some or all of the following characteristics:

- The landowner's pro-rata final entitlement is taxed as a capital disposal at CGT rates, with the potential to secure CGT reliefs including Entrepreneurs' Relief, rather than as a trading transaction taxed at the top rate of income tax of 45%.

- 'Dry' tax charges are avoided at the time the land is pooled (or de-pooled). In other words the tax liability arises at the point of final disposal.

- While land is pooled, the landowner is taxed as if the land is in direct ownership so for income tax purposes, rents are taxed in the hands of the landowner.

- Similarly transparent tax treatment while the land is pooled will preserve IHT reliefs (if the landowner dies during the process of development). The preservation of IHT reliefs for landowners entering into a longer term 'patient' development is likely to exert significant influence on decisions given factors such as the average age of farmers,[4] the conservative approach and risk profile of landowners, and the consequential requirement for certainty.

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[3] Relevant IHT reliefs are Business Property Relief for 'hope' value (for the development value less agricultural value) and Agricultural Property Relief (for the agricultural value).

[4] Average age is 59 years: Table 2.3 *Agriculture in the United Kingdom 2014* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/430411/auk-2014-28may15a.pdf

- Unwinding of the collective arrangement can be achieved neutrally, without a tax cost in the event that the development does not proceed.

- A valuation process on entering the arrangement providing certainty of final entitlement.

5.3 It is recognised that extending comparable treatment to a form of pooling would need to be costed. The CIOT's expertise lies in taxation rather than economics. However, we observe that if the costing comparison is made solely by reference to the higher tax cost of pooling currently (as demonstrated in the example equalisation routes), a reduction in those tax costs would result, in theory at least, in reduced revenue. However, insofar that landowners facing the current choice would tend to choose the traditional route anyway, providing a level playing field in tax terms would not have that effect in practice. It seems reasonable to us that costings should reflect actual behaviour and the real life consequences of each option rather than theoretical costs.

6 How might a level 'tax playing field' be achieved?

6.1 There are a number of possible approaches. One possibility is a land pooling vehicle that effectively freezes the tax status of the land at the point of entry into the pooling vehicle, preserving the status of the land pre-pooling. As with the traditional model tax is charged at the point a tranche of land is sold and a pro-rata share of the proceeds is paid out. If the development does not proceed, the land would revert to the landowner without triggering a tax charge.

6.2 Freezing the tax position for CGT and IHT is the likely focus for landowners but other taxes will need to be considered (Stamp Duty Land Tax, corporation tax, income tax, VAT) in relation to a land pooling vehicle.

6.3 An alternative route might be a wider permissive statutory power to grant particular tax treatment to landowners participating in a development that satisfies the defined requirements of a sustainable development with the costs of exercising the power met, at least in part, out of the development.

6.4 The CIOT would be pleased to consider these and other possible approaches with both the Department and with HMRC to develop potential solutions.

7 Acknowledgement of submission

7.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the CIOT is included in the List of Respondents when any outcome of the consultation is published.

8 The Chartered Institute of Taxation

8.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
10 May 2017

APPENDIX : TAX CONSEQUENCES OF EXAMPLE EQUALISATION MECHANISMS

The examples assume that participating landowners are independent and not connected in any way beyond their participation in the project. The tax consequences for family members pooling land may differ as the tax system applies different rules for transactions between connected parties.

The examples are simplified for the purposes of illustration.

1 An equalisation agreement

1.1 At its simplest an equalisation agreement made between all the landowners might simply provide that each landowner receives the price for their land by reference to the value of the whole site as the development proceeds. For example, A,B and C each own 100 hectares and enter into an equalisation agreement in respect of the 300 hectare development site to split the proceeds equally. Once planning permission is obtained, A's land is sold first for £30m. A has to transfer £10m each to B and C under the equalisation agreement.

1.2 Assuming that the disposal of each tranche of land and the equalising payments are subject to CGT as capital rather than trading assets, although each landowner may preserve a 10% CGT rate on the price for their land before equalisation, the equalisation payments create a double liability to CGT being non-deductible to the paying landowner and taxable (at 20%) on the recipient landowner.

1.3 In the example, if the equalisation payments of £10m each to B and C were deductible, each landowner would be taxed on £10m. However as the payments are non-deductible, A is taxed on £30m at 10%, B and C are taxed on £10m each at 20%.

1.4 In summary the main tax barriers to this arrangement are that ;

- equalisation payments made by each landowner on sale are non-deductible for CGT purposes;
- the equalising payments are fully taxable in the hands of the recipient landowner;
- the equalising payments are not sales of business assets for the purposes of Entrepreneurs Relief (or IHT reliefs) so the tax rate is 20% rather than 10%.

1.5 Although the double assessment to CGT in respect of the proceeds and the equalising payments may be mitigated by the developer entering into the equalisation agreement directly with the participating landowners rather than equalising payments being made between landowners, the equalisation asset will not be eligible for Entrepreneurs' Relief (or IHT reliefs) and may be subject to the higher rate of income tax under the anti-avoidance provisions dealing with 'transactions in land' on the basis that the landowner's right to the equalisation payment is in effect a slice of the developer's trading profits.

1.6 In summary compared to the traditional un-pooled model, the CGT tax cost increases from 10% to (at least) 20% on the equalising element, with the potential for a double assessment and a loss of protection from a full IHT charge that would have been retained under the traditional model, thereby providing a barrier to equalisation.

2 A Land Pooling Trust

2.1 A pooling arrangement involves the transfer of all the development land to a bare trust that achieves equalisation by each landowner holding a percentage of the whole site by reference to the area/value they originally owned. In the simple example above A, B and C would own one third of the 300 hectares rather than their individual 100 hectares. When a tranche is sold, each would receive one third of the proceeds based on the one-third share and taxed at the CGT rate of 20%.

2.2 The pooling results in the loss of CGT reliefs, particularly Entrepreneurs Relief, meaning that the effective CGT rate is 20% rather than 10%. Similarly landowners may lose inheritance reliefs if they pre-decease the completion of the development.

2.3 For CGT purposes, the analysis depends upon case law rather than statute. Provided that the split of interests in the trust is made by value (rather than acreage), on the basis of *Jenkins v Brown, Warrington v Brown*[1] and *Booth v Ellard*[2] the transfer into the trust is not treated as a disposal and the base cost to the landowner when the site or part of the site is sold is based on the original cost of the land contributed. Therefore, a disposal by the trustees gives rise to a CGT liability on the gains of individual landowners according to their percentage share of the whole. The CGT treatment is heavily dependent on the documentation, HMRC's acceptance of the application of the case law as HMRC indicates in the CG manual at CG3441[3] and obtaining valuations to support the transfers into the trust. The valuation process may encourage landowners to delay transfers until the latest possible time in case individual plot values increase.

2.4 For Stamp Duty Land Tax purposes, the technical position (and HMRC's approach) is also uncertain. If SDLT were to be due, the tax cost of transferring the land into the trust could include an upfront SDLT cost of 5%[4] without any proceeds with which to meet the liability (a 'dry' tax charge).

2.5 In summary, compared to the traditional un-pooled model, the landowner's pooled entitlement is taxed at 20% rather than 10% with the risk of other tax charges and the loss of full IHT relief in respect of the value of the land while the land is in the trust pool.

2.6 Untangling the pool if the development does not proceed may also give rise to further 'dry' tax charges.

3 Transfer to a Special Purpose [Equalisation] Vehicle

3.1 Each landowner transfers the whole of his/her land to a company either by way of gift or in consideration of the issue of shares to the landowners in proportion to their land holdings. Obtaining valuations to support the transfers into the vehicle will again be key with the same issue as the trust route ie landowners deferring the point of transfer to gain the highest value.

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[1] [1989] STC 577
[2] [1980] 1WLR 1443
[3] https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg34411
[4] Assuming the land is non-residential

3.2 Both a dry CGT charge (at 20%) and an SDLT charge (at the non-residential rate of 5%) may arise on the transfer of land to the company; although the CGT charge may be mitigated by reliefs dependant on the conditions applicable to each landowner.

3.3 As the company acquires the land to sell on, profits arising in the company are subject to tax as a trading profit at corporation tax at [19% in2017/18][5] with an income tax charge up to 38.1% if the profits are distributed by the company to the landowner by way of dividend. Returning value to the former landowners by way of a sale of the shares in the company (rather than distribution) will be subject to CGT at 20% (subject to reliefs).

3.4 In summary, even leaving aside possible tax charges on the transfer in, a company involves two levels of taxation – corporation tax in the company and income tax on the withdrawal of profits by way of dividends giving a higher effective rate (up to 49.86%) and therefore a reduced return when compared to the traditional model with a 10-20% rate.

3.5 An equalisation vehicle, in whatever legal form, may give rise to further potential tax charges; not only on the transfer of land into the vehicle, but also if the structure needs to be unwound should the development not proceed.

[5] It is proposed that the CT main rate will reduce to 17% in 2020.