30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: post@ciot.org.uk

Residential property developer tax

Uncertainties in respect of 'just and reasonable apportionment' and other aspects

Proactive submission by the Chartered Institute of Taxation

1 Uncertainty in respect of 'just and reasonable' apportionment

1.1 We are seeking clarification of HMRC's approach to the just and reasonable apportionment between property development activities (RPD) activities and non-RPD activities for the purposes of the computation of adjusted trading profits and losses for residential property developer tax (RPDT).

1.2 Our stated objectives for the tax system include greater certainty, so businesses can plan ahead with confidence.

2 Suggestions for expanding the guidance to remove uncertainty

2.1 FA 2022 section 39(3) provides for the apportionment of profits and losses etc derived from residential property development activities (RPD) activities and other activities to be apportioned on a 'just and reasonable basis'.

2.2 HMRC's RPDT manual at RPDT20210 includes the following guidance:

Where a company undertakes activities other than residential property development then an apportionment is to be made on a just and reasonable basis, FA22/S39(3).

The need for apportionment of the profits of a company within scope of RPDT is most likely to arise in the case of mixed-use developments: projects comprising both homes and commercial units or where residential units in a development are offered for both sale and rent.

What might be considered a just and reasonable basis for apportioning profits will depend on the circumstances. For example, a development may comprise a number of apartments and some commercial

spaces, all of which are disposed of by sales of long leaseholds. An apportionment based on floor area may be appropriate but if, for example, the apartments are finished to a very high specification while the commercial units are more basic 'shells' then an apportionment based on sale proceeds or carrying value of unsold units may be more appropriate. Where the residential and non-residential elements are already distinguished for accounting purposes then HMRC would normally expect this to be the starting point for the apportionment.

Where capital allowances are treated as a deduction in computing trading profits then they must be apportioned separately between RPD and other activities, FA22/S39(2)(a).

2.3 As acknowledged within the above HMRC's guidance, there are a number of methodologies that can be applied in determining the apportionment of revenue and costs in relation to residential property development including floor area/acreage, expected profit margin and external valuation of the various real estate elements. There are also likely to be other methodologies applicable for allocated overhead costs such as management costs including allocating based on a proportion of overall costs of the business and time spent. As a result of the number of methodologies, there will be a number of 'just and reasonable' apportionments possible. So whilst one methodology may be seen as 'more appropriate', it would be useful to acknowledge that the legislation requires a just and reasonable allocation and not necessarily 'the most appropriate'.

In addition, it is noted that an apportionment of revenue and costs is likely to have been reflected in the financial statements of the company and been subject to audit scrutiny. Given this fact, it would be useful if HMRC are able to include commentary in the guidance that in determining a just and reasonable methodology, any accounting treatment adopted by the company in its accounts would be generally respected by HMRC as being just and reasonable subject to any specified circumstances where that might not be the case, for example if the taxpayer has acted improperly in adopting that treatment. Currently the guidance simply refers to it as the starting point.

The guidance is useful but supplementing it with generic examples would be helpful to explain HMRC's approach and what methodologies that could be seen as 'just and reasonable'. We provide suggested examples below based on 'live' situations;

- A mixed use tower block is built with the lower part commercial and the top floors residential for sale.
- A developer selling a large farm land site to a third party house builder having obtaining planning permission for housing development on the site. All of the land is sold as bare land with applicable planning consents for development. Under the planning consent, there is a requirement to build a small industrial unit, a school/community hall as well as retaining some surrounding woodland.
- Sale of units under share ownership scheme where the initial disposal of the property to the house owner took place prior to April 2022.

2.4 It would also be useful to expand with examples, HMRC's approach to costs that are not directly attributable to a specific development in particular general overheads/management costs and abortive costs.

By way of example, a promoter is likely to have a number of promotion agreements on which they are seeking to obtain planning permission. Predominantly, the planning consent sought relates to future residential developments. However, it is highly unlikely that successful planning permission will be obtained on all of the promotion agreements held by the promoter and they run the commercial risk of abortive planning costs. All of the costs relate to a property development trade, with an expectation that all/majority being for residential development. On this basis would the abortive costs where planning permission was not granted be

deductible for RPDT purposes? Would HMRC's view change if the promotion agreements were held in separate companies rather than as part of an overall property development trade?

3 The guidance

3.1 The guidance references section 106 obligations :

Where a developer incurs costs for the purposes of a development, such as 'section 106' obligations to build a new school or road then these are deductible in computing the RPDT but should also be apportioned where there is a mixed-use development.

As noted above, there are a number of methodologies that could be applied in determining the allocation of s106 obligations across a mixed-use development. Further, in determining what is appropriate it may be necessary to take into account the underlying reasons as to how the s106 obligation arose for example if the school was required as part of granting residential planning permission, it may well be appropriate that all of these costs should be allocated to residential. Again, where an allocation between the elements have been reflected in the company's accounts, are HMRC able to provide comfort that this will be respected as 'just and reasonable' basis.

3.2 The guidance references appropriation of land to stock

RPDT does not apply to capital gains. For example, a trading company may have surplus land such as a factory site that it wishes to sell. The company may undertake work in order to maximise its return which may include clearing the site and obtaining planning permission for residential development. Unless the nature and extent of the work means that there is a trading activity then RPDT will not apply. If, however, the company appropriates the land to stock or transfers it to another group company that will do, then the activity will then be within the scope of RPDT.

Could the guidance be clarified to make it clearer that RPDT would only apply to the activity arising after the appropriation to stock rather than the whole activity relating to the disposal of the surplus site. It may also be worth referring the user to the guidance in BIM 60560 which sets out examples of property transactions that may fall to be treated as investment, trading and where intentions change.

4 About us

4.1 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. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

4.2 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.

4.3 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.

4.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

5 Acknowledgement of submission

5.1 We would be grateful if you could acknowledge safe receipt of this submission.

The Chartered Institute of Taxation

15 November 2023