Delivering more rural housing

Date: 7 February 2020

Introduction

CLA membership extends to around 30,000 members managing 10 million acres across England and Wales. As well as agriculture and forestry, our members operate 250 different types of business located in the rural area. Their businesses are often at the foundation of the local economy in providing homes, jobs and services to their local communities. They are multi-generational businesses and take a long-term view in business and environmental planning, extending beyond a single generation.

Background

The availability and affordability of housing in rural areas has continued to fall, creating a knock-on effect with regard to employment opportunities, availability of skilled labour, business growth and the sustainability of rural services and amenities.

For the rural economy to thrive, there needs to be an adequate supply of housing in the right place and of the right type. Historically, rural landowners have played a central role in providing housing to help sustain their communities for future generations and wish to continue to do, but are discouraged by the existing tax regime and complexity of the planning system.

Proposals

- **Introduce a conditional exemption from inheritance tax for affordable housing for the period they remain let at affordable rent.**
- **Align VAT on housing renovation and repair with new build in order to stop disincentivising the re-use of existing buildings**
- **Tax neutrality between different collaboration models for the delivery of land for housing development**

Delivering more Affordable Housing

Only 9% of housing in rural areas are affordable compared to 19% of housing in urban areas and this has implications for equality, social cohesion and the rural economy.

In the Queen's Speech on 19th December 2019, the Government pledged to 'renew the Affordable Homes Program, building hundreds of thousands of new homes for a range of people in different places.'

A report by the Royal Society of Arts[1] found that just ten new homes in each village would solve the rural housing crisis. Our members are well placed to ease the affordability crisis by building new affordable houses and by converting their existing market homes into affordable homes.

Rented property is considered an 'investment' asset and included when calculating the value of the estate for inheritance tax purposes. Landowners are unlikely to want to invest in building new affordable homes, if it is likely to increase the inheritance tax faced by their families when financial returns are only likely to be marginal.

Proposal: Introduce a conditional exemption from inheritance tax for affordable housing for the period they remain let at affordable rent

This proposal postpones the payment of inheritance tax, which can act as a significant barrier to many landowners bringing forward new housing for their local communities. It will result in more affordable houses being provided at a lower overall cost to public finances.[2]

The proposal can be achieved by amending the definition of designated property in section 31(1) Inheritance Act 1984 to include affordable property. Affordable property can be defined by reference to the definition in the National Planning Policy Framework (NPPF)[3].

The owners of the affordable property would need to enter into undertakings with HMRC that the property would be let as an affordable property (for example, the rent is set in accordance with the Government's rent policy for Affordable Rent, or is at least 20% below local market rents).

The provisions in section 32 as to chargeable events will apply, so that if an affordable home is disposed of, whether by sale or gift or otherwise and if the owner was in breach of their undertakings because the home was offered for a rent at market rates, then these would be chargeable events for inheritance tax purposes and the tax would be payable on the full market value, as is the case with other conditionally exempt property such as heritage property.

There are 551,000 private rented sector households in rural areas in England. If the tax incentive encouraged 10% of homes currently let at market rates to be let at affordable rates, then the number of affordable homes in rural areas would increase by 15%, considerably easing the rural housing crisis. If the uptake of the tax incentive created a 20% shift to affordable rent, the number of affordable homes would increase by 30%"

Delivering more Sustainable Housing Development

The government's commitment to net zero greenhouse gas emissions adds a further challenge to meeting their ambitious house building targets and so sustainable development has never been more important.

It is widely accepted that the carbon cost of new construction is usually greater than the carbon cost of refurbishing an existing property, yet our tax system encourages new build over re-use.

[1] https://www.thersa.org/discover/publications-and-articles/reports/future-land
[2] RICS policy document on encouraging landowners to release sites for rural affordable housing, 2018
[3] Annex 2: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/810197/NPPF_Feb_2019_revised.pdf

VAT is currently charged at 20 per cent on repair and maintenance and at 5% on qualifying conversion/adaptation work to buildings. In contrast, VAT is charged at zero rate on the construction and first sale or lease of a new buildings. This incentivises demolishing existing buildings and building new ones over regenerative development.

The UK has had limited discretion in setting the rates of VAT on individual goods and services following the introduction of Directive 92/77/EEC which established rules limiting the discretion of all States to set VAT rates. The UK must continue to comply with the EU VAT regime during the transition period, but after that time the government will have full control over what goods and services qualify for zero and reduced rates. The government now has an opportunity to amend the UK VAT rules to take effect from 1 January 2021.

Proposal: Align VAT on housing renovation and repair with new build in order to stop disincentivising the re-use of existing buildings

The proposal to align the VAT regime can be achieved by amending Schedule 8 of the VAT Act 1994 to add a new group of qualifying services, namely the supply of services in carrying out repairs, renovations or works to the fabric of a residential building.

This policy would encourage the re-use of existing buildings, providing more homes to help meet the government's target and deliver wider development to stimulate the economy.

It would have the added benefit of ensuring that VAT was not a barrier to anyone wanting to improve the energy efficiency of their existing homes.

Encouraging More Housing Development

The Government has talked of the need to build significantly more homes in order to keep up with population growth and to tackle years of under-supply. The Ministry for Housing, Communities and Local Government (MHCLG) has identified that the problem is threefold: not enough local authorities planning for the homes they need; house building that is simply too slow; and a construction industry that is too reliant on a small number of big players.

In its Housing White Paper in 2017, MHCLG had asked how land pooling could make a more effective contribution to assembling land and wanted views on any barriers inhibiting greater take up, and how those might be addressed.

Land pooling typically involves owners of adjoining land agreeing with each other to promote or supply the combined site with a view to selling it for development. Often the owners will seek to obtain planning permission and promote the land themselves, although sometimes a third-party promotor will be responsible for obtaining planning permission, promoting the land and finding a buyer for it.

Currently, tax rules associated with land-pooling are highly complex, which is entirely disadvantageous to private landowners entering into and/or leaving land-pooling arrangements. Private sector land pooling does take place but it is affected by very complex Capital Gains Tax considerations. This complexity can deter private landowners to enter into land-pooling arrangements. If the Capital Gains Tax considerations were to be simplified, this might make private land pooling a more attractive option especially if the landowner was given more certainty that no CGT charge would be payable either on entering or exiting such an arrangement.

In recent years, as Governments have looked for larger sites to be brought forward for residential development, landowners have looked to enter into collaboration agreements to facilitate the delivery of land. This has highlighted the potential tax disadvantages that can arise from such arrangements.

At its simplest, Landowner A owns White Acre and Landowner B, Black Acre. They wish to bring forward White Acre and Black Acre for residential development and decide to collaborate so that they can adopt a unified approach in the planning process, something which should help in the making available of strategic land. They are likely to want to agree, therefore, that they will promote the land and will not be concerned as to the land uses which are ultimately applied to White Acre and Black Acre and will wish to provide that if the overall site is sold in tranches, which is very likely in the case of large sites, it will make no difference as to the order in which parts of White Acre and Black Acre are sold in terms of who receives proceeds, and in what shares. They will, therefore, wish to "pool" the site in some way by deciding on the percentage proceeds each should receive on the sale of any part of the site.

Under the current tax legislation, an agreement to "pool" in this way is potentially hugely detrimental. If part of White Acre is sold first then A will receive part of the proceeds as consideration for the sale of the land and will be able to put the relevant part of his base cost against those sale proceeds. A will not, however, get any allowable deduction for the part of the proceeds he is obliged to pay to B and will potentially pay tax on those proceeds. B will also be taxed on those proceeds paid to him by A but because he will not be selling any part of Black Acre, he will have no base cost against which to set the proceeds he receives.

In collaborating, and agreeing to share proceeds landowners will, therefore, wish to structure arrangements in a way that is not prejudicial. It should be emphasised that this is not aimed at achieving some kind of tax advantage, merely to eliminate the tax disadvantages which would otherwise arise from an informal pooling arrangement as set out above. One way of potentially neutralising the tax disadvantage would be through what is referred to as a "*Jenkins v Brown*" arrangement.

However, in recent years, HMRC seem to have been making a deliberate effort to make such arrangements more difficult to put in place:-

They have obfuscated on the stamp duty land tax (SDLT) implications of such arrangements and, notwithstanding statements made by them in the past that such arrangements would not trigger SDLT, have suggested in recent years that they now take a different view. Most recently, HMRC referred an application for SDLT clearance to their legal team. Two years later no response to the application has been issued but the suggestion is that such a change of view would require primary legislation to implement. This has left the position uncertain.

The Finance Act 2016 replaced the Transactions in Land Code previously contained in Chapter 3, Part 13 ITA 2007 with a new code contained in Part 9A ITA 2007. This has eliminated the ability for clearance and it is unclear from the HMRC guidance how widely HMRC will apply the new code. This has brought into question whether a *Jenkins v Brown* type pooling arrangement, and alternatives to pooling such as the use of cross options, might attract adverse tax implications.

The risk for landowner of making an agreement with a developer in these circumstances would mean that the landowner will not enjoy CGT reliefs which he gets with a disposal direct to the planning authority. This is a very complicated area of tax law that requires simplification. (See *Ahad v HMRC*[4] where the relief was lost because the particular party which effected the purchase did not have compulsory powers which were available to another of the parties.)

Proposal: Tax neutrality between different collaboration models for the delivery of land for housing development

The CLA believes that land-pooling is likely to be more successful if undertaken privately. This will be helped if the tax system is made clearer and more predictable. Commercial land-pooling arrangements, which are not put together for tax avoidance reasons, should be able to established without the tax disadvantages outlined above. We consider it very important that a mechanism is put in place which, from the tax perspective achieves neutrality between different types of arrangements. This will facilitate the efficient delivery of land for housing developments to meet Government targets for new homes.

Inevitably the arrangements will be complex and it would be helpful if there could be a clearance procedure to enable the parties to be certain of the tax consequences of what they propose.

For two examples of land pooling, see Annex 1.

[4] See *Abdul Ahad v HMRC Commissioners* [2009] UK FTT 353; http://www.bailii.org/uk/cases/UKFTT/TC/2009/TC00291

Annex 1

Example 1: 16,000 house scheme in the South East

Multiple landowners seeking to equalize land values and infrastructure costs across 2,500 acres for a large development scheme.

Pooling preferred option but as the scheme will be developed over 30 years there will be a pool for a long time.

The landowners were under pressure to pool early due to the need for all of the land to have the same value, as required by *Jenkins v Brown*. This means that the pooled area will inevitably not exactly match the final development area resulting in some landowners being paid too much, and leaving land that will have to be un-pooled at the end of the scheme.

Pooling on value, rather than acreage, also means that during the pool period each of the original landowners will receive a different annual farm income to that achieved prior to pooling (as they will get a share of the whole pool income based on value, not area).

On pooling a new farming business has to be set up, incorporating all of the original landowners, in order that they retain their trading status and the associated CGT and IHT benefits. Adding the land to a new, pooled, farm partnership, can create a SDLT liability.

Alternatives to pooling, such as individual option agreements, cross options, or inter party loans do not necessarily achieve the desired result and leave the landowners exposed to other issues such as loss of IHT relief and loss of CGT rollover relief.

Example 2: 1,000 house scheme in the South East

A scheme involving 4 landowners and 160 acres that has been under promotion, of various sorts, for 20 years. Each collaboration agreement has to leave open the method of value equalization due to the risk of changes in tax legislation during the promotion period. The size of the site means that phased sales over a period of time will achieve the best land price and the optimum housing delivery rate.

The site includes both brownfield and greenfield land. Some of the brownfield has an existing commercial use that gives it a higher value than the greenfield, although the development value is the same as the commercial uses will be removed.

Some of the land has previously been used for mineral extraction and waste filling. This will form the open space element of the proposed scheme but the land has a current value lower than other greenfield land due to the historic use.

Pooling in accordance with *Jenkins v Brown* would therefore achieve a very different result to pooling on an acreage basis.

A sale in tranches will achieve the best price due to the overall size of the scheme. Cross options have been dismissed due to the risk of owners being considered to be trading in land. Cross options will also reduce the availability of CGT rollover relief.

The only method of sale that avoids these tax issues is a combined sale of the whole site, with the landowners having to accept a discount as a result.