
London Borough of Hammersmith & Fulham

Earls Court

Redevelopment –

Tax implications

August 2012

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Executive summary

The Council's direct exposure to SDLT is potentially limited provided:

- s106 obligations are put in place in respect of the Replacement Homes and car parking CapCo provide to the Council and the land transactions take place in the 5 years following the creation of the planning obligation (*If this process is not managed correctly a very large liability could arise.*);
- land acquisitions from the public are carried out in a manner which fulfils the criteria for CPO relief; and
- the Council is not required to repurchase Gibbs Green School or Farm Lane following a termination of the CLSA.

However the Council will have indirect SDLT liabilities (which we currently have insufficient information to quantify) in respect of:

- land acquired directly by CapCo from the tenants and freeholders, and
- land re-acquired by tenants/freeholders.

We understand there is a “blight” agreement that we have not seen. SDLT costs may result from any land acquisitions under these provisions, or any other acquisitions made outside of the CLSA as a result of this project. We would recommend that any such acquisitions are reviewed from a SDLT perspective, especially where the value of the land acquired is significant.

The Council will need to carefully monitor the VAT incurred in relation to the project.

VAT attributable to exempt supplies will need to be included in the partial exemption calculation. Preliminary calculations suggest that this VAT can be managed within the Council's partial exemption de minimis limit so that no VAT will need to be repaid to HMRC. However, costs will need to be monitored carefully.

The Council will not incur any corporation tax as local authorities in the UK are not liable to corporation tax or income tax.

Background and scope

Capital and Counties Limited (“CapCo”), the leasehold owners of the Earl’s Court 1 and 2 exhibition centres and Transport for London (“TfL”), freehold owners of Lillie Bridge Depot want to develop their land. The London Borough of Hammersmith & Fulham (“the Council”), together with 39 freeholders who have exercised their right to buy (“Freeholders”), own the freehold to two housing estates, at West Kensington and Gibbs Green that sit adjacent to this potential development site. The Council and homeowner land represents approximately one third of the total sixty six acre site at Earl’s Court.

CapCo have put forward an offer for the Council’s share of the land which comprises of:

- cash consideration of £105m,
- overage, and
- replacement social homes.

This report;

- outlines the direct tax, VAT and Stamp Duty Land Tax (“SDLT”) implications and liabilities for the Council of the proposed Conditional Land Sale Agreement (“CLSA”); and
- includes the SDLT implications on the transfer of new properties to leaseholders / freeholders and also on stair casing payments associated with the shared equity homes.

We have reviewed the following documentation:

- The draft CLSA, entitled version 5 and dated 27 January 2012, followed by
- the draft CLSA, entitled version 31 July 2012.

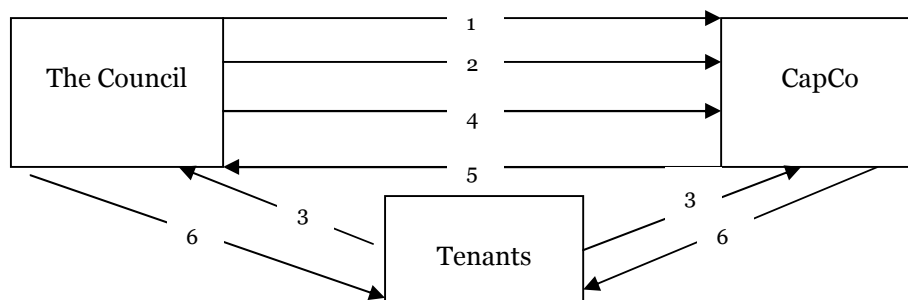
Certain terms of reference that have been defined in the CLSA have been used in our advice.

Summary of the arrangements

We have summarised our understanding of the key elements of the arrangements below, based on the CLSA and the information provided at meetings held with the Council and its representatives.

If our understanding of the arrangements is incorrect, or if any key aspects of the transaction are missing, please let us know as this may affect our analysis.

The CLSA is a conditional contract for the sale of land dealing with a number of movements of land between CapCo and the Council.



The simple diagram above shows the movements of land:

1. Sale of Gibbs Green School
2. Sale of Farm Lane
3. Securing vacant possession of Council land
4. Sale of Council's land
5. Replacement Homes transferred to the Council
6. Replacement Homes transferred to tenants

1. Sale of Gibbs Green School

The Council currently own the freehold of Gibbs Green School which will be transferred to CapCo. The consideration paid will be:

- cash of £9.3m,
- overage (if the CLSA is terminated).

Gibbs Green School is currently being used by the Council to temporarily house its secondary autistic provision. The Council intends to relocate the school to a new facility in White City, following its construction. The cash consideration will become payable by CapCo when the CLSA is entered into. Completion of the transfer is scheduled for 31 August 2014 or such earlier time stipulated by the Council i.e. if the Council is able to vacate the property earlier.

In the event that the CLSA is terminated, the Council will acquire an option to repurchase Gibbs Green School under the Repurchase and Overage Provisions.

2. Sale of Farm Lane

The Council also owns the freehold of 11 Farm Lane, which is to be sold to CapCo. The consideration paid will be:

- £5.7m on completion of the sale, AND
- Overage (if the CLSA is terminated).

The property will be used to assist in the provision of Replacement Homes.

In the event that the CLSA is terminated, the Council will acquire an option to repurchase Farm Lane under the Repurchase and Overage Provisions.

3. Securing vacant possession on Council land

The Council will be responsible for securing vacant possession of its land prior to the transfer to CapCo. This will involve the acquisition of a number of interests from residents and occupying RSLs. The consideration paid will be either in;

- cash, or
- the provision of alternative accommodation.

We understand:

- Following the signing of the CLSA, CapCo will make £7.5m available under a loan facility to fund the Council's acquisitions, and any other costs related with the securing of vacant possession. Following the Council obtaining secure SOS Consent, this loan facility will increase to £15m. The Council does not currently plan to use this loan facility. If the loan facility is used, any payments will in effect be an advance on the cash consideration payable for transaction 4.
- The Council may require CapCo to acquire some of the units directly. Qualifying capital and revenue costs incurred by CapCo in relation to these acquisitions will be refunded, net of any rents CapCo may receive. These costs (including SDLT payable by CapCo) will be accrued and netted off the Advance Payments.

Please note, we are yet to see details of any arrangements that the Council or CapCo has entered into with the RSLs outside of the CLSA. It is understood that the RSLs own long leases in 58 properties within the two Council estates. Negotiations will be taking place with these RSLs in terms of purchasing back their interests and this may include providing sites elsewhere. These arrangements are beyond the scope of this report but will need to be considered from a tax perspective.

4. Sale of Council's Land

The sale of the Council's land to CapCo will take place in Phases. The total cash consideration payable by CapCo will be a combination of:

- £105,000,000 in cash (this includes the consideration paid for Gibbs Green School and Farm Lane);
- overage (its currently anticipated no overage will arise); and
- CapCo will also provide the Replacement Homes to the Council (see below).

The CLSA will become unconditional upon satisfaction of the Conditions Precedent i.e. the SOS Consent Condition (the satisfaction of certain consents under Local Government and Housing legislation) and the Trigger Condition (the service of the Trigger Notice by CapCo following satisfaction of the SOS Consent Condition).

Transfer of each Phase

The obligation on the Council to transfer each Phase of land is currently conditional on the satisfaction of the Vacant Possession Condition for that Phase and the grant, by CapCo, of the necessary Replacement Home Lease(s) or Replacement Accommodation Lease(s).

Advance Payments

Following the satisfaction of the Trigger Condition the balance of the consideration will be paid in five equal annual instalments beginning on:

- 31 December 2015, if the Trigger Condition is satisfied before that date, or
- the date the Trigger Condition is satisfied, if later.

5. Replacement Homes transferred to the Council

It is anticipated that the majority of tenants and occupiers will want to relocate within the immediate locality. CapCo is required to make a number of Replacement Homes available to the Council to facilitate agreement of terms with occupiers and to secure vacant possession.

The Replacement Homes will be made available to the Council, as required, throughout the course of the development, so that they can re-house tenants and Freeholders/leaseholders.

A total of 765 Replacement Homes will be provided by CapCo to the Council under 995 year leases. 171 of the replacement homes are required to house existing resident Freeholders/leaseholders, who have acquired their homes under the Right to Buy. The remaining 594 homes are for existing tenants.

6. Replacement Homes transferred to tenants

Freeholders/leaseholders from whom the Council acquire houses from will be able to take up their new homes at no extra cost. Where Freeholders/leaseholders are to acquire a more valuable house than they gave up we understand equity may be retained by the Council to create a shared ownership structure.

Tax Implications

Local authorities are not liable to corporation tax or income tax. However, the project will have a number of VAT and SDLT issues, which will need to be managed throughout the course of the development.

SDLT

Overview

i) The Councils liabilities

The Council is likely to have a SDLT liability in respect of:

- The acquisition of freehold interests from the public, and of leasehold interests where a new lease is not granted, where CPO relief is not available.
- Reimbursement of tenants/freeholders for SDLT on Replacement Homes transferred to tenants and owners. While this charge is prima facie a cost to the tenants we understand the Council are underwriting it. Further information is required for us to quantify this charge.
- The reimbursement of CapCo for SDLT it suffers when acquiring land directly from tenants or freeholders.

Care needs to be taken that:

- S106 obligations are put in place in respect of the Replacement Homes and car parking CapCo return to the Council and the land transactions take place in 5 years following the creation of the planning obligation. (If this process is not managed correctly a very large liability could arise);
- land acquisitions from the public are carried out in a manner which fulfils the criteria for CPO relief; and
- the Council is not required to repurchase Gibbs Green School or Farm Lane following a termination of the CLSA.

As a separate point, we understand there is a “blight” agreement that we have not seen. SDLT costs may result from any land acquisitions under these provisions, or any other acquisitions made outside of the CLSA as a result of this project. We would recommend that any such acquisitions are reviewed from a SDLT perspective, especially where the value of the land acquired is significant.

ii) CapCo’s liabilities

CapCo will pay SDLT on land it acquires from the Council. We have not been asked to provide detailed advice in this area.

We understand that CapCo will be able to recover SDLT it suffers on land acquired directly from tenants or Freeholders from the Council.

When the CLSA is entered into, the £15m paid by CapCo under the Exclusivity Agreement will be held under the terms of the CLSA. £10m will remain refundable. It will initially become payment for the option under the CLSA. SDLT become due by CapCo on the full £15m when the Exclusivity Agreement was entered into. If the £10m is eventually refunded under the CLSA, a refund of the associated SDLT paid will become due.

We have set out below the SDLT implications for the Council of each step in the CLSA.

1. Securing vacant possession of Council land

The land will be secured by either the Council or CapCo:

i) The Council acquires the subordinate land interests

Unless property is acquired as part of a Compulsory Purchase Order “CPO” (see Appendix 1.4 for details) SDLT will be payable by the Council. Depending on the chargeable consideration, and the type of property acquired, SDLT could be payable at a rate between 1% and 4% (on the basis no single property is valued in excess of £1m, see Appendix 1.1 for further details).

The chargeable consideration could be different depending upon the nature of the interest the Council acquires and the consideration it provides:

- If a freehold is acquired it is likely to be an exchange with chargeable consideration being the higher of market value or consideration paid.
- If leasehold is surrendered in return for the grant of a new lease to the same tenant, the surrender and grant will not be seen as consideration for each other.
- If the only consideration provided for a leasehold or a freehold is cash, this would form the consideration potentially chargeable to SDLT.

SDLT will need to be considered carefully when each land interest is acquired.

CPO Relief (see Appendix 1.8) should be used to mitigate any charge.

ii) Acquisitions by CapCo

SDLT will be payable by CapCo in respect of each interest it acquires directly. Depending on the cash consideration paid, and the type of property acquired, SDLT will be payable at a rate between 1% and 4% (on the basis no single property is valued in excess of £1m, see Appendix 1.1 for further details on rates).

It is worth noting here that SDLT incurred by CapCo on these acquisitions is included in the Allowable Capital Expenditure, which is deducted from the total consideration paid to the Council.

We understand that the facility for CapCo to utilise sub-buyers is intended to allow them to substitute the purchasing entity. Please note, any additional transfers of land (e.g. from a sub-buyer to CapCo or vice versa) could create additional SDLT charges. However, we understand that any subsequent SDLT charges will not be met by the Council.

2. Sale of Gibbs Green School

The acquisition of the freehold of Gibbs Green School by CapCo may be captured by the exchange provisions. If so, CapCo’s SDLT liability will be based on the market value of the freehold transferred or, if higher, the consideration actually given (i.e. a £9.3m payment by CapCo and any overage paid will also be subject to SDLT).

If the Council chooses to repurchase Gibbs Green School following the termination of the CLSA, the acquisition will be subject to SDLT.

It appears that the Council acquire an option to repurchase the property following the termination of the CLSA. If that option were to have a value, its acquisition may trigger an SDLT charge. However, we understand that the option will have little, if any, value.

3. Sale of Farm Lane

The acquisition of the freehold of Farm Lane by CapCo may also be captured by the exchange provisions. Again, if so, SDLT suffered by CapCo will be payable on the market value or, if higher, the consideration actually given (i.e. the £5.7m payment and any overage payment).

If the Council chooses to repurchase Farm Lane following the termination of the CLSA, the acquisition will be subject to SDLT.

It appears that the Council acquire an option to repurchase the property following the termination of the CLSA. If that option were to have a value, its acquisition may trigger an SDLT charge. However, we understand that the option will have little, if any, value.

4. Sale of Council's Land

SDLT will be payable by CapCo on this transaction. As with the other acquisitions, this may be captured by the exchange provisions. If so, the SDLT payable by CapCo will be calculated on the higher of:

- the market value of the interests acquired from the Council, which has been estimated to be between £182m and £246m (*there is subjectivity over if the land valuation and the amount it is depressed by the s106 requirements*) or;
- if higher, the consideration (directly or indirectly) given (*likewise there is subjectivity over the value of the total consideration paid by CapCo i.e. should this include the Replacement Homes?*).

A significant SDLT saving could be achieved if an exchange can be avoided and the Replacement Homes can be excluded from the calculation of the consideration given so that SDLT becomes due on the cash consideration alone.

The rate at which CapCo would pay SDLT would be between 1% and 4% (on the basis no single property is valued in excess of £1m, see Appendix 1.1 for further details), depending upon the split between residential and commercial land and if it could be argued that Multiple Dwellings Relief is available (see Appendix 1.9 for further details).

5. Replacement Homes transferred to the Council

If the transaction is seen as an exchange for SDLT purposes the chargeable consideration for the acquisitions by the Council will be based on the market value or, if higher, the consideration actually paid. The CLSA ascribes a value of approximately £105m to £169m to the Replacement Homes. It should be confirmed if this reflects market value and is thus the potential chargeable consideration for SDLT purposes.

Reliefs

There is a relief for land transactions undertaken to fulfil a section 106 requirement. The duplication of the obligation for CapCo to provide the Replacement Homes in the CLSA as well as in a section 106 agreement does not necessarily preclude the possibility of this relief being claimed, however the position would be cleaner if the obligation only existed in the s106 agreement. Appendix 1.4 provides the criteria for this relief.

If section 106 relief is not available, Multiple Dwellings Relief may be available (see Appendix 1.9 for further details).

6. Replacement Homes transferred to tenants

It is understood that the Council has agreed to meet any SDLT costs of the Freeholders/tenants on their re-acquisition of Replacement Homes.

i) Surrender and re-grant of a lease

The charge to SDLT in respect of any leases exchanged with tenants could be minimal as:

- there is a specific provision for the surrender of an existing lease in return for a grant of a new lease deemed not to be consideration (see Appendix 1.5); and
- the net present value of rental payment may not breach the threshold for SDLT on the rents (see Appendix 1.1).

The position will however need to be considered on a case by case basis. In particular if a leasehold interest is surrendered for a new shared equity leasehold interest further staircasing payments (see Appendix 1.9) could be subject to SDLT.

ii) Sale of a freehold in return for shared equity long lease or freehold

Where there is an exchange of a freehold in return for a freehold or leasehold interest, the exchange is potentially chargeable to SDLT. When someone acquires a share in a property through an approved shared ownership scheme they may have to pay SDLT. The purchaser can either:

- make a one-off payment based on the total market value of the property, or
- pay any SDLT due in stages.

If the buyer opts to make a one-off payment up front this is known as making a 'market value election'.

If the buyer opts to pay SDLT in stages they are required to pay any amount due on the initial purchase amount but will not have to make any further payments until they own more than an 80 per cent share of the property. This is often referred to as staircasing. Given that we understand that the value of the properties in the development will be in the region of £500k, staircasing may be the most attractive option.

Appendix 1.9 gives further details on the market value election and staircasing.

Further information will be required in respect of the interests that will be granted of the Replacement Homes to calculate the total exposure.

VAT

The key issue for the Council in respect of VAT will be managing its partial exemption position (see technical notes). If the Council breaches its partial exemption de minimis limit in any given financial year, the cost is likely to be in excess of £2m.

Therefore, it is important that the VAT on costs attributable to any exempt supplies is captured for the purpose of the partial exemption calculation so that any issues are highlighted at an early stage and planning opportunities can be considered.

The Council will make a number of supplies of land under the CLSA, followed by supplies of new homes to new tenants and leaseholders. The supplies are considered in more detail below.

It will be important to consider the precise nature of the costs incurred in relation to the project to determine if they are correctly attributable to the supplies of land under the CLSA, or the supplies of the new homes.

Supplies of land under the CLSA

The interests in land supplied by the Council under the CLSA will be exempt from VAT, subject to the Council's option to tax.

Please note, it is important that the Council checks to see if any options to tax have been made over any of the land that will be sold to CapCo. If they have, those supplies will be subject to VAT (see notes on value of supplies below). For the purpose of the note, we will assume there are no current options to tax in place.

Therefore, the Council will not be required to charge VAT on the supplies. However, VAT on costs attributable to the supplies will be exempt input tax and will need to be included in the Council's partial exemption calculation.

Although the attributable VAT incurred to date in relation to the project may be minimal (perhaps limited to the VAT incurred on professional fees) securing vacant possession of land and rehousing tenants can often be costly.

Preliminary calculations show that the attributable VAT that will be incurred (based on the forecasted costs) can be managed within the Council's partial exemption de minimis limit. This position could change if any significant, unforeseen VATable costs for the project emerge or if exempt input tax generated from other sources of income were to increase (following our detailed review of the Council's calculations, for example). One of the clauses recently added to the CLSA (clause 36.4) includes a warranty that the Council will not opt to tax. The Council may want to consider removing/altering this clause if it feels that there is a risk that significant additional VATable costs relating to the project could emerge, or the current partial exemption calculations are not accurate, so that the option to tax is available as a last resort should the partial exemption position be put at risk.

It is understood that CapCo's intended use of the land will allow for CapCo to recover VAT charged by the Council. However, since SDLT is payable on the VAT inclusive amount, an option to tax may result in additional SDLT costs for CapCo so it will need to be considered carefully.

There may be scope to consider whether the supplies by the Council will qualify for zero rating (see technical notes). Zero rating would allow for full VAT recovery on costs, with no partial exemption implications, and will not lead to any additional SDLT costs for CapCo. This will only be applicable where the Council originally constructed the dwellings and are yet to grant a major interest in them. The zero rate will therefore not apply to any dwellings that have been sold under the Right to Buy, where the Council will have already granted a major interest.

Value of supplies

In the event that the Council is required to opt to tax to protect its partial exemption position (or an option to tax is already in place) then, to the extent that this will apply, the Council will need to ensure that it charges and accounts for VAT on all of the associated consideration received from CapCo. The Council will need to value any non monetary consideration associated with the standard rated supply.

Time of supplies

It will be important to carefully consider the time of supply for each Phase of land. If an option to tax is required to protect the Council's partial exemption position, it will need to be made before the time of supply.

The freehold interests supplied by the Council will be supplies of goods for VAT purposes. The time of supply for goods is the date that they are made available or, if earlier, the date that payment is made or an invoice is issued.

With the payment schedule as it stands, and with additional consideration being provided in the form of the Replacement Homes, the date that the payment is made in respect of each supply of land is not currently clear. Therefore, it is all the more important to consider what VATable costs will be incurred in relation to each supply to ensure options to tax are made, where required.

The supplies of new homes

The supply of housing to (short term) Council tenants is a non business activity for the Council. As such, no VAT will need to be charged on the rents and the VAT on any attributable costs will be fully recoverable under section 33 of the VAT Act (see technical notes).

However, prima facie, the grant of the shared ownership leasehold interests in the Replacement Homes to the current leaseholders/freeholders will be exempt from VAT. Therefore, VAT attributable to these supplies will be exempt input tax and will need to be included in the Council's partial exemption calculation.

The option to tax does not have effect in relation to dwellings. Therefore, if the VAT attributable to the new leases will present a partial exemption issue, the option to tax will not be an effective solution.

The supply of the leases will not qualify for zero rating since the Council will not be constructing the new homes.

If the VAT attributable to the shared ownership leases will present a partial exemption issue, there may be scope to consider if these supplies can also be treated as non business i.e. where the Council is operating under a special legal regime and, in not charging VAT, there will be no significant distortion of competition. This would allow for full VAT recovery on attributable costs, removing the partial exemption issue.

Nevertheless, since the supply of the Replacement Homes by CapCo should be zero rated, the VAT incurred by the Council that will be attributable to the new leases should be minimal.

Corporation Tax

The Council will not incur any corporation tax as local authorities in the UK are not liable to corporation tax or income tax.

Appendix 1: SDLT Technical Notes

1.1 Rates and thresholds – residential property Freehold purchases and lease premiums

The rates below apply for freehold residential acquisitions and the premium paid for a new lease.

Chargeable consideration	SDLT rate	SDLT rate for first-time buyers
Up to £125,000	Zero	Zero
Over £125,000 to £250,000	1%	Zero
Over £250,000 to £500,000	3%	3%
Over £500,000 to £1 million	4%	4%
Over £1 million	5%	5%
Over £2 million from 22 March 2012	7%	7%
Over £2 million (purchased by certain persons, including corporate bodies) from 21 March 2012	15%	15%

£1 million threshold for wholly residential property

From 6 April 2011 SDLT on residential properties over £1 million is charged at 5%.

Purchasing six or more residential properties as part of a single transaction

If six or more properties form part of a single transaction the rules, rates and thresholds for non-residential properties apply. The amounts paid for all the properties in the transaction must be added together in order to establish the rate of tax payable. This is subject to the availability of Multiple Dwellings Relief.

SDLT on rent - new residential leasehold purchases

Where a new residential lease has a substantial annual rent, SDLT is payable on both of the following, which are calculated separately and then added together:

- the lease premium - see the table above
- the 'net present value' ("NPV") of the rent payable

The NPV is based on the value of the total rent over the life of the lease. The formula to calculate NPV is complicated. It can be worked out using HMRC's online calculator, available on the website.

In practice SDLT only becomes payable on a fairly high rent - starting at around £4,500 a year for a 99-year lease, for example, however the exact amount depends on the length of the lease.

NPV	SDLT rate (includes first-time buyers)
£0 - £125,000	Zero
Over £125,000	1% of the value that exceeds £125,000

1.2 Rates and thresholds – non residential property

Freehold purchases and lease premiums

The rates below apply for freehold non residential acquisitions and the premium paid for a new lease.

Chargeable consideration	SDLT rate(includes first time buyers)
Up to £150,000 - annual rent is under £1,000	Zero
Up to £150,000 - annual rent is £1,000 or more	1%
Over £150,000 to £250,000	1%
Over £250,000 to £500,000	3%
Over £500,000	4%

SDLT on rent - new non-residential leasehold purchases

When a new non-residential or mixed use lease has a substantial annual rent, SDLT is payable on both of the following which are calculated separately and then added together:

- the lease premium or purchase price - see the table above
- the NPV

NPV	SDLT rate (includes first time buyers)
£0 - £150,000	Zero
Over £150,000	1% of the value that exceeds £150,000

1.3 Exchanges

Where a land transaction is entered into wholly or partly by the purchaser in consideration of another land transaction being entered into by him as vendor, this is known as an “exchange” for SDLT purposes.

Each transaction is treated as a separate transaction and the chargeable consideration for both is deemed to be the market value of the interest acquired or, if higher, the consideration actually given.

For completeness, although the term "exchange" is normally understood to be a transaction between two people, the definition for SDLT purposes is widened to tri-partite transactions. This was clarified by HMRC in the second SDLT Practitioners' Newsletter. It uses an example (which is very relevant to this transaction) to illustrate this principle, which I reproduce below:

“A purchase and onward lease (B purchases from A and onward leases to C) may be an exchange in the meaning of the legislation if the onward lease is taken in consideration of the purchase. This will frequently occur where A and C are connected persons.”

It goes on to state *“If there is an exchange of land...there are two transactions and two ‘purchasers’.”*

A sale and leaseback, by its nature is always an exchange.

1.4 Section 106 relief - Compliance with planning obligations

Where a land transaction is undertaken to comply with a planning obligation or a modification of a planning obligation, the purchaser may claim relief from SDLT on that transaction, if the following conditions are fulfilled.

1. The planning obligation or modification is enforceable against vendor

This means that there must be a planning obligation in place against the vendor before the transaction is effected. Additionally that planning obligation must be capable of being enforced, whether through the courts or by other means. It does not matter that no action has been taken to enforce the planning order, it must just be capable of being enforced.

2. The purchaser is a public authority
3. The transaction takes place within a period of five years beginning with the date on which the planning obligation was entered into or modified

It is the latest of these dates from which the time period runs.

1.5 Schedule 17A, Paragraph 16: Surrender of existing lease in return for new lease

Where a lease (or more than one lease) is granted in consideration of the surrender of one or more existing lease(s) (whether of the same or different premises) between the same parties, then:

- the grant of the new lease does not count as chargeable consideration for the surrender and
- the surrender does not count as chargeable consideration for the grant of the new lease.

under Finance Act 2003, Schedule 17A, Paragraph 16.

This applies even if other consideration is given for the surrender of the lease (such as a payment by the landlord to the tenant to procure the surrender which is itself chargeable to stamp duty land tax). However the release of any tenant's obligation is not chargeable consideration in relation to the surrender of the lease.

Where part only of the subject-matter of a lease is surrendered, this is treated as the surrender of a lease for these purposes.

1.6 Sale and leaseback relief

A sale and leaseback is an exchange. Therefore, both parts of the transaction are chargeable to SDLT on the market value of the interest acquired or, if higher, the consideration actually given. However, the leaseback element is exempt from the charge to SDLT if the following conditions are met:

1. The sale transaction is entered into wholly or partly in consideration of the leaseback transaction being entered into.
2. The only other consideration (if any) for the sale is the payment of money (or the assumption of debt).
3. The transaction does not involve the transfer of certain rights (generally for assignment, subsale or other transaction involving the subject matter) involved in the transaction.
4. Where the two parties are both bodies corporate, they are not part of the same corporate group.

1.7 CPO Relief: Compulsory purchase facilitating development

A compulsory purchase facilitating development is exempt from charge i.e. a purchase made under a Compulsory Purchase Order for the purpose of facilitating a development by another person.

On occasion, a local authority will make a Compulsory Purchase Order on a property so that a development by another party - typically a property developer - can proceed. Following the order, the owner of the property sells it to the local authority and the local authority then sells it to the property developer. As there are two purchases, there would normally be two lots of SDLT to pay. However, provided the development is being carried out by the property developer, the local authority can get relief from SDLT on its acquisition of the property. Any subsequent transfer of the chargeable interest to the third party is subject to SDLT in the normal way.

This relief is only available where a party other than a local authority develops the land.

As long as the other conditions are fulfilled, it does not matter if the purchase is part of an agreement between the vendor and a third party (i.e. the developer). So, if the vendor agrees to sell the land, and agrees a price with the third party (i.e. the developer), as long as the subsequent sale, to the maker of the compulsory purchase order, is the subject of a compulsory purchase order the fact that there is an agreement as to terms is not a bar to obtaining the relief.

1.8 Multiple Dwellings Relief

Multiple dwellings relief was introduced in the 2011 Budget. It is a relief for transactions which include the acquisition of interests in more than one dwelling.

Where the relief is claimed, the rate of SDLT which applies to the consideration attributable to interests in dwellings is determined by reference to the amount of this consideration, divided by the number of dwellings (i.e. the mean consideration attributable to the dwellings). This is subject to a minimum rate of 1%.

The rate of SDLT which applies to the consideration attributable to interests in land other than dwellings (if any) is the rate which would apply in the absence of the relief. The consideration allocated to non-dwellings has to be determined in a just and reasonable manner.

Superior freehold or leasehold interests in dwellings subject to leases granted for an initial period of 21 years or more are not eligible for relief.

The relief includes provision for “off-plan” purchases where construction may not have commenced by the effective date of the transaction. It also provides for the tax calculation to be adjusted if the number of dwellings involved is reduced within three years of the effective date of the transaction.

1.9 Shared ownership / Staircasing

There are different options for paying SDLT when a shared ownership lease is granted by an approved qualifying body (which includes a local authority).

These schemes are often known as New Build HomeBuy or Social Homebuy.

Market value election - one-off SDLT payment

If the buyer makes a market value election, a one-off SDLT payment becomes due in the same way as if they had bought a freehold or leasehold property outright. The SDLT will be based on the market value of the property at the time of the transaction, which will be stated in the lease.

No further SDLT will become due. It makes no difference if the buyer 'staircase' their ownership by buying a bigger share in the property later on.

It can be beneficial to make an election when the total market value of the property is no more than the threshold for paying SDLT. The threshold is currently £250,000 for first-time buyers (applies for purchases made on or after 25 March 2010 and before 25 March 2012) and £125,000 for all other purchasers.

Right to acquire the freehold?

Where the lease allows the buyer to acquire the freehold to the property SDLT is charged on the market value of the freehold. This is its value at the time of the initial purchase, as stated in the lease. This most commonly applies to houses.

No right to acquire the freehold?

Where the lease doesn't allow the buyer to acquire the freehold to the property then SDLT is charged on the 'open market premium' - that is, the premium that would be payable at the time of purchase for the maximum share of the property that can be acquired under the terms of the lease.

SDLT will also be due on the 'net present value' of the rent that would be payable under the lease if the maximum share was purchased. This is based on the total amount of rent that would be payable over the term of the lease. In practice, tax will only be due on the rent when it is a significant amount.

The deadline for making a market value election

A market value election should be made on the associated SDLT return but it can be made up to 12 months after the deadline for sending in a return by amending the return.

Acquisition of the freehold

Following a market value election, and an initial payment of SDLT, no further SDLT will become due. However, if the buyer acquires 100 per cent of the property by acquiring the freehold, a further SDLT return must be submitted to inform HMRC of the acquisition.

Paying SDLT in stages – Staircasing

If a buyer opts to pay SDLT in stages the initial charge will be less but further payments will become due if they later increase their share of the property. There are two ways of documenting such a transaction.

i) Staircasing payment as contingent consideration?

The basic rule is that SDLT is payable on the consideration paid (i.e. the discounted price).

If the staircasing payments amount to 'contingent consideration' for the initial lease, they will be included as chargeable consideration. However, the leaseholder may apply to HMRC to defer the SDLT payment on the contingent consideration (i.e. the staircasing payments potentially payable in the future) (s51 and 90 FA 2003).

If and when the staircasing payments are made, SDLT will be payable on those payments (without accruing interest). However, the aggregate payments would be taken into account in deciding on the rate of SDLT.

The term 'contingent' is defined in s51 FA 2003 to mean payment on some 'future event' occurring. If the lease were to state that the additional payment is due in the event of an assignment then this will look like contingent consideration and the leaseholder will need to apply for postponement of SDLT. If on the other hand, these arrangements were to be expressed as a restriction on assignment, then we think this should not be seen as contingent consideration and the analysis in the next section should apply.

ii) Staircasing as a land transaction in its own right?

This analysis applies if the staircasing arrangements were to be expressed as a restriction on assignment, with the option (contained in the lease itself) of permitting assignment on payment of the remaining equity. This would be seen as a restriction embedded in the lease.

The term 'chargeable interest' for SDLT purposes includes 'the benefit of an obligation, restriction or condition affecting the value of any ... estate, interest, right or power in or over land in the United Kingdom' (s48(1)FA2003).

The release of such a restriction is an acquisition of that interest by the person whose interest is benefitted or enlarged by the release (i.e. the leaseholder) and a disposal by the person ceasing to be entitled to that interest (i.e. the council). Under this analysis, staircasing would amount to a land transaction as it would be a release of a restriction on assigning the lease and the leaseholders, being the acquirers of this interest, would be liable to pay SDLT the staircasing payments.

While the restriction will only be release when the last staircasing payment is made (i.e. when the leaseholder acquires 100% of the equity), the payment of 80% of the total consideration would trigger the remaining SDLT liability.

Because the initial lease the subsequent staircasing payments would be linked, the rate of SDLT should be payable based on the cumulative consideration. However, in theory, SDLT would only be payable when the final staircasing payment is made (apart from the payment on grant of the lease) because it is only at that stage that the restriction is 'released'.

Assuming we are correct in anticipating that these arrangements will be expressed as a restriction in the lease then we think this analysis should apply and the benefit over the preceding 'contingent consideration' analysis is that:

- The leaseholder does not need to apply for postponement of SDLT; and
- Additional SDLT would only be due when the final staircasing payment is made and the restriction is release (but this might only be a theoretical advantage).
- The rents' net present value is also taken into account when working how much SDLT is initial payable.

Lease Variations

For completeness, there are special rules for lease variations. Where any consideration is given by the lessee for a variation of a lease that is deemed to be an acquisition of a chargeable interest by the lessee (Para 15A(1A), Sch 17A, FA 2003). This should achieve the same result but we do not think this is relevant as the staircasing arrangements should not be seen as lease variations.

Exchanges

The exchanges rules would apply if the contract to purchase the new lease is entered into by the leaseholder wholly or partly in consideration of the sale by the Freeholder of his existing house to the council. (Note if a leasehold was being surrendered the rules would differ). This is so even if the two transactions are completed by 2 contracts. The key issue is whether one would not be entered into without the other and the favourable conditions in the new lease (discounting and staircasing) are economic compensation for the other.

If the exchanges provision applies, SDLT will be chargeable on the market value of the new lease.

If the exchanges rule were to apply the market value of the new lease should reflect the staircasing restriction so if only 50% of the value has been paid, the market value should only be 50% of the full market value of the property

Appendix 2:

VAT Technical Notes

2.1 Non business activities / Section 33 refund

A lot of the activities undertaken by local authorities are outside the scope of VAT. Generally speaking, goods and services provided free of charge, or those provided by the authority under a special legal regime (applicable to public authorities) where the exclusion from the charge to VAT will not significantly distort competition with the private sector, are outside the scope of VAT.

This covers many of the activities undertaken by local authorities. In the UK, these activities are referred to as “non business” activities.

Under normal rules, taxpayers cannot recover VAT incurred in relation to non business activities. However, section 33 of the VAT Act provides a mechanism for local authorities to recover this VAT.

2.2 Partial exemption

Most of the VAT incurred by local authorities will be recoverable as either section 33 VAT, or normal business input tax (VAT attributable to taxable supplies). In practice, a local authority will recover all of the VAT it incurs, subject to its partial exemption position.

In principle, taxpayers cannot recover any VAT they incur that relates to its exempt supplies. This is known as exempt input tax. However, subject to certain thresholds, local authorities can recover exempt input tax.

Each financial year, the Council undertakes a partial exemption calculation to compare its exempt input tax to its total input tax i.e. all of the VAT incurred in the financial year. If the exempt input tax represents any more than 5% of the total input tax, the Council must repay all of its exempt input tax back to HMRC. The 5% threshold is known as the partial exemption de minimis limit.

Therefore, it is important for the Council to monitor any VAT it incurs in relation to exempt supplies each year to ensure that this does not breach the limit.

2.3 Supplies of land

Subject to a number of exceptions, and the option to tax, the supply of land is exempt from VAT.

2.4 Option to tax

The VAT legislation allows taxpayers to opt to tax land. Following an option to tax, supplies of that land will be liable to VAT at the standard rate. However, VAT incurred on attributable costs by the vendor is recoverable in full, with no partial exemption implications. Also, purchasers are often in a position to recover any VAT charged by the vendor.

Therefore, an option to tax is a tool that is often employed by local authorities when a supply of land will result in its partial exemption de minimis limit being breached, or, when the purchaser can recover its VAT, if it simply wants to reduce its exempt input tax and, therefore, reduce the risk that the de minimis limit will be breached in future.

Dwellings

An option to tax has no effect in relation to the supply of a building, or part of a building, designed or adapted, and intended for use as a dwelling or a number of dwellings.

In a situation where dwellings are sold to a purchaser who will demolish them, the purchaser's intended use of the buildings is not use as a dwelling. So, even if following the demolition the purchaser will construct new dwellings, the vendor's option to tax should normally have effect.

2.5 Zero rating of supplies dwellings

The first grant of a major interest in a building, or part of a building, designed as a dwelling, by the person who constructed that building, is zero rated.

A major interest for these purposes is a freehold interest or a leasehold interest exceeding 21 years.

The vendor will be the person responsible for determining the correct VAT liability of the supply.

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