

CITY OF WESTMINSTER AND HOLBORN LAW SOCIETY
Revenue Committee

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Dear Sirs

The Planning-gain Supplement: fiscal considerations

The Society represents a considerable number of property lawyers practising in Central London. Member firms include those specialising in commercial conveyancing as well and leading private client firms dealing (inter alia) with landed estates and leading charitable and similar institutions.

This Committee will confine its observations to the fiscal and conveyancing aspects of the proposals. It is possible that another Committee will make submissions on the planning aspects.

1. Whether the Government chooses to tax realised development value outside the normal income tax and capital gains tax system is an issue of policy. The Committee would make the observation, however, that past attempts to do this have not met with the greatest success, viz:
 - the Land Tax which was the proximate cause of the 1910 Constitutional Crisis;
 - nationalisation of development value under Town and Country Planning Act 1947;
 - betterment levy under Land Commission Act 1967;
 - development gains tax under Finance Act 1974; and
 - development land tax under Development Land Tax Act 1976.

2. The senior members of the Committee have had extensive professional experience of the 1967 and 1976 regimes and are inclined to doubt whether the introduction of the new fiscal tool at even a “modest” rate of tax would have a successful outcome in planning terms for the following reasons:
 - ❖ the betterment levy and DLT regimes had the effect of reducing the amount of land made available for development because landowners are only prepared to release land for development in return for a “net” sum, i.e. one after all taxes; and
 - ❖ this way of looking at matters is likely in particular to affect homeowners with “large” gardens, who (past experience suggests) will only be willing to deal at all in return for a net sum which meets their minimum expectations; and
 - ❖ possibly withholding from the market a sufficient number of urban in-filling sites in local authority areas such as Winchester to affect the amount of green belt land which will have to be sacrificed in order to meet the District Council’s new dwellings’ target; and
 - ❖ to the extent that this is not the case (perhaps because a “high” threshold has had to be inserted in order to prevent this source of building land from drying up),
 - ❖ the essential switch in payment point from that envisaged by Barker, the date upon which detailed planning consent is issued, to the date upon which development is started, will mean inevitably that it is the developer, rather than (as intended) the vendor, who picks up the bill;
 - ❖ thus defeating one of the principal objectives of the switch from TCPA 1990 s.106 Agreement payments (also) due upon implementation.
3. The same experience of the senior members of the Committee suggests that a self-assessment system of calculation will not be workable in practice.
 - ◆ When notional values have to be assessed surveyors [i.e. the taxpayer’s agent and the District Valuer] have tended to have considerably more difficulty in reaching a consensus than in relation to situations in which actual comparables are available.
 - ◆ In this particular case, the assessment of current use value (without the 10% tolerance built into the 1947, 1967 and 1976 legislation) is likely to be the subject of considerable difficulty; and
 - ◆ there appears, in addition, to be a notional value from which this has to be deducted, namely:
 - the value of an unencumbered freehold (even if a different interest is involved);
 - at the date planning consent is granted, i.e. before any attempt has been made to market the property.
4. The valuation uncertainties are such that, at the very least, the CG34 system will have to be introduced for the purposes of this tax.

- This would be practicable because construction could not possibly be started immediately after the grant of detailed planning consent.
- And would be of benefit to developers because funders [and especially those who lent on mortgage for the purchase of the site with planning permission] would be able to fine tune their risk assessments and, in consequence, lend on finer margins.
- But in reality it would be better if arrangements were to be made for all Returns to be sent on to the VOA automatically.
- Even though this must have downside implications on the cost of collection estimates which lie behind the proposal to use the self-assessment system – not least in the light of unsatisfactory experience with the 1910 land tax;
- a complication which local authorities may not feel to be advantageous, but
- (in fairness to developers) would have to be involved where a site (which presumably has to be valued as a whole) consisted in part only of:
 - land in one local authority area (with the balance in another's); and/or
 - [if relevant] of brownfield land.

In both instances:

- ◆ it should not be the concern of the developer how the money was divided and, in particular,
 - ◆ the overall tax charge should not be capable of being increased by the introduction of *Buccleuch*-style lotting producing a value for the sum of the parts in excess of the open market value of the whole.
 - The financial complications of dividing out the tax take between different local authorities should not be charged to the developers in question, and
 - it follows that the proposed assessment system must be redesigned to avoid this.
5. It has been indicated that, with the possible exception of traders, no credit or allowance will be given against other taxes.
- These have been stated to include inheritance tax.
 - But where land with detailed planning consent has to be valued on a death, it will, surely, not be possible for the in-built charge to be ignored.
 - The notional purchaser (being prudent and prudently advised) would have to be deemed to require it to be discounted (no doubt on a net present value basis) in arriving at a price which he is to be deemed to be willing to pay.
 - This leads on to the issue of the relationship between capital gains tax disposals and this new charge.

❖ To take a simplified mathematical example:

a paddock with an acquisition value of £1,000, a current use value of £5,000 and a value with detailed planning consent of £105,000, the cost to the owner of negotiating that consent being £8,000.

❖ The following seems to be envisaged:

- upon the grant of consent a contingent liability to PGS of (say) 20% of £100,000 (i.e. £105,000 - £5,000) will arise;
- as the owner does not intend to implement the consent himself, he finds a developer willing to buy the land and, when stating the work, pay the £20,000 PGS;
- that developer will reduce the price he is willing to pay from £105,000 to £85,000 (and pay SDLT on the lower amount);
- the owner will therefore sell the paddock for £85,000 and, for CGT purposes, be able to offset £1,000 under TGCA 1992, s.38(1)(a) and £8,000 under s.38(1)(b), giving rise to a pre-taper gain of £75,000.

➤ However, where a transaction such as this is concerned, past experience suggests that the owner will not be prepared to sell for less net than was previously the case.

➤ If, in consequence, the price to the developer increased by (say, to allow for taper) 70% of the £20,000, i.e.

✓ apparently £14,000, but

✓ with compound grossing to achieve a “real” net equivalent, in actually £46,664 (or thereabouts),

that would either:

✓ increase the price of the houses in due course; or

✓ (more probably) be a deal-stopper, preventing the site being offered for development in the first place; thus

✓ making it more likely that Green Belt land will have to be allocated for housing in lieu.

➤ The end product could, therefore, very well be the opposite of what Barker intended, i.e.

✓ a quicker supply

✓ of cheaper housing

✓ with the minimum infringement of the Green Belt.

- If, however, as would be likely with many institutional landlords, especially (now that the Barker levy is to be extended to non-residential developments) in the City of London, the owner does not wish to sell, but to obtain its return through the traditional route of:
 - ❖ entering into an agreement for lease under which the developer:
 - will obtain the necessary planning (and other) consents; and
 - then be granted a building licence;
 - which will be replaced by a formal lease upon the issue of the certificate of practical completion:
 - ❖ what is intended to happen?
 - There will be no capital gain tax event because
 - (under the rules applicable to that tax) there will be no disposal by the institutional owner; and
 - presumably official experience with development gains tax was the same as that of practitioners, namely that the first lettings charge was a major inhibiting factor to development, in addition to being very difficult to quantify in practice.
 - The question does, however, arise as to who is expected to be the accountable party for the PGS in these circumstances?
 - It appears to be a feature of this proposal that no account whatsoever is to be taken of different land law interests in the land when computing the taxable amount.
 - Although, at the time construction starts, the institution will be the only person with a legal interest in the site, to impose the PGS wholly upon it would be wrong because its rental gain would be very much smaller than the value accruing to the developer upon completion.
 - This would have as serious a result upon the supply of land for such projects,
 - ✓ as experience with the aborted first lettings charge under development gains tax will have shown.
 - Liability will therefore have to be imposed, by statute, upon the developer in its capacity as contracting prospective tenant under the agreement for lease.
 - ✓ And this would be consistent with the proposed primary mode of enforcement, i.e. the issue of a Stop Order to prevent

construction work on the project proceeding any further;
moreover

- ✓ the alternative of issuing such an Order against the ground landlord would be of no practical effect.

6. The present situation is unlike those which pertained either in 1967, when there was a considerable controversy over the amount of land which could be “franked” by digging a trench in the corner before the appointed day, or 1976, when developers tended still to be able to secure sites [albeit sometimes on a phased draw-down basis where larger acreages were concerned] after owners had obtained outline planning consent before putting their land on the market.

- EU Directives and PPG 3 changes since 1997 have had the effect of moving the “land bank” build up process several years back, with options (often exercisable over a 10-15 year period) being taken by developers on the basis that it is they who will undertake the whole of the planning negotiations (and, if necessary, allocate the social housing element from other parts of their land bank).
- It follows that either or both of the original Barker Report and the PBR 2005 Consultation (which, in practice, shifted the accountability away from that originally envisaged) will have come as a *novus actus* in the middle of a running option potentially exercisable after 2008.
- The identity of the party being subjected to the financial “risk” of any increased overall cost by the substitution of PGS for “tariff” (as opposed to particular) s.106 contributions will vary from contract to contract, and indeed may have to be ascertained by applying the *officious bystander* test, in relation to, e.g.:
 - ◆ the difference between the rate of PGS and the assumed s.106 tariff element, whether informal or – as in the case of Milton Keynes – formalised;
 - ◆ differences in timing, for instance where the formalised tariff permitted payment by instalments; and
 - ◆ the incidence of relative deductions, and especially the considerable costs of negotiation with the relevant planning and other authorities (including the VOA), in relation to other taxes when (as it appears) these are not to be deductible in ascertaining the value to be brought into charge to PGS.
- These uncertainties (as well as the cost of arriving at an agreement or litigated solution) to the option pricing formulae as a result of the substitution of PGS for s.106 tariff may well delay bringing new, and badly needed, housing onto the market.
- The question therefore needs to be addressed as to what transitional provisions need to be made in the relevant legislation, and, in this context, it needs to be borne in mind that:

- ◆ the (second attempt) transitional provisions adopted on Report in relation to landfill tax have not proved to be equitable as far as landowners are concerned; and
- ◆ so the PGS transitional provisions ought not to be designed to benefit the construction industry, but
- ◆ designed to assist in resolving uncertainties even handedly and by reference to the circumstances pertaining when the option was first granted.
- ◆ And it is suggested that it would therefore be appropriate for an **open and discrete** Consultation to be put in hand in order to arrive at appropriate (and balanced) provisions once the essential provisions of PGS have been determined, presumably in the March Budget.

Yours faithfully

W J de Souza
Chairman