



Clarity

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Budget 22 April 2009

Implications for Real Estate - our response to the Government's Budget announcement

The Chancellor made a number of announcements in the Budget today which will affect the property industry. Many of these were refinements to existing legislation, or temporary measures, and do not go as far as the property industry had hoped for. The Government has, however, announced measures to boost capacity in the house building industry.

REIT's

Very little was announced in the Budget in relation to REITs. It was hoped the Government would help REITs weather the current economic climate by allowing deferment of payment of property income dividends; by allowing stock dividends to count towards property income dividend requirements; and by relaxing the interest cover ratio. In addition it was disappointing that no improvements were made to the REIT regime to facilitate residential REITs.

Artificial Restructuring

In his 2008 Pre-Budget Report, the Chancellor proposed measures to ensure that the REIT regime was only available as originally intended to legitimate property investment businesses with third party tenants. Legislation will be introduced with effect from 22 April 2009 such that groups will be restricted from using internal group structures to enable them to meet the REIT conditions.

There is also an amendment of the legislation which will mean that pub groups with tied premises can be included in the regime more easily.

Minor corrections to legislation

A number of clarifications and amendments were announced, which will have effect from 22 April 2009:

- A correction of the legislation in relation to the issue of convertible preference shares
- The legislation will be updated to apply the same definitions for the 'balance of business assets' test for single company and group REIT's
- Clarification as to the application of the balance of business assets test, where funds awaiting reinvestment have arisen from the disposal of a property that has only been partly used in the property rental business
- Amendment of the legislation with respect to the requirement for a company to be listed and non-close at the time it joins the REIT regime.

These items had previously been identified as requiring amendment.

Capital Allowances

Capital Allowances – Temporary First Year Allowances

The key capital allowances measure introduced in this Budget is a temporary first year allowance (FYA) of 40% for main pool expenditure. Such expenditure would otherwise have attracted a writing down allowance of 20% in the year. As with other FYAs, this will not be available in respect of leased assets or cars, neither will it apply to special rate expenditure on long-life assets or integral features. The Treasury estimates that the cost of this measure is expected to be in the order of £1.64bn but will support investment of around £50bn.

This measure will apply to all businesses spending in excess of £50,000 on plant or machinery (the first £50,000 will still continue to attract a 100% Annual Investment Allowance).

This will apply to expenditure incurred in a 12 month period commencing on 1 April 2009 for companies and 6 April 2009 for individuals.

A similar 40% FYA was previously introduced for a 12 month period in the last recession in 1992/1993 to encourage businesses to continue to invest equipment and technology. Whilst the measure is purely one of timing, a doubling of the level of writing down allowances for expenditure incurred within the period should encourage many businesses to push forward with plans to invest that they might otherwise have considered deferring in the short term.

Enhanced Capital Allowances

As has become expected in each Budget since the introduction of the ECA regime in 2001, the list of qualifying technologies has again been updated.

Uninterruptible power supplies (UPS), air to water heat pumps and close control air conditioning systems have all been added to the list of energy-saving technologies qualifying for the 100% first year allowances, whilst three forms of heat pumps have been removed. Further minor housekeeping changes are also to be made to the existing criteria for both the energy saving and water efficient schemes.

The changes to the schemes will have effect on or after a date to be appointed by Treasury order prior to the summer 2009 Parliamentary recess.

The significant NPV benefit of up to circa 30% in securing ECAs remains, despite the introduction of the temporary 40% FYA for main pool expenditure, as generally assets otherwise attracting ECA's would qualify as special rate assets and therefore only receive writing down allowances at a rate of 10%.

Stamp Duty Land Tax (SDLT)

Extension of exempt threshold

The Pre-Budget Report announced a holiday from SDLT for residential properties where the consideration for the acquisition did not exceed £175,000 and the acquisition occurred between 3 September 2008 and 2 September 2009. This has now been extended until 31 December 2009.

It is disappointing that the Government did not take the opportunity to relax the linked transaction provisions such as to permit the nil rate to apply where a series of properties beneath the relevant threshold were being transferred.

Collective Enfranchisement

Leaseholders acquiring their building's freehold under this process now benefit from a nil rate band (and, where that is exceeded, a threshold) which is multiplied by the number of flats in the building.

Alternative Finance Investment Bonds – Sukuk

With effect from Finance Act 2009 a new stamp duty land tax relief will be introduced for transactions involved in connection with the issuance of sukuk. A sukuk is an Islamic financial certificate, equivalent to a bond that complies with the requirements of Sharia'a Islamic law. The relief is intended to enable sukuk to be held, issued and traded without incurring SDLT costs over and above that which would be incurred in connection with similar dealings in traditional corporate bonds.

Under draft legislation published for consultation in the run-up to Budget, in broad terms the relief will apply where land is transferred by one person to a bond-issuer ('the first transaction') to be held by the latter for the purpose of the issuance of a bond until the termination of the bond (no later than 10 years) at which time ownership of the land reverts back ('the second transaction'), and, for the purpose of generating income or gains for the bond, the bond-issuer and the original owner enter into a leaseback agreement. The first and second transactions are to be relieved subject to satisfying six conditions. A pre-existing SDLT relief for sale and leaseback arrangements is intended to provide a complete exemption for the acquisition of the leaseback.

Shared Ownership

An SDLT relief currently available to Registered Social Landlords is to be extended to certain (public subsidy funded) acquisitions involving the bodies due to replace them in England, known as profit-making Registered Providers of Social Housing. Relief may apply where the acquisition is by the body itself or a shared ownership scheme which it operates. In addition, the SDLT treatment of "Rent to HomeBuy", a new shared ownership scheme, is to be simplified.

Proposed changes to the DOTAS regime for SDLT

Draft regulations were published today for consultation that would change the Disclosure of Tax Avoidance Scheme (DOTAS) regime as it affects SDLT:

1. to extend the regime to residential property with a value of at least £1 million, and
2. introduce arrangements for HMRC to identify users of disclosed SDLT schemes for both residential and commercial property.

The regulations are intended to take effect towards the end of this year. This continues a process of consultation initiated in 2007.

Under the draft regulations, DOTAS would apply to schemes that concern either:

- Non-residential property with an aggregate value of at least £5 million; or
- Residential property with an aggregate value of at least £1 million.

A 'grandfathering' rule would exempt from disclosure any scheme of the same, or substantially the same, description as a scheme that was first made available for implementation by any person before the changes come into force. This is to ensure that only new and innovative schemes are caught.

The draft regulations would extend the Scheme Reference Number (SRN) system to SDLT. The SRN system was designed to identify users of disclosed schemes and applies to the DOTAS regime for other taxes. Promoters of affected schemes must use a particular HMRC form to notify a SRN to clients, providing the client with information about how and when to report a SRN to HMRC. An alternative method of notifying SRNs using the SDLT land transaction return has been ruled out as unworkable.

Responses to the consultation document are requested by 15 July 2009.

VAT – Simplifying the Procedure for Opting to Tax Land and Buildings

Businesses can make an option to tax real estate so as to convert the income from it from being VAT exempt to being subject to VAT. Where the business has already made exempt supplies it needs to have permission from HMRC before exercising this option. In some cases businesses can avail themselves of 'automatic' permission provided they meet various conditions.

The Budget announced a change to one of the conditions and also removes some informal concessions that had facilitated fairer VAT recovery in these circumstances. The change to the 'automatic permission' conditions will have effect from 1 May 2009. The removal of the concessions will have effect from 1 May 2010.

Details have not yet been published but the removal of concessions that facilitate fairer VAT recovery will be of concern if the legislative imperfections that gave rise to them are not also remedied.

Landfill Tax

Standard Rate

An increase in standard rate of landfill tax from £40 to £48 per tonne was announced which will affect landfill site operators and those disposing of materials at a licensed landfill site. The changes are intended to come into effect on 1 April 2010 for any disposal treated as made on or after that date.

The standard rate of LFT has risen by £8 each year since 2007/8 and is anticipated to continue increasing at this rate until at least 2010/11. The Government states that these increases will ultimately discourage the landfilling of waste. In the meantime the increases raise extra revenue.

Taxable Disposals of Waste at a Landfill site

Measures were announced to make certain uses of material on a landfill site subject to tax. This will impact landfill site operators and those disposing of materials at a landfill site. In particular, any materials to be used in the landfill site as daily cover or for temporary roads and hard-standing will be treated as waste and therefore will be subject to landfill tax. The changes are intended to come into effect on 1 September 2009.

HMRC recently lost a case at the Court of Appeal on this point and it appears that these changes are a means of reverting to HMRC's previously held view that certain disposals were taxable for landfill tax purposes. A consultation on modernising landfill tax legislation has been announced and more details will follow.

Waste qualifying for the lower rate

Certain materials currently qualify for the lower LFT rate (£2.50), e.g. inert waste such as minerals, ash, rocks and soils etc. HMRC are looking at what materials are eligible for the lower rate and it is probable that some of these materials will become subject to the full rate (£40 per tonne from 1 April 2009, rising to £48 per tonne from 1 April 2010).

This change is subject to consultation and it is likely that transitional arrangements will be introduced to help taxpayers manage the change. Responses to the consultation are due by 24 July 2009.

HMRC state that these proposed changes are to bring the UK landfill tax legislation into line with the EU Landfill Directive by basing the lower rate on the inert characteristics of the waste. However the changes, which are likely to be introduced in Finance Bill 2010, are also expected to increase landfill tax revenues by up to £160m. This extra cost will fall on both landfill site operators and also on businesses which produce such wastes.

Empty Property Rates Relief

The changes to empty property rates relief that came into effect on 1 April 2008 were intended to prevent property standing empty and to stabilize rent. They were conceived in early 2007, pre-credit crunch, at a time when the economy was booming and were expected to raise £1 billion per year. However, the costs are proving to be prohibitive for many property groups and businesses, in the current economic climate.

The Pre-Budget Report announced a welcome, but minor, relaxation but the proposals did not go far enough, and there were no further announcements made in the Budget. It's unfortunate that the Government hasn't made further relaxations as it is proving to be a real burden for business.

Taxation of Foreign Profits

The Budget announcements on foreign profits reforms are the latest development in more than two years of discussion and consultation on this topic and finally give some certainty as to the commencement date of these provisions. In particular, the delay of the introduction of the worldwide debt cap is welcomed and will give groups more time to consider the potential impact of these wide ranging provisions.

- Dividend exemption will apply to qualifying dividends received on or after 1 July 2009.
- The worldwide debt cap will apply to large groups for accounting periods beginning on or after 1 January 2010 and will restrict UK tax deductions for interest payable by UK members of a group by reference to the gross consolidated finance expense of the group.
- The removal of some of the exemptions from the current Controlled Foreign Company (CFC) regime will apply for accounting periods beginning on or after 1 July 2009 (the Acceptable Distribution Policy exemption and the exemptions for superior and non-local holding companies).
- The current Treasury Consent rules are being repealed and a new reporting requirement will apply to transactions with a value in excess of £100m undertaken on or after 1 July 2009.
- The proposal to extend the unallowable purpose anti-avoidance rule that applies to loan relationships and derivative contracts ('para 13') has been dropped from the package but will be kept under review.

Updated legislation for these reforms is expected in Finance Bill 2009, to be published on 30 April. Separate reform of the current CFC regime will continue on its own timetable as announced at the November Pre-Budget Report.

Anti-avoidance P&M Leasing

With effect from 22 April 2009, 'minor amendments' and clarifications have been announced to draft legislation introduced on 13 November 2008 to counter a range of perceived avoidance involving the grant of long funding leases. New changes are also proposed to existing definitions of a sale and leaseback to ensure the definitions apply where an asset continues to be used by the seller following a sale.

Groups – Reallocation of Chargeable Gains

Legislation will be introduced in Finance Bill 2009 to make it easier for groups to move capital gains and losses within the group without the need to actually transfer the assets within the group. The new legislation will apply to gains or losses arising on or after the date that Finance Bill 2009 receives Royal Assent.

Existing legislation enables groups to elect to move certain capital gains and losses between group companies. However an election cannot normally be made unless the asset on which the gain or loss arose was sold to a third party. Consequently, the election cannot currently be made for some types of gains and losses, for example for the loss which results if an asset has become of negligible value and the company makes a claim to that effect.

The change announced will mean that the group companies can jointly deem to transfer the resulting capital gain or loss from the company which owned the asset to one or more other specified companies within the group. The former restrictions on the type of asset, and the circumstances under which the gain or loss arises, no longer apply.

We welcome this proposal which has been sought by companies and advisors for some time. It will make it a great deal easier for groups to move capital gains or losses from one group member to another.

The Carter Review

As part of its Operational Efficiency Programme (OEP) the Government is seeking significant savings from the public sector property portfolio both in the short and longer term. These include £1.5bn savings from running costs, increasing up to £5 billion a year within 10 years, and a potential £20 billion from property sales.

The public sector's property portfolio, excluding council housing, has an estimated market value (in today's prices) of £100 billion, according to the OEP findings. Its running costs are estimated to be £25 billion per year. The OEP savings targets represent a 20% saving on both property assets and running costs. The OEP also concludes that space per office worker could be reduced by one third in line with private sector best practice.

The actual delivery of this scale of savings will require a fundamental change in the way that property, and associated running costs, are planned, resourced, managed and delivered in the public sector. It will also require a shift in governance, mind-set, skills and culture, not just in policy and process, around how the public sector occupies property.

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