

An aerial photograph of a construction site. Two men wearing hard hats and safety vests are standing on a dirt ground, looking at blueprints. The ground is marked with white lines forming a large hexagonal shape. The background shows tire tracks and other construction markings.

# Hexagon Housing Association 1 White Post Street

Corporation Tax, SDLT and VAT comments on the proposed 1 White Post Street development

**DRAFT**

13 March 2019



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13 March 2019

Dear Bulbul

**Corporation Tax, SDLT and VAT implications of the proposed development of 1 White Post Street.**

Further to our correspondence with you, we have provided high level comments on the Corporation Tax, SDLT and VAT implications of Hexagon Housing Association acquiring and developing a site at 1 White Post Street.

This work has been performed under our Engagement Letter dated 14 February 2019. It should be noted that this written report supersedes all previous oral, draft or interim advice, reports and presentations and that no reliance should be placed by you on any such oral, draft or interim advice, reports or presentations other than at your own risk. Our findings do not constitute recommendations to you as to whether or not you should proceed with the proposed transaction.

I would suggest you look through the report, and let us know if you have any questions or would like to discuss any aspect of the analysis.

Yours sincerely

*Kathryn Mallett*  
*Tax Director*

**Important notice**

This report is provided solely for the benefit of the parties identified in our Engagement Letter addressed to Hexagon Housing Association (the 'Client') dated 14 February 2019 (the 'Services Contract'), and should not be copied, quoted or referred to in whole or in part without our prior written consent. We will not accept responsibility to any other party to whom our report may be shown, or who may acquire a copy. It should not therefore be regarded as suitable to be relied upon by any party wishing to acquire rights against KPMG LLP other than those identified in our Engagement Letter who obtains access to this report or a copy and chooses to rely on this report (or any part of it) will do so at their own risk. KPMG LLP will accept no responsibility or liability in respect to this report to any other party.

Our advice in this document is based upon the facts and assumptions as set out in this report. If any of the facts or assumptions are not entirely complete or correct then it is imperative that we are informed immediately as any such inaccuracy or incompleteness could have a material effect on our conclusions.

Our work has not extended to the delivery of legal advice, which should be obtained separately from legal advisers under separate terms and conditions. We are not responsible for facilitating the supply of legal advice to you, nor are we responsible for monitoring or managing the quality or timing of legal or any other advice that you have obtained in connection with your tax affairs or matters relevant to the subject of our work. We shall have no responsibility or liability in connection with performance of any other suppliers advising you.

No inference should be drawn from the use of the words 'will', 'should' etc., as they relate to the relative strengths of a particular position outlined in each document. Each of the positions described in the document entails certain risks. Tax laws in each country are subject to interpretation and subject to change at any time. Such changes could have a material impact on the advice given.

<b>ACI</b>	Approved Charitable Investment
<b>CT</b>	Corporation Tax
<b>CBS</b>	Community Benefit Society
<b>Hexagon</b>	Hexagon Housing Association Limited
<b>Horniman</b>	Horniman Housing Association Limited
<b>OMS</b>	Open Market Sale
<b>NPRP</b>	Non-profit registered provider of social housing
<b>SDLT</b>	Stamp duty land tax
<b>VAT</b>	Value Added Tax

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# Background and scope



## Group Structure

- Hexagon Housing Association Limited (“Hexagon”) is a Non-Profit Registered Provider of Social Housing (“NPRP”), a Community Benefit Society (“CBS”) and a charity.
- Hexagon has a wholly owned subsidiary Horniman Housing Association Limited (“Horniman”). Shares in Horniman are held by Hexagon board members on Hexagon’s behalf, through Declarations of Trust. Horniman is a CBS and a non-charitable NPRP.
- Hexagon and Horniman are each separately registered for VAT.

## Land acquisition

- Hexagon has exchanged contracts on 1 White Post Street from a private vendor.

## Development plans

### *Residential units*

- Planning permission has been granted for 25 private residential units set over two new build blocks, with completion due to occur in 2-3 months. The vendor has submitted an amendment to the planning for 50% of the site to be developed as shared ownership.
- We understand that Hexagon’s intention is that 5 of the 25 flats are expected to be developed for private sale on the open market, subject to the Board approving this. The remaining 20 flats are expected to be developed as shared ownership units. For the purposes of this report, advice is provided on the assumption that this is the development outcome.

### *Commercial units*

- There will also be 3 commercial units on the ground floor of both blocks which Hexagon will develop and the vendor will retain. Hexagon will construct the commercial units, which will be let back to the vendor for nil premium on 999 year leases.

### *Railway arches*

- The planning consent also requires the refurbishment of 6 railway arches adjacent to the residential units. The arches will be retained by the vendor and Hexagon will agree to undertake the refurbishment works as part of the consideration for acquiring the site.

## *Land transfer*

- Hexagon intend to transfer the portion of the land relating to the private sale units to Horniman soon after acquisition, and prior to development of the land.

## *Commencement of development works*

- Although the development construction works will not begin until after the land has been transferred to Horniman, the contractor will progress the design works now to ensure a prompt commencement of works once the site is acquired.
- It is a condition of the purchase that Hexagon appoint a pre-agreed contractor to carry out the build under a Joint Contracts Tribunal contract.

## **Purchase price**

- The total cash purchase price for the land will be up to £2,916,621 (made up of £2,706,621 payable on completion and a deferred land payment of up to £210,000 to cover the lack of a performance bond, the value of which cannot be determined at the time of completion).
- The construction cost of the residential units (that Hexagon will have the benefit of) is expected to be £5.1m. The construction cost of the commercial units (consists of shell and core build costs of £299,000, £161,375 for the fit-out and £8,340 for the professional fees) is expected to be £468,715. The refurbishment of the arches is expected to cost £450,285.
- The acquisition price of the site by Hexagon has been reduced by £919,000 to take into account the cost of constructing the commercial units and the cost of the railway arches refurbishment. As such the total cost to Hexagon in acquiring the site will be £3,625,621 on completion with a deferred payment of up to £210,000. The commercial units will be let back to the vendor for nil premium on 999 year leases.

## **VAT**

- The site has been elected for VAT as the vendor did not accept Hexagon's notice to dis-apply. Hexagon expect to recover the VAT given that the site is primarily for shared ownership.

## **Funding**

- Hexagon will be using GLA grant funding for the purchase.

This note assesses the high level corporation tax, VAT and SDLT implications of Hexagon's proposed acquisition of, and development at, 1 White Post Street.

In preparing our analysis, we have used the information provided by Bulbul Ali by email on 28 February 2019 and 4 March 2019.

In addition to the information provided, in preparing our analysis we have assumed that:

- The existing buildings on the site are to be completely demolished before construction begins.
- The lease of the commercial units of the developed site to the vendor will be at a peppercorn rent.
- The cash consideration paid by Hexagon for the land takes into account the cost to Hexagon of building the commercial units and refurbishing the railway arches, rather than the market value.
- Grant funding will be available, therefore our analysis will **not** include any commentary on SDLT charities relief.

Should any of these assumptions not be correct, the tax analysis will need to be revised.

The scope of our advice is limited to providing advice to Hexagon on the tax implications of acquiring and developing the proposed site and is not intended for use by any other parties.

# Executive summary



Area of tax	Main points
<p><b>Corporation tax</b></p>	<ul style="list-style-type: none"> <li>Hexagon is a charity and, therefore, is entitled to exemption from corporation tax on certain income and capital gains provided that the profits are applicable and applied to charitable purposes only.</li> <li>Exemption does not extend to the development of properties for sale on the open market and we understand these activities will be transferred to Horniman. Although Horniman is subject to corporation tax on its profits, it is able to claim tax relief on its donations to Hexagon provided these are physically paid either during the year they arise or within nine months following the end of the year.</li> <li>In order for Horniman to be able to afford to make the gift aid donations that it needs to fully mitigate its taxable profits, it is important that land is transferred between Hexagon and Horniman at the same value for tax and accounting purposes.</li> <li>On the basis that the purpose for the acquisition of the land is to develop the majority of units for shared ownership, there is a supportable filing position that the land should be a capital asset in Hexagon. For tax purposes, transfers of capital assets between NPRP's take place for such consideration as ensures that neither a gain nor a loss arises. Therefore, to prevent difficulties with gift aid in Horniman, the land should be transferred at cost.</li> <li>We understand that Hexagon intend to transfer the portion of land relating to private residential units to Horniman immediately after acquisition and prior to development of the land. If Hexagon undertakes any development work before the transfer to Horniman, there is a risk that Hexagon could be taxed on any value that it has created.</li> </ul>
<p><b>SDLT</b></p>	<ul style="list-style-type: none"> <li>On the understanding that Hexagon will be purchasing the Property directly, and the acquisition will be assisted by funding provided by the GLA, the acquisition should qualify for the SDLT exemption for NPRPs, such that no charge arises.</li> <li>An onward transfer of part of the Property from Hexagon to Horniman should also qualify for the NPRP exemption (subject to a detailed consideration of the anti-avoidance legislation).</li> <li>An SDLT return must be filed within 14 days of the effective date of both transactions, ie, the acquisition of the property by Hexagon, as well as the onward transfer of part of the Property to Horniman. The NPRP exemptions can be claimed on the face of the return.</li> <li>For completeness, in the unlikely event that grant funding is not received, charities relief may be available; however, this is outside of the scope of this report.</li> </ul>
<p><b>VAT</b></p>	<ul style="list-style-type: none"> <li>Hexagon should expect to be charged VAT at the standard rate on the agreed consideration for the land being £3,625,621.</li> <li>Hexagon should be entitled to reclaim this VAT in full provided that it uses the land exclusively to make taxable supplies.</li> <li>Provided that Hexagon opts to tax the land such that the leases granted to the vendor and the transfer to Horniman are subject to VAT at the standard rate and uses the rest of the land to make taxable (zero rated) first tranche sales of shared ownership dwellings, Hexagon should use the land exclusively to make taxable supplies.</li> <li>VAT should be charged and accounted for by Hexagon on the agreed value of the leases of the commercial units and the works to refurbish the railway arches on completion of the purchase provided that Hexagon has opted to tax.</li> </ul>

# Technical analysis



# Technical analysis: Corporation Tax

## 1. Basis for taxation

Hexagon is a charity and therefore is entitled to generous exemptions from corporation tax on certain income and capital gains, provided that the profits are applied to charitable purposes only.

Where the conditions for exemption are not met for particular activities or transactions, Hexagon could be taxed on the profits. For instance, the exemptions do not apply to profits arising from trading activities unless they are in the furtherance of a primary purpose of the charity. Such transactions would typically be undertaken by Horniman.

Although Horniman is subject to corporation tax (currently 19%) on its profits, it is able to claim tax relief for any qualifying gift aid donations that it makes to Hexagon. We understand that Horniman is a wholly owned subsidiary of Hexagon. Provided that Horniman meets the gift aid conditions, including making the gift aid donation within 9 months of the year end in which the profits actually arise, it should be able to mitigate and potentially reduce its corporation tax payable to nil.

## 2. Acquisition of site by Hexagon

The proposed scheme involves the acquisition of a site with a view to demolishing the existing buildings on the site and developing two blocks containing 25 residential units in total. Of the 25 units, the intention is to develop 20 units for shared ownership and 5 units are to be developed for private sale on the open market. There will also be 3 commercial units on the ground floor of both blocks where Hexagon will undertake the development and the vendor will retain the units.

On the basis that the disposals will be made to individuals that meet the criteria for charitable beneficiaries of Hexagon and that Hexagon will retain a right to receive rents in respect of a significant stake of each property, the development of shared ownership units should be an approved charitable investment.

For corporation tax purposes, land can be treated as either an investment asset or a trading asset. In general, land or properties held for long term use, for example for affordable rent or shared ownership, are regarded as investment assets. Investment assets give rise to capital gains on disposal, which are generally exempt from corporation tax in charities provided the gains are applied to charitable purposes only.

On the other hand, land or properties acquired with the intention of developing and selling within a relatively short timeframe for profit are regarded as trading assets and will therefore be held as trading stock and/or work in progress rather than fixed asset investments. Trading assets give rise to a trading receipt on disposal, and the resulting trading profits would be subject to corporation tax in a charity unless the trade was furthering a primary purpose.

# Technical analysis: Corporation Tax (continued)

Whether properties are held as investment assets or trading assets is a question of fact, and HMRC would look to a number of factors to assess which category they fall into, including the following: how the properties are accounted for; the intention for the properties at the outset of the project; whether there have been any previous transactions and if so at what intervals; the length of time the property was held and particularly whether there might have been a pre-arranged sale.

On the basis that 1 White Post Street is purchased by Hexagon with the intention of developing charitable social housing and generating long term rental, we consider there is a supportable position that the land purchase is the acquisition of a capital asset for tax purposes and an approved charitable investment.

Whether the land is treated as a capital or trading asset would impact on the treatment of the subsequent disposal of the land and this is covered in more detail below.

### 3. Development costs

The costs of developing the land should also be deductible against future gains on disposal.

We note that the cash consideration for the land was reduced by the costs of building out the commercial space. To the extent that the development costs relate to building the commercial unit, these effectively increase the cost of the land. However, as both the land and development costs are deductible, this makes no real difference to the final outcome.

We assume that the value of the adjustment to the cash consideration is actually based on the costs of building to Hexagon rather than of the works. If the adjustments were actually based on the value of the building works and included a development profit margin for Hexagon, HMRC might argue that the profit margin is taxable as trading income.

# Technical analysis: Corporation Tax (continued)

## 4. Shared Ownership units – sale of first tranche

We understand that the shared ownership units are intended for use by charitable beneficiaries of Hexagon and the intention is to retain the majority of the property interest for long term rental. In this case, no corporation tax liabilities should arise on the sale of the first tranche of the shared ownership properties.

KPMG's view is that a shared ownership property should be an investment asset, therefore the first tranche disposal should be treated as the disposal of a capital asset. As a result, any capital gains should qualify for the tax exemptions available to charities.

However, HMRC considers the first tranche disposal of a shared ownership property to be a trading activity. Trading profits are only exempt from corporation tax if the trade is being carried out in the direct furtherance of a primary purpose of the charity. As shared ownership should be a charitable activity of Hexagon and the shared ownership properties will be sold to charitable beneficiaries, any profits obtained should qualify for the charitable exemption for primary purpose trading.

In summary, whether the first tranche disposal of the shared ownership properties is seen as an investment or trading activity, profits arising on the disposal, should not be liable to corporation tax provided the shared owners are valid beneficiaries of the charity and any gains are applicable and applied for charitable purposes only.

## 5. Shared Ownership units – sale of subsequent tranches

Subsequent staircasing disposals of interests in the 20 shared ownership properties should be exempt from corporation tax as disposals of capital assets and this is consistent with HMRC's view.

## 6. Shared Ownership – rent receipts

Rental income received by Hexagon from the shared ownership properties should qualify for the charitable exemption for income derived from land and buildings and therefore not be liable to corporation tax.

# Technical analysis: Corporation Tax (continued)

## 7. Approved Charitable Investments

Investments can give rise to corporation tax liabilities for a charity unless they are "approved charitable investments". To this end, the investment must be either for the financial benefit of the charity or to carry out its charitable objectives. On the basis that the acquisition of the 1 White Post Street site is to enable the development of 20 shared ownership properties for the charitable beneficiaries of Hexagon, we consider the acquisition of the land should be an approved charitable investment. HMRC could ask to see evidence of the trustees' decision-making process and the information considered as part of that process. Hexagon should be able to evidence that the trustees have adequately considered how the investment would support their charitable objectives.

## 8. Commercial units - grant of leasehold interest

The arrangements involve an acquisition of a freehold interest by Hexagon and a subsequent leaseback of a developed commercial property to the vendor for a peppercorn rent and nil premium on 999 year leases.

In our view, the two legs of the sale and leaseback arrangement are composite parts of a single transaction, which enables: -

- Hexagon to acquire ownership of property rights to enable development of shared ownership homes for its charitable purposes and to retain control over the quality of the entire build, whilst only ultimately bearing the development costs of its own properties.
- The vendor to carve out and retain a leasehold interest from its original freehold asset and to fund the build costs of its own new commercial premises through a reduction in land price.

As such, the leaseback gives effect to an obligation arising from that single composite agreement and is, in itself, a tax nothing. There is a remote possibility that HMRC could take a different view but, on the basis that all amounts have been negotiated between unconnected parties on an arm's length basis and; subject to our comments in section 3, there should not be any additional corporation tax liabilities arising from any challenge.

# Technical analysis: Corporation Tax (continued)

## 9. Market sale units – Hexagon

We consider the development and sale of residential units on the open market by Hexagon would be a non-primary purpose trade and the profits would therefore be subject to corporation tax (current rate 19%). Losses would also give rise to tax implications.

It should be possible to mitigate the corporation tax (“CT”) liability arising in Hexagon on the profit on the sale of open market sales units by undertaking the market sale activities in Horniman. This would require that the land interest relating to this activity is transferred from Hexagon to Horniman. As set out below, care needs to be taken to minimise the risk of an unnecessary corporation tax charge arising in Horniman and / or Hexagon.

## 10. Basis of Taxation –Horniman

Profits in a non-charitable trading company are subject to corporation tax. Taxable profits are based on accounting profits, with adjustments made to arrive at the profits chargeable to corporation tax (“PCTCT”). Adjustments are needed where tax legislation, case law or HMRC practice requires a different treatment of an item for corporate tax purposes from that adopted in the accounts.

It is established practice for trading subsidiaries to mitigate their CT liability by making a gift aid donation to their charitable parent and HMRC actively recommend this approach where a charity might otherwise pay tax. Qualifying donations are essentially tax deductible in the trading subsidiary. In this way, Horniman can potentially reduce its taxable profits to nil and the donation will be exempt from tax in the hands of Hexagon.

Importantly, three key requirements of gift aid payments for a wholly owned subsidiary of a charity are that the donation:

- Is physically paid (e.g. by bank transfer rather than a book entry)
- Does not exceed the distributable reserves of the subsidiary, and
- Is made either during the year in which the profit arises or within nine months following the end of that year.

In the instance that there are tax adjustments to the accounting profits as a result of timing differences, the taxable profit could be higher than the accounting profit for a given period. In this case, there may not be enough distributable reserves to support the necessary payment and the company may have a CT liability in that year.

# Technical analysis: Corporation Tax (continued)

## 11. Transfer of land from Hexagon to Horniman

The corporation tax treatment of transferring a portion of land from the site for development of market sale units from Hexagon to Horniman would depend on whether the land is held as a trading asset or an investment asset in Hexagon.

As set out above, we consider that there is a supportable position that Hexagon will acquire the land as a capital asset. The transfer of the portion of land not required for charitable social housing to Horniman should therefore be treated as a part disposal of a capital asset.

As Hexagon and Horniman are both RPs, the transfer should be treated as taking place at a price that gives rise to neither a gain nor a loss in Hexagon for CT purposes. Horniman will be deemed to acquire the asset at the same cost. Ideally, the transfer value for accounting purposes would be the same as the tax base cost. This should ensure that there is no mismatch between taxable and accounting profits in Horniman, allowing for the full taxable profit to be donated.

If the land is transferred at a higher value for accounting purposes than for tax purposes, there can be a mismatch between the accounting profits and tax profits on subsequent sales of the units by Horniman. This could make it difficult for Horniman to make gift aid payments sufficient to mitigate its taxable profits in full.

If the land is developed to golden brick level before the transfer to Horniman, any costs which have enhanced the value of the asset can be included in determining the tax base cost. If Hexagon undertakes any work on the open market sales units before the land is transferred, there is a risk that Hexagon could be treated as trading or the transaction could be caught by the transactions in land provisions on the basis that it has a main purpose of realising a gain from the development of land for market sale. The transactions in land provisions are widely drafted and could cause Hexagon to be taxed on any value that it has created prior to transferring the land. We therefore recommend that the land interest relating to the 5 open market sale flats is transferred as soon as possible and before any additional value is created.

If HMRC do not accept that the land is a capital asset and hold that there was an over-riding trading intention from the outset, the land could be considered to be a trading asset in Hexagon. In this case, the land interest would transfer at its market value at the date of sale to Horniman for tax purposes. The disposal of the land by Hexagon would be a trading transaction and Hexagon would be subject to corporation tax on the gain on the disposal of the land. The gain would be determined by assessing the difference between the deemed proceeds (i.e. the market value of the land at the date of sale to Horniman) and the cost, including development costs. If the market value at the time of sale is the same as the land cost plus any development costs, there would not be any taxable profit in Hexagon.

# Technical analysis: Corporation Tax (continued)

## 9. Transfer of land from Hexagon to Horniman

As an alternative to undertaking the development of the 5 open market sale units in Horniman, Hexagon could choose to develop and sell the open market sales units in Hexagon, and pay tax on the profits at 19%.

## 1. Hexagon acquires the Property assisted by grant funding

Hexagon is a non-profit registered provider of social housing (“NPRP”). Where a chargeable interest in land is acquired by a NPRP there is an exemption from SDLT if, either:

1. the NPRP is controlled by its tenants,
2. the vendor is a qualifying body (broadly a council or another NPRP), or
3. the transaction is funded with the assistance of a public subsidy.

We understand the first condition is not in point for Hexagon, and that in this instance the vendor is not a council or another NPRP. However, grant funding is expected from the GLA. “Public subsidy” referred to in condition 3 above is a defined term which includes grants made or given by the GLA.

**Therefore, providing that the acquisition of the Property is assisted by the funding received from the GLA the acquisition of the Property by Hexagon should qualify for the NPRP exemption from SDLT.**

The exemption must be claimed on an SDLT land transaction return. The deadline for filing returns is 14 days from the effective date of the transaction.

If the grant funding from the GLA is not available, such that the conditions for the NPRP exemption are not met there is also charities relief from SDLT for purchasers where the purchaser is a body established for charitable purposes only, and the purchaser intends to hold the greater part of the property acquired for “qualifying charitable purposes”. Advice in relation to charities relief is outside the scope of this report, but can be provided in the event that GLA funding is not forthcoming.

The NPRP exemption is not subject to clawback. However, where the exemption is claimed on the basis that grant funding is anticipated (HMRC accept that a claim can be filed on this basis as long as there is a reasonable expectation of the grant being received and applied) but the funding is not subsequently available, then the exemption will not apply. If this is more than 12 months from the filing deadline for the return it will not be possible to amend the return and claim charities relief (if available) and SDLT will therefore be due in full.

Absent any relief SDLT of up to 5% would be due on the chargeable consideration. Chargeable consideration is broadly defined as anything given in money or money’s worth, this would include the value of any works provided on land that is not held by Hexagon, i.e. the works to the railway arches. In addition, as the acquisition is partly in consideration for the grant of a leaseback to the vendor, the transaction would fall within the SDLT exchange provisions. Broadly the exchange provisions operate such that the chargeable consideration is taken to be the higher of the actual consideration given by the purchaser or the market value of the chargeable interest acquired. The chargeable consideration for SDLT purposes should therefore be the higher of the market value of the property acquired by Hexagon and the actual consideration being the purchase price, the value of the works to the railway arches and the value of the leases of the commercial units back to the vendor, plus any VAT charged.

## 2. Hexagon transfers part of the Property to Horniman

On the understanding that the initial purchase of the Property will qualify for the NPRP exemption, there would be no clawback of the exemption claimed if part of the property is transferred to Horniman.

While Hexagon is the sole owner of Horniman, Horniman is a CBS, rather than a company limited by shares. Horniman and Hexagon are not therefore grouped for SDLT purposes and SDLT group relief would not be available.

However, Horniman is an NPRP, and Hexagon would be a qualifying vendor for the purposes of the NPRP exemption (see condition 2 above). **The acquisition of part of the Property by Horniman from Hexagon may therefore qualify for the NPRP exemption such that no SDLT charge arises.** The SDLT anti-avoidance provisions and the GAAR would need to be considered having regard to the specific facts of both the initial acquisition of the Property by Hexagon and the onward transfer of part to Horniman in order to determine if the acquisition qualifies for the NPRP exemption. However, based on our understanding of the transaction, we would expect the NPRP exemption to be available such that no charge arises.

As above, an SDLT return must be filed within 14 days of the effective date of the transaction. The NPRP exemption can be claimed on the face of the return.

If the NPRP exemption were not available, then as Horniman is a corporate body connected with the vendor, SDLT would be due on the higher of the actual VAT inclusive consideration or the market value of the property acquired. Whether the residential or non-residential rates applied would depend on the nature of the property at the time it is transferred.

## 1. Original acquisition of the property

As the vendor has opted to tax the property VAT will be charged on the sale of the property to Hexagon based on the total agreed consideration (£3,625,621) and not just the agreed cash price paid on completion (£2,916,621). The total consideration being the cash price and the cost of the works to develop the ground floor commercial units and the refurbishment of the neighbouring railway arches.

Hexagon will also incur VAT on any costs associated with the acquisition of the property (legal costs etc),

VAT incurred by Hexagon should be recoverable in full providing it opts to tax the property before its transfer to Horniman and uses the property exclusively to make taxable supplies..

## 2. Transfer of the Private Sale Land to Horniman

On the understanding that Horniman is separately registered for VAT and not eligible to be registered in a VAT group with Hexagon, the transfer of the Private Sale land will be a supply by Hexagon for VAT purposes. If the land is transferred prior to any works being undertaken to the land and Hexagon did not opt to tax this land, the transfer would be an exempt supply by Hexagon, such that any VAT incurred by Hexagon on the cost of acquiring the land (the total agreed consideration) and any associated cost of acquiring the land (legal costs etc) will only be residual and recoverable in accordance with Hexagon's partial exemption calculation.

However, if Hexagon were to opt to tax this land, Hexagon would be required to charge and account for VAT on the transfer of the land to Horniman but would then be entitled to reclaim in full the VAT incurred on the costs of acquiring the land.

## 3. VAT liability of development costs

The supply of services in the course of the construction of new dwellings and any building materials supplied with those services and incorporated in the new dwellings will be zero-rated. This will include the supply of demolition services which are closely connected to the construction of the new dwellings. Professional services (architects, surveyors, consultants etc.) will be subject to VAT at the standard rate unless provided under a single 'design and build' contract, in which case they can also be treated as zero rated.

VAT at the standard rate should be charged on non-building materials (such as white goods and carpets) and this VAT will not be recoverable by Hexagon or Horniman irrespective of whether taxable supplies are made. This VAT is always a cost to developers of residential property for sale or shared ownership.

VAT at the standard rate should be charged on the supply of services and materials used to develop the ground floor non-residential commercial units and the refurbishment of the railway arches. The VAT incurred by Hexagon in connection with these will be recoverable in full provided that Hexagon opts to tax the land upon which the commercial units will be constructed and uses this to make taxable supplies.

## 4. Intended supplies and entitlement to recover VAT

The first grant of a major interest (i.e. the sale of the freehold or a long leasehold over 21 years) by a person constructing a building designed as a dwelling or a number of dwellings is zero-rated for VAT purposes. Provided that each residential unit in the development will qualify as a dwelling, where Hexagon is commissioning the construction of the shared ownership units on its land it will have person constructing status (“PCS”) in respect of these dwellings and therefore will be capable of making zero rated first grants. Similarly, where Horniman commissions the construction of the private sale units on its land it will have PCS in respect of these dwellings and therefore will be capable of making zero rated first grants.

In order to qualify as dwellings the residential units need to meet the following conditions:

- each unit needs to consist of self-contained living accommodation;
- there should be no provision for direct internal access to any other dwellings;
- there should not be any prohibition on the separate use or disposal of the dwelling under a covenant, planning consent or similar provisions; and
- statutory planning consent must have been granted and the units constructed in line with that consent.

## 5. Shared ownership units

Hexagon will have PCS in respect of the shared ownership units and so the first tranche sales of the shared ownership units will be zero rated and as such Hexagon will be entitled to recover VAT incurred on related costs, e.g. on professional fees related to the development of these units, and on sales and marketing costs. Ongoing rental income received in respect of the shared ownership units and any future staircasing income will be exempt from VAT. Therefore, any VAT incurred on costs post the first tranche sale (such as ongoing maintenance) will not be recoverable.

## 6. Outright sale units

We understand the outright sale land will be transferred to Horniman.

Horniman will have PCS in respect of the outright sale units and so the first sale or long lease (in excess of 21 years) of the outright sale units will be zero rated and as such Horniman will be entitled to recover VAT incurred on related costs, e.g. on professional fees related to the development of these units, and on sales and marketing costs. Ongoing rental or service charge income received in respect of the outright sale units will be exempt from VAT. Therefore, any VAT incurred on costs post the first sale or grant of a long lease (such as ongoing grounds maintenance) will not be recoverable.

# Technical analysis: VAT (continued)

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## 7. Development of commercial units and refurbishment of railway arches

Part of the consideration payable by Hexagon for the property is Hexagon agreeing to undertake the works to construct the commercial units and lease these back to the vendor on completion, as well as agreeing to undertake works to the vendor's railway arches.

Similarly the land that the vendor is transferring to Hexagon is in part the consideration for Hexagon granting the leases and undertaking the works. As such, provided that Hexagon has opted to tax the land upon which the commercial units will be constructed, on completion of the purchase, Hexagon should raise VAT invoices for the leases it will grant, being for £468,715 plus VAT at 20% and also for the works to be undertaken to the arches, being for £450,285 plus VAT. The consideration for these supplies will have been paid to Hexagon (being part of the value of the land), but these VAT invoices should be issued to the vendor and included on Hexagon's VAT return.

Hexagon will be able to offset the output VAT due to HMRC on this VAT return by the input VAT that will be recoverable on the purchase of the property which should be detailed on a VAT invoice addressed to Hexagon for £3,625,621 plus VAT. This VAT will be recoverable in full by Hexagon provided that Hexagon uses the land exclusively to make taxable supplies, which it will provided that the transfer of land to Horniman and the vendor are taxable as a result of Hexagon opting to tax and the sale of the shared ownership units are zero rated.



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