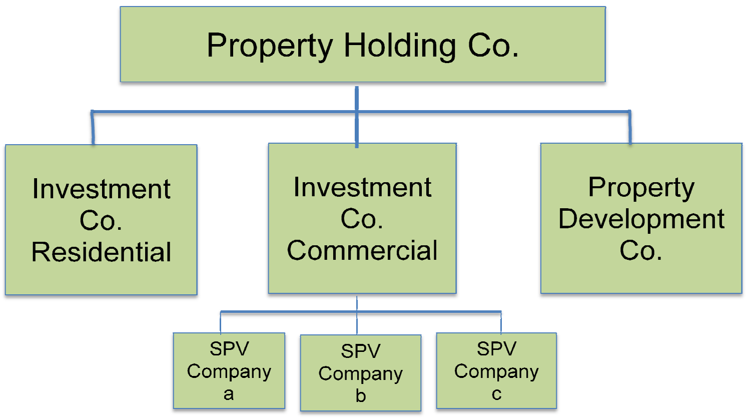
## Tax and Property Company Structure

The proposals set out below in relation to the creation of a property company have been developed with the assistance of independent specialist advisors covering financial, tax and legal disciplines. The most appropriate legal structure under the Companies Act 2006 for the Council to undertake commercial property activities is a company limited by shares.

The recommended structure for the property company has been developed to provide the most appropriate solution bearing in mind the tax implications that arise from making investments in property or undertaking property development activity. These are described in more detail below.

## Recommended Property Company Structure






The proposal is to create a Property Holding Company with three subsidiary companies as follows;

Property Investment Company: Residential

Property Investment Company: Commercial

Property Development Company

Special purpose vehicles (SPV companies) will be created, when required, as subsidiaries to the commercial investment company to hold individual assets of a significant financial value in order to enhance the future sales receipts. These are shown as SPV Company a) to c) in the diagram above.

<u>Recommendation 1: Separate companies for Investments and Developments.</u>

An investment asset, in this context, is a property that is held for the rental return and for the long-term appreciation in capital value. This activity would involve the purchase of an existing asset, most likely with existing tenants and therefore with some certainty regarding the ongoing rental income stream.

Profits made from investment assets are taxed after the deduction of normal business expenses, such as fees paid to managing agents. In addition, profits made from the ongoing rental income can be reduced by capital allowances which will be applicable to relevant spend on plant and machinery, for example the purchase of a new boiler or air-conditioning unit for the building.

When an asset held for the long-term is sold, the profit or gain on the sale of the building can be reduced by an indexation allowance. Indexation allowance recognises the effects of inflation when calculating the gain made upon the sale of an asset.

These tax allowances do not generally apply in relation to property development or trading activity[1] . Property development typically involves site acquisition, planning, design, development and build of a property or an estate of properties for sale. If all the buildings created or some are retained for the ongoing income stream, this effectively creates a transfer to investment stock.

In order to demonstrate the distinction between investment and development activities and to apply the appropriate tax treatment, HMRC will look for evidence of intent. This may include reviewing;

- Documentation supporting the original purchase
- The Company's Articles of Association
- The Length of time the property has been held
- The borrowing arrangements of the company, for example short-term borrowing will be more indicative of development and trading rather than investment activity.

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Within a single company appropriations (i.e. transfers) to and from development stock or investment stock, could give rise to a tax charge, even if no physical cash is paid. This tax charge is calculated on the difference between what was paid for the asset and its value at the date of deemed transfer.

To strengthen the distinction between property investment and development activities, and to appropriately manage the risk of inadvertent tax charges from transfers within a single company, our independent specialist advisors recommend that separate companies are created for these activities. Furthermore, it will be important the development stock is continually reviewed to check whether assets will inadvertently become re-classified as investments and vice versa.

The management structure and support required for each of these activities will also differ significantly. This is also applicable to the day-to-day management of different types of investment assets with the primary differences being between residential and non-residential or commercial sectors.

Recommendation 2: Separate companies for individual investment assets

The Stamp Duty Land Tax (SDLT) payable on the purchase of investment assets will usually be at the highest level of 4%; however the stamp duty payable upon the purchase of existing shares in a company is 0.5%. It is standard practice in the industry to hold significant individual assets within a separate company for this reason – within a special purpose vehicle (SPV). This enhances the eventual sales value of an asset because it is more tax efficient for the purchaser.

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[1] Capital allowances that are applicable to the purchase of plant & machinery are likely to reside with sub-contractors.

The Property Company will therefore create special purpose vehicles (SPV companies) as subsidiaries to the commercial investment company to hold individual asses of a significant financial value, in order to enhance the future sales receipt. Similarly, an approved investment asset purchase may already be held in this way and therefore, where appropriate to do so, the Property Company may purchase the SPV rather than the underlying asset.

SDLT is not payable on transfers between group companies and any transfer of asset between a group company is made on “no gain no loss basis”. There is therefore no tax liability when transferring an asset between the Investment Company to the Property Development Company and vice versa.

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