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Cambridge Colleges newsletter



Happy New Year and welcome to the second edition of our updates for Colleges which we will be publishing termly. The idea behind these is to keep Colleges abreast of developments which specifically affect them and is in addition to our regular Charities and Not For Profit bi-monthly newsletter.

In this edition we look at the complex area of property investment and development which can be a minefield for Colleges. Our tax experts at PEM are on hand at all times to help you avoid falling into the trap of an unexpected tax charge.

If there are any topics you would like us to cover in future editions please let us know.

We look forward to working with you over the next twelve months.

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A group of people, likely students or faculty, are walking away from the camera on a blue carpet. They are wearing black academic gowns with white fur-trimmed hoods. In the background, there is a large, multi-story stone building with arched windows and a crest. A black street lamp is visible on the building's facade.

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PEM have an unrivalled knowledge of Cambridge Colleges, which are much more complex than the size of their operations would suggest. As Trustees, we know that we are getting the best possible advice. Of the many accounting firms with which I have engaged, PEM is exceptional in its responsiveness.

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Property Investment and Development - Corporation Tax Implications

Property transactions can be complicated for any business and this is equally true for Colleges. Whether investing or developing it is worth taking advice to ensure that no unexpected and unnecessary corporation tax charges are incurred.

Rental income from investment properties

There are specific corporation tax exemptions for primary purpose trading and also for rental income from investment properties. However, if activities stray into non-primary purposes (NPP) trading then a tax liability could arise.

When distinguishing between rental and trading activities you should examine the level of services provided with the accommodation, over and above that of a landlord e.g. laundry, cleaning, caretaker, catering. These extra services would tend to indicate a trading activity, rather than passive investment.

If it is a trade then decide whether it is primary purpose e.g. student accommodation. If it is outside the charitable objects this would be non-primary purpose trading, (for example non-educational conference business), and potentially create a tax liability within the College. These types of non-primary purposes trading are best conducted through a subsidiary company, unless they fall within the small trading exemption of turnover of £50,000 or less (rising to £80,000 from April 2019).

Property acquisitions

It is important to identify the intention in respect of a





property being acquired. If it is being acquired with the intention of resale, this indicates trading. If the property is to be held for charitable or investment purposes then this should not cause any tax issues, but from a governance perspective the College should be happy that this investment is sound.

Investment in property development Limited Liability Partnerships (LLPs)

Some developers offer investors the opportunity to invest in a “fund” held in an LLP, which will undertake development projects. However, as LLPs are transparent for tax purposes the College would be deemed to be undertaking a share of the trade, which is likely to be a NPP trade, creating a taxable activity. Investments such as these should take place via a subsidiary company.

Disposal of property

Three typical routes to realise value from the disposal of an investment property are:

- Straight sale to a commercial developer with no overage or other involvement. This is treated as a capital gain in the College and therefore exempt from corporation tax as long as proceeds are applied for charitable purposes;
- Straight disposal but with overage (“slice of the action”) provisions. Anti-avoidance tax legislation can treat the overage as trading income, with no specific exemption available for charities on this activity;
- Acting as a developer where the College is involved in developing the land for non-charitable purposes. This is clearly a NPP trade and therefore profits will be taxable.

It is not always clear at the outset of a transaction what will happen and it will depend on the commercial reality. It is therefore useful to enter into discussions with advisors early on to identify pitfalls and how these can be avoided. Colleges are very different to commercial developers, landowners or individuals and will have different needs in terms of tax as well as other factors.

It may be that a property has been held as an investment for many years but there is a change in intention as the land is to be developed. It is important to document the position as some of the increase in value may be exempt from tax and some taxable. The tax treatment

of property income/gains is dependent on intention and this is a matter of fact. Seeking planning permission alone does not necessarily indicate a trading intention.

Use of a subsidiary company

If a taxable trading activity has been identified and the decision has been made to transfer the activity to a subsidiary there are further matters to consider.

The property asset is transferred from the College to the subsidiary as a fixed asset, then subsequently transferred into stock. At this stage there is likely to be tax charge in the subsidiary as this transfer is deemed to be a capital disposal by the subsidiary at market value then a reacquisition. It is possible to make an election to delay the taxation of the gain until the eventual sale of the property after development has been completed. Generally, the tax cannot be wiped out using gift aid because there will be no distributable reserves from which to make a payment.

Further decisions must be made as to the function of the subsidiary, how it will be funded (debt or equity), whether the funding would be an approved charitable investment/loan, whether a deed of covenant is required for taxable profits to be passed to the College and whether there are any costs which need to be recharged from the College.

An approved charitable investment must be for the benefit of the charity and not for the avoidance of tax. As well as investing within the charitable objects, investing to generate a financial return, which will be applied for charitable purposes, can also qualify as an approved investment. Careful consideration and documentation of the financial return is required to demonstrate the benefit to the charity. If an investment is found not to be "approved" then for each £1 spent on the investment, £1 of the College's tax exemption will be lost.

Construction Industry Scheme (CIS)

Charities no longer fall within CIS but subsidiary companies undertaking construction activities will do. There are various compliance obligations under CIS, which include registering with HMRC, verifying subcontractors with HMRC before payments are made,

deducting tax from subcontractor payments, if necessary, paying this tax to HMRC, providing deduction statements to subcontractors and filing monthly returns with HMRC. There are penalties for non-compliance.

Stamp Duty Land Tax (SDLT)

SDLT is always a consideration where property is concerned. There is a specific charities relief under the following conditions:

- The property is to be used in the furtherance of the charitable purposes of the purchaser or another charity; or
- The property is to be held as an investment from which the profits are applied for the charitable purposes of the purchaser.

If a property is being transferred from the College to a 100% subsidiary then group relief from SDLT is likely to be available.

However, care should be taken not to fall foul of the claw back provisions, which would apply if the subsidiary were to be sold within 3 years of the transfer. A direct property purchase by a subsidiary from a third party will not qualify for SDLT charities relief.

Annual Tax on Enveloped Dwellings (ATED)

This is a relatively new tax and can apply where a dwelling is held by company. The tax applies for dwellings worth over £500,000 and the rates for 2018/19 range from £3,600 to £226,950, depending on the value of the property.

There are various exemptions, including one for charities and also for property development and rental businesses but if a developed property remains within the SPV for sometime after the development, care should be taken in respect of the use of the property to ensure it doesn't fall within the ATED rules.

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