

INVESTING IN STUDENT ACCOMMODATION IN SCOTLAND



A handy tax guide

Purpose Built Student Accommodation is one of the fastest growing asset classes for institutional investors looking to acquire high yield property in Scotland.

However, the tax provisions around developing and operating PBSA are complex and can have pitfalls for the unwary.

This handy guide summarises some of the key tax considerations around developing, owning and selling PBSA projects in Scotland.

Site Acquisition

LBTT

In Scotland, land purchases are subject to Land and Buildings Transaction Tax (LBTT) – which was introduced in April 2015. LBTT is a devolved Scottish tax, and is different from both Stamp Duty Land Tax and Land Transaction Tax which apply elsewhere in the UK. Different rates of LBTT apply to residential and non-residential acquisitions.

The purchase of bare land for a PBSA development will be subject to LBTT, calculated as a proportion of the purchase price plus VAT, at the non-residential rates.

Non-residential LBTT Rates

Amount of Consideration	Rate of LBTT
≤ £150,000	0%
£150,001 - £350,000	3%
> £350,000	4.5%

For example, a site purchase for £1,500,000 + VAT (total £1,800,000) will therefore be subject to LBTT of £71,250.

LBTT and Development Costs

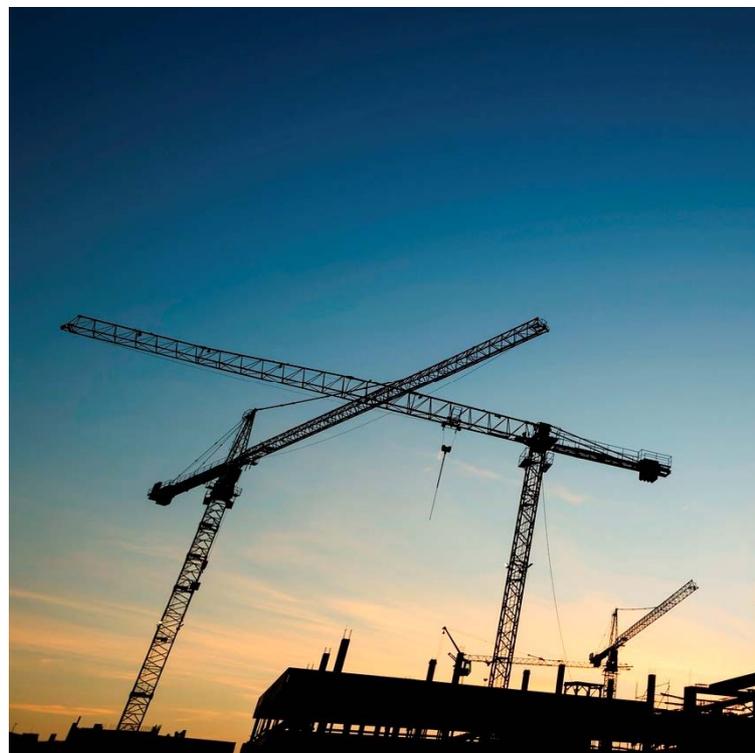
If a site is acquired from a developer who will be engaged to complete the building, care needs to be taken to ensure that the development and purchase contracts are wholly independent of each other. Otherwise the construction costs could also be subject to LBTT.

Brodies are experienced in managing purchase and development contracts to ensure that construction costs are kept outside of the LBTT charge.

VAT

UK VAT may also be payable on the purchase price for the land at 20%. Generally, land in the UK is exempt from VAT, unless the seller has opted to charge VAT on it.

This will usually be the case in PBSA projects, as sellers will seek to charge VAT on the sale in order to recover VAT incurred on their own costs (including professional costs) for the sale.



Project Development

VAT on build costs

VAT treatment of PBSA build costs differs between the construction of new buildings, and conversion of existing buildings into PBSA.

HMRC accepts that if a new PBSA building is designed as a number of dwellings, then construction costs will be zero rated for VAT i.e. VAT is charged, but at a rate of 0%. Supplies by sub-contractors are also zero rated.

The VAT conditions for dwellings are complex, but we have successfully argued in the majority of our PBSA developments that the VAT conditions are met. Each studio or cluster flat is treated as a dwelling for VAT purposes.

If a development is split between PBSA and commercial units, such as retail, then VAT will only be charged on the build costs for the commercial units. The project costs must be apportioned between the PBSA and commercial elements, and this can be done on a variety of bases.

Certain professional fees will not qualify for zero rating, and will be subject to VAT at 20%. This includes, legal fees, and the fees of land agents and architects (unless engaged as part of a single design and build contract).

Conversion of existing buildings to PBSA can potentially qualify for a reduced rate of VAT of 5%, but the conditions for the reduced rate are much more restrictive than those for zero rating on new build. The majority of PBSA projects do not qualify for the reduced rate, but it is possible to claim it in part on some projects.

Recovering VAT on costs

As the letting of PBSA is exempt from VAT, planning is needed to ensure that VAT on acquisition and project costs can be recovered.

This can be done by ensuring that a zero rated supply of the completed PBSA building is made – either by disposing of the asset itself (a “freehold” disposal) or granting a lease of not less than 20 years (a “leasehold” disposal) to an associated entity. The requirements are different in Scotland because of the different land law here. The zero rated supply will

allow recovery of VAT on the land price and the build costs, if VAT has been chargeable, as well as professional fees. . The associated entity can then operate the project, either by letting to students or to a university.

Provided there is an intention to make a zero rated supply, VAT can be reclaimed during the development process – it is not necessary to wait until the end of the project.

Structuring a zero rated supply needs to account for VAT and LBTT, as well as tax efficient extraction of profits from the associated entity.

Brodies have advised on a number of such structures, which are designed to avoid any additional VAT or LBTT costs.

Construction Industry Scheme

Investors carrying out the development of PBSA projects may be required to register as a contractor under the UK Construction Industry Scheme (CIS), as well as verifying that subcontractors are also registered. The CIS requires tax to be deducted from payments to the main contractor, unless they are registered for gross payment, which is normally the case in PBSA projects. We can deal with CIS requirements if required.



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Operating PBSA

Letting Profits

The taxation of letting profits will depend on the nature of the operating vehicle and its tax residence. Opaque vehicles, such as companies, will pay UK corporation tax on their profits if they are UK resident and UK income tax if they are overseas. Corporation tax is charged at a flat rate of 19% (due to reduce to 17% by 2020). Income tax is payable at the basic rate of 20%.

Tax transparent vehicles, such as UK partnerships or Jersey Property Unit Trusts, will not pay any tax themselves but investors in the vehicle will be taxed on the basis above.

Deductions can be claimed in respect of operational, management and finance costs, but the treatment varies between both regimes.

Overseas entities will also be subject to withholding tax of 20% tax on any rental receipts unless they register for gross payment under the UK non-resident landlord scheme.

Council Tax

There is no annual local tax charge on PBSA buildings as PBSA is exempt from Council Tax.

Annual tax on Enveloped Dwellings

The Annual Tax on Enveloped Dwellings (ATED) is an annual tax charge levied on properties held in corporate wrappers. The ATED is assessed on a dwelling by dwelling basis, and only applies where any single dwelling is worth £500,000 or more.

Each unit (e.g., studio or cluster flat) in a PBSA development is a single dwelling for ATED purposes, so the ATED charge is unlikely to apply on the basis that each unit is likely to be worth less than £500,000.

HMO Licences and Landlord Registration

An HMO Licence must be in place where three or more unrelated persons share a house or flat and also share kitchen or bathroom facilities before the property can be let to occupiers. PBSA will generally require an HMO (House in Multiple Occupation) Licence unless it comprises studio flats with their own kitchen and bathroom facilities occupied by less than three people.

Owners (not managers or occupiers) of student accommodation are responsible for obtaining the Licence and must renew it either annually or every three years, depending on the local authority concerned. Whenever ownership of the property changes hands, a new Licence must be obtained by the new owner; any existing Licence cannot be transferred to a new owner.

Every new Licence and renewal application comes with a fee which differs between local authorities. Failure to have a Licence in place can result in sanctions being imposed including a prohibition against continuing to let the property.

Every Landlord of residential property in Scotland must register with the relevant appropriate local authority; this is a separate and additional requirement to the need for an HMO Licence.



Disposing of PBSA

Investors can exit a PBSA development either by disposing of the asset or the vehicle holding it.

The tax issues on a vehicle sale are beyond the scope of this guide.

LBTT on asset sales – Planning points

Completed PBSA developments should be taxed as non-residential property for LBTT purposes, meaning that a purchaser can benefit from the lower non-residential rates. Although each unit in a PBSA development ordinarily qualifies as a dwelling (and therefore is residential property) there is a carve out from the residential rates for the purchase of six or more residential properties. The same carve out applies to the 3% LBTT surcharge (the Additional Dwelling Supplement).

Purchasers of completed PBSA can also benefit from LBTT multiple dwellings relief (MDR), which can significantly reduce their acquisition costs below the non-residential rates.

LBTT MDR is different from the equivalent relief under SDLT, which would be blocked if a long lease has been used to trigger VAT zero rating. There is no such prohibition in LBTT MDR, meaning that purchasers of Scottish PBSA projects can potentially benefit from lower rates of tax on acquisition.

The availability of MDR for future purchasers is therefore something that can be priced in when negotiating commercial terms for any sale.

VAT on asset sales – Planning points

There are a number of VAT planning points that need to be considered when selling a PBSA development that has been subject to a previous zero rated supply.

Risks include:

- incurring a VAT “self-supply” charge if a building was NOT zero rated on the basis of being dwellings. This is best mitigated by ensuring dwellings treatment when a PBSA building is constructed.
- a potential VAT charge for the purchaser under the VAT “capital goods scheme” if a long lease was used for zero rating purposes.

Brodies’ tax team have extensive experience in managing both of these issues, and in structuring disposals to avoid capital goods scheme issues for purchasers. Recently we persuaded HMRC to accept that no VAT arose on a PBSA purchase where the purchaser was not able to replicate the seller’s holding structure for constitutional reasons.

Tax on gains

Onshore sellers will pay UK corporation tax on any gains incurred on a disposal of the property.

Offshore sellers are currently exempt from UK tax on disposals of UK property. However, under proposals introduced in 2017, the UK government intends to extend UK CGT to offshore investors in UK property from April 2019, and full UK corporation tax from April 2020.

These proposals are currently being consulted on by HMRC, and Brodies are closely engaged in the consultation process.



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Key Contacts



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