

Representation

ATED and Higher-Rate SDLT: creating reliefs for non-registered-provider housing co-operatives

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Key points:

- A segment of housing co-operatives are wrongly being made liable to pay punitive taxes intended to combat the tax avoidance/obfuscation practice known as 'enveloping'
- The misapplication of these punitive taxes is having a disproportionate adverse impact by limiting people's housing options in ways we believe run counter to government housing policy, especially when compared to the negligible revenue earned by the Exchequer in the process
- We propose that existing reliefs are extended to protect the affected housing co-operatives in a way that ensures no new opportunities for tax avoidance are inadvertently created

1 Introduction

- 1.1 This paper proposes that HM Treasury takes legislative action to provide targeted interim reliefs from Annual Tax on Enveloped Dwellings ('ATED') and Higher-Rate Stamp Duty Land Tax for corporate bodies ('Higher-Rate SDLT'), for housing co-operatives that are not registered providers of social housing ('non-registered-provider housing co-operatives'). ATED and Higher-Rate SDLT are punitive taxes introduced to combat the tax avoidance practice known as 'enveloping'. As non-registered-provider housing co-operatives are not a form of enveloping these taxes should not be applied to them. The misapplication of these punitive taxes is having a disproportionate adverse impact by limiting people's housing options in ways we believe run counter to government policy. The tax revenue earned by the Exchequer on the other hand is negligible and very likely to remain so.
- 1.2 In **part 2** we explain why non-registered-provider housing co-operatives are not a form of the tax avoidance measure known as 'enveloping'. In **part 3** we propose how eligibility for Higher-Rate SDLT and ATED interim reliefs could be designed in such a way as to ensure new opportunities for tax avoidance are not inadvertently created. In **part 4** we provide assessments of the impact on people's housing choices, on non-registered-provider housing co-operatives, and on the Exchequer, in a 'do nothing' scenario. In **part 5** we provide assessments of the impact on people's housing choices, on non-registered-provider housing co-operatives and on the Exchequer, if Higher-Rate SDLT and ATED interim reliefs were to be extended to these co-operatives.

2 Rationale: why housing co-operatives are not a form of ‘enveloping’

- 2.1 Housing co-operatives are voluntary associations of people (members) who share democratic ownership and control of their housing. Some co-operatives provide housing for their members in one or more shared houses (akin to ‘Houses in Multiple Occupation’), others provide housing in collections of single-occupation dwellings and some do both.
- 2.2 Every housing co-operative we are aware of makes use of a corporate structure to own its residential property and manage its property-related affairs. Legal incorporation is extremely prudent where several people share home ownership, where large amounts of capital are involved, and where the legal liabilities are potentially significant. Incorporation limits each member’s personal liability and facilitates the common ownership and control of capital and assets, and the sharing of contractual rights and responsibilities.
- 2.3 Many housing co-operatives are registered providers of social housing but a significant number are not. Those that are not are referred to here as ‘non-registered-provider’ housing co-operatives.
- 2.4 ATED and Higher-Rate SDLT are measures introduced by Budgets 2012 and 2013 to deter the tax avoidance practice called ‘enveloping’. Enveloping involves the ownership of valuable residential properties being placed in corporate structures (a limited company for example) as a means of avoiding taxes and obscuring asset ownership. These taxes are now applied to all single-dwelling residential properties worth over £500,000 that are owned via a corporate structure, except where HM Treasury deems that there are legitimate reasons for such ownership arrangements, such as a bona fide property rental business and the provision of social housing. Reliefs and exemptions are granted in such cases.
- 2.5 Those housing co-operatives that are registered providers of social housing qualify for the ATED relief available to registered providers. Non-registered-provider co-operatives however, qualify for neither this relief nor the property rental business relief. This is because eligibility for the latter rests on the business trading “with a view to profit” - which housing co-operatives don’t necessarily do, and also that the property business is not controlled by the residents of the property in question – which also excludes all housing co-operatives.
- 2.6 Non-registered-provider housing co-operatives exist for legitimate economic and social purposes, and have very good reasons for owning residential property via corporate structures that have nothing to do with the tax avoidance practice known as enveloping. But unfortunately they were never granted a relief or an exemption from Higher-Rate SDLT or ATED when these taxes were first introduced.
- 2.7 As the property value threshold for Higher-Rate SDLT and ATED liability has dropped from £2 million when first introduced to £500,000 from 2016-17 onwards, more existing and new non-registered-provider housing co-operatives are becoming liable to pay these taxes. The negative impacts of non-registered-provider housing co-operatives being

wrongly caught up in these punitive anti-avoidance measures are detailed in **part 4** below.

3 Relief design

- 3.1 We propose that HM Treasury creates interim reliefs from ATED and Higher-Rate SDLT for qualifying non-registered-provider housing co-operatives. This would put non-registered-provider housing co-operatives on a par with other entities that HM Treasury deems as having legitimate reasons to own residential property via corporate structures, including property rental businesses and social housing providers.
- 3.2 A relief, rather than an exemption, would use an existing annual application process administered by HMRC. This would provide a strong procedural protection against housing co-operatives being exploited as a tax avoidance structure.
- 3.3 Below we propose a design for the reliefs that would provide at least the same level of protection against tax avoidance that is found in the existing reliefs (for property rental businesses etc.).

Qualifying non-registered-provider housing co-operatives

- 3.4 Qualification for interim relief should be determined by two tests: ‘Test A’ and ‘Test B’.
- 3.5 Test A would limit qualification to corporate bodies registered under the Co-operative and Community Benefit Societies Act (2014). Unlike a company registered under the Companies Act, a society registered under this Act is little-suited to tax avoidance purposes. A registered society is a legal structure with a distinct form and function that has evolved specifically to facilitate co-operative action, subject to robust regulation by the registrar, the FCA.¹ The FCA has a statutory duty to ensure registered societies operate for valid mutual or community benefit purposes. There are significant limitations on how registered societies can distribute moneys to members and the FCA must also ensure that registered societies are not used primarily as vehicles for return on investment or capital gain. The FCA also checks to make sure there are not inappropriate ‘close links’ between members of a registered society. All this provides a degree of regulatory protection not present when people transact property using a limited company.
- 3.6 Test B would limit qualification for interim reliefs to registered societies that have legally binding and publicly available rules identifying them as co-operative housing providers and preventing members from making any personal capital gain from the society’s property transactions. Specifically, Test B is that a qualifying society’s rules:
- include the provision of housing to members within the objects of the society, and
 - restrict the society shareholding to nominal non-transferable share capital, and
 - do not provide for any increase in share values, and

¹ For policy concerning this regulatory scrutiny, see FCA Guidance here: <https://www.fca.org.uk/publication/finalised-guidance/fq15-12.pdf>

- do not provide for any distribution of the society's surplus or residual assets other than for:
 - the withdrawal (at initial nominal value or lower) of member's withdrawable share capital
 - the transfer of assets on dissolution to another body corporate satisfying Test A and Test B, and
 - restrict the transfer of any of the society's engagements only to another corporate body satisfying Test A and Test B

Interim relief from ATED

3.7 Eligible non-registered-provider housing co-operatives would have to claim for ATED relief through their annual tax return. The eligibility of any applicant for relief, under Tests A and B, would be easily legible to HMRC tax inspectors. For example, the applicable section of the ATED return could require a housing co-operative to provide its FCA registration details and attach a copy of its registered rules, citing the clauses that demonstrate compliance with Test B. If a non-registered-provider housing co-operative were to change its rules in a way that mean it no longer passed Test B, then to continue to benefit from ATED relief it would have to actively lie on its tax return, and could easily be shown to be doing so through openly available public records. All this builds in procedural protection against tax avoidance and would make the relief straightforward to administer.

Interim relief from Higher-Rate SDLT

- 3.8 Eligible non-registered-provider housing co-operatives would claim Higher-Rate SDLT relief from HMRC through its existing procedure. The eligibility of any applicant for relief, under Tests A and B, would be easily legible to HMRC tax inspectors, as with ATED. As with the other reliefs from Higher-Rate SDLT, such as for property rental businesses for example, the relief for non-registered-provider housing co-operatives should include a 'withdrawal of relief' rule.² This would allow HMRC to claw back any relief given to a non-registered-provider housing co-operative that went on to change its rules in a way that mean it no longer passed Test B.
- 3.9 As qualifying non-registered-provider housing co-operatives would also want to claim ATED relief every year, they would have to re-confirm their eligibility under Tests A and B to HMRC on an ongoing basis.
- 3.10 All this builds in procedural protection against tax avoidance and would make the relief straightforward to administer.

² See existing withdrawal of relief rules here: <https://www.gov.uk/hmrc-internal-manuals/stamp-duty-land-tax-manual/sdlm09655>

4 Impact assessment: 'do nothing' scenario

- 4.1 In this scenario non-registered-provider housing co-operatives will continue to be charged Higher-Rate SDLT when purchasing single-dwelling residential properties worth over £500,000. And ATED will continue to be charged annually to non-registered-provider housing co-operatives owning single-dwelling residential properties worth over £500,000.
- 4.2 These taxes will be significant additional costs for new and existing non-registered-provider housing co-operatives that can only be met through charging higher rents to members. The impact will be felt most severely in areas with high house prices, making this housing option significantly more expensive for the people who might otherwise benefit from it the most.

Impact on existing non-registered-provider housing co-operatives

- 4.3 Analysis conducted by Friendly Housing Action suggests that around 75 percent of non-registered-provider housing co-operatives liable to pay ATED have just one property over the threshold and will therefore be liable to pay £3,500 of ATED a year. Around 10 percent have two properties over the threshold and will be liable to pay £7,000 of ATED a year, while a handful have multiple properties over the threshold and are facing ATED costs of up to £49,000 a year.
- 4.4 The majority of these co-operatives house from 5 to 10 people, while a smaller proportion will house between 11 and 20 people. Only a handful will house either less than 5 or more than 20 people.
- 4.5 We estimate that the average annual cost of ATED per person in these co-operatives is £799, where the average annual rent per person is £4,788, making **the cost of ATED per person per year 16 percent of their rent**. These co-operatives can only meet this sudden new cost by increasing the rent members pay. **Some co-operatives may need to increase rent by as much as 39 percent**. For most people such sudden rent increases are not manageable and we would expect at least some members to be forced to leave their co-operative, losing their homes in the process. In many cases, such large rent increases would render the housing co-operative non-financially viable, potentially resulting in its closure and consequent non-receipt of ATED by the Exchequer.
- 4.6 The continued application of Higher-Rate SDLT will also limit the opportunities for existing non-registered-provider housing co-operatives to expand, by adding significant costs to the purchase of many suitable properties, especially in parts of the country with higher house prices.

Impact on the possible number and scale of new non-registered-provider housing co-operatives

- 4.7 The continued application of Higher-Rate SDLT and ATED will significantly increase the rents in any newly established non-registered-provider housing co-operatives. Where payable, Higher-Rate SDLT adds at a minimum £45,000 to start-up costs for any non-registered-provider housing co-operative, which in practice increases the amount of

borrowing the co-operative has to take out. Whilst the purchase cost of the property itself can, as with owner-occupiers or property investors, be borrowed over a long term at low interest rates via mortgage finance, SDLT does not uplift the property value in any way and cannot be added on to a mortgage. Instead it has to be covered from unsecured borrowing, which is at higher rates of interest and shorter loan term.

- 4.8 The cost of this additional borrowing will be added to the rent members need to pay, as will the ongoing cost of meeting ATED liabilities. The high repayments on this short-term unsecured borrowing disproportionately affects the rent levels the co-operative needs to charge to cover costs, and thus Higher-Rate SDLT has a very high negative impact on the financial viability of a housing co-operative.
- 4.9 Friendly Housing Action has modelled the impact of Higher-Rate SDLT and ATED on a new non-registered-provider housing co-operative purchasing a property for £550,000, where the additional £48,500 in SDLT is paid for by a corresponding increase in a 10 year unsecured loan. The modelling predicts a **23 percent increase in monthly rent** to pay for this.
- 4.10 A 23 percent increase in rent would make living in these housing co-operatives much less affordable for many people. In areas with high house prices, even quite modestly-sized housing co-operatives would become significantly more expensive to live in. In areas with more modest house prices we would expect to see fewer large housing co-operatives established. This may translate into more smaller housing co-operatives being established but will also mostly likely reduce the total number of people who choose this housing option. Meanwhile in areas with high house prices we would expect to see fewer housing co-operatives established altogether.
- 4.11 The current tax treatment could also limit options for expanding the UK's fledgling student housing co-operative sector, where large shared houses are a very popular arrangement. Unfortunately Higher-Rate SDLT and ATED will make such arrangements much less affordable for students.
- 4.12 We are already aware of instances where Higher-Rate SDLT and ATED have changed the behaviour of co-operatives in formation. These taxes have forced them to choose cheaper and sometimes smaller, and generally less suitable, properties to live in. In some cases would-be co-operative founders have abandoned their plans altogether. These instances include both student and general non-registered-provider housing co-operatives.
- 4.13 The number of people of all ages and backgrounds in the UK living in shared housing continues to rise. Living in a shared house is increasingly a sensible economic and social choice for adults of all ages and backgrounds, especially in areas with higher house prices. Within this context, non-registered-provider housing co-operatives are an effective means for people who want to live with others to gain democratic ownership and control of their housing. By increasing the cost of founding and living in non-registered-provider housing co-operatives, particularly in high house price areas, Higher-Rate SDLT and

ATED make what might otherwise be an attractive alternative to private renting less affordable.

Impact on government housing policy

- 4.14 We do not believe it is government's intention to limit people's housing options in the ways set out above. Indeed, increasing the supply of housing in all tenures that is affordable and in line with people's needs and aspirations has been a theme running through many speeches and policy documents, not least the most recent Housing White Paper.³ Furthermore, government has a specific and significant policy of supporting community-led housing, which by its own definition includes housing co-operatives.⁴ And MHCLG has a published commitment to develop policy to improve affordability in the private rented sector.⁵ In a 'do nothing' scenario, these very important policy intentions will be undermined by ATED and Higher-Rate SDLT.

Impact on the Exchequer

- 4.15 At present we estimate that there are perhaps 59 non-registered-provider housing co-operatives eligible to pay ATED and higher-rate SDLT, with a combined annual ATED liability of approximately £225,000. In a 'do nothing scenario' we expect this tax revenue to fall over time as some currently eligible housing co-operatives close, while the replacement rate falls as fewer otherwise viable co-operatives are able to get off the ground. Indeed, we are not aware of any non-registered provider housing co-operative that has sufficiently strong cashflow to cover the costs of Higher-Rate SDLT and offer accommodation at viable rent levels.

Proportionality

- 4.16 The impact on the Exchequer is very marginal, to the point of being almost negligible. The estimated £225,000 in ATED earned from non-registered-provider housing co-operatives amounts to just 0.13 percent of the total revenue earned from ATED in 2016-17.⁶ The simultaneous negative impact on non-registered-provider housing co-operatives as a housing option is disproportionately severe.
- 4.17 HM Treasury clearly followed its own tax impact assessment guidelines when it decided to provide targeted reliefs and exemptions for other legitimate instances of property ownership via corporate structures. However, given the significant negative impacts the misapplication of ATED and Higher-Rate SDLT has on the ability of non-registered-provider housing co-operatives to go about their legitimate activities, it is questionable whether the same guidelines were applied in their case.

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/590464/Fixing_our_broken_housing_market_-_print_ready_version.pdf

⁴ See paragraph 8 here:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/721611/CHF_prospectus_-_FINAL.pdf

⁵ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/733421/Rough-Sleeping-Strategy_WEB.pdf

⁶ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/681333/Ated_1617.pdf

5 Impact assessment: provide interim reliefs

- 5.1 In this scenario HM Treasury provides interim reliefs from ATED and Higher-Rate SDLT in the ways set out in **part 2**.

Impact on existing non-registered-provider housing co-operatives

- 5.2 Qualifying non-registered-provider housing co-operatives would need to ensure they continue to meet Tests A and B set out in **part 2** and would file a claim for ATED relief each year as part of their tax return.
- 5.3 These co-operatives would be able to continue charging rents to cover costs as they were doing prior to their ATED liability. Thus these co-operatives will continue to be an attractive and often more affordable housing option, especially to living in the private rental sector.
- 5.4 Qualifying for Higher-Rate SDLT relief would give non-registered-provider housing co-operatives looking to expand a fuller range of property options. They would be free to choose the most suitable properties in their price range without having to consider significant additional tax costs.

Impact on the possible number and scale of new non-registered-provider housing co-operatives

- 5.5 New qualifying non-registered-provider housing co-operatives would need to claim Higher-Rate SDLT relief when they purchase a property over the threshold. To do so they would need to prove to HMRC that they comply with Test A and B set out in **part 2**. These co-operatives would then need to ensure they continue to meet Tests A and B. As they would also file a claim for ATED relief each year as part of their tax return, they would invite ongoing HMRC scrutiny of their compliance with Tests A and B.
- 5.6 As the costs at start-up would remain as they were prior to the lowering of the thresholds, would-be founders would have a fuller range of property options open to them. They would be free to choose the most suitable properties in their price range without having to consider significant additional tax costs. We would expect to see more new non-registered-provider housing co-operatives established overall and more large ones in particular. We would also expect to see more non-registered-provider housing co-operatives established in areas with high house prices.
- 5.7 The expanded possibilities for establishing these co-operatives would increase the supply of this attractive, and often more affordable, alternative to living in shared housing in the private rental sector. It would especially increase the supply of this housing option in areas with high house prices, where its utility could be particularly great.

Impact on government housing policy

- 5.8 By expanding opportunities for people to live in non-registered-provider housing co-operatives, the proposed reliefs would support government housing policy in relation to affordability and suitability across all tenures. More specifically, the reliefs would

support government's community-led housing agenda and priorities for affordability in the private rental sector.

Impact on the Exchequer

- 5.9 At present we estimate that there are perhaps 59 non-registered-provider housing co-operatives in the whole of the UK that are eligible to pay ATED, with a combined annual ATED liability of approximately £225,000. In a scenario where interim reliefs are provided, this tax revenue would be lost. However, in the 'do nothing' scenario some of these co-operatives would become non-financially viable and at least some of this tax would in practice be uncollectable anyway, so the actual lost revenue to the Exchequer would be even less.
- 5.10 We would also expect the number of property purchases made by new and existing non-registered-provider housing co-operatives to increase in this scenario compared with the 'no nothing' scenario. This would slightly increase the amount of tax revenue earned from the 3 percent 'Additional SDLT' on residential properties bought by corporations for under £500,000, compared to owner-occupier purchase.

Proportionality

- 5.11 These impacts on the Exchequer are very marginal, to the point of being almost negligible. The estimated £225,000 in initial lost ATED revenue amounts to just 0.13 percent of the total revenue earned from ATED in 2016-17.⁷ The simultaneous impact on non-registered-provider housing co-operatives as a housing option would be extremely positive in comparison.

6 Concluding remarks

- 6.1 We hope it is clear that non-registered-provider housing co-operatives are not a form of enveloping but are instead a legitimate housing arrangement; one that makes prudent use of corporate ownership. In light of this, we hope HM Treasury can agree that it is not appropriate to deny non-registered-provider housing co-operatives interim reliefs from higher-rate SDLT and ATED equivalent to those it has provided for other legitimate corporate owners of residential property.
- 6.2 Furthermore, we hope HM Treasury agrees that the impact of continuing to apply Higher-Rate SDLT and ATED to non-registered-provider housing co-operatives is disproportionately negative, when the amount of tax revenue earned is compared with the significant curtailment of an otherwise attractive and affordable housing option. We further hope HM Treasury recognises that these negative impacts run counter to current government housing policy in relation to choice, affordability, suitability and community-led housing.

⁷ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/681333/Ated_1617.pdf

6.3 Finally, we ask HM Treasury to consider seriously our proposal for a targeted interim relief from Higher-Rate SDLT and ATED for carefully defined non-registered-provider housing co-operatives.

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