What is a property developer?

Large Corporate | Personal tax

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Richard Turner examines how the *Hopscotch* case distinguishes between property development and property development trade

Key Points

What is the issue?

In a claim for ATED relief, the First-tier Tribunal has ruled that a property development did not amount to a property development trade.

What can I take away?

Any situations where intentions change should be reviewed to ensure that a suitably robust business plan and budget exist to evidence intentions, as well as evidence of any changes in plans along the way.

What does it mean to me?

This ruling has implications for all property owners but particularly smaller property developers and one-off developments projects, where there may be no track record of property development and a less formalised budget or business plan.

The Annual Tax on Enveloped Dwellings is an annual tax payable mainly by companies that own UK residential property valued at more than £500,000. There is an exemption for a property development trade. In the recent case of *Hopscotch v HMRC* [2019] UKFTT 0288 (TC), concerning a claim for ATED relief, the First-tier Tribunal has ruled that a property development did not amount to a property development trade.

The key message here is that it is not sufficient for a taxpayer to simply be developing a property. They must also be carrying on a property development trade in order to access ATED and other valuable tax reliefs.

The case also clearly illustrated that, for a company which has owned a property for a long time, it may not be enough for a taxpayer’s intention to simply change, as the distinction between improving property investments and a property development trade is narrow.

The Hopscotch case

Hopscotch Ltd was a BVI company that had owned a residential property in Kensington for a number of years. Having failed to sell the property, it decided to redevelop the property with the aim of maximising the value when it came to sell the site.

During this redevelopment, Hopscotch claimed relief from the ATED charge on the basis that it was now carrying on a property development trade. This was subsequently challenged by HMRC, not on the basis that redevelopment was taking place, which was undeniable, but that it was not carrying on a trade.

Relief from the ATED charge may be claimed where a single dwelling interest is held by a property developer carrying on a property development trade, where 'the interest is held exclusively for the purpose of developing and reselling the land in the course of the trade' (FA 2013 s 138(1)(b).

Under FA 2013 s 183(4), 'property development trade' means a trade that:

1. consists of or includes *buying and developing for resale* residential or non-residential property; and
2. is run on a commercial basis and with a view to profit.

References to development include redevelopment

The established facts were that Hopscotch acquired the house in 1993, and until 2007 it was occupied by persons permitted to do so by the company. Certain features were added to the property during this period. The property was put on the market in 2011 but failed to sell. In 2014, the directors decided to redevelop the property and a number of consultants and advisers were appointed in relation to the redevelopment. The property was put back on the market in October 2017. Initial estimates of the cost of redevelopment were £2.75m, although final costs of redevelopment were around £1m. The property had still not been sold at the date of the hearing.

ATED returns were submitted and ATED charges paid for the three years ending 31 March 2016. For the two years to 31 March 2018, relief was claimed on the basis that the company was carrying on a property development trade.

The taxpayer's position

Hopscotch argued that an asset originally acquired on capital account can subsequently be appropriated to stock; and that a trade of property development can exist where there is only a single transaction.

Furthermore, it argued that the property should have been regarded as being appropriated to stock. It drew a distinction between:

- a person wishing to increase their chances of selling a property by undertaking works and then seeking to recover these costs; and
- someone undertaking redevelopment in order to maximise the value of the asset.

The steps taken by Hopscotch included taking the property off the market, taking a considerable amount of professional advice, and the amount of expenditure on the redevelopment. These meant that it was, in its opinion, seeking to realise as much value from the asset as possible and therefore should be seen as being a ‘scheme for profit-making’.

HMRC’s position

HMRC argued that the company was not carrying on a trade at all and was instead doing no more than any other owner wishing to maximise the sale of an asset held on capital account. Furthermore, HMRC maintained that the company would need to have acquired the property in 1993 with the intention of developing it for sale in order to qualify as a property development trade.

The tribunal’s verdict

The First-tier Tribunal examined the case in relation to the badges of trade. However, as is the case with many one-off property developments, these were not found to be conclusive either way.

One-off transactions can be trading

Whilst the taxpayer borrowed to finance the redevelopment, and the works were clearly undertaken to achieve a resale, the transaction was a one-off. Also, the subject matter of the transaction was one that could equally have been sold as an investment or a venture in the nature of trade.

Development was not carried on in the way of a trade

It was found that the transaction was not carried on in a way typical of a property development trade. Upon inspection of the board minutes, they did not discuss the

expected costs or profits of the development, accounts had not been prepared, and there was an absence of financial planning.

Whilst as a matter of British Virgin Island company law, the company was not required to prepare and file annual financial statements, if the company had been truly carrying on a trade on a commercial basis, it is expected that something akin to those financial statements in relation to its business affairs should have been produced for management purposes.

The redevelopment costs were estimated to be £2.75m; however, the actual cost was close to £1m. It is the discrepancy between these figures, without any paperwork to evidence the reason for it and its impact on the anticipated profit, that highlighted the lack of financial planning. This was an important factor in distinguishing a trade from the taking of steps to maximise the value of an investment held on capital account.

The taxpayer subsequently wrote to the tribunal to inform it that the reason for the difference was that it was refused planning permission for a key aspect of the design. Once again, however, there was a failure to adjust plans or revise cost and profit projections in light of this setback.

The company had also not registered for UK corporation tax. Whilst not conclusive evidence in itself, when taken with the other evidence (or lack thereof), the tribunal was satisfied that the directors had not been acting in a manner consistent with operating a trade.

Taxpayers can change their intention

The tribunal went on to reason that the definition of ‘property development trade’ should be construed disjunctively, rather than conjunctively.

The definition of ‘buying and developing for resale residential or non-residential property’ consists of two parts:

- buying property without a specific intention; and then developing it for resale;
- as opposed to buying property for resale, and then developing it for resale.

Thus, it was not only possible for the redevelopment of one property to amount to a venture in the nature of trade, but for a person holding a property as an investment

to decide that going forward it would hold the property for a trading purpose, appropriating it from capital account to trading account. Based on the facts of this case, however, the tribunal found that this had not happened here, as Hopscotch had not carried on a property development trade.

This is excellent news for other taxpayers, as if HMRC had been successful in its arguments it would have made it very hard for a taxpayer to change intention and develop a long-held property for resale.

Conclusion

This case illustrates clearly that it is not sufficient for a company simply to have been carrying on a redevelopment, but that any development must have been carried out in the course of a property development trade. As well as having to ensure that the badges of trade are considered carefully, any situations where intentions change should be reviewed to ensure that a suitably robust business plan and budget are in existence in order to evidence intentions, as well as contemporaneous evidence of any changes in plans along the way. Having the property correctly presented as trading stock in the accounts is relevant.

This ruling has implications for all property owners but particularly smaller property developers and one-off developments projects, where there may be no track record of property development and a less formalised budget or business plan. Taxpayers need to be wary of the possible repercussions of this case to their other tax affairs. The key principle of this case was whether the company was carrying on a trade on a commercial basis. This is a condition of numerous other tax reliefs; for example, where qualification for business property relief or entrepreneurs' relief are being relied upon to reduce inheritance tax and capital gains tax exposures.

What can we take away?

Ultimately, intentions and financial plans should be clearly recorded and will be tested. While the *Hopscotch* case focused on whether the taxpayer was entitled to claim relief from the ATED charge, it could have wider implications for a range of other tax reliefs.