

Aequus Developments Limited

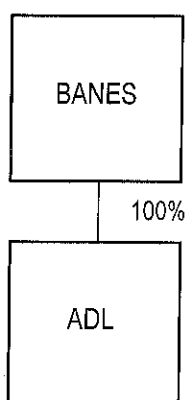
Property Development – Structure Proposal

Monahans have been asked to comment on the proposed structure of Aequus Developments Limited ('ADL') which has been incorporated to develop various sites in the local area. The intention is for ADL to sell a proportion of the development to third parties with the remainder retained within ADL to generate a long term rental income stream.

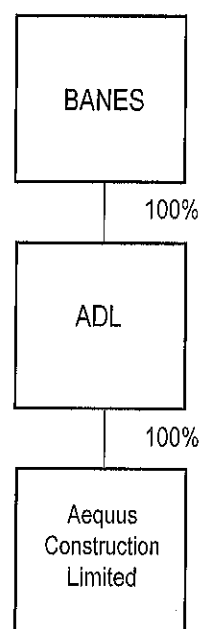
At present, all internal financial modelling has been based on ADL carrying out the development. However, upon review of the current structure, we recommend that Bath & North East Somerset Council ('BANES') and ADL consider incorporating an additional company to carry out the construction projects. As property development carries a high risk factor, a multi-company group should provide greater protection for those properties retained for letting and is likely to improve the VAT and Corporation Tax ('CT') position.

Recommended Structure

Current Structure



Proposed Structure



The following adjustments to the current structure are proposed:

- Aequus Construction Limited ('ACL') is incorporated and wholly owned by ADL.
- Any development sites held by BANES are transferred to ACL for construction and once the sites are complete, ACL will dispose of the units marked for sale with any investment units transferred and let by ADL.



This structure should segregate the risk of the development company from the investment assets retained by the group but should also improve the group's tax position as follows:

VAT

The one company structure originally planned means that the company is making a mixture of supplies (sales) for VAT purposes, some of which are taxable supplies (sale of properties) and some are VAT exempt (rent of properties). The company is therefore partially exempt for VAT purposes and is unable to reclaim any input VAT which relates to the exempt income. As a result the following input VAT is irrecoverable:

- VAT on the proportion of the purchase price of every site which is allocated to properties to be let.
- VAT on the conversion costs of the parts of the properties that will be let.
- A proportion of the VAT on the general overheads of the company based on the ratio of exempt to taxable supplies.

On the provisional figures for the Riverside project the VAT cost for the single company model is estimated to be £394,000.

It is possible for the Company to request that BANES sets aside its option to tax on any properties that are being sold to the Company thus removing the first VAT cost listed above. However we have discussed this idea and BANES do not wish to add to its VAT exempt income because of possible issues with its own VAT position.

A two company structure avoids the partial exemption problem because the company carrying out the construction / conversion work will sell all of the new dwellings it creates and will be fully taxable for VAT purposes. The VAT status of the two companies will be:

- ACL – will purely build and convert dwellings. It will sell those properties to a combination of the general public and ADL. All of its income will be zero rated sales of newly created dwellings which qualify as taxable income for VAT purposes. As a result it will be able to recover all of its input VAT (subject to certain restrictions which apply to all housebuilders) but will not have to charge VAT on its supplies to its customers, including ADL, because the sales are zero rated.
- ADL – all of its income will be the rent of the dwellings, which is VAT exempt. Therefore the company will ultimately not be VAT registered. The current registration will be left in place until this company invoices ACL for the planning and other property related costs to date. It will then de-register and will not be able to reclaim any future input VAT but that input VAT is likely to be minimal.

The two company structure does, therefore, provide a very significant cost saving, as indicated by the Riverside figure above, and this saving is likely to apply to most, if not all, future projects.



Corporation Tax

Mitigation

As detailed above, the major benefit of a multi-company group structure is the VAT saving available and the ring-fencing of the risks associated with property development. There are, however, improvements that can be made to the group's CT position:

- At present, the financial model for the 2019/20 tax year accounts for a corporation tax charge arising on appropriation of development property to fixed assets. However, by identifying those units that will be retained for letting from the outset, it should be possible to categorise those properties and related costs as fixed assets, thus mitigating the corporation tax charge on transfer from work in progress to investments. The units constructed for sale will remain in work in progress.
- By creating an overage between BANES and ACL, an appropriate proportion of any development profit will be paid to BANES, reducing the overall exposure to CT.

As detailed above, we propose to transfer any properties retained to provide a rental stream from ACL to ADL once the construction is complete. This transfer would usually be subject to CT but in a group structure, fixed assets can effectively be transferred free of corporation tax (assuming no market value sale takes place) so on completion of the development, the investment assets within ACL can be transferred to ADL on a no gain, no loss basis.

Corporation Tax

CT is currently chargeable at a rate of 20%. However, this is due to decrease to 19% with effect from 1st April 2017 and 17% from 1st April 2020. Each individual company within the group will be subject to CT and will be responsible for filing an annual CT return with any tax due for payment within 9 months and a day of the company's year end.

However, CT may be payable on a quarterly basis by companies within a group. A large company with profits exceeding £1.5m is required to make quarterly instalments of CT but in a group structure, this limit is reduced based on the number of companies within that group. For example, in a group with 3 companies, the quarterly payment limit would be reduced to £500,000 per company.

Depending on the total number of group companies in existence (including those wholly owned by BANES, which may fall within a group for CT purposes), one or more companies may be required to make quarterly CT payments. The overall amount of CT due will remain the same but quarterly payments may impact on a group's cashflow.

Other Practical Considerations

Although the recommended structure detailed above is likely to maximise tax efficiencies, there are certain practical points which should be considered:

- If possible, the properties categorised as fixed assets in ACL from the outset should be held on their own land title.
- VAT registration will be required for ACL before it starts to work on its first project.
- Professional fees for the management of a group structure are likely to be higher due to the additional accounts, corporation tax and statutory filings required.

