Analysis

Residential properties and SDLT: practical issues

Speed read

Purchasers of residential property are neglecting to take SDLT advice. They rely on figures provided by conveyancers which are often the worst-case result. A small piece of non-residential subject matter in a transaction can reduce SDLT because non-residential rates are less than residential rates – but expect HMRC resistance. There are opportunities around multiple dwellings relief (MDR) and also the very favourable interaction between MDR and non-residential property in a transaction (following a recent change to HMRC's position). The rules around the 3% surcharge can also present difficulties. Sometimes transactions can be structured so as to reduce the charge. Hopefully 'SDLT surveys' will become common-place.

Andrew Marr
Forbes Dawson
Andrew Marr is a partner at Forbes Dawson. Andrew's expertise lies in bespoke tax planning for owner-managed businesses and all aspects of restructuring. He also heads up the firm's SDLT advisory service and prepares SDLT surveys for buyers of high-value residential property. Email: andrew@forbesdawson.co.uk; tel: 0161 927 3854.

Purchasers of residential property will often fail to seek quality SDLT advice. The vast majority of purchasers will simply pay the SDLT that their conveyancer 'instructs' them to pay. This is strange because most conveyancers would claim that they do not provide SDLT advice. Typical wording in a conveyancer's engagement letter is as follows:

> 'The SDLT return is a complex document and we must have all the information necessary to complete the return and have it signed or approved by you in advance of exchange of contracts. It is your responsibility to provide the correct information to be inserted into the return.'

Usually, therefore, a conveyancer will complete the SDLT return based on input from a client who knows very little about SDLT. Conveyancers should be pushing their clients to at least go through a basic SDLT decision-making process (and some do). SDLT will often be the biggest single tax bill that they face in their lives.

In this article, I focus on the various reasons why the initial 'worst case scenario' calculation may not be correct. Furthermore, there may be certain cases where a transaction can be structured in a different way to improve the SDLT position. All references to legislation are FA 2003 unless otherwise stated.

Residential or non-residential rates?

Now more than ever before, residential SDLT rates can be much higher than non-residential rates. This is the case even while we are in the SDLT holiday period with 0% SDLT on the first £500,000 of a purchase. 'Normal' residential SDLT rates have a top rate of 12% over £1.5m which becomes 15% with a 3% surcharge and then 17% from 1 April 2021 if the 2% non-residents surcharge also applies. Compare this with a top rate of 5% (over £250,000) for non-residential rates.

Prima facie, justifying non-residential rates is beguilingly simple. Section 55 (1B) tells us that residential rates only apply if 'the residential land consists *entirely* of residential property'. Therefore, even a small piece of non-residential property in a transaction can mean that rates are significantly reduced.

Consider the SDLT treatment of a £2m terraced house in London compared to a country house in Gloucestershire where a field is let to a farmer. The terraced house should trigger SDLT (at residential rates) of £138,750 (and £198,750 if the 3% surcharge applies) whereas the country house should only trigger SDLT of £89,500 (at non-residential rates).

With the stakes so high it is not surprising that there has been plenty of scrutiny in various tax cases around the s 116 definition of 'residential property'. In particular, cases have focused on whether certain areas of land fall within the definition of 'gardens and grounds' under s 116(1)(b). Perhaps unsurprisingly, HMRC has been keen to contend that as much as possible falls within this definition. The taxpayer is not helped here by the florid language employed in sales particulars which boast about 'the extensive gardens and grounds'.

A couple of recent cases worth reading here are *Hyman and another* [2019] UKFTT 469 (TC) and *Myles-Till* [2020] UKFTT 127 (TC). These show that it is not easy to argue that an area is not 'gardens and grounds'. In the first case, the taxpayer failed to convince the First-tier Tribunal that a wild meadow did not fall into this category, and in the second case the taxpayer failed to argue the case for a 1.1 acre paddock. Also, the *Hyman* case has recently been unsuccessfully appealed to the Upper Tribunal ([2021] UKUT 68 (TCC)).

These cases show that the status of the land on 'the effective date' (usually but not always completion) is key, and also that there needs to be some kind of non-residential (or commercial) activity to preclude land from being 'gardens and grounds'. For example, a grazing agreement with a farmer still seems to be something of a 'magic bullet' here.

Any prospective buyer who hopes to pay SDLT at non-residential rates would be well-advised to ensure that any informal arrangement with a farmer is formalised and assigned to them as part of the completion process.

Demolition cases

It is fairly common for a property to be acquired and then knocked down after purchase. It should usually be possible to structure such a transaction as one subject to non-residential rates.

Although it is clear that the acquisition of a demolished building would be subject to the lower rates, such a transaction needs to be handled carefully. Normally contracts will be exchanged and then the house will be demolished between exchange and completion.

Ideally the purchaser will stay away from the property until completion to avoid any suggestion that they have 'taken possession' which itself will be an 'effective date' for SDLT purposes (s 44(5)(a), (6)). Also, a well-advised seller who is looking to benefit from principal private

residence relief (PPR) will want the property to be intact at the date of exchange. This is because TCGA 1992 s 222(1) requires that a 'dwelling-house' is disposed of for PPR to apply.

Multiple dwellings relief (MDR)

The rules for this valuable relief are set out in Sch 6B. This has been around since 2011 and was aimed mainly at purchasers of portfolios of properties. The rules work by calculating SDLT on the average price of properties and then multiplying that figure by the number of properties (subject to a de minimis rate of 1%). Because of the SDLT banding system this will invariably lead to lower SDLT being payable than if it had been calculated on the total consideration. The relief has to be claimed by a year and 14 days from the effective date of a transaction or it will be lost.

This relief also applies to houses which have an annex. Take for example the purchase of a £2m house with an annex. Without an MDR claim this would currently give rise to SDLT of £138,750, but this would be reduced to £57,500 with a claim. Here the SDLT holiday would be worth £30,000 to this MDR purchaser.

Consideration also needs to be given here to whether the 3% SDLT surcharge applies. This would be the case (without a special relief) in cases where more than one dwelling is owned at midnight on the day of purchase. Fortunately, relief (Sch 4ZA para 5(4), (5)) is available here to exempt the 3% surcharge when the annex is a 'subsidiary' dwelling. For it to be 'subsidiary' it must be part of the same building as the main dwelling or in its grounds and the price attributable to the subsidiary dwelling can be no more than a third of the total price. This 3% issue needs to be considered irrespective of whether MDR is actually claimed.

MDR is a classic example of a claim which will often be overlooked by conveyancers, who often will either not have a good understanding of the relief or the characteristics of the property, or both. Although it is possible for an SDLT reclaim to be made within a year and 14 days of the effective date, often the opportunity will be missed.

Multiple dwelling purchases with some non-residential property

In most cases where MDR is claimed, the 3% SDLT surcharge will apply. MDR can still be claimed in respect of residential property when a transaction includes some non-residential property, although then the surcharge should not apply. The approach here is to calculate MDR on the residential property and apply non-residential rates to the non-residential property.

Take, for example, a £2m transaction which comprises four residential properties and a commercial property worth £100,000. The correct approach is to take SDLT at non-residential rates on £2m (which is £89,500) and then calculate the amount applicable to £100,000 (5%) and then as a separate exercise apply MDR to the remaining £1.9m.

Up until November 2020, the prevailing view was that the MDR calculation in the above transaction should be calculated applying the 3% surcharge. This would have led to SDLT of £61,475 being payable. In November 2020, HMRC changed its guidance (in its *Stamp Duty Land Tax Manual* at SDLTM09740) to say that the 3% would not be applicable where a transaction includes some non-residential property as long as the value of the non-residential property is 'negligible or artificially contrived'.

This change in HMRC's view is based on the conditions set out in Sch 4ZA which sets out when the 3% surcharge is applicable and where it is (arguably) clear that the surcharge can only apply when all the subject matter of a transaction consists of residential property. Incidentally, it is difficult here to find any legislative basis for HMRC's contention that the 3% rate can apply in cases where there is 'negligible' or 'artificially contrived' non-residential property. The rates should simply be driven by the subject matter of the transaction. Furthermore, FA 2003 s 75A (the main SDLT anti-avoidance rule) should not have any sway here because it only has the power to bring amounts into charge which would otherwise avoid charge and cannot impact the rates.

Revisiting our example above, the SDLT on the transaction would be reduced to £23,475 without the 3% surcharge. This replaces the 3% on the £1.9m residential element with the 1% de minimis rate for MDR claims.

This also points to the danger of blindly following HMRC's guidance in SDLT matters. There will be many opportunities for reclaims where the wrong approach has been taken following the old guidance and these should be valid for four years (under Sch 10 paras 34–34E).

Issues around 3% surcharge

The application of the 3% surcharge is another area where mistakes can be made. The main exemption for this surcharge is set out in Sch 4ZA para 3(5)–(7) and applies where a dwelling is intended to replace a main residence that has been lived in as such in the previous three years. The old dwelling must be sold before the replacement dwelling is purchased if the surcharge is to be avoided and otherwise it must be paid but can be reclaimed if the old house is sold within three years.

Although this is a simple rule, complications can occur when joint purchasers are involved. This is because the rule must apply to both purchasers. Take the example of Paul and Jane who buy a new house together for £600,000. This will be Paul's new main residence after disposing of his former home, but Jane has never had a main residence (although she does own an investment flat worth £80,000). Here, there would be an £18,000 surcharge on the purchase because Jane does not meet the conditions. This could have been avoided either if Jane had disposed of her investment property or if Paul had given Jane a share (possibly small) in his old property and she had lived in it for a period before the purchase of the new property. The analysis would be different if they were married. This kind of fairly simple planning will be well outside the remit of the typical conveyancer.

Raising SDLT's profile

I am pleased to report that conveyancers and house buyers are now starting to request specialist SDLT advice on a timely basis. I have a vision that, in light of increasing SDLT complexity and rising SDLT rates, 'SDLT surveys' will become common place. I myself have been conducting these kinds of surveys in recent years and am pleased to report many cases where buyers have discovered that the SDLT bill would not be as high as anticipated. Even where this has not been the case, they got the assurance that they were not missing a trick (or an MDR claim!). ■