Analysis

SDLT: planning for higher rates transactions

Speed read

The 3% additional SDLT charge has applied to the purchase of additional dwellings by individuals and the purchase of first and subsequent dwellings by non-natural persons since 1 April 2016. There is an exception for the replacement of a main residence but there are traps for the unwary. The interaction of the charge with multiple dwellings relief and transactions that are linked needs careful computation of the tax payable. The purchase by trustees of a dwelling also requires careful analysis of the rules.

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The 3% higher rates SDLT charge on the purchase of any dwelling by non-natural persons and the purchase of additional dwellings by individuals under FA 2003 Sch 4ZA has sent a shock wave through the residential property market. Whether you view it as a much needed reform or as a terrible mistake by HM Treasury, which will eventually reduce the stock of properties available to first time buyers and reduce SDLT revenues at the higher end of the market, it looks as though the charge is here to stay.

This article explains some of the considerations that advisers should keep in mind when assisting clients who are potentially within the scope of the charge. Many of the considerations below involve the straightforward application of the statutory rules; however, advisers should also keep an eye on the SDLT disclosure of tax avoidance (DOTAS) rules in the context of some of the issues considered below.

Background

The higher rates of SDLT for additional dwellings purchased by individuals and for first and subsequent dwellings purchased by non-natural persons have applied since 1 April 2016. They are levied on any acquisition that is referred to in the legislation as a 'higher rates transaction', which is broadly as follows:

- the purchase of additional dwellings in England, Wales and Northern Ireland by individuals where, at the end of the day of purchase, sole or joint individual purchasers own two or more dwellings and are not replacing their main residence. The charge does not, however, apply where, at the end of the day of purchase, a sole individual purchaser owns an interest in only one dwelling, or joint individual purchasers together own an interest in only one dwelling; and
- the first and subsequent purchases of dwellings by persons who are not individuals, except where the 15% rate under Sch 4A already applies (FA 2003 Sch 4ZA).

The charge is 3% above the normal SDLT residential rates and is charged on the slices of the price of the property that fall into each rate band. The rates are set out in an alternative 'Table A: Residential' that is substituted for the normal Table A in FA 2003 s 55(1B), for when there is a higher rates transaction. The following table shows a comparison of the rates in both versions of Table A:

Table A

Consideration	Basic residential SDLT rates	Additional SDLT rates
£0–£125k	0%	3%
£125k–£250k	2%	5%
£250k–£925k	5%	8%
£925k–£1.5m	10%	13%
£1.5m+	12%	15%

Transactions under £40,000 do not require a tax return to be filed with HMRC and are not subject to the additional charge.

Acquisitions of mixed residential and non-residential property remain exempt from residential rates and do not attract the 3% additional charge. They are charged under the rates in Table B also using the 'slice' system, with a maximum rate of 5% for consideration above £250,000.

The impact of the additional rates can be significant. The purchase of a dwelling caught by these rates for £175,000 attracts tax of £6,250 (instead of £1,000); a £2m purchase attracts £663,750 (instead of £513,750); and a £5m purchase attracts £663,750 (instead of £513,750).

Main residence exception

There is an exception from the additional charge for main residences. It is slightly curious because it entrenches the position of those individuals who own two or more dwellings, one of which is a major interest in a dwelling that was the purchaser's only or main residence, either at the time of the introduction of the additional charge on 1 April 2016 or during the period of three years prior to the purchase. It does this by conferring on such persons the facility to replace that dwelling with another to be used as the individual's only or main residence without having to pay the additional charge. This is in contrast with those persons who purchase a main residence having previously not owned the freehold or a lease of more than seven years of a dwelling used as such in the previous three years, but who otherwise own a major interest in a dwelling as, say, an investment or through inheritance. Purchasers who previously rented their main residence instead of owning it cannot take advantage of the replacement of main residence exception. There is also a time limited relief that allows someone who has disposed of their only or main residence at any time before 1 April 2016 to access the replacement of main residence exception on the purchase of a new main residence on or before 26 November 2018 (FA 2016 s 116(9)).

The main residence exception is, of course, only available to purchasers who are individuals and not to companies or other types of purchaser. The exception is only available for the acquisition of a dwelling that replaces the purchaser's only or main residence, because one of the tests for a higher rates transaction is that the dwelling acquired is not a replacement for the purchaser's only or main residence. The legislation then sets out what is treated as a replacement of an only or main residence.

Where the previous main residence has been disposed of before or on the same day as the acquisition of the new dwelling, the new dwelling will be treated as the replacement and thus exempt from the additional charge if:

- on the effective date of the transaction, the purchaser intends the new dwelling to be his only or main residence;
- the purchaser, their spouse or civil partner have disposed of a major interest in a dwelling in the three years ending with the effective date of the transaction;
- at any time during that period, the old dwelling was the purchaser's only or main residence; and
- during that period, the purchaser, their spouse or civil partner have not acquired a major interest in any other dwelling with the intention of it being the purchaser's only or main residence since the disposal of the previous main residence (FA 2003 Sch 4ZA para 3(6)).

Where the purchaser's existing only or main residence has not been disposed of by the date of the acquisition of the new dwelling, the new dwelling will become a replacement for the purchaser's only or main residence if:

- on the effective date of the transaction, the purchaser intends the new dwelling to be his only or main residence;
- in the period of three years beginning on the day after the effective date of that transaction, the purchaser or their spouse or civil partner disposes of a major interest in another dwelling; and
- at any time during the three years ending with the effective date of the purchase of the new dwelling, the other dwelling was the purchaser's only or main residence (FA 2003 Sch 4ZA para 3(7)).

In a case where the acquisition of a new dwelling will become a replacement for the purchaser's only or main residence but the latter has not been disposed of at the date of acquisition of the new dwelling, the acquisition is initially treated as a higher rates transaction. However, the acquisition of the new dwelling ceases to be a higher rates transaction if the previous or only main residence is disposed of within three years, beginning with the day after the effective date of the acquisition of the replacement dwelling (FA 2003 Sch 4ZA para 3(7)). In such cases, a disposal that causes an earlier purchase to cease to be a higher rates transaction cannot also make a later purchase into a replacement of a main residence. This rule creates a potential trap for a separating couple, where one spouse buys a property before the jointly held main residence is sold and the other spouse buys a property after the sale of the jointly held main residence. This is in contrast with where the jointly held main residence is sold first and each spouse buys their own property afterwards, where each spouse can take advantage of the main residence replacement exception.

In the case of married couples and civil partners (who are not separated under a deed of separation or a court order or separated under circumstances which are likely to be permanent), where one of them purchases alone, the transaction attracts the 3% charge if it would have done so had the other one been a purchaser. Accordingly, the purchase jointly or individually of an additional dwelling attracts the 3% charge. A dwelling owned by a couple's child under 18 is also taken into account and treated as if it was owned by the couple (FA 2003 Sch 4ZA para 12). If the couple live together or apart but are not estranged and have two residences, then which is their main residence will be a question of fact.

The following examples illustrate the position.

Case A

Mr and Mrs A own two dwellings consisting of a buy to let and their main residence. They sell their main residence and purchase a new one. The 3% will not apply because, although they own two dwellings, at the end of the day of the purchase they have replaced their main residence.

Case B

However, if they sell the buy to let and buy a pied à terre in London, they will own two dwellings at the end of the day of purchase and are not replacing their main residence, so the 3% applies.

Case C

Ms X and Ms Y are civil partners and live in Ms X's property. They separate under a deed of separation and Ms Y then buys her own property. The 3% will not apply because Ms Y owns only one dwelling at the end of the day of her purchase and she is no longer living with Ms X.

Interaction with multiple dwellings relief

Multiple dwellings relief (MDR) allows the buyer of multiple dwellings to pay SDLT at the rates appropriate to the average price of each of the properties purchased.

When six or more dwellings are purchased, HMRC permits the buyer to choose between paying the non-residential rates of SDLT in Table B on the entire price; or at the residential rates under Table A on the average consideration for each of the properties under MDR. This choice continues for purchasers who are individuals under the additional charge when the alternative Table A applies, with the 3% added to the normal rate if MDR is claimed; or the 3% not charged if the rates under Table B are opted for. For example, A buys 10 dwellings for £3m. The average price is £300,000. A can choose to claim MDR and pay tax on the average price under the rates in the alternative Table A (£14,000 × 10 = £140,000 SDLT). However, he can instead opt for the non-residential rates under Table B on the whole price (£139,500 SDLT). Solicitors should advise clients of the choice available to them to enable clients in this position to pay the lower amount of SDLT, or potentially face a negligence claim (for example, see *Mansion Estates Ltd v Hayre & Co* [2016] EWHC 96 concerning a failure to advise on the availability of sub-sale relief).

Settlements and bare trusts

The beneficiary of a settlement who, under the terms of the settlement, is entitled to occupy a dwelling for life or to income earned in respect of a dwelling, will be treated as the purchaser of a dwelling acquired by the trustees, for the purposes of the additional charge. This displaces the normal SDLT rule, which treats the trustees of a settlement as the purchaser.

Where the trustees of a bare trust purchase the lease of a dwelling, the beneficiary of the bare trust is treated as the purchaser for the purpose of the additional charge. This displaces the normal SDLT, which treats the trustees of a bare trust as the purchaser on the grant of a lease (FA 2003 Sch 4ZA para 10).

An existing dwelling owned by a settlement will be treated as owned by a beneficiary who is entitled to occupy the dwelling for life or to income earned in respect of the dwelling for the purposes of the additional charge. The beneficiary of a bare trust which owns a dwelling is also treated as the owner of the dwelling, including where the interest in the dwelling is a lease. Individual trustees of a settlement who purchase a dwelling where there are no beneficiaries entitled to occupy for life or to income from the dwelling will be treated as the purchaser, but they are in effect treated as if they were not individuals, so that Sch 4ZA paras 4 and 7 apply. This means that there is no exclusion for such trustees from the additional charge in relation to a first or only dwelling acquisition and the main residence exception is not available (FA 2003 Sch 4ZA para 13).

There is therefore no advantage in creating a series of settlements, each acquiring only one dwelling.

Mitigating the 3% charge

The higher rates inclusive of the 3% charge may in time come to be seen as the default SDLT charge and the single property/main residence replacement purchase viewed as a 'relief'. This large tax rise on residential purchases may encourage further renting rather than buying, causing rent increases, which in turn affect generation rent's ability to put aside enough for a purchase deposit. There is already evidence of large property funds and investors turning to commercial or mixed use property, instead of developing residential property as a result of the 3% charge.

Advisers should be aware of the following points when assisting clients potentially within the scope of the 3% charge.

Six or more residential properties purchased in a single transaction will be treated as not being residential property (FA 2003 s 116(7)). They will therefore be within the rates in Table B, with a maximum charge of 5% on the slice of the consideration above £250,000. In this regard, it is worth noting the surprising effect of purchasing a share in the freehold of a block of six or more flats, together with the purchase of one of the flats, particularly where the flats are very highly priced. The purchase of property used for mixed residential and non-residential purposes will also be within the rates in Table B and so outside the charge.

The purchase of residential property purchased with non-residential property, including grounds that are not actually necessary for the enjoyment of the house, will be outside the 3% charge and within the rates in Table B. This means that it is always worth considering whether houses with large areas of ground can benefit from the rates in Table B, particularly at a time when large country houses are struggling to sell, partly because of purchasers' perception of a large SDLT cost.

The question of 'linked' transactions is not expressly addressed by the legislation. In relation to linked transactions, where one transaction is chargeable at normal rates and the other is a higher rates transaction, an extended computation is needed, based on both the rates in the normal Table A and the rates in the alternative Table A. For example, X and Y, who are related, each purchase a dwelling from the same vendor in a linked transaction. X pays £600,000 for his dwelling as a replacement main residence; and Y pays £400,000 for his dwelling as a second home. The relevant consideration will be £1,000,000. Total SDLT on this amount under the normal Table A will be £43,750 and under the alternative Table A will be £73,750. X should pay £43,750 x 6/10 = £26,250 (compared with £20,000 for an unlinked transaction). Y should pay £73,750 x 4/10 = £29,500 (compared with £22,000 for an unlinked transaction).

When de-enveloping a dwelling in situations where there is a mortgage debt on the dwelling, so that there is the potential for an SDLT charge if the debt is assumed by the shareholder, the additional charge will apply to the consideration if the transfer meets the conditions for a higher rates transaction. For example, the assumption or satisfaction of mortgage debt of say £1m would normally attract SDLT of £43,750, but this will be £73,750 where the individual shareholder already owns one or more dwellings.

Advisers should also be alert to some surprising results, such as the purchase of buy to let in between the sale of one main residence and the purchase of another. For example, it could be worth delaying the acquisition of a replacement main dwelling to acquire a London pied à terre on the family move to the country.

One issue that remains unresolved is the purchase of a redundant dwelling to knock down and rebuild; and whether the 3% additional rate applies if the vendor undertakes the demolition and the purchaser buys the bare land. Opinions differ on this, and clients should take advice to ensure that the transaction is carefully structured before filing the SDLT return on the basis that the 3% charge will not apply. ■

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- Finance Bill 2016: the 3% higher rates of SDLT (Andrew Constable, 22.6.16)
- The condoc on higher SDLT rates (Paula Tallon, 13.1.16)

Analysis

The new facility for partial closure notices

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Speed read

The Finance Bill 2017 will, among other things, introduce new legislation enabling HMRC to issue a partial closure notice at its own discretion, or with the agreement of the taxpayer, as well as enabling taxpayers to apply to the tribunal for a partial closure notice. The new rules will therefore provide a mechanism for HMRC and/or taxpayers to achieve closure in relation to specific discrete issues, while others remain under enquiry. Where HMRC issues a partial closure notice and amends a tax return, taxpayers will have the right to appeal the partial closure notice and ask for payment of the tax claimed to be postponed.

Before considering the proposed changes contained in the draft Finance Bill 2017, which will enable HMRC to issue partial closure notices (PCNs) in respect of a discrete issue, while other issues remain under enquiry by HMRC, it may be helpful to remind ourselves of the current position.

The enquiry process

HMRC may enquire into any tax return made by an individual, a trustee or a partnership (TMA 1970 ss 9A and 12AC) or a company (FA 1998 Sch 18 para 24(1)). An enquiry may be commenced as a result of HMRC's scrutiny of a tax return or on the basis of information held by HMRC.