Keeping it quiet

Patrick Cannon warns that HMRC may have changed its approach to stamp duty land tax on mixed-use property purchases.

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Since the introduction of stamp duty land tax in December 2003 and until about 12 months ago, HMRC accepted that, when a dwelling was purchased with land in excess of what was required for the reasonable enjoyment of the building, the excess was treated as non-residential property. The effect of this was beneficial to the buyer because they were treated as acquiring both residential and non-residential property as part of the same transaction. Further, as a purchase of mixed-use land, the lower rates of SDLT in FA 2003, s 55 Table B applied to the whole of the purchase price rather than the higher rates in Table A that would apply if all the land were classed as residential.

When the top rates of SDLT under both tables were 4% for consideration above £500,000, and the only difference between the two tables was the starting thresholds of £60,000 under Table A and £150,000 under Table B, the distinction between them was of no great significance. Now, although the top rate of SDLT under Table B is 5% above £250,000, the top rate of SDLT under Table A is 12%, or an eye-watering 15%, if the 3% additional rate applies for purchases of additional dwellings by individuals or any dwelling by non-individuals – on the slice of the purchase price exceeding £1,500,000.

The difference between the tables on a residential purchase has therefore become a matter of great financial significance. For example, on the purchase of a country estate for £5m, the SDLT charge under Table A is £513,750 – or, if the 3% additional rate applies, £663,750. But the charge under Table B is £239,500, a saving of £424,250 on the top Table A rate.

As a result, well-advised purchasers are keen to claim for a mixed-use purchase whenever possible. Moreover, those who pay the full Table A rates on purchases of dwellings with large areas of land are increasingly likely to be contacted out of the blue by claims-farming companies who, in return for a success fee, will offer to make a repayment claim to HMRC on the taxpayer's behalf on the basis that there had been a mixed-use acquisition so that the rates in Table B should have applied instead of Table A. The lure of a refund of, say, £424,250, less commission of perhaps 2.5%, is strong.

HMRC has responded to this by changing its attitude to mixed-use purchases and tightening the scope of the definition of non-residential property to protect the revenue and to frustrate the activities of the claims farmers.

Key points

- SDLT rate and threshold changes have resulted in buyers of dwellings with large areas of land seeking to claim for a mixed-use purchase.
- However, HMRC appears to have changed its approach to mixed-use claims and may not be following its own published guidance.
- HMRC's guidance distinguishes between land that 'is needed for the reasonable enjoyment of the dwelling' and land that is not.
- A good test is whether the loss of the land in question would be a substantial deprivation to the reasonable enjoyment of the dwelling house, judged objectively.

HMRC's position on mixed-use

The starting point is the statutory definition of 'residential property':

'FA 2003, s 116(1):

1) In this Part "residential property" means:
   a) a building that is used or suitable for use as a dwelling, or is in the process of being constructed or adapted for such use, and
   b) land that is or forms part of the garden or grounds of a building within paragraph (a) (including any building or structure on such land), or ...'

Immediately, one can see from the wording in (b) that the definition concedes the possibility that not all the land sold with a dwelling might form part of its garden or grounds, and so might not be residential property. Unfortunately, the definition does not offer much assistance in deciding what part of the land sold with the dwelling will be garden or grounds and what part might not be and so might not be residential property.

This statutory definition was derived from, and is identical to that in, FA 2001, s 92B, which introduced the definition of residential property into the stamp duty regime. This definition became necessary when the

£150,000 limit for the exemption on land in disadvantaged areas was removed from non-residential land but retained for residential land from 10 April 2003. This allowed land that was still subject to the £150,000 limit to be identified. When land in a disadvantaged area was sold and some of it comprised a dwelling, for the exemption it was necessary to apportion the consideration so that the consideration attributable to the dwelling and its garden or grounds was subject to the £150,000 cap, and the consideration for the rest of the land was uncapped.

So, the definition was written to allow for the possibility that there might be sales of dwellings with land if some of the land was classed as residential and some might not be. At that time, the Inland Revenue published guidance on the meaning of the definition in Statement of Practice 1/03:

> '30. Section 92B(1)(b) includes within the definition of residential property "land that is or forms part of the garden or grounds of a building within paragraph (a) (including any building or structure on such land)". The test the Inland Revenue will apply is similar to that applied for the purposes of the capital gains tax relief for main residences (TCGA 1992, s 222(3)). The land will include that which is needed for the reasonable enjoyment of the dwelling having regard to the size and nature of the dwelling.'

The crucial sentence is the final one stating that residential property will include land needed for the reasonable enjoyment of the dwelling, having regard to the building's size and nature. Therefore, by implication, the published guidance, allowed for land that was not so needed to fall outside the definition of residential property.

After SDLT replaced stamp duty, and the disadvantaged areas exemption was replicated in the new duty, HMRC re-issued its guidance in very similar form in SDLTM20070:

> '"Garden or grounds" includes land which is *needed* [author's emphasis] for the reasonable enjoyment of the dwelling, having regard to the size and nature of the dwelling. HMRC will apply a similar test to that applied for the capital gains tax relief for main residences (TCGA 1992, s 222(3)).'

After the SDLT disadvantaged areas exemption was withdrawn in 2013, HMRC archived the section in the *SDLT Manual* on disadvantaged areas relief, which included SDLTM20070.

However, updated HMRC guidance in SDLTM30030 ('Introduction of the 5% rate for residential property') has continued with the same approach:

> 'SDLTM30030 "Garden or grounds" includes land which *is needed for the reasonable enjoyment of the dwelling, having regard to the size and nature of the dwelling.* [author's emphasis]. This will usually be a question of fact depending on the individual circumstances of each case.'

So, for the purchase of a dwelling with a large area of land, HMRC's latest guidance continues to distinguish between

that needed for the reasonable enjoyment of the dwelling and that not so needed. The latter type of land will not form part of the residential property.

Helpfully, there are at least two cases that offer judicial guidance on whether land is needed for the reasonable enjoyment of a dwelling. Neither was decided in the context of SDLT or stamp duty but they are useful nonetheless.

The first is *Longson v Baker* [2001] STC 6, which decided that, for the purposes of the capital gains tax exemption for main residences, the test was objective and it was not objectively necessary to keep horses at a house to enjoy it as a residence. So, although it may have been desirable or convenient to have 7.56 hectares, including stabling for horses, to enjoy with the dwelling house, this was not required for the reasonable enjoyment of the building and so was not exempt from tax.

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The second is the compulsory purchase case of *Re Newhill Compulsory Purchase Order 1937, Payne's Application* [1938] 2 All ER 163, decided by du Parcq J. The issue was that land that formed part of the garden or grounds or was otherwise required for the amenity of any house could not be made the subject of a compulsory purchase order.

The judge held that the word 'required' meant not that the owner of the house would like to have open space around the house or that they would miss it if they lost it, or that someone proposing to purchase the house would think less of the house without it, but that that without it there would be a substantial deprivation of amenity that a real injury would be done to the property owner and that this was a question of fact.

A good test, therefore, is whether the loss of the land in question would be a substantial deprivation to the reasonable enjoyment of the dwelling house, judged objectively and not according to the subjective tastes or interests of the owner of the house for the time being.

Current HMRC enquiries

For many years and consistently with HMRC's published guidance, the author settled numerous disclosure letters in cases that were sent to HMRC Stamp Taxes when SDLT returns were submitted claiming Table B rates on the purchase of dwellings that included land not needed for the reasonable enjoyment of the property. Until recently, in none of those cases was there any dissent by HMRC to such claims for mixed-use treatment.

However, of late, the author has become aware of a pushback by HMRC to mixed-use claims, a response that goes against its published guidance. In enquiry correspondence on which the author has been asked to advise, HMRC has claimed that SDLTM20070 can no longer be relied on because it has been 'withdrawn' and, even if it had not been 'withdrawn', it was specific to disadvantaged areas relief and so could not be relied on generally.

This is surprising because that guidance dealt with the statutory definition of 'residential property' in FA 2003, s 116(1), which remains in effect and is applied consistently across the SDLT code. Moreover, SDLTM20070 was not 'withdrawn', as HMRC claims, but was simply archived after the end of disadvantaged areas relief.

In relation to the guidance in SDLTM30030, HMRC adopts the type of double-speak that George Orwell would have recognised. It states that, although it accepts the extract from SDLTM30030 is relevant and that 'grounds' includes land that is needed for the reasonable enjoyment of the dwelling, the term extends to all other land sold with the property unless there is a clearly identifiable non-residential use. This approach would drive a coach and horses through the published guidance that limits the scope of residential property to land needed for the reasonable enjoyment of the dwelling having regard to its size and nature because it would leave no room in which this test could function.

Honest approach?

HMRC continues to deny that its policy has changed, and last month was quoted as saying in a meeting that 'there may have been a change in compliance activity' because this area has been identified as a risk area. It is apparent to practitioners, however, that the department's approach has changed and that it is not following its published guidance.

An honest approach would require HMRC to acknowledge that it no longer wished to follow its long-standing guidance because too many taxpayers wish to avail themselves of it, withdraw it and issue new guidance. Ideally, such a change should also be backed by legislative amendment to put the change beyond doubt. Instead, taxpayers are left in an unsatisfactory and uncertain situation – one that actively discourages the making of voluntary disclosures with SDLT returns. ●

Planning point

Clients purchasing houses with a large area of land may find that HMRC will challenge claims to pay SDLT at the Table B rates with a top rate of 5% instead of the 12-15% that applies under Table A unless they can show business use before and after the sale on the surplus land.

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