Practice guide

SDLT on land assembly

Speed read

Complex SDLT issues can arise in connection with land assembly projects, not just in terms of the approach adopted by developers in order to gather in various property rights but also in the choice of acquisition vehicle used, the associated VAT treatment and (given the recent rush of residential property case law and updated HMRC guidance) what SDLT rate regime will apply. However, all of the SDLT issues highlighted in this article should be capable of being satisfactorily resolved, with smooth management of related SDLT compliance matters being achievable, if taken into account well in advance of signing legal documents.

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Land assembly can be hard to do. House builders and other developers wishing to source property rights for a development scheme may need to explore different approaches. If the development is in England or Northern Ireland, one of the implications to weigh into the choice of approach should be SDLT.

All statutory references in this article are to FA 2003, unless stated otherwise.

Land options

There are three common approaches, the first of which is the use of land options.

Options can be quite burdensome from an SDLT compliance perspective, as they tend to result in multiple land transactions. The grant of an option over land is a land transaction for SDLT purposes, distinct from the land transaction which arises on subsequent exercise (s 46(1)). Between these two events, there could be more land transactions if the option is extended or otherwise changed, or is renewed. The variation of a chargeable interest is caught under s 43(3)(c) (since the option is a chargeable interest within s 48). An assignment of an option is similarly chargeable as a land transaction.

What adds to the task is that most of these transactions tend to get entangled in the web of the linked transaction rule (s 108). The legislation says that the grant and exercise of options 'may' be linked, but HMRC guidance is closer to the mark when it says that they will 'usually' be linked (see HMRC's *Stamp Duty Land Tax Manual* at SDLTM01300). An exception may be where the option is assigned, as that may involve introducing a new, unconnected purchaser.

To grasp the workings of the linked transaction rule, bear in mind that, before the top rate of 5% applies, a purchaser of non-residential property gets the benefit of £150,000 of consideration being at nil SDLT and the next £100,000 being at the 2% rate. The difference between this and applying a flat 5% rate is £10,500 (i.e. (£150,000 @ 5%) + (100,000 @ 3%) = £10,500). The effect of transactions being linked is that this benefit is only available once across all those transactions, and therefore needs to be spread between them proportionally.

The recently updated HMRC guidance examples (in SDLTM01300A and SDLTM01300B) show how the SDLT on the option grant gets recalculated if and when the option is exercised. We have seen cases where purchasers submit two notifications (rather than the three usually required), but still pay the right overall amount of SDLT. This pragmatic but technically incorrect approach may be less likely to be excused now that the manual has been updated so clearly.

However, even these useful examples in the guidance do not tackle the more complex calculations where the grant was before 17 March 2016 or concerns residential property within the 3% surcharge (Sch 4ZA). In those two cases, the grant and the exercise of the option fall into different rate regimes – and the maths gets much harder!

In conclusion, land options are good for taking control of the ownership rights over a scheme but, as regards to SDLT, they can create a significant amount of housekeeping.

Conditional agreements

The second approach to sourcing scheme land is to go directly to a conditional purchase contract. The conditions are included to deal with scheme uncertainties, such as securing other necessary land ownership, any funding needed for the project and, above all, planning permission.

As a result, it is likely that more of the commercial and legal detail will need to be front-ended. By contrast, the SDLT side of a purchase agreement can be relatively simple, usually making fewer, less immediate compliance demands than options do.

A purchase usually generates only a single land transaction. This is because entering into a contract to purchase or to lease – even if unconditional, such that its effect under English law may be for the purchaser to get beneficial ownership – does not itself cause a land transaction for SDLT purposes (s 44(2)). That will usually only happen when legal title is conveyed on completion (s 44(3)). In addition, having a purchase agreement in place is generally enough to lock-in current rates of SDLT and so, subject to exceptions (for which see *Ladywalk LLP* v *HMRC* [2020] UKFTT 207), limit the risk of any future rate rise applying to the transaction.

But there is an occurrence that can disrupt the smooth running of the SDLT. This is where the developer takes possession of the site, or substantially all the site, ahead of completion. Under an anti-avoidance provision, essentially put in place to prevent SDLT being susceptible to the old stamp duty practice of resting on the effect of the contract and freezing legal title in tradeable nominee companies, the tax point is brought forward to the time of 'substantial performance' (s 44(4)). Substantial performance includes paying all or substantially all the consideration, but the possession trigger is the one more relevant to developers eager to get on site.

As a legal concept, 'possession', even if not needing to be exclusive, may be quite narrow. But it is likely that any sort of licence to occupy (rather than merely obtaining access for a specific purpose and subject to controls around notice, times etc.) could amount to possession. Also, HMRC says entry by a future tenant for fit-out is taking possession (SDLTM07900) and HMRC is probably going to see starting other site preparations, such as clearing and putting in hoarding, no differently. Further, substantial performance could be triggered even if possession is taken for a short time and then handed back. Finally, developers carrying out works on site for the vendor's benefit will not wish to argue a narrow meaning of possession since works carried out before substantial performance do not fall within a specific SDLT exclusion otherwise usually available (Sch 4 para 10).

By itself, acceleration of the tax point is not generally an issue, but three complications can follow. One is relevant to developers who may want to share exposure to the scheme. This may be through a joint venture, passing part of the scheme to another developer or a forward funding agreement with, for example, a build-to-rent fund. It may be possible to claim SDLT relief for such arrangements (Sch 2A paras 15, 16). However, that route is generally blocked if substantial performance occurs before the onward transaction is put in place.

A second concern is where substantial performance has occurred – and SDLT has accordingly been paid – but some years later the contract terminates because, say, the conditions are not met. The developer will reasonably expect to be able to recover the SDLT relying on a provision in the SDLT legislation to do so by way of amendment of the return (s 44(9)). However, HMRC has argued that the general time limit of one year to amend a return (Sch 10 para 6) operates here. This argument effectively succeeded in *Portland Gas Storage Ltd* v *HMRC* [2014] UKUT 0270 but it was apparently overruled in *Smallman* v *HMRC* [2018] UKFTT 680. However, *Smallman* has been seen by many as technically unsustainable (broadly, because it relied on a relief for mistakes where there had been no mistake; Sch 10 para 34) and, in any event, only extended the time limit to four years. This is why the recent decision in *Candy* v *HMRC* [2020] UKFTT 0113 is so welcome. It held that the reclaim was within an exception provided in para 6(3) such that there is no time limit. We do not yet know whether HMRC is appealing.

The third potential problem with substantial performance is that it leaves a trap for developers paying overage. There is a sensible procedure for SDLT on overage to be deferred (s 90). This is already widely used but may become more so if the present climate of very uncertain asset valuation leads to an even greater use of overage arrangements. However, the purchaser only has 30 days from the tax point to apply for the deferral (SI 2003/2837, reg 11). If the tax point has been accelerated as a result of substantial performance, this deadline can be easily missed.

In conclusion, conditional contracts are generally speaking a more sophisticated route than options, but are easier to deal with from an SDLT perspective. This may, however, depend on the contract not being substantially performed before completion.

Local authorities

A third way for a developer to source land is through local authorities. The planning department of local authorities will, of course, always be involved but it is quite common for the local authority to be called upon to play a role as a property owner too.

This is primarily because of its ability to acquire land by compulsory purchase order (CPO). This method of compulsory acquisition is the most widely used since it is open to the majority of bodies possessing statutory powers. Additionally, passing ownership through a local authority can help a developer deal with the rights to light of adjacent owners. Under the Housing and Planning Act 2016 s 203, the fact of acquiring through a local authority may enable the developer to prevent injunctive action to block the development. This ability may have become increasingly relevant as the number of high rise build projects has increased.

There is, under s 60, an SDLT relief for an acquisition under CPO powers, but it is important to know its limits. This relief will be of direct interest to the developer who can expect to write an indemnity for costs incurred by the local authority.

The key requirement for s 60 is that, although the acquisition itself can ultimately be by private treaty rather than through implementation of the CPO (except in Northern Ireland), a CPO still needs to have been 'made'. Our understanding is that this means the local authority submitting a prescribed form to central government for approval of the CPO (although it is at least not necessary to wait for approval before it is regarded as 'made' for s 60).

The problem here is that taking this approach does not fit well with wider policy. Guidance from the Ministry of Housing, Communities & Local Government (*Guidance on compulsory purchase process and the crichel down rules*, see bit.ly/3dbzDkV, updated in July 2019) appears to be to turn to CPOs as a 'last resort' for cases where it is 'expedient' or there is a 'compelling case in the public interest'. Whilst there is also some acknowledgement of the value of initiating formal procedures as a contingency given the time they can take and in order 'to make the seriousness of the authority's intentions clear', many authorities might still feel uncomfortable bringing forward a CPO given the preceding words. Further, making CPOs is understood to be relatively complex (requiring notice to a number of parties for instance).

We know that HMRC is aware of this policy disconnect. Indeed, some suggest that HMRC might therefore be willing to take the view that a CPO is made earlier, for instance, when the local authority resolves to make a CPO, rather than actually makes it. However, HMRC does not mention such a relaxation in its guidance on s 60 (SDLTM22010) and, in any event, such an approach might, if pure concession, not be within HMRC's gift.

Section 60 relief depends on the property being transferred or leased on by the local authority. The CPO must be for 'facilitating development by another person', and that condition would seemingly not be met unless ownership subsequently passes to the developer. As HMRC notes, the relief is only there to prevent the local authority paying SDLT, not the developer.

This is reasonable, but what is a little harsh for the developer is that it can end up with more SDLT than it would have had on a direct acquisition. This is primarily because the reimbursement of the council's various costs (for example, compensation payments for disturbance) may be seen as part of the price paid by the developer for the property and therefore chargeable consideration for SDLT. In this regard, HMRC says that compensation for disturbance payable by the local authority is not chargeable consideration (SDLTM03710) but, when reimbursed to the local authority by the developer, the amount might not retain this non-chargeable character. It could, it seems, still be chargeable consideration for the developer's own acquisition (along with other reimbursements of expenses made to the authority).

Another unwelcome SDLT consequence of acquiring through the local authority is the linked transaction rule can work against you. Whereas multiple direct acquisitions from non-connected vendors are not linked (and each significant acquisition should be able to access the £10,500 benefit discussed above), the benefit is largely lost if the properties are consolidated into a local authority first.

In conclusion, whilst a developer might hope to obtain the advantages of a local authority taking ownership rights without that prejudicing the overall SDLT position, the reality is that this approach does generally introduce some marginal extra SDLT cost. Also, perhaps depending on how far the authority is willing or able to progress CPOs, there is risk of s 60 not applying and therefore of double duty.

Acquisition vehicle

It is also worth considering some other aspects of land assembly which could directly affect or concern SDLT. The aspects are choice of acquisition vehicle, VAT treatment and which SDLT rate regime to apply.

The default for some developers is to use a captive LLP to make the acquisition rather than a group company. Their experience has been that this makes it easier to introduce housing associations and other co-investors requiring a direct tax transparent holding entity.

What works well here is that an interest in a house-builder partnership should not usually incur SDLT so the co-investor can be brought in SDLT-free even after the partnership has got the property. This is because house builder partnerships do not typically get classified as a ‘property investment partnership’ within Sch 15 para 14 (SDLTM34010). Also helpfully, HMRC agrees that, at least where the LLP has remained wholly owned by house builders, the relief for house-building ‘companies’ entering into part exchanges with customers can still apply (Sch 6A para 1).

VAT treatment

Although any VAT itself might be recoverable by the purchaser, SDLT on VAT is not. If the vendor has a business in respect of the land (for example, if the land is let), the acquisition may be capable of being a transfer of a going concern (TOGC) and therefore not a supply for VAT purposes.

Generally, any supply of land for VAT purposes would be exempt from VAT unless the vendor has effectively opted to tax the land. If the vendor has not already opted to tax then the purchaser could ask the vendor to refrain from doing so. If any irrecoverable VAT of the vendor, as a result of the sale, would be less than the 1% SDLT increment (being 5% of 20% VAT) then such VAT cost could be reflected in the price.

It is also possible that the liability of the vendor’s supply might change over time. With overage, for example, payments create further supplies. If dwellings have been constructed on the land, VATA 1994 s 96(10A) and Sch 10 para 5 may mean that any vendor’s option to tax may be ineffective. HMRC’s view is unclear, but it may be that such overage payments would be exempt from VAT and hence the SDLT on that overage would be unaffected.

Rate regime

Most developers will make the assumption that their acquisitions will be chargeable at the 5% rate for non-residential properties under Table B in s 55. Thanks to two rules in particular, this generally holds true even if the subject-matter includes some residential elements. First, only one part of the subject-matter of the transaction, or indeed linked transactions, needs to be non-residential for the 5% rate to apply across the whole transaction under the mixed use rule. Secondly, six or more separate dwellings acquired in a single transaction counts as non-residential under a so-called ‘six-pack’ rule (s 116(7)).

However, both of the above rules are subject to exceptions and, as has been explained in this journal (‘SDLT on purchase of site for development’ (Marc Selby), *Tax Journal*, 6 October 2017), a number of acquisitions may not fall under Table B. If the mixed assets includes a dwelling worth more than £500,000, a 15% flat rate can theoretically apply, albeit that a long list of exemptions includes one which should apply to most developers carrying on a property development trade (Sch 4A para 5(1)(b)).

And the effect of the ‘six-pack’ rule (i.e. the 5% rate) can in some cases be bettered by electing into the relief for multiple dwellings under Sch 6B. A 3% rate might be available, although to note that a 1% rate is theoretically available if the surcharge (in Sch 4ZA) does not apply. This will also be subject to the new 2% surcharge due next year and expected to affect developers controlled by non-residents.

At some point therefore, many developers will need to consider the possibility of residential rates applying, and accordingly engage with the question of what counts as a single dwelling, including its garden and grounds (s 116). Marc Selby’s 2017 article was prescient about this becoming increasingly contentious as, quite suddenly, we have lots of relevant cases to consider. These include *Bewley* v *HMRC* [2019] UKFTT 65, *Hyman* v *HMRC* [2019] UKFTT 469, *Goodfellow* v *HMRC* [2019] UKFTT 750, *Pensfold* v *HMRC* [2020] UKFTT 116, *Myles-Till* v *HMRC* [2020] UKFTT 127, *Fish Homes* v *HMRC* [2020] UKFTT 180 and *Fiander & Brower* v *HMRC* [2020] UKFTT 190.

It is difficult to draw these cases into a single thread, but one theme is the importance of the circumstance existing at the time of completion (see para 54 of *Pensfold*, para 46 of *Myles-Till* and para 66 of *Fiander & Brower*). Indeed, HMRC has recently amended guidance around two of the definitions of dwelling to stress that it is not a future looking test, such that a mere intention to build homes is not enough (SDLTM09520 and SDLTM09750). That action may be aimed at managing taxpayer expectation in relation to the availability of multiple dwellings relief, which is an emerging area of contention (*Troy Homes v HMRC* [2020] UKFTT 174).

However, there is a subtle de-emphasising of that principle where a developer believes that the condition of an empty house has deteriorated to the extent it is no longer suitable for use as a dwelling. HMRC’s view here may be that, in a sense, this test is ‘future looking’. They say that, to decide whether a house is habitable, some future work may be supposed, provided it does not change the ‘structural nature of the property’, and that can go as far as putting in a kitchen or bathroom (SDLTM00385). This may be right but, as was said in *Fish Homes*, there is a difference (even if only a slim one) between a building being suitable for use as a dwelling and being capable of such use. ‘Capable’ could import some adjustment but ‘suitable’ meant evaluating the property in its ‘present condition or facilities’ (para 58).

In this and other areas discussed in this article, the number of cases and guidance updates over just the last few months is striking. They will need to be absorbed by advisers acting on property transactions but particularly those involved in land assembly. ■

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- SDLT on purchase of site for development (Marc Selby, 6.10.17)