

INTRODUCTION TO STAMP DUTY LAND TAX

by Michael Thomas

Introduction

From 1 December 2003 stamp duty on land transactions will be abolished and replaced with stamp duty land tax (“SDLT”). The figures amply demonstrate the importance of the new tax: in 1996-97 stamp duty on land raised £1058 million, for 2002-2003 the figure is £5010 million. SDLT is expected to increase revenues still further and raise in excess of £5 billion, which is more than inheritance tax and capital gains tax combined. Accordingly, SDLT will have huge practical importance for all advisers involved in land transactions. This article is in two parts: in this issue I will introduce SDLT and highlight the major changes from stamp duty. Next month I will address how SDLT will impact upon private client practice with particular reference to how the new tax applies to trusts.

A New Tax

The name “stamp duty land tax” might be thought to imply that SDLT is merely a modernisation of stamp duty on land transactions. This would be a dangerously misleading assumption to make because SDLT, although born out of stamp duty, is a new tax in its own right. Stamp duty is a charge on

instruments whereas SDLT is charged on all land transactions whether or not recorded in a document. There is no longer any requirement to stamp documents under SDLT and the new tax might more appropriately have been named “land transaction tax” because in reality that is what it is.

Retaining the words “stamp duty” in the name does serve the purpose of indicating the origin of the new tax. Like its predecessor, SDLT is intended to be charged on the purchaser on sales of land as a percentage of the purchase price. The only change in the rate of tax is the increased nil rate band threshold for non-residential property of £150,000. Moreover, the new tax is derived from stamp duty and many of the provisions, especially some of the reliefs, have been re-enacted for SDLT. Other provisions, and arguably the new tax as a whole, have been enacted in order to prevent stamp duty planning techniques from being used in SDLT. Nevertheless, SDLT differs fundamentally from stamp duty because not only is the charge to tax founded on an entirely new set of concepts but it is also directly enforceable against the purchaser under a strict new self-assessment regime.

The Purpose of SDLT

In order to understand SDLT it is necessary to know what it is designed to achieve. Like all new taxes, SDLT is intended to raise additional revenue for the government. There are three main ways in which SDLT is designed to achieve this. First, SDLT is designed to close down what, in the Revenue’s

view, were loopholes in the old stamp duty provisions which were being exploited for planning purposes. Secondly, SDLT is now directly enforceable through a self-assessment regime which requires the purchaser to make a return within 30 days of a land transaction accompanied by the tax due. Thirdly, SDLT introduces a new charge on rental leases levied up front by reference to the value of the rental stream over the full term of the lease (in place of the old stamp duty charge on the average annual rent) which is anticipated to raise an additional £200million per year.

The Charge to SDLT

The SDLT code is contained in the Finance Act 2003 (“FA 2003”). Stamp duty, SDLT’s predecessor, was last consolidated in 1891 and reform has been long overdue. However, the new code does not consolidate stamp duty but instead introduces an entirely new basis of charge. Whereas stamp duty was levied on instruments, SDLT is charged on land transactions however effected, including transactions not recorded in writing and those taking effect by operation of law.

A land transaction is defined as the acquisition of a chargeable interest in land. The concept of a chargeable interest includes all rights and powers over land both legal and equitable but not licences and creditors’ charges. Chargeable acquisitions include the creation and surrender of chargeable

interests and remain taxable even though there may be no written instrument and whether or not the parties are present in the UK.

Like its predecessor, SDLT is charged on a percentage of the purchase price and payable by the purchaser. What counts as chargeable consideration is defined very widely and includes consideration in money's worth. No discount is available if the consideration is only payable on a contingency, although an adjustment can be made if it subsequently turns out not to be payable. The old stamp duty rules that an assumption of debt counts as chargeable consideration and, very importantly, that a transfer to a connected company is deemed to take place at market value are re-enacted for SDLT.

The rates of tax are the same as for stamp duty except that there is an increased nil rate band for commercial property of £150,000. Surprisingly, for what is meant to be a modern tax, there is no tapering of rates; instead they rise when they hit a particular figure, aptly known as the slab effect. The reason for this is that the government would have needed to increase rates to compensate for a taper in order to achieve the same yield. As under stamp duty, the consideration for a number of linked transactions is aggregated for the purposes of determining the tax rate; although the new rule is more widely drafted than the old stamp duty provision.

The FA 2003 contains special charging provisions dealing with certain particular transactions. These are designed to prevent the sort of planning that

was used commonly being used for stamp duty. Most importantly, a sale of land requiring a separate conveyance is now chargeable on the earlier of completion or substantial performance. Substantial performance occurs on the earlier of the payment of substantially the whole of the purchase price or the purchaser taking possession: in other words, once either party has received what it bargained for. Accordingly, it will no longer be possible to rest on contract to avoid SDLT. Similarly, sub-sale relief is only available where the original contract is not substantially performed. Much current planning is concerned with seeking to utilise the ability to rest on contract and take advantage of sub-sale relief on a subsequent sale. Structures designed to achieve this, commonly known as split-title arrangements, must be established before 1 December 2003 in order to be effective under the transitional provisions.

Structures involving options have been popular in stamp duty planning, although there are differences of opinion as to how effective these structures are. Under SDLT section 46 FA 2003 removes any doubt by providing that the grant of an option over land not within the general charge is chargeable under that section. Section 47 FA 2003 provides that an exchange is now taxable as two sales. Accordingly, it is no longer possible to structure an exchange as a single sale of the more valuable land.

The new charging provisions mark the end of much of stamp duty planning but only the beginning of SDLT planning. The present stamp duty

planning boom may be at an end but SDLT is such a large transaction cost that finding ways to mitigate it will be extremely important. As the nature of the charge has changed so will the nature of the planning.

New Compliance Regime

Stamp duty's biggest weakness, arguably, was that it was not directly enforceable. Conversely, the most important practical change brought about by SDLT is the rule that tax is directly enforceable and must be self-assessed and paid by the purchaser within 30 days of the land transaction. Where a contract is substantially performed before it is completed then substantial performance will trigger the 30-day window. For example, if before completion a purchaser takes possession of the premises under a licence in order to renovate them then that will trigger the obligation to make a return.

A land transaction return may have to be made even though no tax is payable because the taxpayer is claiming a relief. Although there is no obligation to stamp documents, the Land Registry will require either a certificate of compliance from the Revenue or a self-certificate from the taxpayer stating that a land transaction return is not required. If the land transaction return is not submitted in time then the taxpayer becomes liable for a penalty. In addition, the Inland Revenue is given a whole raft of powers equivalent to those in the Taxes Management Act 1970. These provisions will be familiar to readers specialising in tax.

Following submission of the return the Inland Revenue has a 9-month window in which to raise an enquiry. Taxpayers must keep records for 6 years following a transaction. If, following an enquiry, the parties do not agree on the correct amount of tax due then the taxpayer must appeal to either the General or Special Commissioners. There is no longer a special adjudication procedure although the Revenue may agree to give rulings on particular transactions.

The Charge on Leases

The old stamp duty charge on the average annual rental value of a lease is abolished. For SDLT the rule is that leases are charged by reference to the value of the future rental stream at the time of grant. The value of the rental stream is to be determined according to a statutory formula and tax is levied at 1% on that value. Although the FA 2003 has been passed the charge on leases is subject to ongoing consultation and it is likely that, as a political concession, the government will make some small changes to the formula. Nevertheless, the principles behind the charge are unlikely to change. The result will be a sharp increase in the amount chargeable on a lease. For example, a ten year lease at an annual rent of £50,000 would be chargeable to £4,148 SDLT in comparison to only £1,000 stamp duty, a four-fold increase is fairly typical. It may be that there will be more to say on this next month because the law should be confirmed soon.

Exemptions and Reliefs

The SDLT reliefs are based on the old stamp duty provisions. The major reliefs are retained, although group relief, reconstruction and acquisition reliefs and charities relief are all now subject to clawback provisions designed to prevent them being exploited for tax planning purposes. Several new reliefs are introduced by SDLT. These are, in general, narrowly targeted and several, such as the relief for purchases made by house building companies in part-exchange, are designed to compensate for the abolition of sub-sale relief and the ability to rest on contract. Transactions not made for chargeable consideration are exempt and there is no equivalent charge to the £5 fixed stamp duty. In the next issue I will consider in more detail some of the reliefs of particular interest to private clients.

Commencement and Transitional Provisions

The new SDLT regime is scheduled to take effect from 1 December. However, the FA 2003 is already in force and it is necessary to consider the transitional provisions when advising, especially if any element of the transaction will take place after 1 December. Transactions completed after 1 December are generally chargeable to SDLT.

There is currently an exception from SDLT for transactions involving acquisitions and disposals of partnership interests including where a partner transfers land to or from a partnership resulting in an alteration of her partnership interest. New legislation on the application of SDLT to

partnerships is scheduled to follow in the near future. Other areas are subject to ongoing consultation, the most important being the application of SDLT to leases as mentioned above.

Conclusion

SDLT is an important new £5 billion tax enforceable through a tough compliance regime. The new charging provisions also negate the effectiveness of many of the planning techniques which have been used in the past to mitigate stamp duty. Whereas ten years ago stamp duty was perhaps often an afterthought, SDLT will now be a priority when advising on any transaction involving land. Moreover, SDLT is such an important transaction cost that the FA 2003 is only the beginning as far as SDLT planning is concerned. Next month I will discuss more specific points of interest to private client practitioners with particular emphasis on the operation of reliefs and how SDLT applies to trusts.

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Suggested Bullet Points

- From 1 December 2003 SDLT, a new £5 billion tax, takes effect
- SDLT is directly enforceable through an onerous self-assessment regime
- SDLT abolishes many of the old stamp duty planning techniques, new planning will evolve in its place
- SDLT is a priority to consider when advising on any transaction with a land element