

# Complex rules

Indirect Tax



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*Ginny Offord* gives an overview of the SDLT implications for incorporating a buy to let property portfolio

## Key Points

### What is the issue?

The SDLT rules for residential property transfers are extremely complex. Seemingly straightforward transactions can have surprising results.

## **What does it mean to me?**

The SDLT implications of incorporating a buy-to-let property portfolio will depend on a number of factors, including how the properties are held, the number of properties to be transferred, and the future intentions for holding the properties via a corporate structure.

## **What can I take away?**

There are a number of factors that must be taken into account when considering incorporating a property portfolio; being aware of these issues before incorporation can help avoid potential bear traps.

Though some benefits may have been removed, holding a buy-to-let property portfolio via a company is still an attractive investment model for reasons including lower rates of corporation tax, and full mortgage interest deductions, which is being phased out for individuals.

There have been a number of changes to the stamp duty land tax ('SDLT') regime recently, and incorporating a residential property portfolio, and the manner in which this is achieved, can produce surprising SDLT results. It may also bring your property portfolio within the scope of the annual tax on enveloped dwellings ('ATED').

This article looks only at the SDLT implications of property transfers taking place in England, Northern Ireland, and, for the time being, Wales. Property transfers in Scotland will be subject instead to land and buildings transaction tax, and from 1 April 2018, property transfers in Wales will be subject to land transaction tax.

## **Individual to connected company**

The SDLT impact on incorporation will largely depend on how the property is held by the investors.

Let's look first at where the property is held directly by individuals.

Though seemingly a straightforward transaction, there are a number of points to bear in mind which will affect the SDLT payable on the transfer of residential property from an individual to a company:

- Where property is transferred from an individual to a connected company, the consideration deemed to have been payable for the transfer will be no less than the market value of the property. It will not be possible to reduce your SDLT charge by transferring at an under-value.
- The additional 'surcharge' rates of SDLT, which are 3% higher than the basic 'homeowner' rates, will apply to the transfer (unless the property is valued under £40,000 or subject to a long lease). The rates apply to all residential acquisitions by companies, including the first purchase, and no reliefs are available. There are, however, a few exceptions:
  - Where a transaction is comprised of both residential and non-residential use, then the non-residential rates of SDLT should apply to the entire transfer - there is no apportionment rule for SDLT.
  - Where six or more residential properties are transferred as part of a single transaction, the non-residential rates of SDLT should apply to the price payable.
  - Finally, where two or more properties are being transferred, it may be possible to make a claim for multiple dwellings relief ('MDR'). The relief calculates the amount of SDLT payable (subject to the surcharge rates) by reference to the average value of the properties transferred. Where six or more properties are to be transferred, one should calculate whether it would be beneficial to treat the properties as non-residential, and pay the generally lower non-residential rates of SDLT on a higher aggregate purchase price, or to claim MDR and pay the generally higher surcharge rates of SDLT, but on a lower average purchase price.

### **Let's look at some examples:**

1. Mr A holds six buy-to-let properties. He wishes to transfer them to a company held 100% by him. The aggregate value of the properties is £1,500,000. Ordinarily, a transfer of residential property valued at £1,500,000 from an individual to a connected company would incur a charge to SDLT of £138,750. However, as six properties are transferred as part of a single transaction, and applying the non-residential rates, the SDLT due would be £64,500. Should a claim for MDR be made instead, SDLT would be calculated on the average price of the properties transferred (£250,000), which would produce a charge of £60,000. Accordingly, it would be beneficial to make a claim for MDR.

2. If we take the above example, but increase the aggregate property value to £2,500,000, the total amount of SDLT due if the properties were deemed to be non-residential would be £114,500.

However, if a claim for MDR was made, the SDLT charge would be £139,998. In this instance, it would be beneficial to deem the properties to be non-residential. This highlights the effect of the surcharge rates of SDLT on higher value residential properties.

3. Ms B owns five buy-to-let properties in Mayfair. She wishes to transfer them to a company held 100% by her. The aggregate value of the properties is £30,000,000.

As only five properties are transferred, it will not be possible to apply the non-residential rates to the transfer. An application for MDR could be made instead, which based on the average property value of £6,000,000, would produce a charge to SDLT of £4,068,750.

However, should Ms B have held six properties, with an aggregate value of £36,000,000, the properties would have been deemed to have been non-residential, and the total amount of SDLT due would have been £1,789,500. Therefore Ms B could have paid significantly less SDLT even though she transferred more properties for a higher aggregate value.

One important note to bear in mind is the higher 15% rate of SDLT, which applies where a company acquires a single-interest dwelling valued over £500,000 unless for qualifying business purposes. Where it applies, SDLT at a flat rate of 15% will apply to the entire value of the property transferred. Relief should be available where the properties are held as buy-to-let investments; however, should the company cease to hold the properties for this purpose within three-years of the date of the transfer, further SDLT may be become due.

4. Mrs C holds one buy-to-let property, valued at £2,000,000. She wishes to transfer the property to a company held 100% by her.

Claiming relief from the 15% rate, the SDLT due on this transfer would be £213,750. Had relief not been available (e.g. had Mrs C intended to occupy the property), the total amount of SDLT due would have been £300,000 (£2,000,000 at 15%).

Two years later, the property becomes vacant, and Mrs C wishes to occupy the dwelling. The relief from the 15% rate originally claimed would be withdrawn,

and the amount of SDLT payable on the transfer recalculated. Accordingly, once the company ceases to use the property as a source of rents, further SDLT of £86,250 would become due (£300,000-£213,750).

## **Partnership to connected company**

Next, let's look at the SDLT implications on transferring a buy-to-let portfolio where the properties are held by a partnership.

Where property is being transferred from a partnership, the transaction will fall within special charging provisions. Accordingly, any actual consideration provided for the transfer is disregarded, and the consideration deemed to have been payable for the transfer will be calculated in accordance with the following formula:  $MV \times (100 - SLP)\%$

Where 'MV' is the market value of the interests transferred and 'SLP' is the sum of the lower proportions. Broadly, the SLP is calculated by reference to the partnership shares held by any partners that are connected for tax purposes to the acquiring company.

5. Mr D and Miss D, who are siblings, hold the interests in a general partnership, 50:50. The partnership holds six buy-to-let properties with an aggregate value of £2,500,000. They wish to transfer the properties to a company in which they are each 50% shareholders.

The SLP should be 100, and the chargeable consideration would be calculated as follows:

$$\mathbf{£2,500,000 (MV) \times (100 - 100)\% = £0}$$

Accordingly, no SDLT should be due on this transfer.

6. Mrs and Mrs E, who are spouses, hold the interests in a general partnership, 50:50. The partnership holds 10 buy-to-let properties with an aggregate value of £10,000,000. They wish to transfer the properties to a company in which they are each 35% shareholders. The remaining 30% of the shares are held by Ms F, a third party investor.

Using the above formula, the SLP should be 70, and the chargeable consideration would be £3,000,000. The consideration is not fully reduced to nil, as Ms F is not a partner in the partnership.

Once the consideration is calculated, the SDLT due should be calculated in the

normal way. As 10 properties are being transferred as part of a single transaction, the properties should be deemed to be non-residential, and the SDLT due would be £139,500.

If a claim for MDR was made, SDLT would be calculated on the average price of the properties transferred (£300,000), which would produce a charge of £14,000. Multiplying this figure by the total number of properties to be transferred, would result in a total charge to SDLT of £140,000.

The above examples assume that a partnership exists between the individuals to begin with. Whether or not a partnership exists is a matter of law; however it is possible for individuals to be in partnership together without formally entering into a partnership agreement. Broadly, for a partnership to exist, the individuals must be '*carrying on a business in common with a view to profit*', i.e. there must be active day-to-day management of the buy-to-let business – passive investment activity would not be sufficient.

Given the potential SDLT savings that can be achieved when transferring property from a partnership to a connected company, investors may be tempted to transfer their property to a partnership and subsequently from the partnership to a connected company. However, such transactions are likely to fall foul of the widely drafted SDLT anti-avoidance provision at FA 2003 s 75A.

Broadly, the provision applies where a number of transactions ('scheme transactions') are 'involved in connection with' the acquisition of property. It seeks to charge the SDLT that would be payable on a notional transfer to the ultimate transferee (the connected company) by reference to the highest aggregate amount of consideration paid or received by any party to the scheme transactions, where that results in more SDLT being payable. Accordingly, where the provision applies, the transaction should be regarded as a direct transfer from the individual to the connected company, and SDLT charged accordingly (on not less than 100% of the market value of the properties transferred). Where s.75A FA 2003 applies and an SDLT return is not filed on this basis, tax-gearred penalties can be enforced by HMRC, who would have a 20-year window to make an assessment to recover the loss of tax.

## **ATED**

It is not just the SDLT implications of transferring the property into a company that must be considered. Once the property is held by the company, ongoing ATED

obligations must also be taken into account.

ATED is an annual charge that applies where a company holds a dwelling valued over £500,000. The amount of charge payable depends on the value of the property held, e.g. a property valued at £1,500,000 would incur a charge of £7,050 for the chargeable period 1 April 2017 to 31 March 2018.

There are a number of reliefs available. In the context of buy-to-let portfolios, relief is available where the properties are being exploited as a source of rents in the course of a qualifying property rental business.

Relief will be denied if there is any 'non-qualifying occupation' during the company's ownership of the property. This would be the case, broadly, if an individual connected to the company was *permitted* to occupy the property. Where such occupation occurs, the relief will be withdrawn in respect of that period and, broadly, for any periods preceding and following that occupation, until a period of qualifying occupation occurs.

7. Miss G acquired a buy-to-let property in Brighton for £1,500,000, via her holding company on 1 April 2017. An ATED relief declaration return was filed, claiming relief from the £7,050 charge that would otherwise have applied for the ATED year 1 April 2017–31 March 2018.

The property was let-out from 1 April 2017 to 30 September 2017. Once vacant, Miss G allowed her brother to use the property for any trips he made to Brighton, which he did for one night in November. The property was then let-out to new tenants from 1 December 2017 onwards.

As Miss G permitted her brother to occupy the property from 1 October to 30 November 2017, 'non-qualifying occupation' would have occurred, and the relief previously claimed in respect of this period would be withdrawn, even though he only occupied the property for one night! An amended ATED return would be required, and £1,178 (the proportion of the £7,050 annual charge allocated to the period 1 October 2017 – 30 November 2017) payable.

## **Conclusion**

The SDLT rules for residential property transfers are extremely complex, and how a transaction is structured can have a significant impact on the amount of tax

payable, especially in the context of incorporations. Specialist advice should be sought at an early stage to prevent an under or over payment of tax being made.