

Residential property for SDLT purposes (Lecture B1395 – 19.02 minutes)

The rate at which SDLT is charged on consideration other than rent depends on the amount of the chargeable consideration, and whether the transaction is a residential property transaction or a non-residential property transaction.

The legislation defines what is meant by 'residential property' and then everything else is non-residential. Mixed use property is non-residential.

Therefore, an incentive exists to try and get some of land purchased outside of the definition of residential property.

It is an important distinction for the following reasons:

- The rates are intrinsically higher for residential property;
- Residential property can be subject to the 3% supplement for additional dwellings;
- Residential property can be subject to the 2% supplement for non-resident purchasers; and
- Residential property can be subject to the 15% ATED-linked SDLT rates.

Residential property is defined as follows:

- (a) a building that is used or suitable for use as a dwelling, or a building which is in the process of being built or adapted for use as a dwelling; and
- (b) land that is or forms part of the garden or grounds of a building falling within (a) above, including any building or structure on such land; or
- (c) an interest in or right over land that subsists for the benefit of a building falling within (a) above or for the benefit of land falling within (b) above – for example, access rights across adjacent property.

The definitions of residential property and non-residential property are subject to the rule which provides that where six or more dwellings are acquired as a 'single transaction' then the dwellings are treated as not being residential property. However, it may be more beneficial to claim multiple dwellings relief in this situation and it is possible to do that.

The status of a house or flat as a dwelling is usually obvious. However, there will be other situations where it is not clear as to whether a building is suitable for use as a dwelling, eg when the building is derelict, or where it is used for purposes other than those of a dwelling etc.

Starting with the first part of the definition, a transaction will be a residential property transaction if it comprises the acquisition of a building which is used or suitable for use as a dwelling, or the acquisition of a building which is in the process of being built or adapted for use as a dwelling. The term 'dwelling' is not defined in the legislation and must therefore take its everyday meaning, being 'a building, or a part of a building that affords those who use it the facilities required for day-to-day private domestic existence and a significant degree of permanence'. It also includes buildings under construction where there is evidence to show that it is being built or adapted for use as a dwelling.

However, planning permission to convert to a dwelling is not sufficient if the work has not commenced.

HMRC have confirmed that it is not necessary for the sellers or previous occupants of the building to be in residence on the 'effective date' of transaction for the property to be considered 'in use' as a dwelling. If it is not in use, then HMRC will typically consider the last use.

One argument that is sometimes made is that whilst a property has been a dwelling in the past, it is no longer habitable as such due to dereliction. However, HMRC make a clear distinction between a derelict property and a dwelling which is essentially habitable, but which is in need of modernisation, renovation or repair, which can be carried out without materially changing the structural nature of the property.

This has been confirmed in recent case law which treated a property as residential even though it was acknowledged that some (quite significant) work was needed before the purchasers could actually live in it (*Amarjeet Mudan and Tajinder Mudan v HMRC* [2023] TC08777). The judge was also clearly influenced by the fact the house had previously been occupied as a dwelling.

Another interesting case is that of *Fish Homes Ltd v HMRC* [2020] UKFTT180 where the taxpayer company acquired a two-bedroom flat in Greenwich but subsequently found that the flat was in a block which was covered with cladding similar to that used on the Grenfell tower block. The taxpayer company argued that the acquisition of the flat was not a residential property transaction because the danger created by the cladding meant that the flat was not suitable for use as a dwelling. However, their argument was slightly hampered by the fact that the shareholder's daughter and one of her friends did, in fact, occupy the flat after the purchase. Whilst it could not be rented to a third party it was found that the flat was a dwelling.

If a building falls to be treated as residential property, then any land that is or forms part of the garden or grounds of such a building (including any building or structure on such land) will also be residential property.

If any land acquired along with the building is not 'garden or grounds' of the building, and there is no building on that land that is used or suitable for use as a dwelling, or is in the process of being constructed or adapted for such use, the land will not be residential property, the transaction will, therefore, not consist entirely of the acquisition of residential property, and the lower non-residential property SDLT rates will apply to the transaction.

For the purposes of SDLT there is no statutory concept that land can only be the garden or grounds of a dwelling if the land is required for the 'reasonable enjoyment' of the property, nor does the legislation stipulate a size limit that determines what is meant by the 'garden or grounds' of a dwelling.

This point has been confirmed by a number of recent tax cases.

The purchaser's future intentions as to the use of the land are irrelevant in determining whether, at the 'effective date' of the transaction, the land is, or is part of, the grounds of the building.

As a consequence, the same piece of land may constitute garden or grounds of a building in one transaction but not in a subsequent transaction.

At SDLTM00450 HMRC give the following example:

‘For instance, a purchaser (Person A) may acquire the garden of a dwelling (whether or not fenced / walled off at that time from the rest of the vendor’s property) separately from the dwelling, with the intention to use it for commercial purposes. If at the time of the purchase the garden was enjoyed as a garden by the residents of the dwelling (ie the vendor) then the purchase will be of residential property regardless of the fact that the land is being purchased and the dwelling is not. However, if the same land is subsequently sold on by Person A then it may be the case that by the time of that subsequent sale it is no longer used as the garden of a dwelling and has therefore become non-residential land.’

A number of factors may need to be taken into account in coming to a view as to whether land is the garden or grounds of a building and it is unlikely that any one factor will be determinative.

Some of the major factors to be considered in determining whether land is ‘garden or grounds’ are as follows:

- *The use to which the land is put is likely to be the most important factor*

If, at the ‘effective date’ of the transaction, the land in question is put to a commercial use, then that would be a strong indicator that the land is not garden or grounds of the relevant building. However, at SDLTM00460, HMRC state that ‘It would be expected that the land had been actively and substantively exploited on a regular basis [for the purposes of that commercial use] for this to be the case.’ HMRC point out that a large number of activities, such as beekeeping, grazing and equestrian activities could be purely a leisure activity or could be carried out on a commercial basis. Whilst livestock may graze on the land, if that activity is not carried out on a commercial basis, and the land “...primarily provides an appealing setting for a dwelling...” then the land is likely to be ‘garden or grounds’ of the dwelling. Conversely, if the land is grazed under a genuine commercial arrangement, then it should not be ‘garden or grounds’ of the dwelling. HMRC also state:

‘The grazed land might also have a value as part of a “treasured view” from the dwelling. In this case the relative uses of the land would have to be weighed up in deciding whether it formed part of the ‘garden or grounds’ of the dwelling.’

Where a lease has been granted to a third party for the exclusive occupation of the land, this may indicate that the land should not be ‘garden or grounds’ of the dwelling. Unhelpfully HMRC then qualify this conclusion when they state that:

‘However occasionally allowing third parties to occupy or exploit the land is unlikely to mean the land ceases to be “garden or grounds”. Where a lease or a licence is in place, the true nature (including commencement and duration) of the agreement will need to be established (SDLTM00460).’

This qualification seems to be a reference to the decision of the FTT in *Brandbros Limited v HMRC* [2021] UKFTT 157. The case involved the purchase by Brandbros Limited of a three-bedroomed end of terrace property with features including a garage to the rear. The purchase of the property completed on 27 July 2018. Later that same day Brandbros Limited entered into a lease of the garage with SFEP Limited. The lease was for a term of 25 years, at an initial rent of £2,000 per year, and permitted the tenant to use the garage inter alia for storage.

The FTT held that the garage was a building or structure in the grounds of the property acquired and therefore the use to which it was put was irrelevant in determining the nature of the transaction for the purposes of SDLT. The house acquired was clearly residential property. Residential property extends to any garden or grounds of the house including any buildings or structures on such 'garden or grounds'. Thus, the garage is deemed to be residential property irrespective of its actual use.

The FTT went on to say that even if they had concluded that the use of the garage should be taken into account in determining the nature of the transaction, they were still satisfied that the grant of the lease did not alter the classification of the transaction as the acquisition of residential property. This was on the basis that the lease over the garage was not granted until after the 'completion' of the transaction, and therefore what was acquired was residential property. The fact that the lease was granted on the same day, but after 'completion' of the acquisition of the property, had no effect on the SDLT treatment of the purchase of the property.

- *Layout of land and outbuildings (SDLTM00465)*

The presence of the following may indicate that the land is 'garden or grounds':

- domestic outbuildings;
- areas laid out for leisure use or carrying out hobbies;
- small orchards; or
- stables and paddocks suitable for leisure use.

The presence of the following may indicate that the land is non-residential:

- commercial farming/horticulture;
- commercial woodland;
- commercial equestrian use; or
- some other commercial use.

- *Extent of the land*

The extent/size of the land in question will also be a factor to be considered. At SDLTM00470, HMRC indicate that a small country cottage is unlikely to have dozens of acres of 'garden or grounds' whereas a stately home may well have 'garden or grounds' which extend to that sort of acreage. Large tracts of fells/moorland are unlikely to be 'garden or grounds'.

- *Proximity to the dwelling*

If the land is physically close to the dwelling and easily accessible from it or separated by a feature which is easily crossed such as a small road or river, or even land owned by third parties, this would indicate that the land is 'ground or gardens'. Fencing off the land would not, in itself, cause the land to cease to be 'garden or grounds'. However, the more difficult it is to get to the land from the dwelling and the greater the degree of separation between the dwelling and the land, the less likely it is that the land will be 'garden or grounds'.

- *Legal factors and constraints*

If the land is subject to any legal constraints as to use, for example, there may be planning permission in place which permits the land to be used for commercial purposes, then this may indicate that the land is not 'garden or grounds'. However, in HMRC's view planning law by itself is not determinative and actual use will normally be given greater weight. They give two examples as follows:

- Where planning regulations prohibit commercial use, but these are being breached by longstanding commercial use (particularly if the actual use is unlikely to be challenged by the planning authority), then this would indicate the land is not likely to be 'garden or grounds'; or
- alternatively, where commercial use is permitted but the land is actually being used for residential purposes, then this would be an indicator that the land is 'garden or grounds'.

The terms of any contracts, leases, restrictive covenants or easements will be relevant factors. However, whether the land is registered under one land registry title, or more than one land registry title, will rarely be relevant.

If the owner of the dwelling has no rights to access the land, then this is likely to indicate it is not 'garden or grounds', particularly if the land is physically separate from the dwelling. In contrast, if physically separated land can be accessed via an easement, this could mean that it is garden or grounds.

Rights of way over the land for walkers, or rights of access by utility companies to the land, will not normally prevent the land from being 'garden or grounds'.

The receipt of 'Basic Payment Scheme' payments (scheme under which rural grants and payments are made to the farming industry) for the land would be an indicator that the land is not 'garden or grounds' but, in HMRC's view, it does not, by itself, mean that the land is non-residential in nature.

HMRC indicate at SDLTM00475 that the following factors are likely to indicate non-residential land:

- a non-domestic rateable value for the land has been assessed;
- non-domestic rates are collected for the land; or
- the land has been classified as agricultural land and buildings for the purposes of exemption from business rates.

HMRC have been challenging a number of claims that the non-residential rates of SDLT apply to the purchase of a dwelling with land, where the taxpayer was claiming that the land acquired was not part of the 'garden or grounds' of the dwelling. Unfortunately, from the perspective of establishing sound precedent case law, none of the cases had particularly strong fact patterns from the purchaser's perspective, and HMRC has been very successful in arguing these cases.

Doctor David Hyman and another v HMRC [2019] UK FTT 469 (TC)

The facts were that Doctor Hyman and his wife acquired a farmhouse together with approximately 3.5 acres of land. In the first instance they paid SDLT at the higher residential SDLT rates but then made a repayment claim when they received advice that the lower non-residential SDLT rates should have applied.

The land acquired included a meadow, bridleway and derelict barn (which had been classified as non-residential by the local council). However, even though the land was physically separated by hedges/fences from the farmhouse, and the public had a right of way over the bridleway, the First-tier Tribunal held that the land was the garden or grounds of the farmhouse and therefore that the higher residential rates of SDLT applied, and no repayment was due. The decision of the First-tier Tribunal was appealed to the Upper Tribunal which gave its decision on 18 March 2021 dismissing the appeal. The decision of the Upper Tribunal was then appealed to the Court of Appeal which gave its judgment on 17 February 2022, dismissing the appeal.

C Goodfellow and another v HMRC [2019] UK FTT 750 (TC)

The facts were that Mr and Mrs Goodfellow purchased a property with approximately 4.5 acres of land. As well as a dwelling there was a detached garage, which was used as an office, together with a stable yard and a paddock for horses. As in *Hyman*, the taxpayer initially paid SDLT at the higher residential rates of SDLT but then made a repayment claim on receiving advice that the lower non-residential property rates of SDLT should have applied. The arguments for non-residential property treatment were largely that some paddocks were let to a neighbour, to allow them to graze horses, for a nominal rent of £12 per annum, and that the office space in the garage was non-residential property. These arguments were rejected by the First-tier Tribunal. The tribunal took the view that the office in the garage was no different from a 'home office' and was therefore residential property. As regards the paddocks, the tribunal found that the property was sold as an 'equestrian property' and the equestrian facilities were therefore a necessary part of the property and there was no commercial activity taking place on the land. As such the land constituted the 'garden and grounds' of the dwelling, the property was residential property, and therefore no repayment of SDLT was due. The decision of the First-tier Tribunal was appealed to the Upper Tribunal which gave its decision on 18 March 2021 dismissing the appeal. The decision of the Upper Tribunal was then appealed to the Court of Appeal which gave its judgment on 17 February 2022, dismissing the appeal.

Pensfold v HMRC [2020] UK FTT 0116 (TC)

A Cayman Islands company acquired a farm with 27 acres of land and proposed to develop the site as an eco/agritourism venture. The SDLT land transaction return was filed on the basis that the lower non-residential rates applied to the purchase. The basis for treating the property as non-residential was that the land was subject to a grazing agreement with a third party, who had been grazing the land for some years, every year, from April to October. This third party also maintained the land in the intervening winter. No formal agreement was in place to permit the grazing which took place under a traditional gentleman's agreement. However, at the 'effective date' of the transaction, the land was not being grazed. The marketing brochure advertising the farm for sale made no mention of the sale being subject to grazing rights, and likewise the contract to purchase the property made no mention of the grazing rights. The First-tier Tribunal pointed out that, had the entire 27 acres of land been subject to grazing rights, that would have made the plans to develop an eco/agritourism venture rather difficult to implement. The tribunal therefore concluded that, at the 'effective date' of the transaction, the property was entirely residential and, therefore the higher residential rates of SDLT applied. The decision of the First-tier Tribunal was appealed to the Upper Tribunal which gave

its decision on 18 March 2021 dismissing the appeal. See below for further commentary on the appeal.

Lynda Helen Myles-Till v HMRC [2020] UK FTT 0127 (TC)

The facts were that the taxpayer acquired a property with around three acres of land and the property comprised a three-bedroom house (Shepherds Cottage), a detached double garage, a garden to the rear of the house and a grass-covered field known as the “paddock”. The estate agent’s marketing literature mentioned the paddock a few times; for example, it stated that: ‘The garden looks back on to a paddock enclosed by mature hedging and post and rail fencing.’ In 1983, the paddock had been part of a neighbouring farm. For many years the paddock had been covered in grass and therefore potentially usable for grazing animals. This potential use of the paddock for grazing caused an agricultural and rural planning consultant to refer to the paddock, in his report, as agricultural land.

The arguments for treating the land as non-residential property were largely that the land had historically been used as agricultural land as part of the neighbouring farm, at the ‘effective date’ of the transaction the paddock was overgrown agricultural land that had not been adapted for any other use, and the size of the paddock was far larger than would usually come with a dwelling of the size and character of Shepherds Cottage. In coming to its decision, the tribunal stated that:

‘One must, in addition, look at the use or function of the adjoining land to decide if its character answers to the statutory wording in s 116(1) – in particular, is the land grounds “of” a building whose defining characteristic is its “use” as a dwelling? The emphasised words indicate that the use or function of adjoining land itself must support the use of the building concerned as a dwelling. For the commonly owned adjoining land to be “grounds”, it must be, functionally, an appendage to the dwelling, rather than having a self-standing function.’

In the tribunal’s view it came down to whether ‘... the paddock had a self-standing function as opposed to being a functional appendage of Shepherds Cottage.’ The tribunal concluded that as there was no evidence of actual use of the paddock for grazing since it was last part of a farm in 1983, that at the ‘effective date’ of the transaction the paddock was the ‘grounds’ of Shepherds Cottage, and therefore the property was wholly residential.

Gary Withers v HMRC [2022] UK FTT 00433 (TC)

This case is notable as it is the first case which HMRC have lost at the First Tier Tribunal on the issue of mixed use property.

Mr Withers and his wife bought a dwelling with an annexe and around 39 acres of land including gardens, fields and woodland. They submitted the return on the basis this was mixed use as some of the land was used for sheep grazing and cutting hay as well as an area being part of a Woodland Trust rewilding scheme. HMRC considered that the land was wholly residential.

Further relevant factors were the use of the grazing land by a local farmer for 20 years under a formal agreement with evidence of feeding stations and water troughs being put in place to support these activities. The rewilding land was subject to strict conditions regarding access and use.

The First Tier Tribunal found that the land had a function other than as garden or grounds. The volume and organisation of the sheep grazing was sufficient to make this part of the land commercial. The rewilding agreement was sufficient to take this area of land outside of the definition of ‘garden or grounds’. The following comments were made:

‘There were, importantly, grazing and Woodland Trust agreements in place at the time of the purchase and the Tribunal consider that the relevant areas of land were used for a separate purpose and self standing functions and failed to meet the tests of residential property. Their use or function does not support the use of the dwelling/building concerned as a dwelling.’

The appeal was therefore allowed.

Whilst it is interesting to see this success, it is probably not going to change the view of HMRC in challenging such cases.

Daniel Ridgway v HMRC [2022] UK FTT 00412(TC)

There is a further case which has added to the question of whether property is residential or non-residential by considering firstly whether legal impediment to use as a dwelling is sufficient to change the nature of a property and secondly whether the anti-avoidance provisions at FA 2003, s75A are relevant.

Mr Ridgway was acquiring two properties. The first was a semidetached house and the other was a studio which had previously been converted from a garage. The two properties had separate titles and land registrations.

Mr Ridgway was looking for ways to reduce his SDLT liability and was told if the studio was in commercial use at completion then the transaction would be mixed use and so attract non-residential rates of SDLT. He granted a 9-month commercial lease to a photographic studio which contained a prohibition on using the property as a dwelling.

HMRC denied the claim on the basis that the studio was still ‘suitable for use as a dwelling’ even though there was a lease contained a restriction on use in this way.

The First Tier Tribunal found that the terms of the commercial lease were sufficient to mean that the property was not suitable for use as a dwelling. However, they considered that the provisions at s75A meant that the arrangement did not work in mitigating the SDLT. This legislation applies where transactions are inserted into an arrangement which reduces the overall SDLT liability and the Tribunal found that Mr Ridgway had entered into the lease with the intention to reduce his SDLT liability. Having fallen foul of s75A, the lease was ignored and this was the purchase of residential property.

James Faiers v HMRC [2023] UK FTT 00297 (TC)

Mr Faiers purchased a property in Kent which included land on which there was a commercial electricity distribution network subject to a wayleave in favour of the electricity distributor EPN. The network consisted of a pole supporting two 11KV electricity cables criss-crossing parts of the property with a total of 10% of the land within a ‘safety zone’. However, this area was not physically separated from the rest of the property. A repayment was sought on the basis that this was mixed-use as the part used for commercial purposes could not form part of the garden or grounds of the dwelling.

The appeal was dismissed for the following reasons:

- the whole of the land adjoined and surrounded the dwelling with no part physically separated;

- although the power network was part of a third party's commercial operation, this was not in this case determinative;
- the level of physical intrusion was not extensive; and
- The safety issue did not prevent the landowner from doing anything at all.

The *Withers* case discussed above was considered but there was felt to be a clear difference between the use and intrusion in each case. It is useful to note that, although not binding, the Tribunal judge did state that the presence of an electricity sub-station on the land would probably be sufficient to render it mixed-use.

The conclusion to be drawn from this is that it is difficult to convince HMRC and the Courts that land is mixed use unless there is clear commercial use of the land. HMRC did launch a consultation in 2021 in which they proposed a change in the legislative definition, but this has not yet been implemented.

Contributed by Ros Martin