Establishing real commercial use

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Julie Butler considers the case of Pensfold Farm, in which well-maintained business plans could have enabled the use of mixed-use rate of SDLT

Key Points

What is the issue?

When land and a house are bought together and part of the property is non-residential, the whole property is subject to reduced rate SDLT on purchase. If land is simply part of a property's grounds, the whole transaction is subject to the higher residential rates.

What does it mean to me?

HMRC challenged the non-residential classification on Pensfold Farm. Although the tribunal confirmed previous owners had used the land for grazing every year, HMRC won because the company's paperwork was not capable of scrutiny.

What can I take away?

The need to establish commercial use is very important to reduce the SDLT liability, requiring farm business plans, books and records, and tax returns.

Pensfold, a Cayman Islands company, bought a small farm in 2017 with the intention of developing it into an eco-agritourism business. The stamp duty land tax (SDLT) return was submitted, claiming the property was non-residential and that relief from the higher rate was due (Finance Act 2003 Sch 4A para 5B). HMRC enquired into the return with interesting findings that tie into other tribunal decisions.

The First-tier Tribunal's recent ruling on the case of D Hyman and another v HMRC [2019] UKFTT 469 is a useful pointer as to how HMRC scrutinises 'mixed use' rates of stamp duty land tax (SDLT) and differentiates between residential use and mixed use classifications, as well as when a commercial rate SDLT might apply.

Another case of L Myles-Till v HMRC [2020] UKFTT 127 has provided some further useful guidance. Mrs Myles-Till purchased a residential property with an adjoining grass paddock and assessed the SDLT at the lower rate for mixed use. HMRC argued before the First-tier Tribunal that the paddock was part of the grounds of the residence and that the residential rate of SDLT should apply.

Using the mixed SDLT rate effectively

Historically, farms have survived difficult times by selling off cottages and small parcels of land next to cottages. The mixed rate of SDLT can present an advantage when the land and a house are sold together: where part of a property is non-residential, the whole of the property is subject to a reduced rate of SDLT on sale. If land is simply part of a property's grounds, the whole transaction is subject to the higher residential rates.

Mrs Myles-Till had fi led her SDLT return on the basis that a paddock attached to the property was non-residential, so the reduced rate applied. HMRC challenged this, arguing that the paddock was part of the grounds. Historically, the paddock had

been part of a neighbouring farm and was used for agriculture, so there was potential for the more advantageous rate to be used.

The FTT found for HMRC, based on the technical definition of ‘grounds’, which is not defined in the legislation. The judge commented that it was not enough for the land to be sold with the building, but that its use or ‘function’ must be considered. The paddock did not have a ‘self-standing function’ at the time of sale, but was an appendage and so was therefore considered to be part of the grounds. Action could have been taken to ensure that the paddock was used commercially.

In the similar Hyman case, Dr Hyman had paid the higher residential rate of SDLT on the property purchase of a farmhouse and 3.5 acres, but subsequently claimed that the property should have been classified as mixed use and that SDLT was therefore due at the lower commercial property rate. As well as a farmhouse, the property purchased consisted of two gardens, a duck pond, barn and meadow with a public bridleway running through it and had been advertised by the estate agent as a residential property with grounds. Therefore the tribunal found that the higher residential rate was due. This case has now been referred to the Upper Tribunal.

Pensfold: the intention of use

In the case of Pensfold v HMRC [2020] UKFTT 116, the First-ti er Tribunal found that Pensfold had acquired the farm with the intention of setting up a qualifying trade of an eco-agritourism venture. For companies, the highest rate of SDLT (15%) is payable in respect of a residential property costing over £500,000, compared to 5% for a commercial property; however, the normal residential rate is payable if the property cannot be proved to be used for a trade or intended to be used for the trade. Therefore, the trading intention was important and the plans showed that the farm would be available to the public ‘on at least 28 days in any calendar year’.

The issues before the Pensfold tribunal were:

a) whether relief for non-residential use was due under Finance Act 2003 Sch 4A para 5B;
b) whether the transaction was residential or mixed use (some of the land had been used for grazing for many years); and
c) whether Pensfold had taken reasonable care so as to avoid an inaccuracy penalty.

Pensfold: commercial or non-residential classification

The purchase by Pensfold included a residential property and 27 acres of land. Pensfold's SDLT liability totalled £130,750 on the basis that the purchase was non-residential as it was a farm. HMRC challenged the non-residential classification and sought an additional £206,750 towards the company's SDLT bill. Pensfold claimed non-residential status as the previous owners had a grazing agreement with a neighbouring farm. Statements were given to the tribunal which confirmed that the previous owners had used the land for grazing from April to October every year.

HMRC won at the First-tier Tribunal because the company's paperwork was not robust and capable of scrutiny. Pensfold argued that the grazing agreement was not in place at the time of the purchase, as this would have conflicted with the previous owner's intention of developing rare breeds on the land. Farm business plans are important.

'Reasonable commercial' plans from date of acquisition

On HMRC's assertion that plans must be available on the day of purchase, the tribunal said this did not require 'detailed' plans. The tribunal stated that it would be 'wholly unrealistic' for these to be available so early. The legislation required only 'reasonable commercial' plans to be in place and it seemed to the tribunal that 'clear statements' from Penfold showed this was the case. In tax planning and commercial terms, sadly a large number of farms are purchased without full business plans, let alone 'reasonable commercial' plans as was required to claim the lower relief here.

As to the delay in setting up the business, which HMRC argued was too long, the judge said this was justified by the commercial considerations presented. There was nothing in the legislation that required the project to have begun for it to then qualify for relief. It was important for there to be reasonable plans for its implementation, not that it had been implemented.

The delay to study the land and to draw up detailed plans was not unreasonable. The more substantial delay caused by the enquiry was also reasonable. It could have resulted in much higher tax and penalties so the delay was justified by commercial considerations.

The impact on the rate of SDLT: the brochure

The tribunal concluded that Pensfold met the conditions in para 5B(2) and that the 15% residential rate of SDLT did not apply to the acquisition. The tribunal noted it was not asked to consider whether the relief should be clawed back under para 5H but said this would seem to be the course of action anticipated by the legislation for projects that did not take place.

The tribunal then considered whether the property was mixed use or residential. Pensfold claimed it was mixed use because the land had been subject to a grazing agreement. However, the tribunal found the sales brochure made no mention of the land being used for grazing and, at the time of purchase, it was not being grazed. Therefore, it was wholly residential – on this the Pensfold appeal failed.

Property is determined as mixed use where it does not consist entirely of residential property. Residential property includes ‘land that is or forms part of the garden or grounds of a residential building’. HMRC had argued that for SDLT purposes the meadow was available to be used as part of the owner’s enjoyment of the house itself and was therefore included as part of the residential property.

Once again, lack of evidence and the brochure are used by HMRC in mixed SDLT cases to defeat the taxpayer. The evidence to support the claim was not available.

Those who prepared the brochure should have thought about tax planning and SDLT. Some might say that is beyond their brief but tax planning eligibility would have been achieved had the simple fact of the historic grazing been mentioned.

No penalty: advice of reputable firm of solicitors

The tribunal said that no penalty was due because the buyer had taken reasonable care to avoid inaccuracy by using a reputable firm of solicitors to complete the return. Pensfold’s appeal was won in part, as it did not have to pay penalties. The role of the ‘reputable firm of solicitors’ to protect clients could be the subject of a whole separate article.

SDLT only applies in England and Northern Ireland. The land transaction tax (LTT) and land and buildings transaction tax (LBTT) apply in Wales and Scotland respectively. The rules for LTT and LBTT are different to those for SDLT.

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tax.

Real commercial use

In the Pensfold case, the judgment found in favour of HMRC and stated: ‘Land would not constitute grounds to the extent that it is used for a separate, e.g. commercial, purpose. It would not then be occupied with the residence but would be the premises on which a business is conducted.’ Even so, 27 acres is a surprising amount of land to count as the grounds of a residence. This is much larger acreage than Hyman and Myles-Till.

The need to establish commercial use is very important to reduce the SDLT liability and support the claim. The owner requires farm business plans, books and records, tax returns and a genuine desire with evidence to carry on a business. No one is in any doubt that HMRC will continue to study all mixed rate SDLT claims closely and it is important to take proper advice to avoid harsh denial of relief and possible penalties.

For the tax/SDLT adviser helping their client to buy a smallholding or house with land where some SDLT relief is due, it is essential to have evidence of the historic non-residential use and the future non-business use through outline business plans for intention. The ultimate safety protection is evidence of commercial use from an early stage. Buying agricultural land is more complicated than simple residential, e.g. water supply, boundaries, etc. Some inexperienced professionals fail to ask the correct questions on purchase which can jeopardise both future risks and, as shown in Pensfold, SDLT.

As mentioned, farms have traditionally survived in tough times by selling small parcels of land, especially if they can improve the marriage value of a cottage or house. The owners of some smallholdings that once provided strong income to help with the costs have slipped into non-recording of income as they consider it to be too small. The result of this is the incorrect tax return and no historic evidence for the SDLT. The capital gains tax position on the 27 acres also has to be considered. Although for SDLT it was considered to be part of the grounds, it is very difficult to prove that more than half a hectare qualifies for main residence relief. Such action could disadvantage the purchaser.

It is, however, worth noting that as the residential property threshold has been increased from £125,000 to £500,000 in the Summer Statement until March 2021,

there is a ‘quirky window of opportunity’ for some property with paddocks. Where the choice of the application of residential or mixed use SDLT is marginal for properties of around a certain value, e.g. £1 million, the SDLT bill can be reduced using the residential rate as opposed to the mixed use rate. That might seem impossible but test the calculations – it’s true. Even more reason for advisers to check the exact function of the paddocks when submitting SDLT returns!

Many observers have found it amusing that under the SEISS (the self-employed income support scheme), those who have not recorded and declared self-employed income are not eligible for the grant. It can be argued there is a similar observation here, where those with land attached to a house have not declared the income of, say, a grazing licence and so could jeopardise the mixed rate claim. Outline business plans must be prepared from the date of purchase. Non-compliance with tax and grants or subsidies by elderly smallholders could be negative.

Note: The Pensfold case has been referred to the Upper Tribunal.