Counting houses

Indirect Tax



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Simon Howley examines the complexiti es of the 3% surcharge to stamp duty land tax, and what consti tutes an ‘only or main residence’

Key Points

What is the issue?

The 3% stamp duty land tax surcharge applies if the purchase of the new property means that the purchaser owns more than one residenti al property. The property must be the ‘only or main residence’ to be exempt.

What does it mean for me?

If taxpayers purchase two adjoining properti es intending to combine them into a single residenti al property, HMRC has already successfully argued that there would actually be no replacement of a main residence in such a case, so the surcharge will apply.

What can I take away?

Taxpayers should carefully consider the order in which dwellings are sold and purchased, as this may aff ect whether or not the surcharge is applicable.

A client came to see me recently explaining that he and his wife were in the process of buying an old Victorian terraced house in West London, as a replacement of their main residence, informing me that the 3% surcharge should not be applicable. He was bubbling over with excitement and explained that the property in questi on was currently split into three self-contained apartments, and that he and his wife intended to combine these into one fantastic residential property.

‘Sorry to burst your bubble,’ I said. I then started to explain to him that when a purchaser acquires multiple dwellings, intending the new main residence to be the single dwelling resulting from those dwellings being merged, HMRC has already successfully argued that there would actually be no replacement of a main residence in such a case.

When does the 3% surcharge apply?

The 3% stamp duty land tax surcharge applies if the purchase of the new property means that the purchaser owns more than one residential property. It can only apply to the acquisition of a ‘dwelling’. Bizarrely, the surcharge legislation has its own definition of dwelling, which is based on the general definition of residential property for stamp duty land tax. This is in addition to the separate definitions for multiple dwellings relief and the definition for the purposes of the 15% flat rate.

Essentially a building or part of a building counts as a dwelling for the purpose of the surcharge if, at the effective date:

- it is used, or suitable for use, as a single dwelling; or
- it is in the process of being constructed or adapted for such use.

Thus, the purchase of a mere site for the construction of a dwelling is not caught; nor is the purchase of an existing building for conversion into a dwelling so long as it is not suitable for use as a dwelling at the effective date, and adaptation work has not yet begun.

The main exception to the surcharge rule is the purchase of a replacement property that is to be the purchaser's only or main residence; if he has disposed or does dispose of a previous main residence within a set period, the surcharge does not apply.

This is so regardless of how many other dwellings the purchaser owns.

The ordinary rule is that the effective date of the disposal by the purchaser of his previous main residence must be the same as the effective date of his purchase. If the purchaser has not sold his previous main residence on the day the new purchase is completed, he will be liable for the 3% surcharge. (Note that the purchaser can apply for a refund if he sells his previous main home within three years.)

Example 1

Derek sells the house which was his old main residence and, within the time limit, buys a house to be his new main residence for £1,750,000. He has a portfolio of residential rental properties. He is entitled to the replacement relief and his stamp duty land tax is £123,750.

What counts as a main residence?

The stamp duty land tax legislation does not define what 'only or main residence' means, so it is a matter of looking at the ordinary meaning of the words. For over 50 years, the capital gains tax legislation has had an exemption for a disposal of the taxpayer's only or main residence, and there is a good deal of case law on that. The Stamp Duty Land Tax Manual includes a very useful list of what it considers the main factors to be at SDLTM09812 (see bit.ly/3BRFVlO), and these should be considered by any adviser of a purchase that maybe borderline.

However, matters can become more complex where any purchase is a joint one, as we will see by expanding on our example of Derek above.

Example 2

Derek now sells his house, which was his main residence, and still retains his residential property portfolio. He and his girlfriend Lisa, within the set time limit, jointly buy a house to be their main residence for £1,750,000. Lisa had been living with her parents, but owns a flat that she rents out.

Derek and Lisa must pay the 3% surcharge. Although Derek qualifies for the exception, Lisa does not, because of the flat, and she is not replacing a main residence of hers.

They could have avoided the surcharge if Lisa had sold her flat before the completion on the new house. Alternatively, Derek could have sold or gifted a share in his old house to Lisa – it need only be a fractional share – before he sold it and it had also become her main residence.

Note that where the purchaser is married, that spouse is also treated as a purchaser for the purposes of the 3% stamp duty land tax surcharge. If either spouse triggers the surcharge it would apply to the whole transaction.

Example 3

Fiona and her husband Tim have never owned a main residence, but Tim owns six houses which he rents out. Fiona decides to purchase a house costing £1.1 million, in her own name, for them both to live in.

The joint purchaser rule must be applied and Tim is a joint purchaser of the property for the purpose of deciding whether the surcharge applies. Tim is not responsible for the tax; nor is he the purchaser for other purposes.

Example 4

Simon and Fiona are married and jointly own a holiday home. Simon owns their own main residence. When they jointly buy a replacement property, he sells his previous property within the time limit.

They do not have to pay the surcharge, because they are married. If they had not been married, they would have had to pay the surcharge because Fiona did not sell a major interest in an old dwelling, although she lived in their previous residence, and that is one of the requirements.

As you can see, the rules can have fortunate and unfortunate effects, if transactions are not carried out in the correct order. Advice must always be taken. Anyway, back to my now thoroughly depressed client, as I explained to him the recent tax case and the impact this could have on his proposed purchase.

The Moaref case: the significance of an 'only or main residence'

The case in question is Moaref and another v HMRC [2020] UKFTT 396 (TC). The First-tier Tribunal held that for the purposes of the 3% stamp duty land tax surcharge, the buyers did not replace their only or main residence when they bought two new apartments, with the intention of converting them into one new main residence, and then subsequently sold their old main residence.

The taxpayers owned a dwelling in Dubai (the 'old main residence'), which they lived in as their only or main residence up to August 2016. In 2017, they acquired two neighbouring apartments in separate land transactions, from separate vendors in central London, paying the surcharge on each property. The first apartment cost £5.2 million, with stamp duty land tax of £690,000; and the second apartment cost £7.4 million, with £1,023,750 being paid in stamp duty land tax. The case only related to the second apartment.

Following the sale of their old main residence, the purchasers sought to reclaim the surcharge. HMRC repaid the surcharge on the first land transaction, but not the second. HMRC later concluded that the surcharge should not have been repaid on the first land transaction, but it was time-barred from recovering that repayment.

The taxpayers had been living in both apartments since the purchase, using an outside balcony to connect them. The children were sleeping in one apartment and the parents were sleeping in the other. They generally used the kitchen facilities of only one apartment, and the reception area of the other larger apartment for day-to-day living.

The taxpayers did not consider that either of the apartments on their own were suitable residences for them and their family. They also stated that 'they only bought the apartments on the basis that they would carry out works to convert them into one residential property'. Although works had not been commenced to amalgamate the apartments, planning applications were submitted, amended and consent eventually granted. Consent from the Crown Estate, which was required, had not yet been granted.

Whilst it was accepted that the taxpayers had a clear intention to combine the two apartments, it was this very intention that was relevant to HMRC's argument. In Mr Moaref's witness statement, he said:

- 'individually the properties were not suitable for my wife and two children';
- 'the properties were always intended to be one residence'; and
- 'it was my clear intention from the first time I saw the properties to amalgamate them into one'.

These statements all supported HMRC's main argument that neither of the apartments was intended to be the taxpayers' 'only or main residence'. If the draftsman had used wording such as 'intend to occupy as' we may have ended up with a different result, but the words 'to be' have a narrow meaning.

Accordingly, the tribunal found that the taxpayers did not intend the second apartment to be their only or main residence. The purchased dwelling must be the same as the dwelling that the buyer intends to be their only or main residence. Rather, the buyers intended the amalgamated dwelling to be their main residence.

While the judgment in this case only concerned the second transaction, this reasoning also applied to the first land transaction and the tribunal stated that the evidence showed that the first apartment was also not intended to be the taxpayers' only or main residence.

As the tribunal highlighted, the wording in Finance Act 2003 Sch 4ZA is prescriptive and detailed, with the result that a black letter approach to interpretation applies rather than a principles-based drafting approach.

With this in mind, taxpayers should carefully consider the order in which dwellings are sold and purchased, as this may affect whether or not the surcharge is applicable.