Stamp Duty Land Tax 3% surcharge on 'Granny Flats' such as self-contained annexes and other subsidiary dwellings

14 April 2020

SDLT Guide

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CONTENTS

1 SUMMARY

Someone buying a house with a granny annexe, or with a second dwelling like a gardener's cottage, needs to check particularly carefully whether the 3% surcharge to Stamp Duty Land Tax (SDLT) will apply to the whole of the purchase price.

Changes were made during the passage of the Finance Act 2016 which are of assistance. Royal Assent was granted on 15 September 2016 and the amendments have retrospective effect.

Even better, multiple dwellings relief can sometimes be claimed without triggering the surcharge. This would mean less SDLT for such a purchase than when buying a single dwelling for the same price.

If you require professional advice on SDLT, please contact John Shallcross at Blake Morgan at john.shallcross@blakemorgan.co.uk or 023 8085 7469.

2 BACKGROUND

The 3% surcharge to SDLT was announced in the Autumn Statement of 25 November 2015. It was said that these higher rates of SDLT were intended to dampen down demand for residential properties not being bought for owner occupation. Where it applies, it increases the SDLT by an extra 3% of the entire purchase price.

There was a consultation paper issued on the same day which discussed at para 2.17 purchases of multiple residential properties in one transaction. It said where some or all of the properties are additional properties, the transaction would be eligible for multiple dwellings relief, with the higher rates applied to the average price of the dwellings purchased. However it gave no indication of any particular problem for those buying a house with a self-contained annexe or other subsidiary dwelling such as a gardener's cottage (I will refer to these as "granny flats").

The proposals were firmed up in the Budget on 16 March 2016 with a Guidance Note being published and the Budget Resolutions passed a few days later bringing the 3% surcharge into force for many transactions completing on or after 1 April 2016. The Budget Resolutions had the force of law and applied until they were replaced by the Finance Act 2016 which became law on 15 September 2016.

The Guidance Note of 16 March 2016 hardly acknowledged that there was any issue with granny flats:

- para 2.10 said it is important to determine whether a property consists of one, or more than one dwelling.
- chapter 4 of the Guidance Note dealt with the purchase of two or more dwellings in one transaction (though not mentioning granny flats).
- para 4.1 of the Guidance Note made it clear that if two dwellings are dealt with in the same transaction, then either the normal rates or the higher rates of SDLT apply to the whole transaction, not a combination of rates.

- para 4.7 of the Guidance Note dealt with situation of granny flats without mentioning them as such, saying the higher rates are due on the whole transaction if two or more dwellings are purchased in the same transaction.

The 16 March 2016 Guidance Note was published before the amendments referred to in Section 5 below, so para 4.7 became out of date.

There were articles in the press in April 2016 about the 3% surcharge working in an unfortunate way for those buying a property with a granny flat. In some cases they would be treated as buying two dwellings at once, and so automatically suffer the surcharge on the whole transaction even if the buyers owned no other properties, or were replacing an only or main residence.

In Parliament on 11 April 2016 there was a statement by David Gauke, Financial Secretary to the Treasury, saying that it was not the intention for the surcharge to catch houses with granny flats in this way and that an amendment would be tabled in Committee "to correct the error and ensure fair treatment for annexes".

The Finance Act 2016 became law on 15 September 2016. These amendments have retrospective effect to 1 April 2016.

The revised Guidance Note published on 29 November 2016 dealt with granny flats at paragraph 2.10A – 2.10F with examples in Chapter 9 at 20, 21 and 22. At the end of March 2018 the guidance was moved to HMRC's Manual and the pdf Guidance Note was withdrawn. The text from 2.10A can be found in SDLTM09755, but the Chapter 9 examples referred to were not brought forwards; they can still be found in the archived Guidance Note.

3 ONE DWELLING OR MORE

3.1 The legislation

The legislation says that even if a building or part of a building is not used as a single dwelling, it can still count as a dwelling if is suitable for use as a single dwelling. This interpretation was confirmed in the First Tier Tribunal case of Fiander and Brower discussed at 3.6 below.

3.2 My view

The legislation does not fully define what a dwelling is. A good start might be to say that a dwelling is a place where the occupier habitually sleeps and lives, treating it as home. The nature of a dwelling is that it provides a long term home rather than being for a short term stay. Inevitably there are grey areas in the case of a property with a granny flat.

In my view a house with a granny flat is likely to count as two dwellings if:

- Each part has its own separate front door (it not being necessary to pass through one set of living space to get to the other, though the front door might be off common parts such as a hall).

- Each has the normal living accommodation that you would expect of a dwelling including facilities to cook and wash, a lavatory, a sleeping area and a living area.

- Each has a sufficient degree of privacy and security such that two unconnected households could live in the separate parts on a stand-alone basis. (This can be particularly relevant where there is a connecting door or opening between the two parts).

- The services (such as heating, electricity, gas, hot and cold water) are sufficiently capable of independent operation and isolation. For example if the electricity consumer unit or central heating controls were in one set of living accommodation with no means of control from the other, then that would be an indication against the property counting as two dwellings.

- It is lawful (for example under the terms of any lease or under planning legislation) for each part to be lived in by a separate household or in practice that has happened for a period. (Although it is not clear how much weight should be put on this factor. As will be seen from the comments below it seemed originally that little weight should be attached to legal factors. As from the publication of new guidance on 1 October 2019 HMRC say legal factors such as planning should be taken into account.) The decision of 9 April 20120 in the First Tier Tribunal case of Fiander and Brower v HMRC referred to below indicates that it is only the physical attributes of a property which have to be taken into account.

See Appendix 1 for some of my suggestions as to what features need to be weighed up when looking at the physical configuration of a property to see if it is suitable for use as more than one dwelling. See Appendix 2 for some notes as what HMRC appear to have been asking for in practice when making checks of claims for MDR.

3.3 HMRC guidance

Until 1 October 2019 the most directly applicable guidance was that in HMRC's Manual for the 3% surcharge, with some in the guidance for multiple dwellings relief:

(a) At SDLTM09755 HMRC say: "A self-contained part of a building will be a separate dwelling if the residents of that part can live independently of the residents of the rest of the building, including independent access and domestic facilities."

( ) SDLTM09750 used to describe a dwelling as "a building, or a part of a building that affords to those who use it the facilities required for day-to-day private domestic existence". On 30 March 2020 this page was re-written and now refers to the guidance from page SDLTM00372 onwards.

(a) SDLTM29955 for multiple dwellings relief says: "For the purposes of the relief a “dwelling” means a building or part of a building which is suitable for use as a single dwelling or is in the process of being constructed or adapted for such use"

On 1 October 2019 HMRC published further pages in the Manual from SDLTM00410 to SDLTM00430 to state their view on how to assess whether a property with an annexe or outbuilding counts as one dwelling or as two dwellings.

- SDLTM00410 sets the scene saying: "*dwelling takes its everyday meaning*". Also: "*It must be sufficiently self-contained to be considered a ‘single dwelling.’ The test of*

whether a property is "suitable for use" as a single dwelling is a more stringent test than whether it forms a self-contained part of a larger dwelling. Furthermore, whether or not it is suitable for use as a single dwelling requires consideration of whether it is sufficiently independent to be considered a dwelling on its own."

- SDLTM00415 explains: "*In considering whether or not a property includes one or more dwellings (and if so, how many) a wide range of factors come into consideration. No single factor is likely to be determinative by itself. However, not all factors are of equal weight either, and one strong factor can outweigh several weaker contrary indicators. Where a number of contrasting indicators exist, it may be necessary to weigh up the factors to come to a balanced judgement."*

- SDLTM00420 is about physical configuration which it explains "*relates to the facilities of the dwelling, independent access to the dwelling and privacy from other dwellings. These aspects are considered to be of great importance and the lack of one of them would normally cast significant doubt on whether the area in question could be considered suitable for use as a separate 'single dwelling.'*"

- SDLTM00425 looks at particular facilities one would expect a dwelling to have, including a sleeping areas, living area, bathroom, kitchen, independent entrances and sufficient privacy.

- SDLTM00430 deals with control of utilities such as electricity, cold water, heating and gas.

3.4 Legal suitability

What is less clear is the relevance of "legal suitability" for use as a dwelling, such as whether separate use would be lawful under planning rules or under covenants affecting the property. The legislation is silent on the point.

The Head of Policy of HMRC Stamp Taxes at a meeting with tax professionals on 22 March 2016 had expressed a view on this. He indicated that for the purposes of the definition of dwelling for the surcharge (and for multiple dwellings relief) his view was that it comes down to the property's physical configuration, not what it is legally capable of being used for.

There had been other indications that HMRC consider that the planning position is not of great weight. For example in the Manual at SDLTM09750, HMRC used to say that holiday homes are dwellings, including those which cannot be used all year round, suggesting that planning restrictions are not relevant. This wording was removed on 30 March 2020 and references to holiday homes can now be found in SDLTM00385 (introduced on 1 October 2019) with a more nuanced approach. It says that if planning restrictions only permitted short stays then this would be a factor indicating that the property is not suitable for use as a dwelling.

From some wording in SDLTM00430 published on 1 October 2019 it appears that HMRC's view now is that planning restrictions are more relevant than previously indicated. This says: "*The property may be subject to legal conditions, including planning restrictions and restrictive covenants, whether public or private law, which inhibit use as a separate dwelling. These conditions will be a factor in considering suitability of use as a dwelling, although*

where these conditions are not being respected for any reason, actual use will prove more helpful than theoretical use."

For example:

- A condition that a property can only be occupied for 11 months of the year might well be consistent with a property being used as a dwelling.

- But a condition restricting occupation by any one person to no more than 6 weeks a year would not be.

It is therefore not clear how much weight should be given to planning conditions that the granny flat can only be used by a relative of the occupant of the main house or can only be used for purposes ancillary to the use of the main house. It might be that some conditions of this nature do allow the granny flat to be lived in as a separate dwelling, but limit the class of persons who can live there. Other conditions might prevent anyone at all from living in the granny flat as a separate dwelling.

Longstanding breach of a condition without any enforcement action being taken would also be relevant.

See below at 3.6 for the First Tier Tribunal decision in Fiander and Brower suggesting that physical configuration is all important and legal suitability is hardly relevant.

3.5 Council tax treatment

It is not determinative whether the granny flat has its own separate council tax banding. That works on a different definition including the wording: “a building or part of a building, which has been constructed or adapted for use as separate living accommodation”. There is case law around this with information from the Valuation Office Agency and guidance in their Council Tax Manual (see Practice Note 5). The relevance of council tax banding is mentioned at SDLTM00430 and see below for Fiander and Brower which indicates council tax banding was of little relevance in that case.

3.6 First Tier Tribunal in Fiander and Brower

These issues were considered by the First Tier Tribunal in the case of Fiander and Brower v HMRC; the decision was released on 9 April 2020. A fuller discussion of the implications of the case can be found on a link from this page.

The Tribunal decided that a property with an annexe did not qualify for multiple dwellings relief for stamp duty land tax because there was no lockable door on a corridor joining the two parts. In the box below is some analysis and some quotes from the decision indicating how the Tribunal saw the relevant tests.

As the property was unoccupied at the time of acquisition, the Tribunal confirmed the issue was to be addressed by asking whether the main house and annexe were, at that time, each "suitable for use as a single dwelling".

The Tribunal approached “suitability for use” as *"an objective determination to be*

made on the basis of the physical attributes of the property at the relevant time. Suitability for a given use is to be adjudged from the perspective of a reasonable person observing the physical attributes of the property at the time of the transaction."

The Tribunal said: *"A dwelling is the place where a person (or a group of persons) lives. A building or part can be suitable for use as a dwelling only if it accommodates all of a person's basic domestic living needs: to sleep, to eat, to attend to one's personal and hygiene needs; and to do so with a reasonable degree of privacy and security. By requiring that the building or part be suitable for use as a "single" dwelling, the statutory language emphasises suitability for self-sufficient and stand-alone use as a dwelling. Use as a "single" dwelling excludes, in our view, use as a dwelling joined to another dwelling."*

The Tribunal found that the formulation of multiple dwellings relief by reference to a single dwelling required more than that the annexe could be occupied as separate living accommodation in specific circumstances (such as by a family member or by a lodger where there would be "ties of trust"). Instead the Tribunal decided that the test is a higher one; that the annexe could "generally" be used as separate living accommodation, so that if a member of the public were to occupy the annexe on a stand-alone basis, there would be enough privacy and security for the occupants of both parts.

Counsel for the tax payer had argued that (in the same way as a property not ready for immediate use because it is out of repair is treated as "suitable for use" as a dwelling) an annexe which, with minor work could be made sufficiently private and secure, should count as "suitable for use" as a dwelling.

However the Tribunal did not accept this, saying: *"it would be wrong to determine "suitability for use" at the time of completion on the assumption that a door, or doors, or some other physical barrier, would be introduced to the corridor. This is because the suitability test in paragraph 7 is an objective one based on the physical features of the property as at completion – it cannot be performed on the assumption that new physical features will be introduced to enable a new and different kind of use. This is the case even if the new physical features are relatively easy or quick to install."*

The Tribunal said it did not put a great deal of weight on:

- The council tax status of the two parts.
- Whether there was a separate postal address for the annexe or if post had been addressed to the annexe.

These were not dismissed entirely, but were not seen as very significant factors.

The Tribunal said it placed no weight on the evidence of a restrictive covenant and the lawful planning use of the property was not even mentioned in the decision.

3.7 Generally and examples

Often the position will be uncertain. HMRC guidance only represents HMRC's view of the law, which in the final analysis is for the courts to determine. In the meanwhile SDLT is a self-assessed tax and buyers have to do their best to interpret and apply it.

There are bound to be difficult cases where it is not clear if a property comprises one or more dwellings. For example:

(a) A main house with a detached double garage over which is a "guest suite" with a large bedroom that doubles as a living area with a bathroom and small kitchenette leading off it. The guest suite is accessible without going into the main house and has not been separately let, but has been occupied by a relative who has lived an independent life in it, cooking their own meals. It has water, electricity and heating systems that can operate and be isolated independently. This might count as two dwellings as it is physically capable of being used as two dwellings. It is not clear how much weight should be given to the planning position; if it is not lawful for the "guest suite" to be used as a separate dwelling then this would be a factor against it counting as a second dwelling, though a history of independent use will be of great relevance.

(b) A London four storey house where the basement has its own separate access from the outside, has all of the usual facilities for a separate dwelling and no interior access from the upper floors. It has in fact been used with the upper floors as part of a single dwelling by a family and has from time to time been "let out" on an Airbnb basis. Its services can operate and be isolated independently. It is thought that the fact that it is capable of being used as a separate dwelling means that it could count as a separate dwelling, though again the planning law position is relevant. It is not particularly helpful that it has been used temporarily for Airbnb as that is a transient use rather than use as a "dwelling" which connotes a greater degree of permanence and expectation of continuity by those occupying it.

(c) A house with a staff flat which has a lockable door and all the usual facilities (including a bathroom and kitchen) but is accessible only through the living accommodation in the main part of the house. The house and staff flat probably do not form separate dwellings because the flat does not have its own independent access. In these type of cases HMRC sometimes say that a sufficient degree of independence can be demonstrated for the flat, but the main part of the house cannot count as a dwelling because it does not have the necessary degree of privacy (by virtue those using the flat having to pass through the living accommodation of the main house).

(d) A house with a flat which has the usual facilities but is accessible both from the outside and from through the living accommodation in the house itself. This is difficult, but might well count as two dwellings, particularly if it would be very easy to block the door linking the flat to the inside of the house giving each the necessary degree of privacy. It will be important whether the services can operate

and be isolated independently. The legal position (such as with lawful planning use) will also be relevant.

(e) A house with a holiday lodge in the garden. The holiday lodge has all of the usual facilities for a home, but the planning consent limits its use to certain periods of the year. HMRC had previously appeared to indicate in the Manual at SDLTM09750 that it is the physical suitability of a building for use as a dwelling that matters most, not its legal suitability. But as mentioned above, the 1 October 2019 guidance at SDLTM00430 indicates a change of view here and it will be important to look at the detail of the planning conditions, whether they are likely to be enforced and the past pattern of use. This was discussed in my Case Notes, see the entry of 28 October 2019.

The usual surcharge rules apply if the property counts as a single dwelling (so the surcharge would not apply if the buyer has no other property interests that count against him or benefits from the replacement of only or main residence exception). The position is more complex if the property counts as two dwellings. This article is looking at the position where a property counts as two (or more) dwellings.

4 LAW UNDER THE BUDGET RESOLUTIONS

The problem under the law that was in force by virtue of the 2016 Budget Resolutions (not allowing for the amendments made during the passage of the Finance Act) was that where a single transaction included two dwellings then if:

- the part of the price fairly apportioned to each of them would be £40,000 or more
- neither is subject to a long lease with over 21 years unexpired (this is not referring to leasehold properties, but to properties which are subject to a long lease, so normally where the buyer will just receive a ground rent)

the 3% surcharge would apply to the whole transaction even if:

(a) the buyer did not have any other property interests that counted against him

(b) the buyer owned other property, but would qualify for the replacement of only or main residence exception.

This meant most purchases of properties with granny flats would, under the Budget Resolutions, have been subject to the 3% surcharge.

It helps to understand the rules to know that the surcharge applies to a transaction if it falls within any one of five charging paragraphs (paragraphs 3 to 7). The charging paragraphs have different conditions and exceptions. The five different charging paragraphs can be summarised as applying to the following kinds of cases:

3: An individual buys a single dwelling. This is the one that concerns most cases in practice (but not properties with granny annexes counting as two dwellings). There are exceptions to the surcharge here: including where the buyer does not have

other property interests that count against him or is replacing an only or main residence.

4: The purchaser is not an individual and buys a single dwelling (this catches companies and other bodies). There are few exceptions to the surcharge here.

5: An individual buys two or more dwellings and two or more of them are of a kind that the surcharge is looking to catch. There are few exceptions to the surcharge here.

6: An individual buys two or more dwellings, but only one is of a kind that the surcharge is looking to catch. It is this provision which has been amended to provide that a granny flat does not count as of a kind to be caught. There are exceptions to the surcharge here: including where the buyer does not have other property interests that count against him or is replacing an only or main residence.

7: The purchaser is not an individual and buys two or more dwellings where at least one of the dwellings is of a kind that the surcharge is looking to catch. There are few exceptions to the surcharge here.

The focus of this article is on charging paragraph 6. Section 5 below sometimes mentions being "out of the frying pan and into the fire". That refers to cases where failing a condition in charging paragraph 6 means the transaction ends up in a less favourable charging paragraph, such as 5 or 7 which has fewer exceptions.

5 AMENDMENTS TO THE RULES FOR GRANNY FLATS

The effect of the amendments to the Finance Bill 2016 tabled on 28 June 2016 (which became law on 15 September 2016 with retrospective effect to 1 April 2016) is to treat the purchase of a dwelling with a granny flat for surcharge purposes very much as if it was the purchase of a single property, if some conditions are fulfilled.

The changes were summarised in the explanatory note issued with the amendments: "The amendments affect purchasers of dwellings with self-contained annexes or outbuildings that are, themselves, dwellings. These purchasers will not be subject to the higher rates of SDLT only because they have purchased such a pair of dwellings. The purchases will still be subject to the higher rates of SDLT if the purchaser already owns another dwelling and is not replacing a main residence."

The test, which I call the "subsidiary dwelling test" is that:

- **on making a just and reasonable apportionment of the price, at least two thirds of the price is paid for the main dwelling.**
- **the subsidiary dwelling is part of the same building as the main dwelling or is within the 'grounds' of the main dwelling.**

It is not relevant how the subsidiary dwelling is to be used (for example it could be let out to an unrelated tenant rather than used for a family member). Nor is there any requirement within the subsidiary dwelling test as to planning conditions requiring the subsidiary dwelling to be occupied or disposed of in limited ways.

The statutory provisions as amended are not easy to follow, so the examples set out afterwards in Section 9 should make things clearer. If you are brave you can read the following paragraphs (a) to (e) which paraphrase the parts of the legislation which can make the surcharge apply to the purchase of a property comprising two dwellings. It is often hard to follow the effect of not meeting a condition. I have therefore indicated whether it is a Good Thing or a Bad Thing for the transaction not to meet a condition.

The surcharge is due on a transaction under the charging provision in paragraph 6 where all of the following conditions (a) to (e) are met:

(a) The purchaser is an individual. It is a Bad Thing to fail this condition as other charging provisions catch purchases by other entities such as companies and discretionary trusts. Out of the frying pan and into the fire.

(b) The property counts as two or more dwellings. The condition will be failed if it is only one dwelling, other charging paragraphs come into play. However this article is about cases where the property counts as two dwellings. The surcharge does not always apply just because there are two dwellings (other conditions such as (d) and (e) below may not be met).

This article suggests it can be a Bad Thing to fail this condition (by virtue of there being only one dwelling). One can be better off having two dwellings and being within this charging paragraph. That is because if the **subsidiary dwelling test** in this charging provision is passed then multiple dwellings relief can be claimed without incurring the surcharge. In this scenario one pays less SDLT for a given price buying two dwellings in a single transaction than buying one dwelling.

It would often be a Good Thing to fail this condition (by virtue of there only being one dwelling) if otherwise the **subsidiary dwelling test** would be failed. If one has several dwellings but that test is not passed then as a consequence the surcharge would apply to the whole transaction.

(c) Only one of the dwellings (it is likely to be the main dwelling) meets all of conditions A, B and C summarised as follows:

Conditions A and B: These are likely to be met for both dwellings in the kind of case we are looking at, the purchase of a house with a granny flat. The conditions relate to the apportioned part of the price for the dwelling being £40,000 or more and the dwellings not being bought subject to a long lease.

Condition C: There is only one dwelling (the main dwelling) that is not subsidiary to any of the other dwellings. See the **subsidiary dwelling test** set out in bold above. It is a Bad Thing to fail this condition as, if there are two or more such dwellings one is out of the frying pan and into the fire.

The way the condition is phrased in the negative justifies some explanation. The condition is there to filter out (from the paragraph 6 charging paragraph) cases where there is more than one main dwelling.

If the application of the **subsidiary dwelling test** leaves only one main dwelling,

then the charging provisions we are looking at are likely to be the relevant ones. So for example, the surcharge will not then apply if the buyer is replacing a main residence or has no other property interests that count against him (see (d) and (e) below).

However, if there is more than one non subsidiary dwelling in the transaction, then we need to look at much less favourable provisions which are likely to lead to the surcharge applying in most cases (there are not then the "get outs" offered by (d) and (e) below).

(d) The main dwelling is not a replacement for the buyer's only or main residence. It is a Good Thing, in fact a Very Good Thing to fail this test. This condition provides an exception from this branch of the surcharge if the main dwelling replaces a previous residence, even if the buyer has other property interests. The replacement exception is subject to some conditions; see the separate article HERE. The Autumn Budget of 22 November 2017 tightened up the conditions. Note that to escape the surcharge on this ground the buyer needs to intend to live in the most valuable dwelling (two thirds or more of the total value). It does not work if he intends to live in a subsidiary one.

(e) At completion the buyer has other property interests that count against him. For example other property interests have to be worth £40,000 or more to count. It is a Good Thing, in fact a Very Good Thing to fail this test. It provides an exception from this branch of the surcharge for someone who does not have other relevant property interests buying two dwellings in one transaction where the **subsidiary dwelling test** is passed.

6 MULTIPLE DWELLINGS RELIEF GENERALLY

Multiple Dwellings Relief (MDR) has been available since 2011. It can offer a valuable relief where a number of dwellings are purchased in a single transaction or in linked transactions. The definition of "dwelling" is almost identical to that used for the 3% surcharge. MDR works by calculating the SDLT on each dwelling by reference to the average price of all the dwellings. Savings can therefore be achieved due to the multiple use of the lower rate SDLT charging bands. There are worked examples of this in Section 9 at Examples 1, 2 and 6.

For a transaction which is one of a number of linked transactions, MDR works by first calculating a notional tax for the combined payments made for all of the linked transactions. It then apportions it down to the individual transactions proportionally by the price for each. For a worked example, see Example 6 in Section 9 below.

7 MIXING NORMAL AND SURCHARGED PROPERTIES

HMRC correctly say in the Manual at SDLTM09766 that "the rules do not allow for a single transaction to be a combination of higher and normal residential rates".

The HMRC Guidance Note contains no examples of how to work out the amount of SDLT where there are linked transactions, some of which are at normal rates of SDLT, some with the surcharge applying.

The Head of Stamp Taxes Policy at HMRC confirmed at a meeting with tax professionals on 22 March 2016 that for linked transactions one could have some that suffer from the surcharge and others that do not. He approved the calculation of tax using the Finance Act 2003 s55 formula where, in a similar way to that described at Section 6 above, one works out a notional amount of tax on the combined consideration, both with and without the surcharge. One then takes a proportion of the different figures, using the relevant proportion of the chargeable consideration. Lost? There is a worked example of this in Section 9 at Example 6.

8 MULTIPLE DWELLINGS RELIEF AND SURCHARGE INTERACTION

The interaction between the higher rates of stamp duty land tax (the 3% surcharge) and multiple dwellings relief (MDR) for a purchase including a subsidiary dwelling had initially been unclear. Advisers were concerned that the effect of claiming multiple dwellings relief could be that the 3% extra SDLT would apply (even though it would not otherwise have been due). These concerns arose from:

(a) Para 71 of the Explanatory Note published with the draft Budget Resolutions of March 2016 (commenting on what became s128(4) of the Finance Act 2016) had said: “where a claim to multiple dwellings relief is made, the higher rates apply in calculating that claim”.

(b) HMRC’s original Guidance Note on the higher rates of SDLT for additional properties of 16.03.2016 had said at para 71 “The higher rates will apply to claims for multiple dwellings relief”.

(c) Conveyancers who are part of the Conveyancing Quality Scheme have to undertaking training. The CQS Risk and Compliance 2016 Update had a section on the higher rates of SDLT. It mentioned multiple dwellings relief and the example indicated that the higher rates would apply where MDR is claimed.

The amendment made to the MDR provisions by the surcharge provisions says that in working out the tax due when MDR is claimed "account is to be taken" of the surcharge "if the **relevant transaction** is a higher rates transaction".

The way the MDR provisions work for linked transactions is that:

- each of the individual transactions is a "relevant transaction"
- SDLT is to be worked out on each relevant transaction independently as a fraction of a notional amount of tax on the combined payment for all of the linked transactions.

The same meeting of 22 March 2016 discussed cases of MDR and how that works if there are linked transactions, with some of the dwellings liable to the surcharge and others not. It was concluded that as MDR works on a transaction by transaction basis for linked transactions then the same calculation approach at Section 7 as above can be used. There is a worked example of this in Section 9 at Example 6.

Looking carefully at:

- **the typical granny flat case where there are two or more dwellings in a single transaction and where the surcharge would not otherwise be due and**
- **the way the MDR statutory provisions are worded**

it seems to be the case that MDR can be claimed without the surcharge automatically becoming due as a consequence.

HMRC had come within a whisker of confirming that a buyer can have the "best of both worlds" (being able to claim MDR without the higher rates applying) in the Manual when the guidance was migrated across Guidance Note of 16.03.2016 and amended at SDLTM09755. Frustratingly they did not specifically confirm there that a claim for multiple dwellings relief in the right kind of case would not itself trigger the higher rates.

The confirmation has now been given in a "Talking Points" webinar of 23 July 2019. It confirms what they had said informally before and in individual cases. Here is the text of what HMRC said in Talking Points webinar on 23 July 2019:

"In a situation where one of the dwellings being acquired is subsidiary to another of the purchased dwellings (often referred to as an annexe) the higher rates may not apply but multiple dwellings relief may still be claimed if the purchase meets the qualifying conditions. A dwelling is a subsidiary dwelling if it is within the grounds of or the same building as the main dwelling and the chargeable consideration when apportioned on a just and reasonable basis for the subsidiary dwelling is no more than a third of the chargeable consideration for the whole transaction. To clarify: where an individual buys a property which includes a subsidiary dwelling, multiple dwellings relief could be claimed if the qualifying conditions are met and the higher rates won't apply unless they are triggered by other property that the individual already owns."

It is ultimately a matter for the courts to interpret the meaning of the legislation. In the meanwhile as this a self-assessed tax, taxpayers have to apply it as well as they can.

There are odd provisions in the legislation about the 15% rate for purchases of dwellings by "non-natural persons" for over £500,000 (FA 2003/Sch 4A) that can have the effect of splitting transactions into two for certain purposes. However this does not seem to affect the type of granny flat case we are dealing with here. HMRC seem to accept this point: in the revised Guidance Note of 26 November 2016 see Chapter 9 examples 21 and 22. This can be found in the archived Guidance Note, these examples were not carried forwards into the Manual when the guidance was moved across at the end of March 2018.

9 EXAMPLES

Example 1 House with a granny flat, no other property interests

Question: *My husband and I are selling our only home and buying a larger house with a granny flat for £600,000. We intend to live in the main part as our only home and expect my mother to move into the flat. The flat has its own front door and is self-contained with its own kitchen, bathroom, bedroom, living room and separate utilities. There has been a history of separate use of the two parts. We have been told that a reasonable apportionment of the price would be £450,000 for the main part and £150,000 for the flat*.

Neither my husband nor I have any other property interests, nor do we have relevant interests in trust, nor minor children with property interests. What is the position as to the SDLT surcharge?

Answer: From the description given it sounds as if the main part and the granny flat are likely to count as two separate dwellings for SDLT purposes.

The amendments brought in during the passage of the Finance Act 2016 will save you from the surcharge on the basis that the granny flat is part of the same building as the main part and that the value of the main part is more than two thirds of the total value. As you own no other property interests, then on the amended rules you would not be liable to pay the surcharge, suggesting you would pay the normal SDLT of **£20,000**.

On the basis explained in Section 8 above (see the bold boxed text) that it is possible to claim multiple dwellings relief in this case without triggering the surcharge, then the SDLT on the £600,000 price reduces from the normal £20,000 to **£10,000** (calculated as 2 x £5,000 which would be the normal SDLT on a property at the average price of £300,000). So you would be better off with the property being treated as two dwellings than as one.

Example 2 House with a cottage and paddock, no other property interests

Question: *I am buying a large house on the outskirts of a village. The house has a garden, orchard, paddock and a cottage which used to be a gardener's cottage but is now vacant. I am paying a total of £1.2 million. I am buying it with my spouse in a single transaction from the existing owner. We plan to live in the large house and will rent out the cottage*.

I am told that a fair apportionment of the price would be about £900,000 for the house and gardens with the orchard, about £200,000 for the cottage and about £100,000 for the paddock. By the time of the purchase completing there are no other property interests that count against us for surcharge purposes. Will we have to pay the surcharge?

Answer: First you should check whether the property is "mixed" residential and nonresidential property. HMRC published guidance on the issue on 25 June 2019 in their SDLT Manual starting at SDLTM00440. For example the paddock might not be part of the garden and grounds, but be let to a local farmer and used in a farming business, so it does not count as residential property. If the property is mixed, then the 3% surcharge cannot apply and the SDLT will be assessed on the basis of the non-residential rates. For a price of £1.2 million this will be SDLT of **£49,500** (using slice rates with the top slice of the price over £250,000 being charged at 5%).

Even better, multiple dwellings relief could be claimed. MDR would then apply to £1.1m (the house and cottage) and £100,000 would be taxed at 1/12 of £49,500 (the non-residential rate applying to the whole property if MDR were not claimed). On the average price of £550,000 per dwelling standard rate SDLT is £17,500, giving £35,000, and the non-residential element is £4,125 - a total of **£39,125**.

Note: In about December 2018 HMRC updated the section in the Manual for multiple dwellings relief. They changed the example at SDLTM29975 for a mixed use property. They said that if MDR is claimed the dwellings would be charged at higher rates. This does not

appear correct, but the analysis is not a simple one. HMRC are presently reviewing this and we will see if they change their example. There is a write up about the issues here.

If the property is entirely residential (with the paddock forming part of the garden and grounds of the house) then the amendments made during the passage of the Finance Act 2016 might save you from the surcharge. Of particular concern could be the test that the cottage must be in the grounds of the house. If the cottage sits within the grounds of the house then the **subsidiary dwelling test** should be satisfied. From the price apportionment figures you give, over two thirds of the price of the whole transaction is payable for the house. So the surcharge will not apply to the transaction at all. Normal SDLT of **£67,350** would be due.

On the basis that MDR can be claimed without the surcharge applying, the SDLT would be reduced to **£40,000** (2 x £20,000 which would be due on the average price of £600,000 per dwelling without the surcharge).

If for some reason the surcharge does apply to this transaction (perhaps the cottage does not sit in the grounds of the house) then SDLT would be higher.

That would mean normal SDLT of £63,750 (using slice rates including 10% for the part of the price over £925,000) and a surcharge of £36,000, so the total SDLT would be **£99,750**.

With a valid claim to MDR this would reduce to **£76,000** (2 x £38,000 which would be due on the average price per dwelling of £600,000 with the surcharge).

Example 3 Replacement of residence by a house with a granny flat when owning other properties

Question: *We are an unmarried couple selling the house we jointly own and that we live in as our only residence. We are buying a house to live in which will be our only residence. However the new house has a flat which will be suitable in due course for my elderly parents. We intend to rent the flat out for a while before my parents need it. We could let the flat out without making any alterations to the property. We have other property interests which we intend to retain:*

- *a holiday home in France worth £75,000 that we own equally*
- *a house that we let out worth £250,000 with a mortgage of £220,000 so our equity is £30,000.*

We are concerned that we will be hit by the SDLT surcharge.

Answer: It seems that the amendments made during the passage of the Finance Act 2016 will be of assistance assuming that the flat passes the **subsidiary dwelling test** (it is part of the same building as the main part of the house and that main part is worth at least two thirds of the total transaction price). It does not matter that you intend to rent the flat out.

This does not quite get you out of the woods for the surcharge, given that you have other property interests.

The French property, though worth £75,000, should not "count against" you as the surcharge tests are applied to each of you separately. Each of you has an interest worth less than £40,000, so below the threshold. It seems from the Manual at SDLTM09780 and SDLTM09785 that HMRC accept the point, as they confirm one has to look at each joint buyer (or deemed joint buyer) individually. See also Chapter 8 of HMRC's Guidance Note and question 7 (not carried forward into the Manual in March 2018).

The house you let out does count against you for surcharge purposes. The value is taken before deducting any mortgage, so each of you has an interest worth £40,000 or more in another property.

Because you have other property interests counting against you, you need to pass the usual replacement of main residence tests to avoid the surcharge. It seems you pass the usual tests, as you are selling your main residence and intend to live in the main part of the new house.

It also seems (see Section 8 above) that you could claim MDR to reduce the normal SDLT without incurring the surcharge.

Example 4 House with two subsidiary flats

Question: *We are buying a house with a large garden and grounds within which are garages with two flats over. The flats are both self-contained dwellings. In order to buy this property we are selling all of our other property interests. We will live in the main house but plan to let out the two flats. Will we have to pay the SDLT surcharge?*

Answer: It seems that the amendments made during the passage of the Finance Act 2016 will allow your purchase to escape the surcharge even though there are two other dwellings as long as:

(a) the two flats are within the grounds of the house.

(b) a just and reasonable apportionment of the price over the whole transaction would be two thirds or more to the main dwelling.

It also seems (see Section 8 above) that you could claim MDR to reduce the normal SDLT without incurring the surcharge. As there are three dwellings you would work out the SDLT on one third of the price and then multiply it by three. That could give a considerable saving.

Example 5 Two flats in the same building

Question: *We are buying a freehold of a new building in order to have the two unsold flats in the building, the other three having been sold on long leases at nominal rents. The other lessees have been offered the freehold, but cannot afford it. The two flats are a large one at the top of the building and a smaller less valuable one on the ground floor. We intend to live in the larger flat and let the smaller one out. We are selling our jointly owned only residence to fund the purchase, but have other property interests*.

What is the position as to the surcharge? It would make sense to me that I should be able to escape the surcharge on the more valuable flat I am to live in on the basis of the

replacement of only or main residence exception. I expect the surcharge will apply to the other one, surely the granny flat rules do not apply?

Answer: Oddly the granny flat rules could potentially apply here as the two flats are bought in the same transaction and are in the same building.

- If a fair apportionment of the price would be two thirds or more to the more valuable flat, then the granny flat rules work in your favour. The surcharge does not apply at all (assuming that there is no problem with the replacement of main residence exception).

- The rules work against you though if the values of the flats are not different enough and the whole transaction would be caught by the surcharge.

It seems that in this kind of a case if the values work out the **subsidiary dwelling test** could be satisfied and you could claim MDR to reduce the normal SDLT without incurring the surcharge if it would not otherwise have been due (see Section 8 above).

Example 6 House and cottage in two linked transactions, calculations

Question: *We are buying a large house with a cottage in the grounds, but find that these are held in two titles by different (though connected) sellers. We have been offered two contracts for £800,000 and £300,000 (a fair apportionment) to be signed on the same day and there will be two transfers, one from each seller. One will be of the house, the other of the cottage and they will complete on the same day. The sellers have made clear that they will only proceed on the basis that both transactions go through together.*

We need to sell our existing property (the only residence for both of us) in order to fund the purchase. We will live in the large house as our only home and elderly relatives will live in the cottage. Will we be liable for the surcharge or should we benefit from the amended granny flat provisions?

Answer: The "granny flat" amendments made during the passage of the Finance Act 2016 do not apply here, because the two dwellings are not being bought in the same transaction.

If the two transactions complete on the same day, then at the end of the day of the transaction you will own two properties. However, from what you say, you should escape the surcharge on one transaction (for the large house) as it is a replacement of your main or only home. Your purchase of the cottage will be liable to the surcharge.

So we have a position of two linked transactions, one liable to surcharge, the other not. The calculations are complicated. One first has to work out two notional amounts of tax, being the amounts that would have applied to the combined payments for the linked transactions. The first notional amount is on the basis that the surcharge does apply and the second on the basis the surcharge does not apply. One then works out the actual amount of tax for each property by taking a proportion of the notional amount of tax, the proportion relating to the value of the property. In this case:

The total consideration for the two linked transactions is £1,100,000. With the surcharge the SDLT on that total would be £86,750. Without the surcharge the normal SDLT on that total

would be £53,750.

So the actual SDLT using the formula is:

For the house (without the surcharge): £800,000 / £1,100,000 x £53,750 = £39,090

For the cottage (with the surcharge): £300,000 / £1,100,000 x £86,750 = £23,659

Total SDLT for the two linked transactions is **£62,749**, but this is before MDR is claimed.

The SDLT calculation if multiple dwellings relief is claimed in this case, with the house being free of surcharge and cottage subject to

The total consideration for the two linked transactions is £1,100,000. With the surcharge the SDLT on that total claiming MDR would be £68,000 (2 x £34,000 on the average price per property of £550,000 with the surcharge). Without the surcharge, but with MDR, the SDLT would be £35,000 (SDLT of 2 x £17,500 on the average price of £550,000). So the calculation is:

For the house (without the surcharge): £800,000 / £1,100,000 x £35,000 = £25,454

For the cottage (with the surcharge): £300,000 / £1,100,000 x £68,000 = £18,545

Total SDLT for the two linked transactions is **£43,999** if MDR is claimed.

surcharge looks like this:

10 FIRST TIME BUYERS' RELIEF

First time buyers' relief was introduced by the Autumn Budget of 2017 for some purchases completing on or after 22 November 2017 where the price is up to £500,000. But the relief can never be available where two or more dwellings are acquired in a single or linked transactions. Nor can the relief be available where the surcharge applies. The closest any of the examples in section 9 above gets to a claim for first time buyers' relief is Example 6 where the cottage is in a separate contract for £300,000. But the relief is not available there for a number of reasons:

(i) The buyers are selling an existing property and so are not first time buyers

(ii) The cottage is subject to the surcharge

(iii) There is a linked transaction which does not just involve garden and grounds

11 WALES

"Land Transaction Tax" applies to most purchases in Wales completing from 1 April 2018. The rules there are differently (most notably as to the rates of tax). This article covers only stamp duty land tax.

APPENDIX 1: One dwelling or more, physical configuration

In considering whether a property is suitable for use as one or more dwellings (and if so, how many) a wide range of factors comes into consideration. No single factor is likely to be determinative by itself. However not all factors are of equal weight and one strong factor can outweigh several weaker contrary indicators. Where a number of contrasting indicators exist, the taxpayer needs to weigh up all the factors in coming to a balanced judgement.

The following table considers a number of factors about the physical configuration of the property which should be taken into account when assessing how many dwellings are included in a property for the purposes of multiple dwellings relief and the higher rates of SDLT.

The physical configuration of the property has to be considered as it is on the effective date of the transaction (normally completion). **Accommodation etc**	
Kitchen	Most dwellings have their own kitchen or kitchenette where a full meal can be prepared. It would normally be more than a room where one could plug in a kettle, microwave, toaster and grill. There are areas though, such as in parts of central London, where some dwellings have very limited facilities for the cooking of food and this should be taken into account. The services to the kitchen would usually include hot and cold water, drainage for a sink (large enough to wash up in), lighting, power points at work top level and often heating. Many kitchens have an electrical circuit from the consumer unit for a cooker and a power source specifically installed for a cooker. A kitchen would normally have a sufficient work surface and appropriate storage areas. The presence or absence of cookers and white goods such as fridges and dishwasher is of little relevance because these are sometimes removed on a house sale, but there should be space and facilities to install appropriate appliances. Most dwellings would also have somewhere suitable to eat a full meal.
Washing facilities	Most dwellings have their own bathroom or room containing a shower. The doors are usually lockable. The services to the bathroom usually include hot and cold water, drainage, lighting and often heating. Power sockets are usually specific to bathroom use. Often there is an extractor fan or other arrangement to prevent dampness.

Lavatory	Most dwellings would have their own lavatory within the building with a lockable door. Occasionally there might be an outside lavatory for older properties. There is usually a sink in the same or in an adjoining room.
Sleeping accommodation	It is of the essence that a dwelling has somewhere to sleep. A room to sleep in would normally have lighting, power points, heating and a window and be of an appropriate size, with a door separating it from living accommodation.
Living accommodation	A dwelling needs to have enough suitable accommodation for day to day living including having visitors, for storing belongings and for carrying out pastimes. There would be enough space for chairs, tables and cupboards and other furniture. The room or rooms would normally have lighting and power points and usually heating and a window.
Independent entrances	A dwelling normally has a sufficiently independent access. This does not necessarily have to be a separate entrance from outside of the building; it could be from common parts such as in a block of flats. Typically there will be common parts such as hallways and staircases off which each dwelling will have a single lockable door. If for example an upstairs flat appears sufficiently independent on its own but gains access through the living accommodation of the larger unit downstairs, then the larger unit might not be independent enough to count as a dwelling on its own and the combined accommodation might be a single dwelling.
Privacy and interconnecting doors	A dwelling requires a degree of privacy; this is usually a result of the application of the criteria above, especially independence of access. It is unusual for adjoining dwellings to have interconnecting doors, but this can happen, for example in the case of self-contained annexes for elderly relatives. It is relevant whether the door between the parts can be locked, or is readily capable of being made secure; perhaps it can be easily blocked by large items of furniture either side. The quality of sound insulation between the two parts could be relevant, but this is often poor in converted properties, especially older ones. (These issues were to the fore in the First Tier Tribunal case of Fiander and Brower.)
Stripping out of fixtures	The fact that a building / part of a building has had fixtures removed (for example from a kitchen or a bathroom) is unlikely to mean that it is not suitable for use as a dwelling. Replacement of such fixtures is fairly common. Often the removal of fixtures would leave in place the infrastructure needed for the function of the room, such as the water supplies, drainage facilities and electrical circuits.

	All factors will be taken into account, including when the fixtures were removed and why. The nature of a property at the effective date of a transaction can be judged bearing in mind the previous and habitual use.
Services and the degree of independence of operation and isolation	
Electricity	Most dwellings have an electricity supply which can be switched off from its own consumer unit, usually within the dwelling, otherwise in common parts. The circuitry is normally such that if a circuit trips out, that will not affect other dwellings. Some dwellings have their own private electricity supply. With renewable energy schemes there might be a greater degree of interdependence and cooperation required between different households.
Cold water	Dwellings require a supply of water fit for human use. The majority of dwellings have a water supply which can be turned off from its own stop tap, sometimes within the dwelling, sometimes in common parts, sometimes outside the building. It is however relatively common for a single water stop tap to isolate a number of dwellings.
Hot water	Dwellings will usually have their own independent system for heating water, but it is not uncommon to have shared supplies, with the water being heated in common parts, perhaps as part of a renewable energy scheme. Each dwelling would normally be able to turn off its supply (for example whilst works are done) and it would not normally be necessary to go through the living accommodation of another dwelling to manage the common system.
Heating	Dwellings will usually have their own independent system or systems for heating, but it is not uncommon to have shared supplies, with the power being generated in common parts, perhaps as part of a renewable energy scheme. Each dwelling would normally be able to turn off its own heating (for example whilst works are done) and it would not normally be necessary to go through the living accommodation of another dwelling to manage the common system (such as a boiler).
Gas	Where dwellings have a gas supply they are normally able to isolate it from within the property, from common parts, or from outside the building.

Burglar alarm	Separate dwellings would not normally share a burglar alarm system, but many systems have “zones” so areas can be deactivated.
Laundry	Many dwellings have facilities to connect in a clothes washing machine, but this is not universal and small flats in city centres well served by laundrettes or by a communal facility might not have facilities to install a washing machine.
Drainage	In practice nearby dwellings often share drainage systems so a high degree of independence is not to be expected here.
Telephone and telecommunications	Little weight should be given to whether the two parts have separate telephone lines and telecommunications services on the effective date.
Postal arrangements	A dwelling would normally be able to receive its own post, but not all dwellings have their own letter box; it can be relatively easy to arrange for a post box outside or in common parts, so that each dwelling would only have access to its own post. Accommodation for elderly relatives might generally be independent but the post be received through the main house; this would only be viewed as a minor degree of dependence in that context.
Meters for utilities	Perhaps little weight should be placed on whether each part is metered and billed separately for utilities such as electricity and water. It is relatively common for service costs to be estimated, or for properties to be rented out on a “utilities inclusive” rent.

Context

The context is important: an old dwelling in an isolated what might be usual for a modern central city dwelling will be different from rural area.

A lower degree of independence assisted living but where might be expected in housing for the elderly with a degree of residents are able to lead independent lives if they want to.

There are examples of with environmentally friendly one developments encouraging a more communal style of living, often associated features. The test of whether a property is a dwelling is an adaptable to fit the circumstances.

APPENDIX 2: Information requested by HMRC in making a check of a return

In a schedule of information required to check a return with a claim for MDR, HMRC have asked for an explanation as to why it is believed the property contains a separate dwelling, especially the features that enables it be to a self-contained separate residence capable of independent occupation. They ask for:

(a) Floor plans annotated with the information below.

(b) The number of "council tax references" for the property at the date of the purchase.

(c) Whether the parts had distinct postal addresses.

(d) Whether the parts could be independently accessed from outside of the property.

(e) Whether any internal doors between the two parts were lockable at the time of the purchase (to be shown on the floor plan).

(f) Confirmation of the ability independently for each dwelling to start / stop essential facilities (fuse box and water supply) and electricity, gas and water meters.

(g) To be shown on the floorplan, the location of fuse boxes and water stopcocks.

(h) To be shown on the floorplan, the location of electricity, gas and water meters.

(i) For the kitchen / cooking facilities to be marked on the floorplan.

(j) For the toilet, shower, bath etc. to be marked on the floorplan.

(k) For the bedrooms to be marked on the plan.

(l) Supporting photographs to show the items above to demonstrate how the two dwellings are clearly separated.

Written January 2017; updated 18 November 2018, 18 May 2019, 27 July 2019, 6 January 2020 and 14 April 2020.

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December 2020 Public