SQUIRE SANDERS

SUBSALES RE-STAMPED

When stamp duty land tax (SDLT) replaced stamp duty on land transactions nearly 10 years ago, one of the government's principal concerns was the perception of widespread avoidance of stamp duty. SDLT was to be a robust new tax that would stop tax advisers in their tracks.

However, this has proved an empty boast, as an ongoing war of attrition between HM Revenue and Customs (HMRC) and taxpayers has played out over the past decade: regular changes to the SDLT legislation to address avoidance; new obligations to disclose tax planning to HMRC before implementation; and, more recently, a series of successful challenges to schemes in the courts.

One area of SDLT law that has wide commercial implications has come under increasing scrutiny. It is now undergoing a radical overhaul in a further attempt by HMRC to clamp down on avoidance. The changes will increase the compliance burden on taxpayers and, in some cases, result in extra tax charges.

Subsale Relief

The situation being referred to arises quite commonly: A agrees to sell some land to B; before that contract completes, B enters into a transaction that will result in C getting the land. This can be achieved in a number of ways:

- B agrees to procure that A transfers the land direct to C;
- B assigns the benefit of its contract to C;
- A transfers the land to B, who immediately transfers it to C.

Strictly speaking, only the first example is a subsale. The SDLT legislation calls all of them "transfers of rights", which does not really cover the third. Each could give rise to two SDLT charges. Recognising that this is not necessarily the "fair" outcome, the SDLT rules provide, broadly, that B should not have to pay SDLT.

Like much of the SDLT legislation, the subsale rules are hardly a model of clarity. In a straightforward situation, they work pretty well, relieving B of SDLT and the need to file an SDLT return. C is liable to pay SDLT and the rules are intended to impose a charge by reference to the amount C pays. This will include amounts that C pays to A, but also amounts that C pays to B.

The lack of clarity in the rules has allowed for exploitation and the widespread promotion of structures to limit the amount of SDLT that C pays. A number of these schemes are now being tested in the courts and are often found wanting. Technically they do not work, but they have given the existing rules a bad name and diverted attention away from the legitimate use of the rules incommercially motivated situations.

HMRC consulted last year on how to deal with the subsale "problem". One solution was to abolish the concept so that both B and C would pay SDLT. Until recently, this would probably have been first announced in the Budget. Fortunately, as a result of the new approach of consulting on tax changes, the property industry was given advance warning of HMRC's thinking and was able to persuade it not to adopt this sledgehammer approach.

Despite this, HMRC was not convinced that the other tools it already had could be used to block the more egregious planning structures. Nothing less than a complete rewrite of the subsale rules would do.

Draft legislation appeared at the end of 2012 and is now working its way through Parliament in the Finance Bill. It is expected to come into force when the Bill receives Royal Assent, which is generally in the second half of July. The new rules will then apply to any transaction whose effective date occurs after Royal Assent, even if elements of the transaction occur at an earlier date.

In the meantime, in a final assault on the existing subsale rules, the government last month announced changes to make it clear that a variant of a scheme that has already been blocked is caught. Significantly, the changes are effective from March 2012, carrying through a previous threat to introduce retrospective legislation here.

Into the Compliance Net

What do the new rules look like? First, there is a change in terminology: in future, there will be "pre-completion transactions" rather than subsales or transfers of rights. Secondly, the new rules distinguish between two types of pre-completion transaction:

- B assigns the benefit of his contract with A to C, so C can complete the contract and have the land transferred direct to him;
- Any other situation in which C ends up with the land.

The second is described in the legislation as a "free-standing transfer" and this will cover back-to-back transfers, B directing A to transfer to C and also the situation where the contract between A and B is novated in favour of C. Perversely, HMRC has recently argued in the courts that the existing subsale rules do not cover novations so, oddly, the new rules may actually extend the ambit of the relief.

In some ways, this is a distinction without a difference. The rules preserve the basic proposition that B should not pay SDLT whether there is an assignment of the contract or a free-standing transfer. However, in a key change, B will need to file an SDLT return and formally claim subsale relief. This will give HMRC an easier route to find out about subsale transactions and enquire into them. Although it brings B into the compliance net, it is widely seen as an acceptable price for preserving the SDLT exemption for B.

Of course, given the background to the new rules, there is more to them than imposing a requirement to claim relief. First, B will not get relief if it would be reasonable to conclude that obtaining a tax advantage for him or anyone else was the main purpose, or one of the main purposes, behind his entering into the transactions. This is not limited to avoiding SDLT – all taxes are covered.

This new avoidance test supplements SDLT's existing general anti-avoidance rule that allows HMRC to look through structures to impose the highest SDLT charge. The Finance Act will also introduce a general anti-abuse rule that can be used to challenge SDLT avoidance. Therefore, in future, there will be three sets of avoidance rules to consider.

In a further step to clamp down on avoidance, there will be special rules that apply where B and C are connected to each other. Much subsale planning has revolved around the B to C transaction being taxable at a much lower rate than the economic value of the transaction – perhaps a gift by one spouse to another or a dividend in specie of the land from B to C. Often the real price was paid by B to A, but funded by C.

The courts have so far given these schemes short shrift, but HMRC will now have a legislative rule that imposes a minimum taxable consideration on C where B and C are connected or not acting at arm's length. Generally speaking, the rules should not be an issue where B subsells at cost or above, but will need careful consideration where, for what may be good commercial reasons, B subsells at a loss.

Much ado About Nothing?

After the threat of withdrawal last year, you might ask what all the fuss was about. HMRC has stated that the new rules are not supposed to change the fundamental principle that B should not pay SDLT. Of course, B will now have to file an SDLT return and claim relief. And in most commercially motivated transactions, that should be the only change that B notices, as can be seen from the examples in the box below.

However, in getting to that outcome, B's advisers will have the thankless task of working through 20 pages of closely drafted legislation to ensure the conditions for relief are met

How will the new subsale rules work in practice?

- **B enters into a contract to buy a piece of land from A for £10m. B is intending to develop the land, but before the sale is completed, C approaches B and offers to take the land for £12m. A agrees to assign the contract to C. At completion, A transfers the land to C for the original contract price of £10m and C pays B £2m.**

  Under the new subsale rules (as under the existing rules), C is liable to pay SDLT on the £10m contract price plus the £2m paid to B. B is not liable to pay SDLT (again, no change). Under the new rules, B will be required to file an SDLT return and formally claim subsale relief (under the existing rules, there is no obligation on B to file a return).

- **B finds a development site for C. The owner, A, will only deal with B, so B enters into a contract with A to buy the land for £5m. B then contracts with C to sell the land to C for £6m. At completion, A transfers the land to B and B transfers the land to C.**

  The analysis is the same as in the first example. C is liable to pay SDLT on the £6m it pays to B and B has no liability to pay SDLT. The key change in the new rules is that B will be required to file an SDLT return and claim subsale relief.

- **B contracts to buy an investment property from A for £10m, paying a £1m deposit. B's bank withdraws its offer of finance. Rather than walk away from the deal, B agrees with C, a company associated with B, to sell the property to C for £8m. At completion, A transfers the property to B for £10m and B transfers it to C for £8m. B pays the £9m balance due to A using £1m of its own funds and the £8m paid by C.**

  The new subsale rules change the way SDLT works in this situation. B has sold to C at a loss and, because of the connection between B and C, the minimum consideration rule is triggered. B is in the same position as the previous examples and is not liable to pay any SDLT, but will be required to file an SDLT return. Under the current rules, C should only be liable to pay SDLT on the £8m it actually pays (this assumes it has not put B in funds to pay the balance of the £10m price). Under the new rules, C will be liable to pay SDLT on £10m – the £2m paid by B is added back, even though B has funded this cost itself.