

## **A TRAP TO ENSNARE THE LAYMAN - STAMP DUTY LAND TAX (SDLT)**

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Tenants of commercial premises who entered into a lease after 30 November 2003 and who are coming up to a rent review or the end of their lease may find



that they have a nasty surprise awaiting them.

In the old days a tenant would pay Stamp Duty on the grant of a lease, calculated on the basis of any payment made for the lease (called a premium) and on the level of rent payable throughout the period of the lease (called the term). Depending on the length of the lease, in addition to paying Stamp Duty the tenant might have to make a simple return to the Inland Revenue giving details of the lease.

Stamp Duty was only payable on a document, so if the agreement was verbal it was not subject to Stamp Duty. With a written document there was usually a one-off payment only. It did not matter if the rent went up on a rent review or if the tenant remained at the premises after the end of the term.

But with SDLT the position is very different. SDLT is a tax on transactions, not on documents, and if a return has to be made then it is on a very different type of return from the old one. Depending on the nature of the transaction, instead of taking 5 minutes to complete the relevant form, this can now take anything from 20 to 45 minutes for even relatively simple every day transactions.

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If the return is not made within 30 days of what is called the relevant date, usually but not always the date of the lease, then a penalty of £100.00 is payable. This rises to £200.00 after 3 months, plus the payment of any SDLT and interest on late payment.

## **Example 1:**

Imagine that the landlord and tenant agree to let a commercial property. Nothing is in writing and no legal advice was sought as it was only intended to last for a year.

At the end of the first year, and each following year, the lease just continues because it has worked well.

- A rent of £27,500.00 a year is paid and no SDLT is payable. There was no need to make a return.
- At the end of year 6 the lease becomes a 7 year lease.
- SDLT is payable.
- It is only £181.00 but the tenant has no idea that he has to make a return let alone pay SDLT.
- He does not do so within the 30 day period and he has just committed an offence, which can be subject to criminal penalties.

Ignorance of the law is no excuse.

## **Example 2:**

Imagine the same facts but here you have a written lease for 6 years with a rent review at the end of year 3.

Again no legal advice is sought. The landlord has his standard lease and it looks reasonable enough, and indeed it is. There is no SDLT payable but the tenant has to make an assessment now of what the rent is going to be at the end of year 3, because if the rental level is going to increase at year 3, he has to add this to the rent and calculate what the rent is going to be.

And the regulations reveal that if the lease is for less than 7 years then, generally, it does not have to be notified (i.e. a return made) to HMRC.

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However, if the lease is for a term of less than 7 years the tenant still has to check whether SDLT is payable on any "premium" or purchase price or the amount of the rent. Usually on the grant of a commercial lease there is no premium or purchase price and it is only the level of rent that has to be assessed, to determine whether the rent payable is enough to trigger a liability to pay SDLT. If there is a liability then there is an obligation to notify or make a return.

The trap is that the unrepresented tenant may not realise that the current rent is not all he is supposed to assess. Where there is a rent review in the lease before 5 years have passed (e.g. at year 3), the tenant must assess now not only the amount of rent payable, but also the prospective amount of rent payable in 3 years' time. The tenant must also assess whether SDLT might be chargeable on what is usually a hypothetical level of rent.

Also the tenant should document the process because, if he forms the view that the rent will not go up, or not increase to an amount that will cause SDLT to be payable whereas in fact it does go up at review and SDLT is now payable, at least he can argue that he thought about it and complied with his statutory duty. In the example the tenant didn't think about all the possible eventualities, so when it comes to light, as it may well do, the tenant will find that he has to pay penalties for late delivery (of possibly 2 SDLT returns) plus interest and possibly a fine.

With low value rentals and leases for less than 7 years, this may never be a problem but the Government have created a highly complex system that is a trap for the unwary. Also, at present you could say that the prospect of rents going up are low – although in the last property crash the Inland Revenue argued strongly in some cases where valuation was in issue that the particular property concerned, unlike every other property in the area, had gone up in value!

In this instance a prudent tenant might think he needs to employ the services of a professional valuer, usually a Chartered Surveyor, to produce a valuation in order to back up the claim.

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Crystal ball gazing is never easy and even if a valuer is asked to advise the tenant may well get the response that no sensible valuer will advise on hypothetical matters and will decline to give a valuation – this is a problem that tenants come across in practice. And just to make matters more complex, if the lease continues - or in some cases is deemed to continue – beyond the sixth year, then the reporting obligations come into effect anyway!

## **Example 3:**

Sometimes the landlord may accept a lower level of rent than the open market value, which will “catch up” to market rent at a particular point during the life of the lease.

There are many variations and sometimes the reasons for agreeing a lower rent can affect the amount of SDLT payable, but imagine a lease where the value of the open market rent is £35,000.00 a year.

The parties agree that for the first 3 years of the lease the annual rent is £27,500.00, as the market is not good and the landlord is anxious to get a tenant into the premises. It is agreed that the rent will go up to the prevailing market rent at the end of year 3.

The tenant has to assess SDLT on what the likely level of rent will be in 3 years' time. As it is known that the current level of rent is below market rent then the correct approach may be to state what the current open market rent is (the legislation is not clear but this is what the Revenue suggest you should do).

So if the first 3 years rent is £27,500.00 and the open market rent is £35,000.00 then SDLT is payable at £154.00, which is higher than in the earlier example even though the amount of rent being paid is the same.

At the end of year 3 there is the rent review. However, the tenant and the landlord don't agree what the new rent will be - which sometimes can take months if not years to resolve.

The tenant still has to assess at the time of the rent review what the new rent is going to be, and may have to make a return to the Revenue. If he thinks the rent will be higher than originally estimated then he will have to pay further SDLT. And when the new rent is finally decided then the

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tenant may have to make another return to the Revenue and pay any further tax that may be due (or sometimes even get some back).

Guess what, our tenant has not made any returns because it did not occur to him in a million years that he would have to and when the Revenue finds out then we have got possibly £600.00 of fines plus interest and penalties. The tenant may have instructed a valuer but do not assume that the valuer will warn about SDLT; the valuer may not think that it is his job. Although if luck is on the side of the tenant, the valuer may say that SDLT is an issue and should be thought about but then again, he may not.

## **Example 4:**

Imagine a lease where the tenant has already made a return and has paid SDLT and there is no rent review until the end of year 5. Congratulations. The good news is that if the tenant has a rent review at year 5 and not at year 3 then in theory he does not have to worry about SDLT on the rent because the legislation says so.

However, there are provisions that apply if the level of increase in rent is deemed abnormal and there is a different and highly complex procedure to work out if the rent increase is, in fact, abnormal.

In brief, the tenant must find out 20% of the highest rent on which SDLT has already been paid, multiply it by the number of years from the date on which that rent first became payable and the date when the new rent is payable (rounding up to whole years if necessary). If the resulting figure is lower than the increase in the reviewed rent the increase in the rent is abnormal and the whole of the increase is subject to additional SDLT and further returns will have to be made. This also has to be repeated for any further rent reviews or indeed any time when the rent is varied.

How will the Revenue find out about the lease?

- The tenant may have received a Request for Information Form in response to which he must give details of his tenancy to the Valuation Office Agency. The VOA is an executive agency of HM Revenue & Customs and one of its

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main functions is to value property in England, Wales and Scotland for the purposes of taxes administered by HM Revenue & Customs. Valuations are carried out every 5 years and the last one was carried out in 2005. The next review is due in 2010 and will be based on valuations for 1 April 2008.

- If the tenant purchased the lease at that point he should have made an SDLT return in which he gave details of the lease including the rent review.

The Revenue already knows about the tenant's lease but the Revenue is not going to remind the tenant. It is the tenant's job to make the SDLT return, not theirs.

As you will see the law relating to SDLT is very complex and is a potential minefield for the unwary tenant.

The moral is that if you are a tenant or going to be a tenant then take legal advice in good time not only before entering into a lease, but also when you get to a rent review or indeed when your lease ends, as you may have liabilities that you never dreamt of.

For further information contact Peter Daniels on 01634 811444.

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