TAXREP 5/03

MODERNISATION OF STAMP DUTY; DRAFT LEGISLATION

Memorandum submitted in February 2003 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in November 2002 by the Inland Revenue

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MODERNISATION OF STAMP DUTY

INTRODUCTION

1. We welcome the opportunity to comment on the draft legislation in the consultation document issued in November 2002.

GENERAL POINTS

2. The Consultation Document is entitled Modernising Stamp Duty on land and buildings in the UK" when in fact it concerns the abolition of stamp duty and the introduction of a new tax on land transactions.

3. We understand that the new regime is to be implemented using three taxes:

    - Stamp duty reserve tax, largely to deal with on exchange share transactions (FA 1986)
    - Stamp duty for off exchange share transfers (Stamp Act 1891 and subsequent amending Finance Acts)
    - The new land transaction tax (Finance Bill 2003)

4. It would be clearer and easier to understand the latter if it was enacted in an Act bearing the name of the tax (for example, the Land Transaction Tax Act) rather than in the Finance Act.

5. For reasons explained below the interaction between clauses 26, 37 and 38 is completely inadequate. These issues would fall away if the new tax were charged upon receipt of consideration under a contract rather than on the making of the contract.

6. It is disappointing that draft legislation relating to special purpose vehicles, the calculation of lease duty and the availability of reliefs was not included in the draft legislation. These are major areas which will need to be scrutinised carefully. In order to do this, draft legislation should be published as soon as possible

7. Because of the large gaps in the draft legislation it is essential that the consultation process continues and that the ICAEW have representation on the various committees.

8. In the "Outline of the Modernised Regime", the objectives are stated as fairness, e business and modernisation. It is stated that artificial arrangements to avoid Stamp Duty are "unfair to the compliant majority". By definition, however, successful tax avoidance is compliant with the law. It is extremely dangerous to blur the distinction between perfectly legal and proper tax avoidance and illegal and dishonest tax evasion in this way.

9. An important point of the detailed drafting is that the term 'transaction' is not defined in the draft legislation, leading to uncertainty surrounding for example, exchange of contracts and completion.

Professional privilege

10. Much of the information supporting a transaction will be found in papers that are covered by solicitors' professional privilege. It remains of concern that professionally qualified accountants do not have the same degree of protection as solicitors.

Style

11. Although we welcome the drafting of this legislation in "modern English", care is needed with wording. In particular, the definition of "purchaser" in clause 3(4) and clauses 11 and 26 creates considerable difficulties of construction. This is commented on in more detail below.

Reliefs

12. When will we hear whether existing reliefs, such as those given by s42 FA 1930, ss75, 76 and 77 FA 1986, and s151 FA 1995 are to be included without amendment?

13. Consideration should be given to relief for:

a) First time residential buyers (as in the Republic of Ireland)
b) Transfers between spouses (in line with s58 TCGA 1992)
c) Sole traders and partnerships incorporating their business (see s162 TCGA1992; the current exemption for a general partnership becoming a limited liability partnership should be extended to incorporation). This would provide a welcome boost to many small businesses.

Statements of Practice and other guidance

14. We would welcome confirmation of what current guidance and which statements of practice are to remain in force?

15. When may we expect a Land Transaction Tax Manual?

Extensions of the charge to tax

16. Nothing in the criteria stated in the Explanatory Notes justifies producing a new tax with a more extensive charge than the old stamp duty on land transactions. The charge to tax appears to be extended by clauses 3, 9, 11, 17 and 25.

SPECIFIC POINTS

Clause 1

17. The normal formulation in a charging clause is that tax shall be charged. Clause 1 states that "a tax" will be charged. If you say "a tax" you normally expect to see the name of the tax. No reference is made in clause 1 to "land transaction tax" ("LTT"). Only in clause 28(2) is a reference to "land transaction tax" made and then it is made without definition or explanation..

Clause 3

18. We have a number of comments in relation to this clause. In an attempt to be comprehensive, the clause has become flawed.

19. We would welcome clarification of whether the phrase "relating to land in England and Wales" in clause 3(1) is a descriptive or limiting phrase? If it is merely a descriptive phrase the result would be to bring into charge transactions

which have no relationship to UK land because of the wide definition of covenant and the use of the word condition in ss 1(f). The matter would be clarified if the first line of ss1 became "this part applies to the following transactions if they relate to land in England and Wales-".

20. In the explanatory notes at paragraph 42 it is said that a contractual licence to occupy will not fall within clause 3. Clearly it will. A covenant is defined as any contractual obligation and plainly a contractual licence to occupy creates a contractual obligation to allow occupation which relates to land.

21. It is not obvious why ss1(f) refers to "making" a covenant whereas ss3 refers to an estate etc being "created". Is there meant to be a distinction between making and creating?

22. Sub clauses (3) and (4) appear to be unnecessarily complex and lead to difficulties of overlapping transactions. For example in the sale of freehold land it is common for the purchaser to grant covenants in favour of the vendor as well as vice versa. The grant of a covenant is a land transaction within clause 3(1)(f). For the purposes of Clause 3 therefore the grant of the covenant will fall within clauses 3(3)(b) in relation to the sale and within clause 3(3)(a) in relation to the grant of the covenant itself. Under clause 4 therefore "the purchaser" in relation to the covenant appears to be both the real vendor and the real purchaser! The difficulty arises from the over complex definitions in sub clauses (1) and (3) and from the failure to provide a definition of "transaction" within the phrase "land transaction".

23. A question as to the identity of the purchaser arises in relation to section 106 agreements and local authorities. It is commonplace for a local authority to impose conditions and take covenants in s106, Town and Country Planning Act 1990 agreements. For example, if a supermarket is to be built a local daycentre has also to be built. In this situation the local authority benefits from the covenants, so appears to be a purchaser within clause 3(4)?

24. Under clause 3(4) it is possible that someone who is not a party to a transaction in any way may be subject to tax? This would seem to apply in the following circumstances.

25. Mr A holds an acre of land. Contiguous with this land, Mr B also holds an acre of land which is subject to a covenant preventing commercial development. Mr B, a famous restaurateur wishes to open a restaurant and pays £100k for the release of the covenant. Mr A's land increases in value because of the prospect of improved commercial opportunities in the area. It appears that Mr A is a purchaser because the release of the covenant is a transaction in land and Mr A's estate in land is benefited by the release. Mr A has no control over the transaction and may be very displeased at the prospect of a busy restaurant opening on his neighbour's land.

26. It is quite wrong that persons who are not parties to a contract should be exposed to a tax charge because of it. If this point is not acceptable at the least there should be a rule providing that the parties to the transaction are to be charged in priority to any other person.

27. This clause appears to have the result that difficult apportionments of the consideration in a transaction between major and minor interests will be necessary, for example, where a covenant is granted by the vendor of land over adjoining land.

28. This clause appears to have a much wider effect than simply to charge declarations of trust on sale, agreements for lease, assignments etc. It would appear to cover assignments and disclaimers of interests arising under trusts of land, for example, which surely cannot be the draftsman's intention.

29. Will a reverse premium on an assignment or surrender of a lease trigger a charge and, if so, on whom? If so this clause imposes a charge where there was none previously.

Clause 6

30. As Land Transaction Tax is to move away from being a duty impressed on documents to a "transaction tax", we do not see that there is a need to identify both conveyances/leases etc and the underlying contract as being chargeable "land transactions". A better approach might be to regard the contract and completion as parts of a single transaction so one would identify the transaction giving rise to a charge and then treat receipt of consideration as crystallising the stamp duty in respect of each instalment. There would then be no need to provide for both contracts and conveyances to be chargeable, with provisions for avoidance of a double charge.

31. Clause 6(4)(a) provides that both the contract and the transaction entered into on completion are notifiable transactions which creates an administrative burden.

32. The use of the imprecise term "substantial" produces uncertainty. Although the Revenue have said that they will publish guidance, the publication of such guidance is not a substitute for precision in drafting and is irrelevant to a court or tribunal. In relation to the guidance the Explanatory Notes refer to a 90% test but state that you are considering whether this is an appropriate cut off point. Whatever the percentage test it should be included in the legislation rather than in guidance. Either way this test is going to introduce considerable uncertainty. According to the Revenue notes it is an anti avoidance provision. If it is considered that an anti avoidance test is particularly necessary, then, rather than subject all purchasers to uncertainty it would be better to provide that the clause only applies where the sole or main purpose of the transaction is the avoidance of taxation. These anti avoidance provisions will often apply in family situations where there is no intention at all of avoiding tax. For example, parents will often wish to allow their children to occupy property and to allow them to acquire real ownership of it but are not financially able to give the property away because they fear for their financial security in the future. The solution to their problem may be to sell the property to the children leaving the consideration outstanding. In a case such as this, these anti avoidance provisions will apply forcing the parents to pay Land Transaction Tax on money which they have not received.

33. The definition of completion is inadequate and introduces uncertainty. In particular, the word "proposed" appears to be redundant.

34. If, as the guidance notes suggest, a 90% test is to be applied to (2)(b), the legislation should include this directly.

35. A more detailed and precise definition of "completion" is needed than that offered at sub-clause (3).

Clause 7

36. What is the function of "so as" in clause 7(1)(a)?

37. Although clause 7(2) is in the style of the rewrite project we find that mixing substantive law with explanatory material in the legislation is unhelpful.

Clause 9

38. In principle, land exchanges should not be treated as two transactions. Contractually, as well as economically, they are a single transaction. If the Stamp Office believes that a land transaction should be charged whether or not consideration is in the form of cash or property, then it is equally arguable that there should only be a single charge whether the consideration is cash or property.

39. Clause 9 in any event misses its target. It is presumably meant to provide that what would otherwise be a single transaction is treated as two or more transactions. Actually it only applies where there are two land transactions one of which is entered into in consideration of the other. If an exchange is two transactions the clause is unnecessary. If it is one transaction the clause does not apply.

40. We would welcome confirmation that the current exemption for new build houses will be retained.

Clause 10

41. This is an area of the law where the equivalent stamp duty provision has always caused difficulties in interpretation. The new legislation should aim to improve on the old. It could do this by giving statutory definitions to partitions and divisions dealing in particular with more complex situations where joint interests in a number of parcels of land form part of a single transaction.

42. There is a reference to “part” in clause 10(2) but the legislation has not been divided into parts which is misleading.

Clause 11

43. Clause 11 identifies a land transaction as being chargeable if it is "effected for consideration". A reverse premium is certainly consideration so has a transaction been effected "for" consideration. Arguably it has. It would seem therefore that the new tax will apply to the reverse premia. The purchaser here is clearly the tenant or buyer (under the general definition) and will now have to pay duty when that has hitherto not been the case under stamp duty. So this is another example of the new tax having a wider scope than the old.

44. Clarification is needed as to whether the words "effective for consideration" is intended to be equivalent to the VAT charging clause, so that VAT case law is relevant to Land Transaction Tax matters. For example, following *Mirror Group plc v C&E Commrs, CJEC Case C-409/98, [2001]STC 1453* and *C&E Commrs v Cantor Fitzgerald International, CJEC Case C-108/99; [2001] STC 1453* it could be argued that a reverse premium on the grant of a lease is not subject to this tax but when an existing tenant pays a new tenant to take over a lease, that does constitute a taxable transaction.

45. The last sentence in Clause 11 is not substantive legislation but merely explanatory. It introduces the risk of contradiction. The proper place for material such as this is in a commercial commentary on the legislation.

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Clause 12

46. We would welcome clarification of the definition of a security interest as it appears to be wider than intended. For example, where a landlord contracts to grant a lease under which there are to be various landlord's covenants it is arguable that the grant of the lease secures the performance of the obligations under the contract to enter into the landlord's covenants.

Clause 13

47. The creation of Land Transaction Tax is an opportunity to modernise the tax system. Consideration should also be given to extending the business reliefs for income tax and capital gains tax to Land Transaction Tax.

Clause 15

48. We are awaiting the draft legislation. It should be noted that leases should not be seen as the acquisition of assets; they represent rental obligations. It would be useful to have some indication of which transactions relating to leases will require exemption and the reasons for this clause.

Clause 16

49. Liquidation distributions are not normally for consideration and therefore it appears that they would not normally need the specific exemption given in sub clause (2). There are, however, some liquidation distributions which do involve consideration. For example, where assets and liabilities are transferred to a shareholder, the liabilities are treated as consideration for the assets. The exemption would not seem to apply in this case because the assets are partially transferred in consideration of the assumption of liabilities. Clarification on this point would be helpful.

Clause 17

50. The explanatory notes state that a "slightly wider" aggregation rule than the current one is being introduced. This is not a "slightly wider" aggregation rule than the current one. It is fundamentally different and although its scope is unacceptably uncertain it is clearly considerably wider than the current rule. It is clear from case law that under current law there must be a contractual link

between transactions for them to be aggregated. It is clear that transactions that are part of a single arrangement need not necessarily be contractually linked. If the Revenue's intention is to considerably widen the ambit of this provision and make its effect far more uncertain they should say so. The reason they give for the change in paragraph 90 could not justify such a fundamental change. Indeed, the fact that transactions are documented independently, which presumably means by separate documents, would not of itself prevent aggregation under current rules if the transactions were contractually linked.

51. The current guidance on "linked" transactions brings a test of independence of contractual completion. New and more substantial guidance is needed on the "series" point stating explicitly whether it is intended now to catch all transactions negotiated simultaneously between the same parties. The Stamp Office should indicate, in a Statement of Practice, where transactions are "linked". We would welcome clarification where:

    a) An option is granted and subsequently exercised in circumstances where the exercise is not inevitable or pre-ordained;
    b) A number of bids are submitted by one person in respect of a number of properties, offered for sale by a single vendor. Acceptance of one bid would not be dependent upon the others.

52. Clause 17(4) defines when transactions are "linked". This definition is extremely wide and we would welcome further clarification on the meaning of "arrangements". It will be particularly difficult for persons to certify that transactions are not linked without further statutory definition.

53. Furthermore, we would expect clarification on the taxability of quotas transferred with land. We would welcome confirmation that these will remain exempt.

54. We would welcome clarification of the function of "the general rule is that". If it is intended to make clear that clause 17 is subject to other rules it is more precise to say "subject to any other provision in this Act".

Clause 20

55. It is wrong in principle that tax should be charged on amounts of another tax. It is therefore quite clear that Land Transaction tax should not be charged on VAT.

56. We can see no reason why the allocation of consideration could not be determined as the parties think fit thus avoiding the considerable uncertainty of a just and reasonable rule. Where parties are unable to agree, or the contract is silent, then the allocation should be on the basis of proportionate market value.

57. This clause appears to give the Revenue the scope to rewrite agreements between relevant parties. Will a return be incorrect if the allocation is as the parties see fit even if the avoidance of tax is not a motive?

58. Will the new legislation supersede ss119-121 FA 2000, so abandoning the market value rule for connected company transactions?

Clause 21

59. The failure to take account of the fact that in many transactions and especially in land transactions, payments of consideration may be deferred for long periods. This is a flaw of current stamp duty, which should be corrected in any modernisation process. It is disappointing that this opportunity has not been taken. It is clear from our comments on clause 38 that the postponement conditions are not an adequate substitute.

Clause 23

60. This section appears to have the effect that where a debt is assumed satisfied or released in consideration of a land transaction the consideration is deemed to include the principal amount of the debt but is limited to the market value of the land. Subject to the point made below this reproduces the existing position in stamp duty. It seems, however, inconsistent with the scheme of the new Land Transaction Tax where the charge is based on money or moneys worth given in consideration. To be consistent with that approach the debt should surely be valued at its market value at the time of the transaction.

61. Clauses 23(3) and (4) does not appear to take account of situations where a property is charged with a debt but the vendor retains responsibility for the payment of the debt either by retaining his contractual obligations to the creditor or alternatively by virtue of the contractual relations between the vendor and the purchaser. For example, a gift of property subject to a charge where the donor retains the legal liability for the debt. If gifts are not to be charged why should a charge arise simply because the property remains charged to secure the donor's continuing mortgage liability?

62. It would be helpful to rationalise the position regarding dividends in specie. The Revenue Manual at para 4.49 states that there is a distinction between

> "1. where the dividend is declared to be the shares in X Limited the shareholders in Y Limited never have a right to receive any money. These circumstances are considered to be certifiable under Category L in the Schedule to the Stamp Duty (Exempt Instruments) Regulations 1987.
> 2. Where Y Limited declares a dividend and agrees that the shares it owns in X Limited are to be transferred in lieu of that dividend, the shareholders in Y Limited have a right to receive money. Section 57 of the Stamp Act 1891 applies and ad valorem duty is chargeable on the monetary value of the dividend payable."

63. If the Revenue's view is correct many practitioners are falling into a trap in which liability to tax depends purely on form and not on economic substance. A modern successor to stamp duty should eliminate this trap by providing that land transferred in lieu of dividends are not subject to Land Transaction Tax.

<u>Clause 25</u>

64. Clause 25(4) introduces a wholly new tax charge on employee benefits. It is quite inappropriate to introduce a new substantive charge of this nature in legislation which purports to only introduce a "modernised" stamp duty with the objectives as set out in the Revenue's explanatory notes.

Drafting points

65. We question why the phrase “fair value” is used here when a more appropriate phrase “market value” is used in clause 24. In any event clause 25(2)(b) seems to impose a market value charge.

66. Why in clause 25(2) is the phrase “might reasonably be expected to” when “would” would appear to have the same effect?

67. There is a drafting error in clause 25(4)(c) “as” should be “at”.

Clause 26

68. Clause 26 is of fundamental importance to the new tax and we are surprised at its poor drafting. The concepts of "contingent" and "uncertain future events" are not dealt with elsewhere and are fundamental. They need defining. Notwithstanding the platitudes in the notes (paras 130 to 134), we do not consider that the legislation is at all clear. Take, for example, paragraph 131. Land is purchased for £3m and a further £1m will be paid if planning permission is obtained. This is described as a "contingency" in that note and therefore 26(1) applies. However we can see no reason why it does not also fall within 26(2) since the value of the consideration depends on an uncertain future event, (i.e. whether planning permission will be granted). It would therefore be subject to two contradictory computation provisions. Under clause 26(1) the taxpayer is taxed on £4m subject to discretionary postponement of £1m under clause 38 and later adjustment under Clause 37. Under clause 26(2) it seems you should evaluate the probability that planning consent is granted. If the probability is 51%, Land Transaction Tax will be payable immediately on £4million again subject to discretionary postponement under clause 38 and adjustment under clause 37.

69. The application of the contingency principle is one of the fundamental defects of stamp duty which should be corrected in any modernisation. Unfortunately Land Transaction Tax largely reproduces those faults. It provides in clause 26 an all or nothing result even when one takes into account clause 37. For example, if a transaction falls within clause 26(1) stamp duty is payable initially on the whole consideration regardless of the probability of the contingency occurring. Under

clause 26(2) one takes into account the probability of a future event but only in arriving at whether or not to take the dependent consideration into account.

70. Although clause 37 provides for repayment of stamp duty in the light of future events with interest in many circumstances this may not be sufficient compensation. Clause 38 as we explain below provides inadequate protection because it merely gives the Revenue a discretionary power to permit postponement.

71. Consider the following. Mr A sells 10 acres of agricultural land for £20,000. In the event that planning permission is granted within 30 years the consideration paid is to be increased to £10m. It appears that the consideration is contingent within s 26(1). In that case stamp duty is immediately payable of £400,000 (20 times the consideration). Even if this falls within clause 26(2) if it is probable that permission will be granted his liability for Land Transaction Tax will also be £400,000.

Clause 27

72. "It" should be deleted.

73. The notes at paragraph 137 claim that this clause refers readers to clause 55(linked transactions) which it does not. If the Revenue wish to audit such transactions they could in most cases do so from the Land Registry information rather than imposing an unnecessary compliance burden on the taxpayer.

Clause 28

74. It is not clear why "zero rated" transactions now need to be notified to the Stamp Office given that they are currently excluded from all forms of stamping.

75. The final sentence in clause 28(1)(a), a signposting phrase, shows the danger of signposting in substantive legislation. To be consistent with clause 12 it should refer to ss12 – 16. It might be interpreted as implying that clauses 17-27 are relevant to determining whether a transaction is exempt.

76. This clause makes the draft legislation's only reference to LAND TRANSACTION TAX and that phrase is not defined. This is in fact a more appropriate name for the new tax than "modernised stamp duty" and should be adopted as the name of the new tax..

Clause 29

77. Important administrative provisions require proper Parliamentary scrutiny no less than substantive provisions. It is therefore inappropriate that primary legislation can be changed by Statutory Instrument

Clause 30

78. Under current law documents need to be stamped before they can be registered. The stamping process is largely within the control of the purchaser, at least as regards straightforward transactions. Under this clause, the purchaser would need to obtain a certificate from the Stamp office that a return has been delivered. It would not be acceptable to have to rely on postal arrangements for obtaining these certificates. What is more, an unacceptable number of documents sent from the Stamp Office currently become "lost in the post".

79. This enforcement provision illustrates a tendency to cling to the fundamental nature of stamp duty, rather than a bolder move to a modernised tax like SDRT.

80. It would be helpful to have clarification in the legislation as to who is responsible for self-certification?

Clause 33

81. Tax is payable when the Land Transaction Tax return is made. It must be made within 30 days of completion or substantial performance in most circumstances. Because the time of substantial performance will often be uncertain and because of the provisions of clauses 24, 25 and 26 amongst others it will be difficult to make an accurate calculation of the liability within this time. Thirty days is a wholly inadequate period. We would suggest three to six months.

Clause 34

82. It is not clear why the Revenue should have the power to shorten and not lengthen the period. In any event, it is objectionable that primary legislation should be amended by Statutory Instrument.

Clause 35

83. Interest is to be payable on penalties paid late. It is unclear when a penalty "becomes due and payable". Clarification on this point would be helpful

Clause 36

84. Where a taxpayer is liable to pay interest under 34 and 35, the interest runs from the date the taxpayer should have paid the tax to the date it is actually paid. In contrast, interest on tax overpaid only runs from the date of payment to the date when the "order for repayment is issued". The taxpayer does not appear to be able to obtain interest if there is delay between the issuing of the order and the actual repayment itself. This is unacceptable. The taxpayer should be paid interest from the date of the overpayment to the date of the repayment.
85. Clause 36(4) seems unnecessary because a Court in making its order will be aware of and will be able to take into account interest payable under this clause.

Clause 37

86. For reasons explained in this paper the interaction between clauses 26, 37 and 38 is completely inadequate. These issues would fall away if the new tax was charged upon receipt of consideration under a contract rather than on the making of the contract.

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Clause 38

87. This is an extremely poorly drafted section and to the extent that it is possible to ascertain what it means is wholly inadequate. It does not in words allow the Revenue to accept payments by instalments. It does not provide any principles by which the Revenue are to determine if it is appropriate to allow payment by instalments or the extent to which the terms on which payment by instalments is to be allowed. It does not give the taxpayer an enforceable right to pay by instalments. It provides an avoidance purpose test in clause 38(3) which appears

to have no justification. It appears not to apply to the most obvious case when an instalment option is necessary; that is where consideration is payable by instalments where the total amount of the consideration is certain and ascertained.

88. Although an appeal against the decision of the Revenue may be made in the absence of a right to pay by instalments determinable on clear principles the right of appeal is of little value.

89. Once again, it is not clear what the difference is between "contingent" transactions and transactions which "depend on uncertain future events".

Clause 41

90. This clause appears to allow the Revenue to inspect property where a major interest is held by a person who has no relationship to the person who is liable for the tax.

91. This power seems unacceptably wide. It would seem to extend to situations where the right of occupation of property is held by a person with no connection to the person liable for the duty.

92. For example, Mr A purchases a property with a mortgage loan in year O. He puts in his return claiming the property consideration is £499k. In year 1 the mortgagee repossesses the property and sells to Mr B. Mr B conducts his business there for 8 years. In year 9 the Revenue allege that Mr A understated the consideration and was negligent in doing so. They now have the right to inspect the property regardless of the disruption to Mr B's trade which this causes by reference to a liability of a person who has had no interest in the property for 8 years. Surely, this power should be limited to allowing inspection only to the extent that a person who is liable for the duty would himself be able to undertake that inspection.

93. This, and Section 105 TMA, reflect the 1990 Hansard statement that has now been superseded by that of 7 November 2002. Will this new wording (and indeed that in Section 105 TMA) be amended to reflect this updated Hansard statement?

Clause 52

94. We note that Limited partners can be made liable for the whole of the tax, plus penalties. This seems to be in conflict with general law.

Clause 58

95. It would appear that this clause needs further review in relation to the consideration for the grant of an option.

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