Love and the buildings transaction tax

A First-tier tribunal decision brings stark focus to the harsh effect of the Scottish surcharge.

In *Dr C Goudie & Dr A Sheldon v Revenue Scotland* [2018] FTSTC 3, the First-tier Tribunal for Scotland dismissed an appeal against Revenue Scotland's decision to refuse to repay the land and buildings transaction tax additional dwelling supplement to the appellants. The additional dwelling supplement is a 3% surcharge payable on the purchase of 'additional' Scottish dwellings by individuals and the purchase of Scottish dwellings by companies. The decision, though unarguably correct in law, illustrates the harsh effect of the legislation on couples.

The relevant facts were these: the (unmarried) appellants bought a property in Edinburgh together. At completion, one of the appellants, Dr Goudie, retained a share of another property that he had purchased jointly with others in the past. He had since moved out of that property to live with the other appellant, Dr Sheldon, in rented accommodation. The appellants (correctly) paid the additional dwelling supplement (£11,460) on the purchase of the new property. Dr Sheldon was deemed to own Dr Goudie's interest in the first property due to her living with him as though married to him. Later, Dr Goudie disposed of his interest in the first property and the appellants applied to reclaim the £11,460. Their application was refused and their appeal against that decision was dismissed. The reason is that Dr Sheldon had never lived in the first property. If she had done at any time in the 18-month period preceding her purchase with Dr Goudie, the appellants' application would have been valid.

> The decision, though unarguably correct in law, illustrates the harsh effect of the legislation on couples

The effect of the legislation is harsh because had she purchased the property in her sole name (and provided that she had not been living with Dr Goudie as though married to him), the additional dwelling supplement would not have been payable by her. Similarly, had Dr Goudie purchased the property in his sole name, although the additional dwelling supplement would have been payable initially, he would have been entitled to reclaim it on the disposal of the first property. So Dr Goudie is worse off because he purchased jointly with Dr Sheldon (who, remember, did not own another dwelling) and Dr Sheldon is worse off because she had not lived in the first property. The result would have been the same if they had purchased a property in the rest of the UK unless Dr Goudie had purchased the property in his sole name. The distinction is because the SDLT and land transaction tax higher rates – the equivalents to the additional dwelling supplement for purchases of dwellings in the rest of the UK – are not engaged by virtue of a cohabitant's ownership of a dwelling. This is the result of the decision to use complex, closely-articulated legislation to determine the incidence of the additional-dwelling surcharge (and the higher rates) and a deeming provision that, in effect, punishes purchasers for being in love. ■

Sean Randall, head of stamp taxes, KPMG (sean.randall@kpmg.co.uk)

Recent changes to capital allowances for large infrastructure projects

How do the recent changes affect the issues raised in the recent *SSE* decision?

The recent FTT decision in *SSE Generation Ltd v HMRC* [2018] UKFTT 416 (SSE) (reviewed in 'Capital allowances in large infrastructure projects' (Matthew Hodkin & David Schultz), *Tax Journal*, 12 October 2018) highlighted not only the difficulties in distinguishing where to draw the legislative line when applying the UK's capital allowances regime in CAA 2001 to expenditure on complex infrastructure projects, but also the economic importance of obtaining capital allowances on such projects under the current 'all or nothing' approach to capital allowances.

Prior to the removal of industrial buildings allowances (IBAs) from 1 April 2011, expenditure on a project that consisted of a mixture of structures, buildings and equipment (such as a railway depot or factory) would typically be capable of depreciation for tax purposes almost in its entirety, with expenditure qualifying for a mixture of IBAs and capital allowances. Although IBAs were only available on a 4% per annum straight line basis, the fact that the expenditure was capable of depreciation at all was economically important to taxpayers. However, since the abolition of the IBA regime, taxpayers faced with a large mismatch between their accounting depreciation and their tax depreciation were forced into arguments such as those brought by the taxpayer in *SSE* (largely successfully) to the effect that expenditure on what might ordinarily be considered a structure should instead qualify for capital allowances. This gave rise to some of the difficulties highlighted by the FTT decision in *SSE*, such as the fact that expenditure on certain types of water conduit qualified for capital allowances, whereas other types of conduit did not so qualify and SSE therefore received no tax relief on its expenditure on those items.

> Whilst the SBA regime is welcome news, the Finance Bill also confirmed that the writing-down allowance in respect of 'special rate expenditure' will be reduced

The Budget 2018 announced a new regime which may go some way to addressing this 'cliff edge' by introducing a new structures and buildings allowance (SBA). Whilst the Finance (No. 3) Bill 2017–19 contains little detail and provides that the specific detail of the SBA regime will be introduced by way of regulations, HMRC has released a technical note that contains more information. The technical note states that there will be a straight-line 2% annual allowance for expenditure incurred to build new commercial structures and buildings (i.e. allowing the expenditure to be written off over 50 years), including costs for new conversions or renovations. This will apply where the contracts for the physical construction works are entered into on or after 29 October 2018. Unlike the IBA regime however, there is no balancing adjustment on sale of the asset. Instead, it appears that the purchaser will simply take over the remainder of the allowances written down for the remaining part of the 50 year period. Land costs will not be eligible for SBA relief.

Importantly, expenditure on 'integral features' and fittings of a structure or building that currently attract capital allowances as expenditure on plant and machinery will continue to qualify for those allowances, rather than being required to apply the less generous SBA regime. However, there is a provision in the Finance Bill that makes it clear that references to 'plant' in list C in CAA 2001 s 23 do not include plant that is excluded by either of ss 21 or 22. This means that some of the arguments made by SSE in relation to the hydro-electric plant would no longer be successful, although the availability of the SBA will help in this regard.

Whilst the SBA regime is welcome news, the Finance Bill also confirmed that the writing-down allowance in respect of 'special rate expenditure' (being expenditure on, amongst other things, certain long-life assets and integral features) will be reduced from 8% to 6% with effect from April 2019. ■

Matthew Hodkin, partner & David Schultz, associate, Norton Rose Fulbright

Amendments to the IHT position of settlements after the settlor becomes deemed domiciled

The government intends to legislate to counter the effect of *Barclays Wealth Trustees (Jersey) Ltd & M Dreelan v HMRC*.

The proposed legislation will confirm that any property added to an excluded property settlement after the settlor becomes deemed domiciled in the UK will be subject to UK inheritance tax. It may also mean that property transferred between settlements will be subject to inheritance tax if the settlor of the recipient trust is deemed domiciled at the time of the transfer.

Dreelan: The inheritance tax legislation provides that foreign property in a settlement is 'excluded property' – not subject to inheritance tax – as long as the settlor was not UK domiciled (or deemed domiciled) at the time the settlement was 'made'. Where property is transferred between settlements, the settlor of the recipient settlement must also have been non-UK domiciled (or deemed domiciled) when the recipient settlement was 'made'.

HMRC has historically taken the view that a settlor 'makes' a new settlement each time he adds property to an existing settlement. On that basis, property added to a settlement after the settlor became deemed domiciled (whether directly or by transfer from another excluded property trust) would never qualify as excluded property.

The Court of Appeal rejected that view in *Dreelan* [2017] EWCA Civ 1512. It held that a settlement is 'made' when it is first established and not every time there is an addition to the settlement. For a full overview of that case, see here. The logical conclusion of the Court of Appeal's reasoning in *Dreelan* is that a settlor could continue adding property to an excluded property trust even after becoming deemed domiciled.

To avoid the implications of the *Dreelan* case, the government now intends to amend the inheritance tax legislation in Finance Bill 2019-20.

Additions to excluded property settlements: The first amendment will confirm that property added to a settlement after the settlor becomes deemed domiciled is 'relevant property' (i.e. subject to inheritance tax), even if the addition is to an existing excluded property settlement.

Settlors should generally avoid making any additions to their settlements after they become deemed domiciled, as the added property will be subject to inheritance tax

This will be a retrospective change, in that any property added to a settlement while the settlor was deemed domiciled will be relevant property after the legislation comes into effect (expected to be 6 April 2020), regardless of when the property was added.

This is unlikely to have a major impact, as most advisors cautioned against adding property to a settlement after becoming deemed domiciled, even in light of the Dreelan case. If there are any affected settlements, the trustees could consider distributing the added property (assuming it can be identified) before this legislation comes into force, to avoid an inheritance tax exit charge.

Transfers between settlements: The second amendment will be to impose additional excluded property tests on property transferred between settlements. The government has not specified what those additional tests will be, but it seems likely (in light of *Dreelan*) that transferred property will only be excluded property if the settlor of the recipient trust is not UK domiciled or deemed domiciled at the date of the transfer.

This could lead to the illogical outcome that transferring property from one excluded property settlement to another would mean the transferred property loses its excluded property status. This may make it more attractive to amend an existing settlement rather than transfer property into a different settlement.

The government has indicated that this change will only affect transfers made after the legislation comes into effect, so if there is a need to do this, trustees could consider transferring property between excluded property settlements before April 2020. However, this should be avoided where the recipient settlement is a protected settlement for income and capital gains tax purposes, as the transfer would cause the recipient settlement to lose its protected status.

Conclusions: The key message is that settlors should generally avoid making any additions to their settlements after they become deemed domiciled, as the added property will be subject to inheritance tax.

The position on transfers between settlements is less clear for the time being, but settlors who are establishing or reviewing trust structures now should not assume that they will have complete flexibility to transfer funds between their settlements in the future. We will know more about this proposed amendment when the draft Finance Bill 2019-20 is published next year. ■

Nicholas Harries, partner, Charlotte Kynaston, barrister & Robin Vos, solicitor, Macfarlanes

Most read on taxjournal.com:

1. Budget 2018: The impact on SMEs (David Whiscombe, 31.10.18)
2. Tax issues on private equity transactions (Brenda Coleman, Andrew Howard & Leo Arnaboldi III, 8.11.18)
3. Budget report 2018 (30.10.18)
4. Can taxpayers trust HMRC's guidance? (Andrew Hubbard, 23.10.18)
5. Self's assessment: What's wrong with a digital user tax? (Heather Self, 24.10.18)