

## **Converting commercial property to residential: which SDLT regime applies?**

### **Introduction**

Following the overhaul of the SDLT regime for residential property announced in the 2014 Autumn statement, the question of whether a property is residential (and taxed under the new “slice” regime) or commercial (and taxed under the old “slab” regime) may make a significant difference to the SDLT payable on a purchase (we have written a separate article on the general implications of the new regime for residential property, available at: <http://www.steinfeldlaw.co.uk/clients-deals/Changes-in-Law>). In most cases it will be obvious whether a property is commercial or residential, but there are a number of grey areas and one common one concerns the purchase of properties which have been or are still being used as commercial premises but have been, are being or are intended to be converted for residential use. This scenario is particularly significant in the context of the change in the residential regime because before the change the SDLT payable would generally be the same whether the property was commercial or residential, but following the change there may be significant differences depending on how the property is classified.

### **Under the old regime**

Prior to 4 December 2014, commercial and residential property were both taxed in the same way (under the “slab” regime) and the thresholds and rates were the same for the majority of properties, with two exceptions:

- 1) For residential property the 0% rate only applied for properties purchased for £125k or less, but for commercial properties it applies to properties purchased for up to £150k.
- 2) For commercial properties all properties purchased for more than £500k are taxed at the 4% rate, but for residential properties there were additional 5% and 7% rates for properties purchased for more than £1mil and £2mil respectively.

As a result, other than properties purchased for between £125k and £150k or for more than £1mil, the SDLT payable was the same whether the property was commercial or residential.

### **Under the new regime**

Since 4 December 2014 residential properties are subject to the new “slice” regime. For an explanation of this new regime, see our separate article available on our website, but the result is that there is now a potentially significant difference between the SDLT payable on commercial and residential properties purchased for the same price (illustrated in the table below)

Purchase price	SDLT for residential property	SDLT for commercial property	Difference in SDLT (red indicates SDLT lower for commercial property)
£200,000	£1,500	£2,000	£500
£350,000	£7,500	£10,500	£3,000
£600,000	£20,000	£24,000	£4,000
£750,000	£27,500	£30,000	£2,500
£1million	£43,750	£40,000	£3,750
£2million	£153,750	£80,000	£73,750

As you will see from the table, SDLT is often significantly lower for residential properties than for commercial properties under the new regime for properties purchased for less than £1mil. For properties purchased for over £1mil SDLT continues to be higher for residential properties and this difference has in fact increased for properties purchased for substantially more than £1mil, as the table below shows.

Purchase price	SDLT for commercial property	SDLT for residential property (old regime)	SDLT for residential property (new regime)
£1.5million	£60,000	£75,000	£93,750
£2million	£80,000	£100,000	£153,750
£5million	£200,000	£350,000	£513,750

So, whereas under the old regime purchasers may not have been especially concerned whether the property was treated as residential or commercial they may now have a significant interest in ensuring it is treated as one or the other (depending on the purchase price).

### Commercial or residential?

Property is classified as residential for SDLT purposes if it is:

- Used as a dwelling;
- Suitable for use as a dwelling; or
- In the process of being constructed or adapted for that use.

If a property does not fall within this definition then it is classified as commercial for SDLT purposes.

Depending on when in the process of conversion from commercial use to residential use the property is purchased different regimes may therefore apply.

HMRC guidance makes it clear that if the property is in use at the time of completion then this will override either of the other tests. So, if at the time of completion the property is still being used as commercial premises then the commercial SDLT regime will apply and, similarly, if it has already been converted for use as a dwelling and is being used as such then the residential SDLT regime will apply.

Where the property has already been converted for residential use it should be classified as residential on the basis that it is suitable for use as a dwelling. Similarly, if the property is purchased

after work has commenced to convert it for residential use it should be classified as residential on the basis that it is being adapted for use as a dwelling.

The situation is more ambiguous, however, where a property previously used as commercial premises but currently unoccupied is purchased with the intention of converting it for use as a dwelling but before work has commenced. HMRC guidance suggests that it would be sufficient for a property to be marketed for sale as a residential development with consent for change of use; however some tax specialists have suggested that this actually goes beyond the legislation. In such scenarios prospective purchasers are advised to consult a specialist solicitor prior to exchange of contracts.