

SDLT implications of property incorporations

(Lecture P1150 – 14.07 minutes)

For Stamp Duty Land Tax (SDLT) purposes, a chargeable interest held by or on behalf of a partnership is treated as held by or on behalf of the partners and a land transaction entered into for the purposes of the partnership is treated as entered into by or on behalf of the partners. This is logical given that ordinary partnerships have no separate legal identity in England and Wales but it also applies in scenarios where they do have a separate legal identity. The provisions apply equally to LLPs and limited partnerships.

Anything that is required or authorised to be done by the purchaser is required or authorised to be done in relation to all of the responsible partners. The responsible partners are the persons who are partners at the effective date of the transaction and any person who becomes a partner after that date. The responsible partners can nominate a representative partner to act on their behalf and this person is deemed to be such until the nomination is formally revoked.

Liability for tax, interest and penalties within the SDLT legislation is joint and several on all of the partners, although there is a restriction on the liability of a person who becomes a partner after the effective date of the transaction.

There are specific rules applying to the following partnership transactions:

- The transfer of a chargeable interest to a partnership;
- The transfer of an interest in a partnership;
- The transfer of a chargeable interest from a partnership.

The transfer of a chargeable interest expressly includes:

- The grant or creation of a chargeable interest;
- The variation of a chargeable interest;
- The surrender, release or renunciation of a chargeable interest.

What these rules do is impose a special mechanism for calculating the chargeable consideration for SDLT purposes for any of the transactions outlined in the previous paragraph. The one is most pertinent at the moment is the transfer of a chargeable interest from a partnership. This is due to the current planning around incorporation of property businesses due to the interest restriction that applies to individual's property businesses.

Normally the transfer of property from an individual to a company with which they are connected or where the transfer is in exchange for shares, the legislation states that the chargeable consideration cannot be less than the market value of the property transferred.

Since most transactions will be in exchange for shares in order to benefit from incorporation relief, this legislation would apply. However, the partnership rules take priority so that if the partnership provisions impose a chargeable consideration of less than market value, then the SDLT charge is reduced. In some cases, it will be eliminated completely.

Transfer of chargeable interest from a partnership

The transfer of an interest in land from a partnership to a person who is or has been a partner – or to anyone connected with them – is chargeable to SDLT. This is an important point as many people refer to an exemption from SDLT on incorporation of property partnerships but this is simply not true. The legislation imposes the special method of calculating the chargeable consideration that, as noted above, may eliminate the charge altogether but this needs to be calculated.

The chargeable consideration is therefore taken to be equal to:

$$MV \times (100 - SLP)\%$$

SLP (which is an abbreviation of the sum of the lower proportions) is calculated using the following steps.

Step 1: First you need to identify the relevant owner or owners. A person is a relevant owner if immediately after the transaction he is entitled to a proportion of the chargeable interest and immediately before the transaction he was a partner or connected with a partner.

Step 2: For each relevant owner, you need to identify the corresponding partner or partners. A person is a corresponding partner to a relevant owner if immediately before the transaction he was a partner and he was either the relevant owner or was connected with the relevant owner.

Step 3: For each relevant owner, you then need to find the proportion of the chargeable interest to which he is entitled immediately after the transaction and this is apportioned between any one or more of the relevant owner's corresponding partners.

Step 4: The next stage is to find the lower proportion for each person who is a corresponding partner in relation to one or more relevant owner. The lower proportion is the lower of:

- The proportion of the chargeable interest attributable to the partner (i.e. the sum of all interests allocated to him under Step 3); or
- The partnership share attributable to the partner (see below to determine partnership share).

Step 5: The final stage is to add together the lower proportions of each person who is a corresponding partner in relation to one or more relevant owners. This is the SLP.

It must be remembered that the legislation determines the partnership shares by reference to income shares and not capital shares; so the same formula applies even where the land is held within the partnership by one or more partners in isolation to the others.

What is also important in the above analysis is the definition of connected parties. It is the definition that will be familiar to many as it is the one contained in s1122 CTA 2010 with one important exception. This is that partners are not connected with each other for the purposes of these provisions. To summarise, as far as the provisions are relevant for these partnership rules:

- A company is connected with another person (A) if:
 - A has control of the company; or
 - A together with persons connected with A have control of the company.

Note that any two or more persons acting together to secure or exercise control of the company are connected with one another.

- An individual (A) is connected with another individual (B) if:
 - A is B's spouse or civil partner;
 - A is a relative of B;
 - A is the spouse or civil partner of a relative of B;
 - A is the relative of B's spouse or civil partner;
 - A is the spouse or civil partner of a relative of B's spouse or civil partner.

(Relative means ancestor, descendant or sibling)

Let's have a look at how the steps work by looking at an example. We have a partnership with a husband and wife who split the income 60:40 and are wanting to transfer the property to a company where the shareholding will be split in the same way. We will call the husband and wife Mr and Mrs X and the company Y Ltd. Y Ltd is connected to both Mr and Mrs X.

Step 1: First you need to identify the relevant owner or owners. This is Y Ltd.

Step 2: For each relevant owner, you need to identify the corresponding partner or partners. This is Mr and Mrs X.

Step 3: For each relevant owner, you then need to find the proportion of the chargeable interest to which he is entitled immediately after the transaction and this is apportioned between any one or more of the relevant owner's corresponding partners. Y Ltd is entitled to 100% of the property after the transaction. This can be split in any proportion between the corresponding partners so we will split it 60:40 between the couple.

Step 4: The next stage is to find the lower proportion for each person who is a corresponding partner in relation to one or more relevant owner.

The lower proportion is the lower of:

- The proportion of the chargeable interest attributable to the partner (i.e. the sum of all interests allocated to him under Step 3); or
- The partnership share attributable to the partner (see below to determine partnership share).

For each of Mr and Mrs X, this figure is the same so that the proportion allocated to Mr X is 60% and to Mrs X is 40%.

Step 5: The final stage is to add together the lower proportions of each person who is a corresponding partner in relation to one or more relevant owners. This is the SLP. In this it is $60 + 40 = 100$. If we input this into the formula above we can see that the chargeable consideration is $MV \times 0\%$. So no SDLT is payable.

What about a partnership with 2 unconnected individuals who split the income 60:40 and are wanting to transfer the property to a company where the shareholding will be split in the same way? We will call the two individuals Mr F and Ms G. The company is Z Ltd.

Step 1: First you need to identify the relevant owner or owners. This is Z Ltd.

Step 2: For each relevant owner, you need to identify the corresponding partner or partners. In this case, only the 60% partner is connected with Z Ltd. So Mr F is the corresponding partner.

Step 3: For each relevant owner, you then need to find the proportion of the chargeable interest to which he is entitled immediately after the transaction and this is apportioned between any one or more of the relevant owner's corresponding partners. Z Ltd is entitled to 100% of the property after the transaction. This is allocated entirely to Mr F.

Step 4: The next stage is to find the lower proportion for each person who is a corresponding partner in relation to one or more relevant owner. The lower proportion is the lower of:

- The proportion of the chargeable interest attributable to the partner (i.e. the sum of all interests allocated to him under Step 3); or
- The partnership share attributable to the partner (see below to determine partnership share).

For Mr F, the partnership share is lower than the amount allocated under Step 3. So the lower proportion is 60.

Step 5: The final stage is to add together the lower proportions of each person who is a corresponding partner in relation to one or more relevant owners. This is the SLP. In this it is 60. If we input this into the formula above we can see that the chargeable consideration is $MV \times 40\%$. So SDLT would be payable on 40% of the value of the property.

The reality is that many of these types of partnerships are going to be family owned and so there will be no SDLT but there will be partnerships where this does not apply. Remember that unmarried couples are not connected.

Another interesting point arises in 50:50 situations between unconnected parties. Unless the company has a shareholder's agreement saying that neither party has a casting vote then HMRC might argue that they are not acting together to control the company such that neither is connected with the company and the SLP is 0.

It is also important to note that the partnership share attributable to each partner will depend on when and how the partnership acquired the chargeable interest now being transferred out. The partnership share will be nil unless the effective date of transfer of the relevant chargeable interest to the partnership was:

- before 20 October 2003; or
- on or after that date but the stamp duty or SDLT liability on the transfer was fully paid.

If either of the conditions above is met, then the partnership share attributable to the partner is determined as follows.

Step 1: Find the partner's actual partnership share on the relevant date which is:

- For cases under the first heading of the conditions, the later of 19 October 2003 and the date on which the individual became a partner;
- For cases under the second heading of the conditions, the later of the effective date of the transfer of the relevant chargeable interest to the partnership and the date on which the individual became a partner.

Step 2: To that partnership share are added any increases in the partner's partnership share which occurs between the day after the relevant date and immediately before the transfer of the chargeable interest from the partnership and which 'count' for this purpose. An increase counts for this purpose only where ad valorem Stamp Duty or SDLT has been paid on the transfer.

Step 3: Deduct from the increased partnership share any decreases in the partner's partnership share which occur between the day after the relevant date and immediately before the transfer of the chargeable interest from the partnership.

The answer is the partnership share attributable to the partner, but this cannot fall below zero. This can have a significant impact where partnership shares are variable.

Practical issues arising from these provisions

The biggest issue that we see with these provisions is the question of whether a partnership exists at all. If the parties involved have been returning income on their own tax return as joint income then HMRC are unlikely to accept a partnership exists unless there are factors pointing towards the existence of a partnership.

What about forming a partnership and then incorporating it? If you do this, you will have to wait at least 3 years to incorporate. This is because the calculation involving the SLT is also relevant when calculating the SDLT liability on formation of a partnership.

So if you have, say, a husband and wife jointly owning property, who form a new partnership, the SLP will be 100 and no SDLT will be charged.

However, the rules relating to transfer into a partnership also contain some anti-avoidance provisions which state that if you withdraw capital from the partnership within 3 years of formation then you have to go back and recalculate the SDLT on formation to take account of the withdrawn capital. Transferring of property would fall into the category of withdrawal of capital.

There are other general anti-avoidance provisions too which look at transactions undertaken by more than one step where the SDLT would have been greater if it had been done as a single transaction (found at s75A FA2003). The individual steps do have to be pre-ordained to an extent but incorporating at three years and one day would definitely be vulnerable to attack under these provisions too.

Contributed by Ros Martin