Back to basics

SDLT and partnerships

Speed read

There are two broad categories where SDLT applies to transactions involving partnerships: (i) a property is transferred in or out of the partnership (by way of a partner contribution or an acquisition, or a distribution to a partner or a sale); and (ii) where there is a transfer of a partnership interest (including a change in the income profit sharing ratios between the partners, for example, when new partners join, or a partner retires). The SDLT rules for partnerships are among the most complex of all the SDLT provisions, and there are particular traps for the unwary on transfers of a partnership asset to another partnership; where special limited partner interests are reserved for a fund manager; and on the insertion of a limited liability partnership into the group structure.

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The SDLT rules were introduced to replace stamp duty in respect of transactions in land or in interests in land nearly two decades ago, on 1 December 2003. In deference to the use of limited partnerships as the main institutional property fund vehicle at the time, HMRC took more care and time in extending the regime to partnerships, but it did so on 23 April 2004.

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1. a property is transferred in or out of the partnership (this could be by way of a partner contribution or an acquisition, or a distribution to a partner or a sale); and
2. where there is a transfer of a partnership interest (including a change in the income profit sharing ratios between the partners; for example, when a new partner joins the partnership or a partner retires).

We look at each of those alternatives below. However, it's worth noting at the outset that this article provides only a basic introduction, and it does not cover various permutations that could apply when partnerships are mixed and/or stacked with other entities.

This article is also limited to land situated in England and Northern Ireland. Welsh land transaction tax and Scottish land and buildings transactions tax apply to land in Wales (on or after 1 April 2018) and Scotland (on or after 1 April 2015) respectively and are outside the scope of this note. Whilst the rules are very similar to the SDLT rules, there are slight variances between the different regimes.

The legislation is primarily set out in FA 2003 Sch 15. Schedule 15 is divided into three sections:

- Part 1 explains the character of partnerships;
- Part 2 sets out the rules that apply to ordinary transactions in a partnership context; and
- Part 3 sets out the rules that apply to certain 'special transactions' that are outlined in the legislation.

Note that any property held by the partnership is treated as being held by the partners. Any action done or required to be done in respect of any land interest is treated as being done or required to be done by the existing partners on a joint and several basis. This SDLT principle also applies to foreign partnerships which, in their resident countries, may be treated as opaque entities. This can cause some confusion in practice, although HMRC provides some guidance on what constitutes a partnership in its *Stamp Duty Land Tax Manual* and *Property Income Manual*.

SDLT liabilities apply on a joint and several basis to partners who were members of the partnership at the effective date of the relevant transaction (Sch 15 para 7).

When does it apply?

Transfer of land into a partnership

SDLT is applicable when a land interest is transferred into a partnership, by way of:

- acquisition of a land interest from a third party;
- contribution of a land interest by an existing partner;
- contribution of a land interest by an incoming partner; or
- contribution of a land interest by a person connected with an existing or incoming partner.

Acquisition from a third party: This is the most straightforward of the above scenarios concerning the transfer of a land interest into a partnership. An acquisition of the land interest from an unconnected third party to a partnership is simply treated as an acquisition by each of the existing partners in the partnership in accordance with their profit-sharing ratio. The legislation brings into charge the actual consideration given for the chargeable interest together with the amount of any debt assumed by the partnership (if any). The SDLT calculation is carried out at the partnership level, such that the 0% threshold is only available once. The SDLT liability is then split between the partners and each of them is separately liable to comply with the notification and payment requirements. The partners will also have access to any reliefs specifically available to them; for example, if one of the partners in a partnership is a charity, it can separately apply for charities relief under the SDLT legislation (Sch 15 para 28).

Contribution from a partner or person connected with a partner: The contribution of a land by a partner (new or existing) or by a person connected to a partner is more complicated. The SDLT charge is calculated using a formula which involves the market value of the land interest and the sum of lower proportions (SLP). The actual consideration given by the partnership or the assumption of any related debt is ignored.

When property is contributed by a partner to a partnership, the transfer is between connected parties. The connection test is set out in CTA 2010 ss 1122 and 1123, with the caveat that the partners are not treated automatically as being connected to each other. There may, of course, be occasions where the partners are connected; for example, where a husband and a wife are partners in the same partnership, or where there are companies within the same group or consortium.

In accordance with Sch 15 para 10, the chargeable consideration is determined by the formula:

MV x (100 – SLP) %

where:

- MV = market value of the property; and
- SLP = broadly, the profit share in the partnership of the purchasers and persons connected to them (after the land interest is contributed)

The legislation provides a step by step approach to determining the SLP in para 12:

1. Identify the relevant owner: this is the partner (or person connected to a partner) contributing the property to the partnership.
2. Identify the corresponding partner: this is the person who, *after* the transfer of the property, is a partner in the partnership and is also the relevant owner (or a person connected to the relevant owner). There may be more than one corresponding partner for each relevant owner.
3. For each relevant owner, one must find the proportion of the property to which he was entitled immediately before the transaction. That proportion is then divided between the corresponding partners of that particular relevant owner. Generally, the overall SDLT will reduce if the allocation to partners with a proportion of the property is at least equal to their partnership share.
4. Determine the lower proportion for each corresponding partner in relation to one or more relevant owners. The lower proportion is the lower of:
   - the proportion of the property attributable to the partner, and
   - the partner's partnership share immediately after the transaction.
5. If a relevant owner has multiple corresponding partners, aggregate the lower proportions to determine the sum of lower proportions. The higher the SLP, the lower therefore the overall SDLT when applying the above formula.

Where the land interest being transferred is a lease, SDLT is payable by reference to the net present value (NPV) of the rents, and the formula above is applied to the NPV of the rents.

It is possible for property-investment partnerships to disapply the above treatment by making a s 12A election. If such an election is validly made, the SDLT is payable on the full market value of the land interest. The advantage here is that there is then no SDLT charge in respect of the property in certain circumstances (for Type B transfers, see below)where the partnership's profit sharing ratios change.

Transfer of land out of a partnership

A sale of a partnership land interest to a third party is a straightforward transaction where SDLT is charged on the third party in the normal way. The chargeable consideration is any consideration given by the third party for the land interest.

However, when property is being transferred from a partnership to a partner (or to a person connected with a partner), the transaction will fall within special charging provisions (Sch 10 para 18). Any actual consideration given is disregarded and the charge is calculated using the SLP formula and by reference to the market value of the property. The formula is:

MV x (100 – SLP)%

where:

- MV = market value of the property; and
- SLP = the profit share in the partnership of the purchasers and persons connected to them.

For example, if in a partnership of A, B and C (in equal proportions), a partnership property is distributed to A, then the sum of lower proportions is A's share of the total partnership profits. The chargeable consideration is the market value of the property distributed, multiplied by 100 – SLP%, which broadly equates to the aggregate percentage of the partnership interests of B and C (the partners not receiving the asset). The step by step methodology is set out in para 20:

1. Identify the relevant owner, i.e. the person receiving the property from the partnership who was also either a partner or a person connected to a partner.
2. Identify the corresponding partner: this is someone who, *before* the transfer of the property, was a partner and also a relevant owner (or connected to the relevant owner).
3. For each relevant owner, find the proportion of the property to which they were entitled immediately after the transaction, and then divide this between any of his corresponding partners.
4. Determine the lower proportion for each corresponding partner in relation to one or more relevant owners. The lower proportion is the lower of:
   - the proportion of the property attributable to the partner, and
   - the partner's partnership share.
5. If a relevant owner has multiple corresponding partners, then one must aggregate the lower proportions to reach the sum of lower proportions.

Where a property is transferred from a partnership consisting wholly of partners who are bodies corporate, the rules in Sch 15 para 24 should be considered. This sets out, broadly, that if the SLP is 75% or higher, the chargeable consideration shall be taken to be equal to market value of the property. The effect is that full SDLT will be payable unless the transaction qualifies for SDLT group relief.

Transfer of a partnership interest

A transfer of a partnership interest is only subject to SDLT in certain circumstances. Only partnership interests in a property investment partnership (PiP) that hold UK property are drawn into the SDLT net under Part 3 of Sch 15.

Any change in the partnership interests of any existing, exiting or new partners in a PiP can give rise to a SDLT charge. A charge to SDLT can also arise on a change in the income profit sharing ratios resulting from certain operational functions of the partnership agreement (see the 'three-year catch' below). SDLT is calculated by reference to the market value of the relevant partnership property at the time of a transfer of a partnership interest. The relevant partnership property is determined by para 14. Relevant partnership property does not include any interests transferred into the partnership by a new joining partner.

It is important to determine whether transaction is a Type A or Type B transfer, as this determines which chargeable interests are 'relevant' for the purposes of calculating the SDLT charge (Sch 15 para 14(5), (5A)).

Type A transfers are:

- where the whole or part of a partner's interest is acquired by another person (an existing or a new partner) and consideration in money or money's worth is given by the partner acquiring the interest; or
- arrangements under which a person becomes a partner, the interests of an existing partner is reduced (partly or completely) and there is a withdrawal of money or money's worth from the partnership by the partner reducing his interests. This has to be a withdrawal from resources available only after the new partner has joined or increased his share.

For Type A transfers, all chargeable interests held by the partnership immediately after the transfer are relevant for the SDLT calculation, except any interest brought in by the transfer or certain market rent leases.

Any other transfer is a Type B transfer. The chargeable consideration for Type B transfers is equal to the proportion of the market value of the relevant partnership property, and the proportion is equal to the partnership share acquired by a new or existing partner as a result of the transfer.

There are various caveats set out in para 14(5A) when determining the relevant partnership property. No SDLT will arise on any Type B transfer if all the property in the partnership was acquired from third parties, as such properties are not within the relevant partnership property definition.

Traps for the unwary

Transfers from and to a partnership

Schedule 15 para 23 deals with scenarios where there is a transfer of a partnership asset to another partnership. This is broadly where there is some commonality between the partners of the vendor partnership and the purchasing partnership. In such circumstances, para 23 disengages both paras 10 and 18 (as to which, see above), and instead imposes the highest of the chargeable consideration, as calculated by para 10 and para 18. This can sometimes be missed in practice.

Special limited partnership interests and ratcheting

Many limited partnership agreements (LPAs) will have special limited partner interests reserved for the fund manager (the carry interest). The trigger for the vesting of the carry can be the partnership profits reaching thresholds or targets set at the outset. When the carry vests, there is a ratcheting effect, whereby the manager's partnership interest increases at that point. This could result in a Type A or B transfer if there is relevant partnership property in the partnership at that time.

This can also implicate partners joining the partnership at the time the carry vests, because this could then be seen as a Type A transfer, whereby new partners are providing the capital which the carry manager may be seen as withdrawing as part of the carry vesting, and the manager reducing their share in the partnership.

Such events can be an unexpected consequence of how carry interests are drafted in the LPAs, so it is something of which to be aware and review when property investment partnerships reach certain thresholds or exit points.

Group relief

Partnerships (including LLPs) historically were not considered as body corporates and therefore, unable to form part of a SDLT group to claim relief. However, HMRC's view on LLPs has since been challenged, and HMRC now accepts that LLP can be the parent in a group structure, but as it does not have issued share capital, it cannot be a subsidiary in a group for SDLT relief (see SDLTM34360). It is key to be alive to this difference in treatment, as SDLT relief groups might be unintentionally broken by the insertion of a LLP in the structure (often for non-tax related reasons).

The three-year catch: anti-avoidance

The 'three-year catch' features prominently on tax structure papers, but it is often overlooked in practice. It concerns an anti-avoidance provision which acts as an exit charge to partnerships; and it can incur a further SDLT charge by an act as inconspicuous as withdrawing capital from the partnership.

Under these rules, an SDLT charge would arise (under para 17A) if, within three years of a transfer of a land interest by a partner into a partnership, the contributing partner:

- withdraws money or money's worth from the partnership (not income);
- reduces his/her partnership share; or
- ceases to be a partner.

The above charge would not arise if a para 12A election had been made when the land interest was contributed to the partnership.

There may also be instances of potential double taxation, whereby a property is transferred into a partnership (using the para 10 SLP rules), and within three years, it is sold to a third party, and the sale proceeds withdrawn from the partnership. SDLT would be payable by the third party in the normal way, and then a potential further SDLT charge arises to the vendor who withdraws sales proceeds from the partnership.

Recent developments

It would be remiss not to mention the role of FA 2003 s 75A as the preferred route for HMRC to target any SDLT avoidance or perceived avoidance, as is evident from the recent tax cases including the Supreme Court case of *Project Blue* [2018] UKSC 30. Therefore, while it is important to highlight the pitfalls of para 17A to clients, it becomes a little redundant in the light of the all-encompassing s 75A.

A recent SDLT case to touch upon the convoluted nature of the SDLT partnership rules was the First-tier Tribunal's decision in *Hannover Leasing v HMRC* [2019] UKFTT 262, where Judge Aleksander reinforced the *Project Blue* interpretation of s 75A that no tax avoidance motive was needed for that section to apply. As an aside, it is worth noting that, when applying the s 75A analysis in that case, the notional transaction was held to subsist between two partnerships. As these two partnerships had no commonality, the special transaction rules did not engage. This was notwithstanding that the actual transactions did in fact use the partnership SDLT special rules. The tribunal conclusion could only be reached by completely ignoring the actual set of transactions, but then that is the modus operandi of s 75A.

Concluding thoughts

The complexity of the SDLT partnership rules, together with the prevalence of partnerships generally, make this area a key focus for HMRC. Taxpayers and their tax advisers walk a tightrope when balancing the advantages and flexibility of the partnership structure with the special SDLT transaction rules and the Damocles' sword of s 75A. The taxpayer's position is made more difficult by Judge Aleksander's scathing comments in *Hannover* about the taxpayer being unable to rely on HMRC's (incorrect) guidance in its manual. All one can really do is to proceed with caution. ■

For related reading visit www.taxjournal.com

- *Project Blue*, SDLT sub-sales and s 75A (L Wilson, 21.6.18)
- *Hannover Leasing* and s 75A: automatic anti-avoidance (Sean Randall, 2.5.19)