

STAMP DUTY LAND TAX (“SDLT”) AND PARTNERSHIPS: AN INTRODUCTION

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Introduction

The SDLT regime for partnerships is a very unsatisfactory area of law. It is also in a state of flux, both because there is considerable uncertainty as to how the law currently applies and because the Finance (No. 2) Bill 2006 contains proposed changes. However, if enacted – as expected – the proposed changes will at least serve to reduce two of the areas of uncertainty. This article is meant to be introductory and is intended primarily for those who have not yet had the misfortune to have to study this area of law in detail or to apply in practice. My aim is to outline the SDLT partnerships regime, to highlight some areas of difficulty and to deal with the proposed changes in the Finance (No. 2) Bill 2006.

The history of the provisions demonstrates that those responsible for SDLT have struggled to provide a satisfactory regime to deal with partnerships. As readers will be aware, SDLT originally contained no charging provisions dealing with partnerships, and the old stamp duty regime was initially kept in place for partnerships. The reason for this was that it was thought too difficult to enact legislation in time for the implementation of SDLT on 1 December 2003. Draft legislation was published, which followed the principle that a charge should be levied on the market value of the land interest transferred. However, this principle was largely abandoned in the legislation which was enacted in FA 2004 as Part 3 Schedule 15 FA 2003. This legislation, which I shall refer to as the “current law”, is deeply unsatisfactory and riddled with complications and uncertainties. HM Revenue and Customs (“HMRC”) acknowledge this, although in practice this acknowledgement has given rise to further problems, in that, by trying to achieve fair results, HMRC have caused further confusion by presenting as interpretations what are in substance concessions. The changes proposed in Budget 2006 will remove some of these difficulties and are to be welcomed. However, they will not be the last word on what remains a difficult area of law.

General Rules Concerning the application of SDLT to Partnerships

The first issue is whether a partnership, which for SDLT purposes includes a limited partnership or an LLP, exists. The starting point is whether a business is carried on “in common”, in the sense of an agreement to share profits and losses, with a view to profit: see s.1(1) Partnership Act 1890. As a general rule, taxpayers will wish to avoid creating a partnership unwittingly for SDLT purposes. This is an important point to consider when a joint venture involving land is being proposed. The general rule is that a partnership is treated as transparent for SDLT purposes so that land is held by the partners. Where a partnership purchases land from a third party then SDLT is payable in the usual way and the partners are liable.

Special Charging Regime for Partnerships

The SDLT partnerships regime contains 3 main occasions of charge:-

- (1) The transfer of land to a partnership by a partner;
- (2) The transfer of an interest in a partnership;
- (3) The transfer of land from a partnership to a partner.

When SDLT was enacted, the most important new charge was made by (2), which prevented the avoidance of stamp duty by the old technique of dropping land into a Jersey partnership and selling partnership interests. The charges under (1) and (3) are mirror images of one another: both contain special rules for rental leases and partnerships consisting entirely of bodies corporate. Part 3 Schedule 15 contains special charges for each of transactions (1) to (3), notwithstanding that charges would arise on general principles (because a partnership is treated as transparent) provided that it was put beyond doubt that a variation in a partner's interest in a partnership in consequence of a land transfer amounts to the giving of consideration. One can see that the general principle is meant to be that a charge should be levied on the proportion of the market value of the land which is effectively transferred. Unfortunately, that is not what the current law provides, as regards charges (1) and (3) above. However, the market value principle should be restored if the changes proposed are enacted.

Charge on Transfer of Land to a Partnership by a Partner

The Current Law

The first issue is to determine when land becomes "partnership property." Uncertainty arises where land used by a partnership is not partnership property as a matter of general law. Land is partnership property for SDLT purposes when it is "*held by or on behalf of a partnership, or the members of a partnership, for the purposes of the partnership business.*" see para 34(1) Sch. 15 FA 2003. HMRC's view is that this is an 'economic use test', so that land owned by one of the partners is partnership property if it is used by the partnership. This catches, for example, an arrangement such as that featured in *Harrison-Broadley v Smith* [1964] 1 All ER 867, where agricultural land is held by a partner outside a family farming partnership. HMRC's view is extremely controversial and hotly disputed: the partner who owns the land may, for example, hold it primarily for investment purposes. In the author's view, land held outside the partnership will generally not be partnership property, although there may be limited exceptions to this, such as where land is held on some sort of "shadow partnership" arrangement for the purposes of avoiding SDLT. For present purposes the important point to be aware of is that SDLT may be in point even where land is held outside a partnership as a matter of general law.

Tax is currently charged by determining the chargeable consideration, using the formula contained in para 10 Sch. 15 FA 2003:-

The chargeable consideration for the transaction shall (subject to paragraph 13) be taken to be equal to –

$$(RCP \times MV) + (RCP \times AC)$$

where –

RCP is the relevant chargeable proportion,

MV is the market value of the interest transferred,
and AC is the actual consideration for the transaction.

The relevant chargeable proportion in relation to the market value of the interest transferred is –

$$(100 - \text{SLP}) \%$$

where SLP is the sum of the lower proportions.

The relevant chargeable proportion in relation to the actual consideration for the transaction is –

SLP %

where SLP is the sum of the lower proportions.

It is necessary to go through a tortuous three-stage process to determine the Sum of the Lower Proportion (“SLP”), but – to put it shortly – the SLP is the proportionate share of the land treated as retained by the transferor-partner (or persons connected with him).

What amounts to “actual consideration” is another controversial issue. The better view is that the legislation uses the term to contrast with deemed consideration, so actual consideration is anything given to the transferor-partner in return for the land. It is generally accepted that an increase in a partner’s share in the partnership and any credit to a partner’s capital account do not count as actual consideration. This is both helpful to taxpayers and generally accepted, but the basis for it is unclear. In addition, HMRC controversially takes the view that actual consideration is only chargeable where the partners are connected (and therefore a charge based on market value will not arise) – “connected” for these purposes having the meaning as in ICTA 1988 s.839. Para 33700 of HMRC’s draft manual provides as follows:

SDLT TM33700 What is the actual consideration to be taken into account?

Consideration is only actual consideration where the sum of the lower proportions (SLP see SDLTM33700) is higher than it otherwise would be because the transfer is to a partnership where one or more persons is connected with the transferrer.

Thus where a property is transferred by a parent into a partnership of their offspring, the sum of the lower proportions will be 100 and the market value charge will be nil.

If the partnership or partners make a payment to the parent, this payment is actual consideration.

Actual consideration can take the usual forms of consideration, that is

- monetary payment
- assumption or release of debt
- property in exchange

It does not matter whether the payment is made by the partnership directly or by the partners individually, if the payment is for the transfer.

This means that there can never be actual consideration when the transfer is by a partner into a partnership and there are no connected persons.

This view is helpful to taxpayers but there is no basis for it in the legislation as it currently stands.

Proposed Reform

If the Budget 2006 changes are enacted, the charge on “actual consideration” where land is transferred to a partnership by a partner will be abolished from the date of the Royal Assent. The charge will then be only by reference to the market value. Para. 2 Sch. 24 of the Finance (no. 2) Bill 2006 substitutes the charging formula set out above with the following:-

The chargeable consideration for the transaction shall (subject to paragraph 13) be taken to be equal to –

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

where –

MV is the market value of the interest transferred, and

SLP is the sum of the lower proportions.

Where a rental lease is involved, the current charge on that proportion of the net present value of the rent which corresponds to the share in the land treated as transferred will be retained, but there will be no charge on any other actual consideration. Minor amendments will also be made to the relevant parts of Schedule 15 to accommodate this change.

Example

Suppose that A and B farm land in partnership. C joins the partnership, taking a one third equal share in return for contributing land worth £1 million. Once the proposed changes are enacted, it will be clear that the charge is on £666,666, being the value of the two-thirds share in the land which C is treated as transferring. This assumes that C is not connected to A and B.

If C were connected to A and B, then on the current law, supplemented by HMRC's practice, the charge would be on any actual consideration, but it is proposed that this charge on actual consideration will be abolished. So, if C were paid £600,000 for transferring the land, then currently a charge (of £24,000) would arise – if C were connected to A and B, whereas once the proposed changes are enacted then no charge will arise.

Charge on Transfer of Land from a Partnership to a Partner

The charge on the transfer of land from a partnership to a partner or a person connected with him operates in essentially the same way as the charge in the reverse situation described above. The partner is charged on the market value of the land which he is treated as acquiring. Currently there is also a charge on the inverse proportion of any actual consideration but it is again proposed that this charge will be abolished.

Transfer of a Partnership Interest

An SDLT charge arises where consideration is given for the transfer of a partnership interest, when the partnership assets include UK land. Tax is charged not on the consideration, but on the proportion of the market value of the partnership land equal to the increased partnership share. Again, there is controversy and uncertainty over the scope of this charge. The statute contemplates a rights-based approach to determine whether an interest in a partnership is transferred. However, HMRC takes an inconsistent approach in relation to the two limbs of charge on the transfer of a partnership interest under para 36 Sch 15. HMRC says that partnership interest means the “cash equivalent” value of a partner's rights in relation to a straightforward transfer of an interest in a partnership. In contrast, where a new partner joins and a partner reduces his interest in the partnership, HMRC takes a rights-based approach. Further uncertainties also arise, the details of which are beyond the scope of this article. For example, where a new partner joins and an existing partner retires and withdraws capital, HMRC's view is that a charge only arises when the withdrawal of capital is funded by arrangements which are dependant upon the introduction of a new partner as otherwise no consideration is treated as given. However, there is again no basis in the legislation for this view. HMRC's views in this area are generally favourable to taxpayers, but the problem is that it is difficult to ascertain where the taxpayer stands as a matter of strict law and – naturally – this makes advising difficult.

It is now proposed that the charge on the transfer of an interest in a partnership will be restricted to partnerships whose main activity is either investing or dealing in land. Trading partnerships which do not deal in land will not be subject to this charge. This change is helpful to taxpayers, but it does nothing to alleviate the uncertainty for those who remain within the charge.

Other Matters

This article is chiefly concerned with the three main charges to tax which arise under the partnerships regime. However, the regime also contains other rules which

should not be overlooked. The general rule is that the SDLT reliefs apply to the partnerships regime. Perhaps the most important point to be aware of here is that in order to claim group relief on a land transfer, all the partners will need to be group companies: there is no ability to claim a proportion of the relief. Finally, the partnerships regime contains anti-avoidance rules to prevent the regime being used for the purposes of saving SDLT. As a regime which prescribes very precise results and is less amenable to broad-brush interpretations, the partnerships regime is potentially a fertile ground for tax planning, and the anti-avoidance rules are certain to be scrutinised in order to see if there is a way around them.

Conclusion

In summary, perhaps the key points to take away from this article are:

- (1) The SDLT treatment of partnerships is a very complicated and unsatisfactory area, which requires caution;
- (2) HMRC takes some controversial views which have no basis in the current legislation (although many of these are favourable to taxpayers);
- (3) Creating a partnership may result in an SDLT charge;
- (4) SDLT is still a potential issue even though, as a matter of general law, land is held outside the partnership;
- (5) There is considerable uncertainty as to the scope of many of the key concepts including “actual consideration”, “partnership property” and the issue of when consideration is given for the transfer of an interest in a partnership; and
- (6) Although welcome reforms are proposed from Royal Assent of the FA 2006, which will remove the charge on actual consideration and confine the charge on the transfer of an interest in a partnership to partnerships whose main activity is investing or dealing in land, many problems will remain.

A real practical problem which advisers face is that often the complexity of the analysis required to determine what should be a straightforward tax charge is totally disproportionate to the tax at stake. This should be a serious concern to taxpayers, their advisers and to HMRC.

Further Reading

Schedule 15 FA 2003

Schedule 24 Finance (No. 2) Bill 2006 (and explanatory notes).

HMRC's draft partnerships manual, available at www.hmrc.gov.uk/so/pftmanual.htm
"Stamp Duty Land Tax" (2nd edition) Michael Thomas (Cambridge University Press)