

Investment properties

Tax treatment of business partnership holding property.

I was interested to read the reply in Readers' forum 'Selling farmland' (*Taxation*, 9 March 2023).

I have a situation where a husband and wife are joint owners of the large portfolio of residential investment property in England. Some years ago we registered the business as a partnership with HMRC although the underlying ownership of the properties remains in joint names of the married couple. This was with a view to incorporating the business and possibly mitigating SDLT using the sum of the parts on SDLT relief in FA 2003, Sch 15 – which the couple have subsequently decided they do not wish to do. The property portfolio contains large capital gains. There are no borrowings.

Taking the point from CG30360 that interest in a partnership assets are not included for the purposes of TCGA 1992, s 62(1), does this mean that this situation is actually disadvantageous vis-à-vis a married couple? On death, they have each left their estate to the other. I am assuming, therefore, that there would be no CGT on death because of the exemption for transfers between married persons. Does this mean, though, that on the death of the last surviving spouse, the capital gains uplift would apply to the entire value of the property portfolio?

Also, in view of the fact that the couple are not now intending to incorporate their property portfolio, is there any disadvantage in simply advising HMRC that it is no longer a partnership as such and simply file two individual SA returns on the basis of jointly owned investment properties?

Query 20,120

– Landlord.

Landlord should retain his objectivity.

It is possible to be both co-owners of residential investment properties and in partnership letting them out. For there to be a partnership each co-owner needs to be involved in the management and also act as the agent for their joint venture. This naturally follows on from the definition of a partnership in the Partnership Act 1890, s 1: 'A partnership subsists where a business is carried on with a view of profit.' 'Business' here has a wider meaning than 'trade' as it includes property letting and other activities. If only one co-owner managed the properties and paid for their management out of their own pocket, there would not be a partnership and only co-ownership.

In this scenario only half of their revenue expenses incurred would be validly deductible for income tax purposes against their share of rental income because of the 'wholly and exclusively' rule in ITTOIA 2005, s 34, which applies to property letting by s 272. It might be possible to have joint management without one co-owner acting as the agent for the joint venture; although, this could be difficult. So, it can be understood why there has to date been a partnership based on the facts.

One only gets a chargeable gain (CG) free uplift on death (TCGA 1992, s 62(1)) if the owner of an asset was competent to dispose of it prior to their death. If an asset devolves by survivorship as a beneficial interest in a joint tenancy does via *jus accrescendi* to the other tenant(s), then this qualifies for a CG free uplift (s 62(10)). But, if there is a devolution per an external agreement, this will not be an asset of which they were competent to dispose and there will be a 'disposal' of their interest. Any gain(s) may need to be disclosed to HMRC.

Transfers of value between spouses/civil partners (CPs) are exempt for IHT. Inter vivos transfers are made on a 'no gain no loss' basis. On the death of the surviving spouse a CG free uplift will apply to properties devolving by will or intestacy to legatees. Whether the partnership is deregistered with HMRC should depend on whether it has ceased to exist based on a 'finding of facts'. Landlord should retain his professional objectivity and form his opinion on whether or not a partnership continues to exist by applying the relevant aspects of partnership law to what is occurring now. There may well be an income tax advantage of continuing as a partnership.

– Paul Steward, tax consultant.

Is property held as partnership assets?

Unfortunately it is not clear whether the property is deemed to be partnership property. It seems that the rental income has been registered partnership for income tax purposes but there is no partnership agreement as such. There are presumably annual partnership accounts but do they show the properties on a balance sheet as partnership assets and is this enough to constitute partnership property? If not, without any other documentation to make them partnership assets, they remain outside the partnership and will pass under the terms of their wills. In that event there is CGT uplift on death of either partner.

If, on the other hand, there is some documentation to show that the portfolio as is held as partnership assets, then without a partnership agreement detailing what happens on the death of a partner, HMRC is likely to take the view that the share of one automatically passes to the other. In that case the survivor takes the additional half share of the assets at cost price due the transfer being between married persons and there is no CGT-free uplift on the death.

It does seem sensible either to wind up the partnership or alternatively put a standard partnership agreement in place making the portfolio partnership property with provisions for what happens on the death of a partner, these are usual standard clauses such as:

- Clause allowing a partner to nominate someone to be a partner by their will and assign capital and income to them.
- Provisions relating to an option for continuing partners to purchase interest including clauses on basis of valuation to be used, payments, etc.
- Basis for preparation of accounts for withdrawing partner.
- Provisions for payment of monies or property to deceased's estate.

Overall this is another extremely important reason to review the partnership agreement position even with a simple husband and wife partnership. Winding up the partnership should not cause any SDLT or CGT issues to arise. – Butler and Co.