Structuring the recovery

Good deals What is the most efficient way to acquire commercial property in the UK? Jon Blackburn examines a raft of options

There is no doubt that the going remains tough in the UK real estate market and investors are doing all they can to save costs. Against this backdrop, it is essential that property transactions are structured in the most efficient way possible. This article reviews a number of the vehicles open to investors looking to acquire commercial real estate in the UK (whether alone or via joint ventures), including limited liability companies, limited liability partnerships, limited partnerships, publicly-listed entities and offshore unit trusts.

Private limited companies

Perhaps the most common way of structuring a property investment is by way of a private limited company, typically a special purpose vehicle (SPV) set up for the purpose of the relevant transaction. From a buyer's perspective, the main advantage of acquiring shares in the SPV, rather than the property directly, is that it will only be required to pay 0.5% stamp duty on the transfer (or potentially no duty at all if the SPV is an off-shore company), rather than Stamp Duty Land Tax at 4%.

Despite this obvious advantage, using an on-shore limited company for property investment purposes may not optimise tax efficiency for a seller as there may be a double tax charge on any asset disposal to the extent that the proceeds of sale are then distributed to the shareholders.

The SDLT saving alone is a strong argument for structuring a transaction in this way and if the company that owns the property is a genuine SPV that has not traded, it should be a relatively straightforward acquisition process. However, it may be that the target company isn't a simple SPV. It may have a trading history that the buyer was not aware of prior to carrying out its due diligence.

It is possible that the risks associated with acquiring an older company "warts and all" (and the costs associated with a more wide-ranging due diligence exercise) may still be outweighed by the expected SDLT saving, but this will depend on the overall deal value.

Limited liability partnerships (LLPs) and limited partnerships

Over recent years, LLPs have gained in popularity. They have the advantages of partnerships (they are treated as being tax transparent as if the business is carried on directly by the members of the LLP) and companies (the members, as with company shareholders, have limited liability).

They are typically used as a holding structure for a joint venture. This is because, despite the advantages of LLPs, an LLP may not be a particularly attractive structure for a purchaser to acquire.

A transfer of all or part of an interest in an LLP is not treated in the same way as, say, a transfer of shares in a company or units in a unit trust. A transfer of an interest in an LLP is subject to SDLT in the same way as a transfer of the underlying property (albeit calculated by reference to the proportionate interest in the LLP).

Limited partnerships (often, English, Scottish or Jersey) are also commonly used for property investments and bring with them much of the same advantages as LLPs. The main difference between the two is that a limited partnership is not (under English law) a legal entity in its own right.

A limited partnership is comprised of at least one limited partner and, typically, one general partner. The general partner carries on the partnership business. The limited partners must not be involved in the partnership business as otherwise they will lose their limited liability status.

Depending on the overall investment structure, the number of investors and the operational involvement of those investors, both LLPs and limited partnerships are likely to be treated as "collective investment schemes" for the purposes of the Financial Services and Markets Act 2000.

The consequence of this, put simply, is that the relevant LLP or limited partnership may need to be regulated by the FSA and operated by an FSA-authorised operator. Professional property investment groups, particularly those that also undertake property and/or asset management functions, will invariably have authorised companies within their group that can carry out this role. It is, however, something that must be considered by anyone looking to set up such a structure with one or more investors. Failure to comply with the FSA's requirements is a criminal offence. This tends to focus the minds of all involved!

La Corbiere lighthouse, Jersey: the Channel Island is linked to a popular property unit trust

REX FEATURES

JPUTs

Another popular structure for property investment is the offshore unit trust, particularly the Jersey property unit trust or JPUT. In essence, legal ownership of a JPUT's assets (ie the property) is vested in a trustee or trustees who hold them on trust for the benefit of the holders of the units in the trust (ie the investors). JPUTs can be structured very simply or can be more complex to reflect the investors' commercial requirements and, in much the same way as companies or partnerships, can be set up with more than one class of units, enabling the unit holders to have different rights and/or receive different returns.

As with any form of trust arrangement, the trustees have certain fiduciary duties when operating the JPUT. However, beyond this, JPUTs are extremely flexible and are not otherwise subject to the sort of statutory restrictions that one might face with, say, a limited company. In addition, buying and selling units in a JPUT is as simple as buying and selling shares in a company. Although "seeding relief" no longer exists, JPUTs remain tax-efficient. A transfer of units in a JPUT does not attract stamp duty or SDLT. A purchaser can therefore make substantial savings by acquiring the units in the JPUT that owns a property rather than by acquiring the property directly.

In addition, if structured correctly, a JPUT will be treated as transparent for UK income tax purposes, meaning that there will be no income tax charge on rental (or other) income at the JPUT level. At the same time, a JPUT is treated as a company for UK capital gains tax purposes, so that, provided the management of the JPUT is not inadvertently brought on-shore, it may be possible to avoid (or at least defer) tax on capital gains.

REITs

Real estate investment trusts (REITs) have been hitting the news again in recent months in the light of the proposed changes to the REIT regime due to take effect later this year.

In essence, a REIT is a company – or a group of companies, the main one of which is tax resident in the UK – which is fully listed on a stock exchange recognised by HMRC and has at least 75% of its business in property investment.

If these and certain other conditions are met, the REIT status of the relevant company or group means that it will be exempt from paying corporation tax on the profits that it derives from the property investment part of its business.

To date, REITs have not been anywhere near as popular in the UK as intended. However, it is hoped that certain key changes to the REIT regime will lead to renewed interest. These include:

- The abolition of the one-off entry charge (of two per cent of the market value of the properties forming part of the company's/group's property investment business), which should be attractive to both companies looking to convert into REITs and start-ups.
- The possibility for companies whose shares are traded on AIM (and not just those listed on the main market of the London Stock Exchange) to qualify for REIT status, which should provide companies with considerable cost and compliance savings.
- The introduction of a three-year "grace period" for companies to demonstrate that they are not "close", and the exclusion of certain institutional investors when determining whether or not a company is close. The fact that, in order to qualify as a REIT, a company must not be a private investment (or "close") company has been a source of frustration for companies owned by institutions (such as pension funds) which themselves have a diverse investor base but which would not technically satisfy the "close" company test.

The most obvious beneficiaries of the upcoming changes to the regime will be owners holding, by way of corporate structures, properties with sizeable inherent capital gains, as those gains would disappear upon conversion into a REIT (meaning that the REIT would subsequently be in a position to sell the shares in the relevant property holding company without having to factor in inherent gain valuation issues).

In addition, as and when a REIT looks to acquire additional properties held in corporate vehicles, the REIT would not only benefit from SDLT savings (incurring only a 0.5% stamp duty charge in relation to the acquisition of the shares in those vehicles) but would also not be required to pay the two per cent entry charge.

Joint ventures

Joint ventures have always been a useful way for parties to share risk and pool resources and this is very much the case in the real estate sector (for example, between investors and asset managers or developers). With less (and more expensive) debt available in the market these days, "all equity" transactions, structured through joint ventures, are becoming more common.

Joint ventures have their own complications as the vehicle(s) chosen by the parties will be driven by the tax requirements of each party (which will often differ) and may thus be a compromise structure (that may, for example, be tax-efficient for one party and only tax-neutral for another). They are frequently structured through any one or a combination of the vehicles detailed above. However, the dynamics, commercial drivers and tax considerations associated with joint ventures, would easily warrant an article in its own right.

Conclusion

Clearly, there is a variety of options available to investors for structuring their investments in the UK real estate market. Choosing the most appropriate vehicle or structure (from a tax, administrative, operating or any other perspective) is an extremely important factor in determining the financial success of any investment, and seeking the right advice at the right time (and from the right professionals) is critical in achieving that success.

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Key points

- **An LLP or limited partnership may need to be regulated by the FSA and operated by an FSA-authorised operator. Failure to comply with FSA requirements is a criminal offence.**
- **A purchaser can make substantial savings by acquiring the units in the JPUT that owns a property rather than by acquiring the property directly.**
- **It is hoped that certain key changes to the REIT regime, including the abolition of the one-off entry charge, will lead to renewed interest in the vehicle.**