

PROPERTY FUNDS & JOINT VENTURES: COMMON STRUCTURES

The choice of structure for property co-ownership and funds can be baffling. Whilst there are endless variations many will fall into the categories below. The following series of tables should help in starting the thought process as to which structure is best for you.

For an explanation of terminology used see “Property Funds & Joint Ventures: A Glossary.”

LIMITED LIABILITY

	Limited liability of investors	Duties of managers
Co-ownership	No, and risk that co-owners are treated as partners.	No distinction between investors and managers.
Partnership	Joint and several liability between partners.	No distinction between investors and managers.
Limited Liability Partnership	Members have a similar legal position to company shareholders and directors.	As for company directors plus additional right to claw back excessive drawings on insolvency.
Limited Partnership	Investors are limited partners and will have liability limited to their agreed contribution unless they become involved with management (and so become general partners) or withdraw capital.	Must have at least one general partner with unlimited liability (usually a new company with few assets) which manages the partnership.
Trust	Beneficiaries generally bear no liability but could be categorised as partners.	Trustees subject to fiduciary duties (especially to act in the best interests of beneficiaries, for proper purposes, and to avoid conflict of interest).
English Unit Trust	As for Trust.	As for Trust.
JPUT/GPUT	As for Trust.	As for Trust.
English company	Yes for shareholders beyond the obligation to pay up agreed amount on shares.	Directors owe duties to shareholders, creditors, and others especially under Companies Acts and Insolvency Act 1986.
REIT	As for an English company.	As for company but enhanced duties as listed company (especially under Listing Rules and FSMA).
Offshore Co (in low tax jurisdiction)	Depends on jurisdiction but likely to be similar to position of English company.	Likely to be similar to English company but governed by local law.
PAIF	As for an English company.	As for English company but additional duties under FSMA.

TAX - SOME KEY CONCEPTS

Tax transparency arises where the investor is treated for tax purposes as if they had received income or realised a gain directly. This is vitally important for pension funds, charities and non-UK residents who do not pay full UK tax. Tax payers will want to ensure that investing via a fund puts them in no worse tax position than if they had invested directly into the property. Partnership and trust structures are generally transparent while company structures are not.

Overseas Establishment is required for vehicles where they claim to fall outside of the UK tax net on geographical grounds. They are required to show that their “central management and control” is outside the UK which requires that they take all material decisions, hold board meetings outside the UK, have an office outside the UK, and have a majority of directors resident abroad. This can add considerably to expense if many of the decision makers are based in the UK. See also **overseas landlord scheme**.

The **overseas landlord scheme** applies where the property owner is based outside of the UK. This requires tenants to deduct basic rate tax at source unless the landlord is pre-approved by HMRC. This effects cash flow of the vehicle. It can be mitigated by having a UK agent collect rent but this adds complication (and expense) to the structure.

Trading v capital: Different taxes arise on realisation of a capital gain from trading income. The difference can be significant (currently CGT 18% whereas income tax is up to 50%). Whether a property holding is treated as capital or trading stock will depend on many factors including the intention of the owner. If it is intended to hold the property long term it is likely to be capital. Inferences will, however, be drawn from circumstances (and in particular, for how long the property was held in practice).

REIT Restrictions: REITs are required to comply with a series of restrictions on their business to qualify for REIT status which are set out in the attached Glossary.

	Tax transparent?	Tax rate in vehicle (NB in addition to tax payable by investor if any)	UK Stamp duty / SDLT on transfer of units	Need for offshore establishment
Co-ownership	Yes.	n/a.	1-4%	No.
Partnership	Yes.	n/a.	1-4%	No.
Limited Liability Partnership	Yes (but not for pension fund investment in property investment LLPs).	n/a.	1-4%	No.
Limited Partnership	Yes.	n/a.	1-4%	No.
Trust	Yes.	n/a.	1-4%	No.
English Unit Trust	No.	AUT exempt CGT. UUT 20% CGT. AUT and UUT 20% on income.	SDLT on surrender or transfer at 0.5%.	No.
JPUT/GPUT	No but usually no capital gains as resident in Jersey/ Guernsey and “transparent” for income tax if it is a Baker trust.	n/a.	Nil.	Yes.
English company	No.	22-28%	0.5%	No.
REIT	No.	Exempt on profits and gains from qualifying property.	0.5%	No.
Offshore Co (in low tax jurisdiction)	No.	Income from UK property 20%, capital at local rate (nil in many low tax jurisdiction).	Nil.	Yes.
PAIF	No.	Exempt CGT. Exempt on income from ring-fenced investment business and certain categories of dividend income.	SDLT as surrender or transfer at 0.5%.	No.

REGULATORY ISSUES - SOME TERMS EXPLAINED

Conducting Investment Business: Subject to certain limited exceptions, FSMA prohibits a person from carrying on regulated activity in the UK unless he is authorised under that act. Regulated activity is broadly defined but includes dealing in or arranging deals in shares and debt instruments.

Collective Investment Schemes are, essentially, arrangements for the pooling of investments by which some participators are excluded from day to day control. FSMA prohibits their establishment, promotion and operation other than by authorised persons. This is usually dealt with by the appointment of an operator authorised by FSMA which adds to expense of operation of the scheme.

Financial Promotion is also prohibited by FSMA other than by authorised persons. This arises when a person, in the course of business communicates an invitation or inducement to engage in investment activity. There are a number of exceptions (such as promotions to high net worth individuals or sophisticated investors) but these are tightly worded and need to be applied with great care.

An **approved prospectus** (approved by the FSA) is required for the issue to the public of shares or debt instruments unless they fall within certain exceptions (such as an offer directed at less than 100 persons, fund raisings below €100,000 or where the minimum investment size is at least €50,000).

	Collective investment scheme	Regulation to promote
Co-ownership	Yes if some investors excluded from day to day management.	No - unless collective investment scheme.
Partnership	Yes if some investors excluded from day to day management.	No - unless collective investment scheme.
Limited Liability Partnership	Yes if some investors excluded from day to day management.	No - unless collective investment scheme (but arguably within financial promotion regime).
Limited Partnership	Usually.	Yes - usually a collective investment scheme.
Trust	Possible.	No - unless collective investment scheme.
English Unit Trust	Special highly regulated structure for AUTs and PAIFs.	Yes.
JPUT/GPUT	No (but subject to funds regulation in Jersey/ Guernsey).	Yes.
English company	No.	May need (i) authorised person to deal with financial promotion; and/or (ii) prospectus (see above).
REIT	No.	May need (i) authorised person to deal with financial promotion; and/or (ii) prospectus (see above).
Offshore Co (in low tax jurisdiction)	No.	May need (i) authorised person to deal with financial promotion; and/or (ii) prospectus (see above).
PAIF	Yes.	Yes.

SUMMARY - WHEN TO USE THIS STRUCTURE?

As will be seen, there are a number of factors to throw into the mix when deciding what type of vehicle to use. Having weighed up these factors, where does this leave the promoters? In the table below we pull together a number of these threads.

Co-ownership	Simple inactive investments with no anticipated trading of units.
Partnership	Simple investment with partners knowing each other well in advance and no anticipated trading of units.
Limited Liability Partnership	Good for individuals where property held as capital not trading (while differential tax rates on capital and trading).
Limited Partnership	Good for pension funds and charities but cost of operating collective investment scheme may be prohibitive for smaller schemes.
Trust	Tax transparency is good for offshore investors. But the risk of being deemed to be a partnership may rule this out for pension funds, charities and other risk averse investors.
English Unit Trust	Uncommon outside authorised funds as JPUT/GPUT are preferred.
JPUT/GPUT	Popular for offshore investors or to hold limited partnership interest and permit transfer without SDLT/stamp duty.
English company	Investors all UK tax payers none of whom are pension funds or charities. NB for capital, individuals may prefer tax transparent structure.
REIT	Good for restructuring listed property companies but REIT restrictions mean that for new funds this structure may be unattractive.
Offshore Co (in low tax jurisdiction)	Good for offshore investors but 20% tax on rental income means that pension funds and charities will often prefer a transparent structure.
PAIF	Retail investors.

We hope that this gives a useful introduction to the topic. Forsters has extensive experience of advising on establishment, investment in and management of fund structures and would be happy to advise further.

This briefing offers general guidance only. It reflects the law as at December 2009. The circumstances of each case vary and this article should not be relied upon in place of specific legal advice.

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PROPERTY FUNDS & JOINT VENTURES: A GLOSSARY

For a brief comparison of common structures see our Briefing “Property Funds & Joint Ventures: Common Structures.”

- An **Authorised Unit Trust (AUT)** is a unit trust authorised by the FSA under FSMA. A UK unit trust must be authorised before it can offer units to the public.
- **Baker Trust** an interest in possession trust governed by non-UK law typically Guernsey or Jersey. The trust deed ensures that the income of the trust passes directly to the beneficiaries.
- **CGT Capital Gains Tax.**
- **Collective Investment Schemes (CIS)** are arrangements (eg. partnerships, trusts, companies contracts of even understandings) under which participants who do not have day-to-day control over the management of the property (of any description including money) whether or not they have the right to be consulted or to give directions, participate in or receive income, profit or gains from the property so held.
- **Co-ownership** is a simple arrangement for joint ownership of property. Property is registered in the names of two or more owners with ownership and management of the property divided between owners in accordance with an express or implied agreement or if none as directed by general law. These arrangements may amount to partnerships or trusts.
- An **English company** must be incorporated in accordance with the Companies Acts. Management will be conducted by the directors and the company must be operated in accordance with the Companies Acts, the company’s constitution (previously known as its “memorandum and articles of association”) and any shareholders’ agreement.
- An **English Unit Trust** is created by trustees issuing units to unit holders which represent underlying trust property. No formality is required unless the unit trust is to be an **Authorised Unit Trust (AUT)** or **Property Authorised Investment Fund (PAIF)** which are heavily regulated.
- **FSA** Financial Services Authority.
- **FSMA** Financial Services of Markets Act 2000.
- **HM Revenue and Customs (HMRC)** the UK government department responsible for administration of UK taxes.
- A **Jersey Property Unit Trust (JPUT)** or **Guernsey Property Unit Trust (GPUT)** will be formed under Jersey/Guernsey law and have trustees who would usually be resident in Jersey or Guernsey. Approval of investors and authorisation of the fund may be required under Jersey/Guernsey law details of which are outside the scope of this paper.
- A **Limited Liability Partnership** is a body corporate formed and registered in accordance with the Limited Partnership Act 2000. The law is based on the Companies Acts with modifications. “Members” have legal rights and duties which are similar to both those of shareholders and directors of a company. Arrangements between themselves will typically be set out in a Members’ Agreement.

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- A **Limited Partnership** is a Partnership formed and registered under Limited Partnership Act 1907. It is governed by partnership law as supplemented by this Act. Each Limited Partnership must have at least one general partner (with unlimited liability) and any number of limited partners, who enjoy limited liability subject to exceptions touched upon below.
- **Listing Rules** are published by FSA and lay down minimum requirements for admission of securities to listing on the London Stock Exchange, the content, scrutiny and publication of the listing particulars and the continuing obligations of issuers after admission.
- **Offshore Companies** incorporated and resident in Channel Islands, Isle of Man, British Virgin Islands or other low tax jurisdiction, will be formed and operated in accordance with local law.
- An **Open Ended Investment Company (OEIC)** is a body corporate meeting the conditions set by section 236 FSMA. The tax treatment of OEICs is broadly similar to that for AUTs and is designed for retail investors who wish to invest in quoted stocks or bonds etc with the aim of spreading risks and giving its investors who hold shares in the OEIC a return based upon those investments. An OEIC is defined as a company incorporated in the UK to which section 236 of FSMA 2000 applies and is subject to a 20% corporation tax rate.
- A **PAIF** is an OEIC which is authorised and regulated by the FSA under the terms of FSMA to invest in property. They allow exempt investors to (e.g. charities, pension funds, ISAs and SIPPs) to invest in collectively held rental property without suffering the 20% OEIC corporation tax charge. To benefit there are 6 key conditions that have to be satisfied including that the shares of the PAIF must be genuinely available to a large number unconnected persons, the majority of its income and assets must relate to property investment and the PAIF must take reasonable steps to ensure that no company acquires a 10% plus beneficial interest in the net asset value of the fund.
- **Partnership** is established as a matter of law (and without registration or formality) when two or more persons are carrying on business in common with a view to profit. The arrangements are governed by Partnership Act 1890 and general law but subject to any express or implied partnership agreement.
- A **Real Estate Investment Trust (REIT)** is a company listed on the Official List of the London Stock Exchange (or other recognised investment exchange). It must meet the requirements for a REIT set out in Finance Act 2006 and subsequent guidance. In particular, it must derive at least 75% of their income from and hold 75% of assets in rental property, have interest cover of 1.25:1, and must hold at least three properties and additional tax charges arise on distribution to a shareholder entitled to 10% or more of shares. A REIT is subject to an entry charge at 2% of gross assets and in return qualifies for a special tax treatment. As a listed company, directors will need to ensure compliance with Listing Rules, FSMA and other guidance.
- **Stamp Duty** is a tax on documents. Stamp duty is chargeable on shares and other marketable securities. The rate of stamp duty on the transfer of these stampable assets is 0.5%.
- **Stamp Duty Land Tax (SDLT)** is a tax on transactions involving acquisitions of interests in UK land. Under SDLT, an acquisition includes the creation, surrender, release or variation of a land interest.
- A **Trust** arises where legal owners (trustees) declare that they hold property for others (beneficiaries) or trust law implies such an arrangement.
- **Unauthorised Unit Trust (UUT)** an English Unit Trust which is not an AUT.

This glossary offers general guidance only. It reflects the law as at December 2009. The circumstances of each case vary and this article should not be relied upon in place of specific legal advice.

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