

## Structuring Property Funds and Joint Ventures

### Introduction

Finding the best structure for the ownership of property investments and developments can be highly complex. Choosing between the options open to you can make a substantial difference to the success and overall returns of your investment or development scheme.

Joint ventures and property funds can spread the risk and cost of a property investment or development between a number of parties and can take many forms. At their simplest, these arrangements can be constituted as co-ownership of property or contractual arrangements providing for profit sharing. More formal arrangements include jointly owned companies and a variety of partnership and trust structures.

This guide outlines the main types of structure and some of their advantages and disadvantages, together with some of the other factors that you may need to take into account before making a decision.

As a leading property law firm, Forsters regularly advises on structuring property funds and joint ventures. Our clients include institutional pension funds, developers and owner occupiers and we have broad experience of development and investment structures. If you have any questions about issues raised by this guide or would like to discuss your own plans, then please do contact us.

### Issues to consider

Before you can reach a decision on the appropriate structure you will need to consider your position on a range of issues and their relative importance to your strategy. These may include the following.

#### Tax considerations

Minimising tax is often high on the list of priorities of property developers and investors.





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**Tax transparency** (that is taxing the venture as if the investors themselves, rather than a separate vehicle, had directly acquired or developed the property) is often required by pension funds, charities and non-UK residents who have beneficial status on treatment of capital gains. It can also be advantageous for individuals wishing to use taper relief or other personal allowances and reliefs.

Other issues to consider include:

- minimising **stamp taxes**;
- using available **chargeable gains and income tax** reliefs and allowances;
- optimising treatment of **capital allowances**; and
- for developers, the availability of an appropriately qualified and certified party to pay **sub-contractors** without deducting tax.

#### Limiting liability

Avoiding personal liability for the debts of an investment vehicle is often another high priority. Choosing a limited liability structure (such as a company, limited liability partners or limited partnership) will be a step towards achieving this. However, you will still need to be wary of avoiding the pitfalls. Breach of directors' duties, inadvertent creation of an unlimited partnership or entering into poorly drafted guarantees can all create unexpected personal liabilities.

#### The regulatory environment

This can raise a number of issues.

- If the structure used amounts to a **collective investment scheme** (which many common structures will) then you will need to involve an authorised operator and comply with appropriate regulations (which may add significantly to costs and reduce flexibility).
- Where companies are used you will need to consider whether you are required to issue a **prospectus** (and may need to alter the structure to fit within exemptions).
- Raising funds can easily bring you within the prohibition on engaging in **financial promotion**. Again you may need to alter the structure to fit within exemptions and if this is not achievable involve an authorised person in the promotion.

#### Funding

The requirements of debt or equity funders can impose restrictions on the choice of structure and the terms of key documents. Issues to consider will include:

- the availability and enforceability of security;
- repayment terms;
- drawdown;
- warranties and covenants;
- financial returns expected by interested parties; and
- the division and transfer of equity.

### Management

You will need to document how key decisions are to be made and may need to plan for the risk of deadlock. You will also need to think about how managers are to be rewarded and incentivised. The resolution of these questions may also influence your choice of structure by raising the issue of personal liability (particularly with regard to breach of directors' duties or the statutory imposition of liability on limited partners engaging in management).

### Exit plans

You should consider at the outset how you want to handle individual and collective exit by any or all of the people involved in your scheme.

### Common structures - an overview

In this section we give an overview of the most common forms of structure for joint ventures or property funds, together with an indication of the advantages and disadvantages. As discussed, your final choice of structure is likely to be based on complex range of factors, so do talk to us if you would like more information.

### UK Limited Companies

UK companies are popular joint venture vehicles. Used as special purpose vehicles (SPVs) they are also popular acquisition vehicles. **Advantages** include the following:

- they are convenient vehicles for **raising debt and equity finance**;
- bespoke arrangements for **management, funding and exit** are easily accommodated;
- they are relatively **inexpensive** to form and run;
- a body corporate will not generally be classified as a **collective investment scheme**; and
- as **stamp duty** on the transfer of shares is normally 0.5% they offer a significant saving over transfers of land where SDLT is payable at higher rates (usually 4% for properties with a value in excess of £500,000).



However, there are some **drawbacks**.

- They are not an ideal structure for those for whom **tax transparency** is important, such as pension funds, overseas investors, charities and UK residents who are eligible for taper relief.
- Where property has appreciated since purchase by an SPV, the SPV will carry an **embedded liability for tax** on chargeable gains which may be a disincentive to acquiring an SPV rather than the property itself.
- Where the SPV has acquired property from a group company there can be a **de-grouping tax charge** for chargeable gains or SDLT.
- Where there are substantial numbers of investors you will be required to issue a **prospectus**.
- A buyer of an SPV company will generally require **warranties and indemnities** from a person or company of substance to try to confirm, essentially that any undisclosed or unexpected liabilities of the company are left with the sellers. This can significantly complicate a sale process and create difficulties if the sellers are themselves a company or are unwilling to accept this liability.

Partnerships as tax transparent ownership structures

If tax transparency is important to you, the most appropriate structure may be some kind of partnership or trust structure.

The tax liability of a partnership will generally be apportioned to the partners within it in accordance with their participation in the partnership.

- **Unlimited partnerships**

An unlimited partnership is formed where two or more persons together carry on business with a view to profit. While it is prudent to have a partnership agreement to regulate the partners' relationship **no formality is required** to establish the partnership. **Costs** are, therefore, low.

Partners in an unlimited partnership, however, will be **jointly and severally liable for the firm's debts**. Fear of unlimited liability has promoted the use of partnerships formed under the Limited Partnership Act 1907 (Limited Partnerships) and the Limited Liability Partnership Act 2000 (Limited Liability Partnerships).

Because no formality is required unlimited partnerships **can easily be**

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**created inadvertently** and this should be borne in mind when considering other structures. While pure **co-ownership** will not of itself create a partnership, the line between this and carrying on business can often be difficult to discern. **Contractual profit shares** can easily amount to unlimited partnerships.

- **Limited Partnerships**

With a Limited Partnership there must be at least one general partner (who has unlimited liability). The other partners (the limited partners) may enjoy limited liability.

Potential **drawbacks** for Limited Partnerships include the following.

- Limited partners will face **personal liability if they take part in management**. Investors, however, will often want some degree of control. It may be difficult to give limited partners sufficient influence without stripping away their protection.
- Limited partners will also face **personal liability if they withdraw capital** during the life of the partnership. This may impose restrictions on how the parties would want to distribute partnership profits.
- Unless one of the specific exceptions applies, a Limited Partnership will generally be a **collective investment scheme** which also requires the appointment of an authorised operator with the cost implications mentioned above.
- While being taxed as partnerships for general purposes there is a **ban on the deductibility of interest on loans** incurred in connection with the acquisition of a partnership share and restrictions on the deductibility of interest incurred by the Limited Partnership.
- Where the Limited Partnership is trading, rather than holding investments, partners who are charities and pension funds (that for other purposes would be treated as exempt) will be **treated as receiving trading income** (for which they are not exempt in the way that they would be for investment income and chargeable gains).
- For foreign investors there can also be a risk that they would be imputed to have a **UK place of business** and so fall within the UK tax net.



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- **Limited Liability Partnerships**

Limited Liability Partnerships offer the advantages of being a more robust and flexible structure than a Limited Partnership. They may, however, be inappropriate vehicles for large numbers of investors as a person dealing with the partnership is entitled to assume that each “member” has authority to commit the partnership.

All “members” may limit their liability so there is no need to have a general partner with unlimited liability. Limited liability is also **not jeopardised by the involvement of any member in the management or a return of a capital** during the currency of the partnership.

There are, however, some potential **disadvantages**.

- In the event of the insolvent liquidation of the Limited Liability Partnership a member may be liable to **repay drawings made in the preceding two years** if he knew, or ought to have concluded, that the partnership was hopelessly insolvent.
- The point above implies a higher standard for more skilled members, leading to the need for active involvement and monitoring by all members (by contrast to Limited Partnerships where active management by limited partners can undermine limited liability). This may make Limited Liability Partnerships **inappropriate for those unwilling or unable to actively monitor the operations**.
- Every member of a Limited Liability Partnership is its agent and may bind the partnership save where there is a limitation on his authority which a person dealing with the partnership is aware of. As mentioned, this makes Limited Liability Partnerships **inappropriate vehicles for large numbers of investors**.
- While a Limited Liability Partnership, unlike a Limited Partnership, is a body corporate and bodies corporate are generally taken to be outside the **collective investment scheme** regime, the regulations specify that a Limited Liability Partnership will not benefit from this exemption. Where all members, however, are actively involved in management the arrangement may not amount to a collective investment scheme.



- As with Limited Partnerships, Limited Liability Partnerships are generally taxed as partnerships. Limited Liability Partnerships, however, also face **restriction on transparency** as investment entities if they are “property investment LLPs”, rendering Limited Liability Partnerships undesirable for exempt pension funds (but not charities) in most property investment scenarios.

#### Trust structures as tax transparent ownership structures

- **Express trusts and nominee arrangements**

These can be created with **minimal formality and cost** by a person or company (the trustee or nominee) declaring that they hold property on behalf of one or more beneficiaries. Often the trustee or nominee will be a company owned by the beneficiaries. On a disposal of the property a nominal price would be paid to the trustee who holds only a bare legal title to the property, with the bulk of the price (and the tax on any gain) payable by the beneficiaries (at their own rates of tax). The structure is, therefore, effectively **tax transparent**. There is, however, a significant **risk of inadvertently creating an unlimited partnership** resulting in personal liability for beneficiaries (see above).

- **Unit trusts**

In terms of trading vehicles, an onshore unit trust may be an attractive structure for exempt pension funds or charities concerned about **tax transparency**. The investors each subscribe for units in the unit trust. If the unit trust has income profits, it is liable to tax but can issue to unit holders a certificate allowing them a full credit against this tax liability which they are usually able to reclaim. This structure overcomes the transparency concerns associated with Limited Partnerships and Limited Liability Partnerships and provides effective transparency for trading operations. **It will not, however, offer effective transparency for chargeable gains**. Corporation tax will be payable on a chargeable gain without the possibility of passing on the tax credit to unit holders. The transfer of units in a UK unit trust attracts stamp duty at 0.5%. Authorised unit trusts (which can be marketed to the public) are highly regulated entities.

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#### Offshore structures

Non-resident companies, trustees and individuals are generally not liable for UK tax on chargeable gains for disposals of UK based property. Consequently, offshore structures may prove attractive to some investors. It is worth, however, bearing in mind the following points.



- **Central management and control:**

With companies, the country of residence will be decided by reference to where the “central management and control” is situated. This is judged on issues such as the location of board meetings and permanent office facilities, where management decisions are really taken and where the staff are located. It is easy to fall foul of these rules if the company does not have a substantial operational office outside the UK.
- **Offshore structures and individuals:**

For individuals’ tax planning, settlement of property on trustees who are resident in an appropriate jurisdiction outside the UK may be a means of mitigating tax on chargeable gains and inheritance tax. Anti-avoidance rules, however, make the use of offshore trusts for such purposes increasingly difficult.
- **Non-resident landlords and income tax:**

For landlords, non-resident status may create complications on collection of rent. A special regime requires tax to be deducted from rent paid to non-resident landlords and paid directly to the Inland Revenue by the tenant. If a UK-resident agent collects the rent on behalf of an overseas landlord the rent may be paid gross but the agent (after deducting expenses wholly and exclusively incurred for the purposes of his trade) must then deduct the appropriate tax before remitting the rent to the landlord. A non-resident landlord with a clean tax record can get permission for rent to be paid gross but they then must make annual UK tax returns and pay income tax as it falls due.

This note offers general guidance on structuring property funds and joint ventures. It reflects the law at April 2005. The circumstances of each case vary and this note should not be relied upon in place of specific legal advice.

## Next steps

We hope that this briefing paper has given you a useful overview of structuring property funds and joint ventures.

If you would like to discuss your plans further, or would like more information on any of the issues that we raise, please contact:

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