

LEASEHOLD ENFRANCHISEMENT

Participation agreements: the double duty trap

Participation agreements between individuals have become popular in leasehold enfranchisement. Tamara Solecki of **Pemberton Greenish** considers how the double stamp duty pitfall in such agreements is best dealt with



Participation agreements have become a very popular venture in leasehold enfranchisement. They involve a group of individuals (usually existing leaseholders) entering into an agreement between themselves and a company (which they have set up). They agree that the company should purchase the freehold of their building, and then grant them new leases in exchange for their individual contributions towards the freehold purchase price. These individuals are shareholders (and also usually directors) of the company, and their shares generally reflect their individual financial contributions (see figure 1).

The company (and thus its members) will be liable to the full *ad valorem* stamp duty on the purchase of the freehold, as a purchase price is paid to the vendor by the company (assuming the value

is over the current limit of £60,000). However, the question that plagues practitioners and clients alike is whether the next set of transactions – the grant of individual leases – is liable to full stamp duty as well? If so, is there a way to avoid it? (See figure 2.)

Take the following example: A, B, C and D form a company (E) in order to purchase the freehold of property X for the sum of £500,000 from a vendor. They each purchase a quarter of the shares in E to the value of £500,000. E then purchases the freehold from the vendor, and subsequently grants individual leases to A, B, C and D respectively. Will A, B, C and D have to pay full stamp duty on the grants of the leases, as well as via E on the purchase of the freehold?

The deed and grant of lease

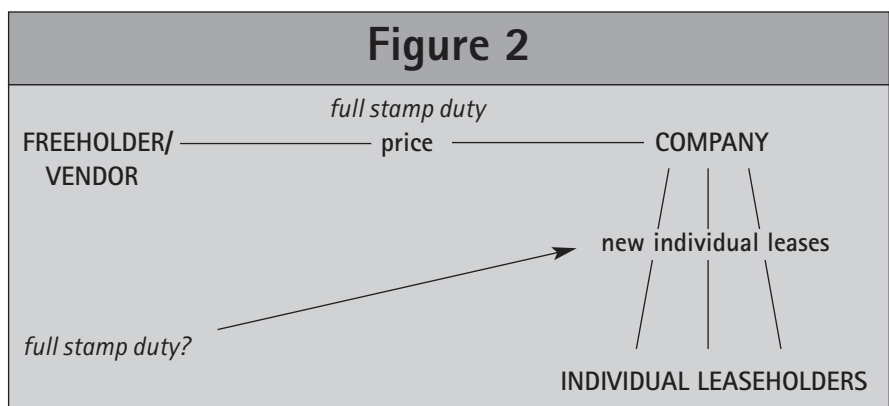
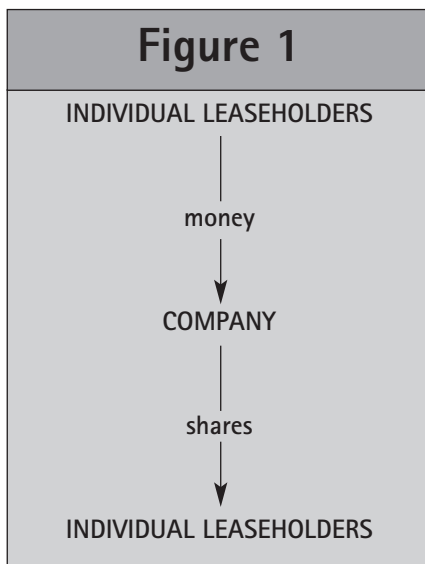
In order for the prospective lessees to avoid the full charge to stamp duty, the deeds containing the grant of the leases must come within paragraph 13 of Schedule 13, Part II of the Finance

Act 1999, which imposes a fixed duty of £5 on those leases which do not come within Paragraphs 11 and 12 of the same Schedule (see box on page 23).

Paragraph 11 deals with leases of less than a year, and so does not apply in our situation. Paragraph 12 deals with all other leases (more than a year of definite term, and any indefinite term) and imposes certain rates of stamp duty, depending on the value of the consideration involved¹. Equally, our leases do not come within paragraph 12, as the deeds on their face would not contain any consideration. Therefore, they must come within paragraph 13.

The participation agreement

However, there still remains the matter of the participation agreement. Of course, this may never be presented to the Stamp Office, as it is a private and confidential agreement between members and there is no obligation for such presentation. Yet, if the participation agreement contains an agreement to lease (which, in this situation, it is



bound to do), then several problems arise:

- leases executed on or after 6 May 1994 must either contain a certificate to the effect that there was no prior agreement, or be stamped with a stamp denoting either that the agreement is not chargeable with duty, or that the duty has been paid on the agreement;
- agreements for lease are subject to full stamp duty if they are for consideration; and
- agreements for lease in participation structures do not have a premium or rent provisions (as the grants are gratuitous), but they do usually contain a provision that the grant of a lease is in exchange for the payment of the freehold purchase price money into the company by its members.

Thus, a practitioner will have a choice – either not to disclose the agreement to lease (which would amount to at least misconduct) or to find a satisfactory solution.

The consideration issue

Most participation agreements are either agreements to grant leases or contain agreements to grant leases, as in a transaction such as this. It is their purpose to do so. Thus a typical clause will be:

Upon completion of the purchase of the freehold... by the Tenants' Company... the Buyers... shall (as shareholders of the Tenants' Company) procure that the Tenants' Company grants to each of the Buyers a lease of the Flat shown against his name in the First Schedule for a term of 999 years at a peppercorn rent but otherwise upon the same terms and conditions.

An agreement for a lease is subject to full stamp duty (paragraph 14(1), Schedule 13 of the 1999 Act) as an actual lease for the term and consideration provided in the agreement. Thus, if there is consideration it will be chargeable.

In a normal situation, the consideration would be rent and/or the premium, and this would be contained in the agreement and the lease – in which case, full stamp duty would only be paid once as credit is given.

Finance Act 1999, Schedule 13, Part II
<p>LEASE</p> <p><i>Charge</i></p> <p>10. Stamp duty is chargeable on a lease.</p> <p><i>Rates of duty</i></p> <p>11. In the case of a lease for a definite term less than a year the duty is as follows...</p> <p>12.(1) In the case of a lease of land for any other definite term, or for an indefinite term, the duty is determined as follows.</p> <p>(2) If the consideration or part of the consideration moving to the lessor or to any other person consists of money, stock, security or other property, the duty in respect of that consideration is the same as that on a conveyance on a sale for the same consideration². But if:</p> <p>(a) part of the consideration is rent; and (b) that rent exceeds £600 a year</p> <p>the duty is calculated as if paragraph 1 of the Table in paragraph 4 of this Schedule were omitted.</p> <p>(3) If the consideration or part of the consideration is rent, the duty in respect of that consideration is determined by reference to the rate or average rate of the rent...³</p> <p>13. Stamp duty of £5 is chargeable on a lease not within paragraph 11 or 12 above.</p>

In a participation agreement scenario, however, there is no premium as such, nor rent, but there is usually

which is to be released in exchange for the grant of the leases:

The consideration for the grant of each new 999-year lease shall be the release of the aggregate balance of the amounts of the loan paid or payable to the Tenants' Company... by the Buyer to whom the new 999-year lease is granted.

Thus, whilst the lease itself is only subject to a fixed stamp duty of £5, the participation agreement is potentially liable to full stamp duty for the consideration that has been provided to purchase the freehold.

This, of course, means that the members of the participation agreement will be potentially liable twice. It also means that as we have now identified a consideration for the leases, the deeds containing the grants of lease may no longer be eligible for a fixed duty charge of £5, but would come under paragraph 12 and so be subject to its full-value rates.

'One means of avoiding a double charge to full stamp duty is through the careful drafting of the participation agreement.'

another type of consideration – the money that has been lent to the company in order to purchase the freehold,

So is there any way to avoid this? A scheme that has grown in prevalence is to declare that the tenants' company will hold the freehold upon trust to grant new leases. But there always remains the danger that they will be deemed to be bargain instruments that are intended to transfer property from vendor to purchaser, and not simple declarations of trust so as to benefit from a fixed duty of £5⁴.

Possible solutions

A solution is to draft the participating agreement in such a way that it avoids making the payment of the purchase money for the freehold to the company in exchange for the grants of the leases. Rather, the agreement should state that the payment of the money is in exchange for the company (through its members) agreeing to buying the freehold. This will not incur a charge to stamp duty. To err on the side of caution, it would be advisable to draft two participating agreements, both done by deed (so that the agreements are binding even if without consideration). The first of these contains the obligation by

the company to grant leases to the individual members. The second contains the promise that the members will pay the purchase price and expenses money

'An agreement for a lease is subject to full stamp duty as an actual lease for the term and consideration provided in the agreement.'

into the company, and that they will ensure that the company buys the freehold. If the agreements are in deed form, they will not require any consideration – the obligations can be

drafted so that they are independent and there is no mention of any exchanges. In this way, it will be possible to argue that the grant of the leases is without consideration, and that the agreement to lease is without consideration, avoiding the charge to full stamp duty.

Conclusion

The charge to full stamp duty can be avoided in the above context if the following guidelines are adopted:

- Each deed grant of a lease must state that the grant is to be made free of consideration.
- Any participating agreement must avoid making the payment of the purchase money into the company by the potential lessees 'in exchange' for the granting of the leases.
- It is advisable to draft two participating agreements – one containing the agreement to grant the leases for no consideration, the second containing the obligations of the company and its members, including the agreement to purchase the freehold.
- By drafting both agreements in deed form, one avoids any dangers of contractual invalidity.

Of course, the above solution can always be challenged by the Stamp Office itself. However, this article does hopefully provide an arguable case against any such challenge.

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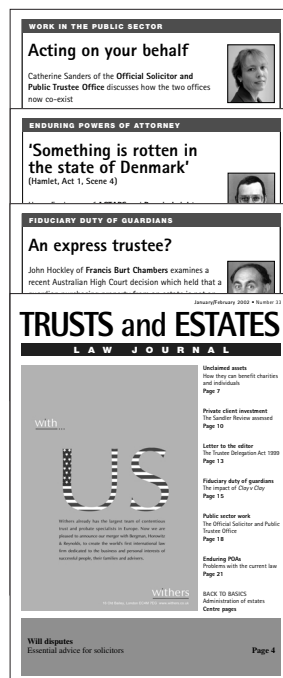
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Footnotes:

1. Unless the value is £60,000 or under.
2. The duties are contained in Part I, s4 of the same Schedule and range between nil and 3.5%, depending on the value or amount of the consideration.
3. The duties range between nil and 24%, depending on the value of the rent.
4. Part III, paragraph 17(1), Schedule 13, Finance Act 1999. See also *Wills J in Chesterfield Brewery Co v IRC* [1899] 2 QB 12.