



Introduction

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The complexities of Tax Clearance unravelled

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Why do you need new leases if you have bought your freehold?

Although you may own the freehold of your building, the original leases remain in place. They cannot be “cancelled” as they regulate the legal relationship between the flat owners and the freehold company.

Taxation Issues

The usual position when purchasing the freehold collectively is that new 999 year leases at a nominal ground rent are granted following completion of a freehold purchase. When new leases are put in place shortly after completion, no tax consideration is due.

Where a significant time has elapsed since completion of the freehold purchase in this case, it is likely there has been a substantial increase in the value between what was paid for the notional “share of the freehold” and the actual value of a new lease extension.

If therefore the lease extension process is not carried out sufficiently close in time to the purchase of the freehold, HMRC can view the benefit the leaseholders receive as of a higher value than their original contribution of purchasing the “share” in the freehold. The company can then be viewed as granting a benefit to the flat owner which, for tax purposes, may be treated as making a “disposal” of value out of the freehold.

This could have adverse consequences in terms of capital gains tax for the freehold company. There could also be a separate tax charge for the leaseholder as a result of their lease being extended - when this happens the company may face a corporation tax charge.

Why is this an issue?

If the company grants a lease extension which is worth significantly more than the amount paid for the freehold purchase, the difference can result in a tax liability for the freehold company. As it is unlikely the company has any liquid assets or cash to meet such liability, HMRC could demand payment from the leaseholder before granting the lease extension.

What is the solution?

Where lease extensions are to be granted to participating lessees many years after completion of the purchase of a freehold, it is possible to make an application to HMRC to obtain a ruling that tax does not arise for the company or lessees.

To obtain tax clearance, clear evidence would need to be shown from the date of the freehold purchase denoting it was always the intention of the participating lessees to extend their leases to 999 years.

Without clearance, the Revenue may claim shareholders are receiving a benefit from the company by buying a lease extension for less than the market value and make a tax charge.

Moving forward

The costs for dealing with the application for HMRC clearance could total thousands. There are many benefits to extending your lease straight after completion of the freehold purchase, including the marketability of your property and preventing issues arising with lenders later down the line. Delays in addressing this issue can be costly and time consuming and really should be addressed at the time of the freehold purchase to avoid further difficulties.

For further information on this case or advice on leasehold law please contact:

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