HMRC Spotlight 69: property business incorporations

Property Tax

25 June 2025

A HMRC Spotlight examines a tax avoidance scheme used by landlords to reduce their tax liability, warning taxpayers that it will recover outstanding tax, interest and penalties if the scheme is used.

Key Points

What is the issue?

HMRC’s Spotlight 69 targets a tax avoidance scheme involving property business incorporations using limited liability partnerships followed by a members’ voluntary liquidation. It was designed primarily for individual residential property landlords to mitigate increased tax burdens using LLP structures before incorporating their business.

What does it mean to me?

HMRC asserts that the scheme does not work. On the capital gains front, new provisions deem a disposal at market value, triggering tax liabilities on gains that the scheme intended to avoid. With respect to stamp duty land tax, it anticipates that existing anti-avoidance rules will impose a full market value charge in notional land transactions.

What can I take away?

Tax advisers should review client affairs carefully if any variant of the scheme was applied. Voluntary disclosure to HMRC will avoid penalties. Advisers should obtain advice if clients have implemented such schemes without their full involvement.

On 28 April 2025, HMRC published Spotlight 69 ‘Liquidation of a limited liability partnership used to avoid capital gains tax’, targeting a scheme (the Scheme) predominantly used by individual landlords carrying on a residential property rental business as a partnership. This article considers the nature of these spotlights and the Scheme that was the subject of Spotlight 69 (see tinyurl.com/yjc3jc9m).

What is a HMRC Spotlight?

Before discussing the Scheme in question, it is worth explaining that HMRC Spotlights are short guides published periodically by HMRC on its website, to shine a ‘spotlight’ on tax avoidance schemes that it believes do not work but may have been used by a large number of taxpayers, and which are usually marketed by promoters.

The Spotlight explains why HMRC considers that the Scheme doesn’t work and warns users that it will seek to recover all outstanding tax, interest and appropriate penalties in relation to the Scheme. A full archive of HMRC spotlight articles can be found at tinyurl.com/4sj82kjm. While outside the scope of this article, there may be significant implications for the promoters and enablers of such schemes being included in a HMRC Spotlight.

What is a tax avoidance scheme?

The definition of a tax avoidance scheme can vary, depending on the relevant tax statute, but under Finance Act 2013 s 207, the General Anti Abuse Rule (GAAR)

definition is any arrangement whereby, ‘having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements’.

Hallmarks of such avoidance schemes are:

- a ‘package’ service with pre-prepared template documents, which can be tailored to each client before execution; and
- tax advice provided by the scheme promoter which may not be tailored to the specific client. This is unlikely to be considered as independent advice that will protect taxpayers from inaccuracy penalties, because it is likely to be ‘disqualified advice’ (see Finance Act 2017 Sch 24 paras 3A and 3B).

The members’ voluntary liquidation scheme for LLPs: why was it devised?

The tax burden on residential property landlords has progressively increased in the last decade or so, most notably the 2017 phasing out of deductions for loan interest in calculating taxable profits from a residential (not commercial) property rental business which are liable to income tax. Statute now permits only a basic rate (currently 20%) income tax reducer for the loan interest paid during the year and/or unrelieved amounts brought forward (see Income Tax (Trading and Other Income) Act 2005 s 272A to 274AA).

This represents a tax relief reduction of up to 25%, which has been a substantial financial issue for some landlords. Some landlords may now be making an economic (and cash) annual loss using ordinary accounting principles yet remain taxable because there is a profit for tax purposes and the tax liability in respect of such is not reduced to nil by the tax reducer.

The Scheme was devised because a company carrying on the same residential property business as the individual landlord is not subject to the same interest relief restrictions. Regardless of the additional legal and tax complexities, the prospect of a full tax deduction under corporation tax rules offered a financially lucrative incentive for aggrieved landlords to incorporate their property businesses.

However, transferring a property business to a company, subject to individual circumstances, can trigger large capital gains tax and stamp duty land tax liabilities.

The Scheme seeks to avoid these tax liabilities by using the interim step of transferring the property business to an LLP and then to a company in short order; typically, holding the property in the LLP for less than 12 months.

Capital gains tax

The disposal of the properties to a company by landlords may trigger a chargeable gain on the landlord if the property has increased in value since acquisition, which will be common considering long-term house price growth.

Incorporation relief

Where the landlord transfers the property business to the company wholly in exchange for the issue of shares by the company, the landlord can claim incorporation relief in respect of such a gain (net of losses), and this net gain is deducted against the allowable base cost of shares issued to them by the company (see the Taxation of Capital Gains Act (TCGA) 1992 s 162). See the HMRC manual CG65750 for an example of this.

However, a claim for incorporation on the return is liable to HMRC scrutiny, usually via a formal enquiry into the return within the statutory period of 12 months.

The key condition for incorporation relief is that there must be a transfer of a business as a going concern to the company in exchange for the issue of shares. There is no statutory definition of ‘business’ in the capital gains tax legislation and so case law provides authority that a property-letting concern amounts to a ‘business’ for these purposes, where the degree of activity outweighed what might normally be expected to be carried out by a mere passive investor, even a diligent and conscientious one (see *Ramsay v HMRC* [2013] UKUT 226).

This means a landlord who does not actively participate in the business will not qualify. Consequently, most landlords who have a passive property business in addition to their main economic activity, whether employment or self-employment, are likely to fall at this key hurdle. As discussed below in more detail, the Scheme circumvented the need for incorporation relief by relying on the partnership (and specifically LLPs) rules for capital gains tax purposes.

Stamp duty land tax

The transfer of the properties to a company that the landlord is connected with would trigger stamp duty land tax (SDLT) on the market value of the property at the higher rate (see Finance Act 2003 s 53 and para 3 Sch 4A). This connection is normally satisfied by the landlord having a controlling shareholding, either alone or by aggregating the shareholdings of persons connected with the landlord, such as spouses and other relatives (see Corporation Tax Act 2010 s 1122).

Inheritance tax

While HMRC mentions possible inheritance tax benefits of the Scheme, in my view it is unlikely to credibly improve the prospects of the shares qualifying for business property relief, as it would likely be excluded from relief on the basis that the business carried on by the company would in most cases consist wholly or mainly of making or holding investments.

How did the Scheme intend to work?

The first point to note is that for both capital gains tax and SDLT purposes, the Scheme required that the property business was carried on by a general partnership, typically landlords and spouses (who benefit from capital gains tax free disposals to each other) but possibly other close relatives.

The partners may formalise a partnership arrangement by entering into a written partnership agreement many years after the partnership is claimed to have commenced, and submitting their individual tax returns (and sometimes partnership returns) on that basis. The test whether there is a partnership in law is outside the scope of this article, but holding property jointly is not in itself sufficient.

The steps which follow can be summarised (in simplified terms) as follows (references below are to TCGA 1992 unless otherwise stated):

Capital gains tax

1. The rental property business (including the properties) is contributed by the partners to an LLP at market value and credited to the member’s capital account or potentially sold for cash consideration. This may be an LLP incorporated in England and Wales or a similar partnership in a foreign jurisdiction, which is often favoured by such schemes. This does not trigger capital gains tax as, provided the LLP carries

on a business (the property business), the individual partners (now referred to as members in the context of an LLP) are deemed to still hold the property; i.e. the LLP remains tax transparent (s 59A(1)).

2. Within a short period of time, the LLP is put into a members' voluntary liquidation. The commencement of the members' voluntary liquidation does not immediately trigger a disposal by the LLP or its members (s 59A(2)).

3. The members' voluntary liquidation involves the property business (namely the properties) being transferred by the LLP to a company owned by the LLP members. At this point, the LLP:

a) has ceased to carry on the property business and so the capital gains tax transparency deeming provision is switched off (s 59A(1)); and

b) reverts to a body corporate for capital gains tax purposes, as it is for general law purposes (Limited Liability Partnership Act 2000 s 1(2)).

4. Accordingly, the LLP is chargeable to corporation tax on chargeable gains following the end of tax transparency, as if it had never been transparent to begin with (s 59A(5) and s 2). This means:

a) the chargeable gain for the LLP is based on the increase in the market value on acquisition of the property by the LLP and the disposal to the company (s 18). However, no significant gain is likely to accrue if the LLP only holds the property for a short period of time; and

b) the LLP members will be disposing of their interest in the LLP, which for similar reasons should not result in any meaningful gain.

5. The key point that the Scheme exploited was the fact that under the statute before October 2024, there was no retroactive capital gains tax charge on the disposal by the partners to the LLP because the statute specifically stated that when the LLP transparent status ceases, there is no deemed disposal by the LLP members of any assets (s 59A(5)).

6. Thus, it was only for disposals after transparency ceases that chargeable gains are assessed as if there had never been transparency, and in that case the LLP obtained a full market value uplift on its acquisition of the properties from the members. The result was that the gain accruing to the landlords was washed out on

a tax-free basis before incorporation of the property business.

Stamp duty land tax

In summary, and in simplified terms considering the complexity of these rules, under the SDLT partnership rules:

1. There is no chargeable consideration for SDLT where the partner's interest in the property remains the same as it was before the transfer to the LLP, based on their respective LLP membership interests and partnership interests (Finance Act 2003 Sch 15 para 10).
2. Similarly, the transfer of the property from the LLP to the company will not give rise to any chargeable consideration if the members of the LLP own shares in the company in the same proportion as their membership interests in the LLP (Finance Act 2003 Sch 15 para 18).
3. An SDLT charge can arise if anti-avoidance provisions are engaged – this should be self-assessed by the purchaser (though it rarely is) – meaning that because the partnership rules discussed above apply to the transfer, there is no need for an SDLT incorporation relief claim, which in any case is only possible after at least one year from the date of incorporation of the LLP (Finance Act 2003 s 65). This means the chargeable consideration on the SDLT 1 form in respect of the transaction would be nil and so is not strictly notifiable to HMRC by filing a return.

HMRC's view of the scheme

HMRC says that the Scheme does not work for the following reasons.

Capital gains tax

For liquidations on or after 30 October 2024, a new s 59AA was added to TCGA 1992 under Finance Act 2025 to the existing capital gains tax rules applicable to LLPs. This applies where property was contributed by partners to an LLP, which is later liquidated. The new rule provides that on disposal of the property by the LLP following the LLP's capital gains tax transparency ceasing:

- there will be a deemed disposal and reacquisition of the property by the partners immediately before the time that they were contributed to the LLP, at

their market value on that date. Thus, the landlords (i.e. the partners) will be liable to capital gains tax on the gain accruing between the price paid for the property and the market value on the date it was acquired by the LLP (s 59AA(2)); and
- that chargeable gain (or loss) will be deemed to have accrued on the date that the LLP makes the disposal to the company (s 59AA(3)).

This new provision specifically targets and closes the loophole that the Scheme sought to exploit, without the need for application of the GAAR. However, HMRC suggests the GAAR may apply to the Scheme in respect of liquidations that took place before 30 October 2024 to counteract the Scheme. This view is based on the artificiality and pre-planned steps involved, effectively removing the tax relief they seek to provide and imposing penalties (of up to 60%).

A full discussion of the GAAR is outside the scope of this article, but I am not aware the GAAR panel has issued a published opinion on the application of the GAAR to the Scheme.

Stamp duty land tax

HMRC believes that the existing widely drafted anti-avoidance provisions will apply to the Scheme, meaning that there is no SDLT relief on the transfer to the company and a full market value charge is imposed on the company under a notional land transaction, ignoring the interim steps involving the transfer to the LLP.

HMRC has enjoyed considerable success at the tribunals in cases involving the application of these provisions and, on that basis, may be well placed to press taxpayers to settle disputes on this specific issue relatively early in the process.

Final comments

Spotlight 69 should prompt advisers to review their client’s affairs and ensure that if any variant of the Scheme was used, careful consideration is given to making a voluntary disclosure to HMRC to protect against a later discovery assessment by HMRC and possibly higher inaccuracy penalties for an involuntary disclosure.

Advisers should also ensure that if clients have used this Scheme without their involvement, they should also take advice to ensure HMRC cannot take steps

against them as enablers.

Now that the Spotlight has been shone on the Scheme, ignorance is unlikely to be a feasible approach for any party involved in the Scheme.