

WHAT REVERSE PREMIUMS ARE TAX FREE?

by Patrick Soares

Introduction

With the present state of the economy, we are going through a “reverse premium” phase:-

- tenants paying reverse premiums to landlords to rid of their leases;
- landlords paying extraordinary premiums to tenants to take on leases (in the form of cash payments and very long rent-free periods);
- tenants ridding of leases, which they find too onerous, to new tenants.

Two types of reverse premiums could potentially be tax free in the hands of the recipient.

General Principles

Generally, if the taxpayer is paid monies to take on a lease the receipt should be free of capital gains tax in his hands. He could hardly be said to have disposed of an asset in consideration of the monies received. See, for good measure, CGT Manual 70835 which reads thus:-

70835. Recipient of reverse premium

If the receipt cannot be charged to Income Tax, you will need to consider whether it is chargeable to Capital Gains Tax. It will only be so chargeable if it is derived from an asset held by the tenant. Normally, the reverse premium will be paid before the tenant has actually entered into the lease and in these circumstances it is not possible to argue that the reverse premium is derived from the lease. Unless there is some other asset from which the reverse premium derived, it will be exempt from Capital Gains Tax.

When it comes to income tax, the tenant is paid a lump sum to take a lease. One would expect the sum to be capital in nature (unless the recipient is a land dealer) and indeed generally case law indicates that the receipt would not be of an income tax nature (*CIR v Wattie and Lawrence* 72 TC 639: see HMRC’s caveats in IRM/BIM 35610).

The Special Reverse Premium Code

There is, however, a special code contained in ITTOIA 2005 ss.99-103 (for corporation tax see CTA 2009 s.96-100) which ensures that there is an income tax charge on the recipient of a reverse premium in certain circumstances.

This code applies if three conditions are satisfied (ITTOIA 2005 s.99).

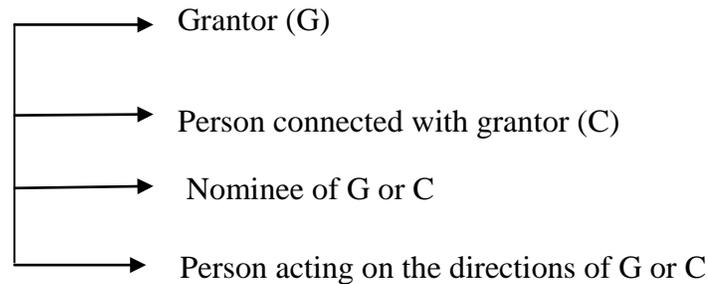
Condition A is that the recipient or a person connected with the recipient receives a payment or other benefit by way of an inducement to enter into a transaction.

Condition B is the transaction is one under which the recipient or a person connected with the recipient becomes entitled to an estate, interest or right in or over land.

Condition C is the payment or other benefit is paid or provided by one or other of the following persons:-

- (a) the person (“the grantor”) by whom the estate, interest or right is *granted* or was granted at an earlier time; or
- (b) a person connected with the grantor; or
- (c) a nominee of the grantor or a person connected with the grantor; or
- (d) a person acting on the directions of the grantor or a person connected with the grantor.

The offending
payers
are thus:



(N.B. it would seem that a payment made by a person connected only with a person acting on the directions of the grantor would not be caught!)

HMRC accept that the use of the words “grantor” and “granted” means that these provisions only apply where some sort of sub-interest is created out of the interest in question.

If a freeholder grants a lease to a tenant the provision would have application (IRM/BIM 41105).

On the other hand, if the freeholder assigned his freehold to the purchaser and paid the purchaser for taking over the freehold the payment would not fall within this legislation. There may be scope for planning here.

Equally, if a tenant of an onerous lease, who is not connected with the landlord, assigns his lease to an incoming tenant, and the outgoing tenant pays the incoming tenant a reverse premium, these provisions would not apply: IRM/BIM 41110 states:-

Thus, a commercial payment by an existing tenant to induce a new tenant to take over an onerous lease will not normally result in a charge on the new tenant. There will be a charge only if the tenant paying the reverse premium is connected with the landlord, or is acting on the landlord’s behalf in making the payment.

Two Situations

Thus the first situation where a reverse premium can potentially be paid tax free is one where a tenant assigns an onerous lease to an incoming tenant and the incoming tenant is paid a premium by the outgoing tenant.

The reverse premium provisions do not apply in this situation. Under general principles the incoming tenant does not receive income and he will not have disposed of an asset for capital gains tax purposes: the payment is therefore free of income tax and free of capital gains tax.

The second situation where a reverse premium can be tax free is if a lease is granted by the landlord to the tenant and the person paying the premium to the incoming tenant is not in one of the four categories mentioned above. It may be, for example, that a developer, who is unconnected with the land owner, is keen to enter into development agreement with the land owner and would be content to pay out of its own funds (the developer's funds) monies to the incoming tenant as an inducement for the incoming tenant to take a lease which would have the knock on effect that the developer would be able to enter into the development contract. If this is the case then the special reverse premium provisions in ITTOIA 2005 should not have application and thus the incoming tenant would receive a sum which is chargeable neither to capital gains tax nor income tax.