**You may owe tax if your business uses a hybrid business model**

Some property landlords have been advised to structure their business using a 'hybrid business model'. This aims to avoid mortgage interest relief restrictions, Capital Gains Tax (CGT) and Inheritance Tax (IHT).

Our view is that following this advice doesn't produce the tax outcomes it claims to. We've enclosed a factsheet about hybrid business models that explains why.

If you've taken advice and started using an arrangement like this, you may owe tax. We strongly advise you to withdraw from the arrangement and settle your tax affairs.

**What you need to do [by xxxx date?]**

1. Tell us about your arrangements. Email us at Spotlight63@hmrc.gov.uk or write to us at the address at the top of this letter, including **the CFSS-[xxxx] reference**. We call this a disclosure. At this stage, you only need to tell us that you'll be making a disclosure. You don't need to give any details of the undisclosed income or the tax you believe you owe as we will write back to you for the details we need.

   If you email us, please first read the attached email protocol disclaimer. When you contact us, please state 'I accept the risks associated with using email and I am happy to proceed.' We can't reply to your email until you do this.

2. You may also need to amend your tax return, which could mean you need to pay more tax. To do this, go to GOV.UK, search 'Self Assessment tax returns' and then select the link for 'If you need to change your return'.

   If you haven't paid enough tax, we may also charge you a penalty.

If you don't make a disclosure in response to this letter by 31/1/24, we may open an enquiry and you may have to pay a higher penalty.

**More information**

Go to GOV.UK and search:

- 'CC/FS7a' for our factsheet 'Penalties for inaccuracies in returns or documents'
- 'CC/FS9' for our factsheet 'The Human Rights Act and penalties'

If you're concerned about the schemes you're using, you can also:

- get independent professional tax advice search GOV.UK 'tax help'
- speak to a tax charity such as TaxAid. You can find out more by visiting www.taxaid.org.uk

**If you need extra support**

If you have any health or personal circumstances that may make it difficult for you to deal with us, please let us know. We'll help you in whatever way we can.

For more information about this, go to GOV.UK and search 'Get help from HMRC if you need extra support'.

Yours sincerely

Wealthy and Midsized Business Compliance Officer

**Hybrid Structures factsheet**

## How the hybrid business model is set up

These arrangements try to avoid tax by allowing individual or joint property landlords to transfer their properties to a limited liability partnership (LLP) with a corporate member.

1) The landlords or their family members set up a limited company
2) The landlords set up an LLP alongside the limited company
3) The landlords transfer their properties to the LLP
4) The members of the LLP (the landlords and corporate member) allocate the LLP profits to themselves on a discretionary basis

The individual members are allocated an amount of profit which keeps them as basic rate taxpayers. The remaining profits are allocated to the corporate member, which claims a tax deduction for finance costs relating to the properties, such as mortgage interest.

| Advice you may have been given about hybrid partnerships | Our view of the law |
| --- | --- |
| The transfer of the properties to the LLP has no upfront tax cost.<br><br>For CGT purposes, the properties' base costs (the amount that can be set against the sale price of an asset) increase to their market value at the date of transfer.<br><br>CGT will be reduced if the properties are sold, because of the increased base cost at the date the properties transfer to the LLP. | Taxation of Capital Gains Act 1992 S59A treats any dealing in chargeable assets by an LLP as by the individual members. LLPs are transparent for tax purposes, so members own a fractional share of assets.<br><br>This means the base cost of properties doesn't change following their transfer to the LLP. |
| The landlords are still basic rate taxpayers, so are not affected by finance cost restrictions. The corporate member can claim a full deduction for its share of finance costs, as restrictions do not apply to it.<br><br>The corporate member pays Corporation Tax on its net profit share. If profits are allocated to the landlords, they pay higher Income Tax rates. | Disposal of income streams through partnerships anti-avoidance legislation in Income Tax Act 2007, Chapter 5AA, S809AAZA. This charges the corporate members income on the landlord who transfers the income stream.<br><br>Mixed member partnership legislation in the Income Tax (Trading and Other Income) Act 2005, S850C and S850D.<br><br>This details how excess profits of a corporate member of an LLP are reallocated to individual members. |
| If the landlords die, Business Property Relief (BPR) may be claimed and no IHT will be due. | Most property rental businesses are likely to be within the exclusions from BPR of 'making or holding investments' under the Inheritance Tax Act 1984, s105(3). The use of the hybrid business model does not change the availability of BPR. |

To read more about this, go to GOV.UK and search 'Property business arrangements involving hybrid partnerships (Spotlight 63) '