Lease extensions within shared freehold arrangements: the tax implications

Property Tax | Personal tax



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Lease extensions within shared freehold arrangements can create complex tax consequences for both companies and individual leaseholders.

Key Points

What is the issue?

When leaseholders extend leases in blocks where they collectively own the freehold, complex tax consequences arise for both the company and the individual lessees, as the company is deemed to receive market value consideration.

What does it mean to me?

HMRC’s view is that such transactions involve part disposals, generating potential corporation tax, income tax, Class 1A NIC liabilities and shareholder income tax liabilities.

What can I take away?

Extending a lease through a shared freehold company should be carefully structured and priced at arm’s length to avoid additional tax exposure.

In his article ‘Leasehold Interests: controversial tax implications’ (*Tax Adviser*, October 2025), Leigh Sayliss questions HMRC’s position on the taxation of lease extensions. While his article raises some interesting concerns, on this occasion I must side with HMRC.

In England and Wales, there is no such thing as the freehold reversion to an individual flat within a block. The freehold interest encompasses the land beneath the building and the common parts, subject to the leases of the individual flats. When a leaseholder of one of the flats wants to extend their lease, they pay the freeholder, who then makes a part disposal for capital gains tax purposes.

If the freehold is jointly owned by some or all the lessees – perhaps through a company as nominee – that is a part disposal of each lessee’s interest in the freehold.

For example, suppose Jack owns one flat in a block of ten flats where the freehold is owned collectively by the lessees. Jack pays a £4,000 premium to extend his lease, so each of the other nine lessees will receive £400 from Jack. This amount is too small to trigger a capital gains tax liability unless the lessees have already used their annual exemption and allowable losses. The main residence exemption will not apply as it is not a gain on an interest in the lessees’ flats.

If the freehold is owned beneficially by a company whose shares are owned by some or all the lessees, those lessees might think that they effectively own the freehold, so that Jack needs to pay nothing for an extension. Unfortunately, of course, for tax purposes the disposal consideration will be deemed to be equal to the open market value. Unless the company receives ground rents, it is likely to have no liquid assets to meet the corporation tax liability on its part disposal. The individual lessees will therefore have to finance the company through loans.

Furthermore, the lessees – as shareholders and possibly directors – would have personal income tax liabilities on distributions under Corporation Tax Action 2010 s1064 CTA, and the company will face a liability for Class 1A NIC. (These liabilities will also be financed by loans.)

Strictly, a lease 'extension' involves the surrender of the current lease (i.e. a disposal) and the grant of a new one. If the lease extension is granted on arm's length terms, ESC D39 will apply; otherwise, the transaction will be taxed on the basis that there is a disposal of the lessee's current lease and the grant of a new lease. Thus, if the lessee does not pay the full market price for a lease extension, they might face a chargeable gain on disposal of their lease – though a main residence exemption is often available.

If actual consideration is given, the lessees might expect the company to distribute the post-tax profit by way of dividend.

Practical considerations

Suppose that Jack's £4,000 payment is equal to market value, and the chargeable gain is £3,500. The company's corporation tax liability at 19% would be £693, leaving £3,307 to be distributed. The shareholders would receive about £331 each. Thus, when a company owns the freehold beneficially, Jack faces two choices.

Jack could choose to pay the market price of £4,000 to the company and receive a dividend of £331, plus lending the company £693 to meet its corporation tax liability – a total outlay £4,362. Jack's nine fellow lessees would also each receive a dividend of £331, totalling £2,979.

Alternatively, Jack could pay no consideration and instead:

- incur income tax on a £4,000 benefit in kind as a director at 20%, 40% or 45%; or incur income tax on a distribution of £4,000 as a shareholder at 8.75%, 33.75% or 39.35% (the worst case scenario would be to pay £1,800 – a rate of 45% on £4,000);
- lend the company £693 to meet its corporation tax liability; and
- lend the company £600 to meet the 15% Class 1A NIC liability on the benefit in kind if Jack is a director.
- This would amount to a total outlay up to £3,093.

For stamp duty land tax purposes, neither the surrender of the existing lease nor the grant of a new lease applies as chargeable consideration under Finance Act 2003 Sch 17A para16. Only the actual cash payment is chargeable consideration.

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