Changing structure, maintaining security

Limited liability partnerships

As the benefits of different business structures change over time, tenant businesses may decide to convert, but this might jeopardise their security of tenure, warns Simon Hartley.

When the Limited Liability Partnerships Act 2000 ("the 2000 Act") introduced the concept of limited liability partnerships ("LLPs") into English law, many professional businesses changed their structure from a partnership to a LLP to keep the partners' personal assets separate from those of their business (except in cases of fraud). This year's budget included changes to the tax treatment of partners and LLPs, which have led to many businesses considering incorporation.

Not all of the risks of changing a business structure are readily apparent. One such risk may arise if the business is a partnership, which may lead to many businesses considering incorporation.

Security of tenure

Security of tenure under Part II of the Landlord and Tenant Act 1954 ("the 1954 Act") can be very valuable to tenants when the costs of relocation are high. Care must be taken when tenants change their business structure during the term of a protected lease to ensure that security is not lost.

Take, for example, a partnership wishing to transfer its business to a LLP during the term of a protected tenancy held in the partners' names. The lease prohibits dealings with the premises, including parting with or sharing possession, save for assignment with the landlord's consent, not to be unreasonably withheld or delayed.

Assignment

If the lease is assigned to the LLP with the landlord's consent before the term expires, security of tenure will be maintained. The partners should bear in mind that applying for licence to assign can be a lengthy process.

The safest course for the tenants would be, if possible, to obtain written consent to the assignment in advance of the conversion. Tenants taking new leases should seek sufficient flexibility when negotiating alienation clauses to allow for changes to the structure of their business during the lease term.

The impact on statutory compensation

Where there is security of tenure, if a building has been occupied for the purposes of the occupier's business for 14 years prior to termination of the current tenancy, the tenant will be entitled, on vacating the premises, to statutory compensation equivalent to twice the rateable value of its holding following the tenancy.

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If the tenancy is reassigned to the LLP, that LLP is likely to be regarded as a successor to the partnership's business and, therefore, that change would not preclude an entitlement to double compensation.

Many commercial leases seek to expressly exclude statutory compensation in their boilerplate clauses. However, section 38(2) of the 1954 Act provides that if the tenant has been in business for five years or more up to the date of quitting and any new occupier during that five years was a successor to its predecessor's business, such a provision is void in respect of any part of the premises satisfying those conditions.