Winter International Tax Services

NON UK RESIDENTS AND UK RESIDENTIAL PROPERTY

The UK Government has set out, in a consultation paper, its proposals to tax non UK residents on gains arising on UK residential property they hold. If implemented, disposals of UK residential property from April 2015 will be subject to UK Capital Gains Tax ("CGT") on gains arising from April 2015 onwards.

Background

Historically non UK resident individuals have been able to benefit from a very favourable UK tax regime for UK residential property to encourage investment in the UK. As non UK residents, they would not pay UK CGT on any property disposal. By using companies and trusts they have also been able to escape UK inheritance tax ("IHT"). When holding rental property, the use of debt finance generating tax deductible interest has helped to reduce UK tax on rental income. Generally Stamp Duty Land Tax ("SDLT") was the UK tax which non residents were most likely to pay when acquiring the property.

However in recent years, there have been a series of critical media stories focussing on those tax reliefs, and on the amount of property held by non UK residents, particularly in London. These stories, combined with financial pressures generally, have encouraged the Government to start reducing the reliefs. The first sign of this was the introduction of a variety of taxes where residential property was held by non UK resident companies. Non UK companies purchasing UK residential property face a higher SDLT charge (15%), an Annual Tax on Enveloped Dwellings ("ATED"), and, related to ATED, CGT on property disposal, unless they are able to claim exemption because, for example, the property was being let out.

The new consultation paper is the next phase and is more wide ranging.

The Proposal

Broadly the UK Government is suggesting that, with certain exceptions, all residential property disposals by non UK residents will be chargeable to CGT as of April 2015, and only gains arising from April 2015 will be taxed.

For this purpose residential property is to be defined as property that is either used or is suitable to be used as a dwelling. There are exemptions where the property is for communal use (i.e. care homes, hospitals, prisons etc). At the moment there are no plans to include commercial property. Unlike the ATED regime, and ATED related CGT charge, there will be no exemption for properties that are let out so this will affect property investors.

CGT will be payable by individuals, partnerships and trusts. Funds investing in UK property will not generally be subject to the tax charge on UK residential property provided they can satisfy a test to show that there is genuine diversity of ownership within the fund and that it is not a vehicle for a small group of connected people. There may also be a second stage test so that if the genuine diversity of ownership test is not met, the fund could still be exempt if the vast majority of its portfolio is commercial property. Certain types of funds such as pension schemes will be entirely exempt from the tax charge. UK Real Estate Investment Trusts ("REITs") will not be subject to the tax charge and nor will non UK REITs provided HM Revenue and Customs accept that they are equivalent to UK REITs in their effect.

Companies investing in residential property will also be subject to the charge where they dispose of property. This will catch property investing companies where they receive rental income from the property. This will also catch companies holding properties worth less than the limits (currently £2 million but with a proposed extension to properties worth as little as £500,000) for the ATED related CGT charge There is no suggestion yet that a disposal of shares in the company would be subject to CGT.

Non UK resident individuals holding residential property directly and who use it as their home may be able to claim relief from the CGT charge if they can claim it as their principal private residence. The UK gives individuals a tax exemption on the property they use as their principal private residence. Where they have two homes an election can be made as to which property the relief is claimed on. However the Government is looking at changing the rules for principal private residence exemption. The changes are likely to make it difficult for non UK residents to claim the relief without putting their non UK residence status at risk.

The rate of tax will be at the usual CGT rates for individuals (28% would be the maximum rate) and companies (probably 20%). Tax may be withheld on sale or the non resident would have to settle the tax due within 30 days of the sale.

What should non UK resident residential property investors be considering?

This is a consultation so there is a chance, though probably remote, that this legislation will not be introduced, or that the legislation introduced will be very different from the consultation paper. The UK also has elections in 2015 but a different Government would be unlikely to reverse the legislation.

Actions investors or potential investors could consider in the lead up to April 2015 include:-

- Building a possible tax charge into their return on investment forecasts

- If considering future investments would the return be better if investing through a fund that could be outside the scope of the charge rather than direct investment?

- The paper talks about taxing gains arising after April 2015. It seems (though it is not yet entirely clear) that the intention may be to tax only that part of the gain arising after that date and not the total gain on any disposal made after April 2015. If that is the case then there may be a need to value the property in April 2015 to establish a clear value for a CGT calculation on later disposal.

- Keep good records of all costs incurred on the property. The UK CGT charge is on proceeds less costs of sale less purchase cost (or possibly April 2015 value in this case) less any capital costs incurred on the property. There are no reliefs for inflation (except for property owned by companies) or length of ownership so costs incurred are the key tax deduction.

- In some cases it may be worth considering moving property from current ownership structures to fund or other collective investment structures that could potentially be exempt from the regime.

- For individuals who do use the property as their home when in the UK could they benefit from the principal private residence exemption? In some cases it may be worth becoming UK tax resident (but probably retaining a non UK domicile status) to claim that relief.

How Winter International Tax Services can help

We can help with:-

- Calculating the impact on any planned property investments
- Advising on possible structuring of property investments or restructuring of existing property investments
- Advice on eligible expenditure for CGT purposes
- Helping individuals decide if they will be eligible for the principal private residence exemption

We will be following the proposals through this year and next year and will provide updates on the planned legislation.

For further information contact
Ross Welland
rossw@winternationaltax.com
+44 (0) 7557 385836