BRIEFING NOTE

February 2015

ROOKS RIDER SOLICITORS

UK Taxes on UK Residential Property

There have been a number of UK tax changes affecting higher value residential property structures in recent years. The complexity and tax cost associated with owning such properties have been of particular relevance to non-UK domiciled and/or non-resident individuals.

The primary changes relate to Stamp Duty Land Tax, the Annual Tax on Enveloped Dwellings (**"ATED"**), ATED related Capital Gains Tax and Capital Gains Tax for Non-Residents. The changes only affect residential property which, essentially, is any property which can be used as a dwelling. Dwelling has its normal meaning and whether a property is suitable as a dwelling is a question of fact. There are some specific exemptions from the definition of a dwelling, including most types of communal property including school buildings, hospitals, prisons, residential homes, hotels and most types of purpose-built student accommodation.

1. Stamp Duty Land Tax ("SDLT")

SDLT is paid whenever a property is acquired for "consideration". Generally, the consideration will be the price paid for the property but, in some circumstances, SDLT may apply to a gift of property. The rate of SDLT which applies to the acquisition of residential property will depend on the value/price paid and, in some circumstances, on the nature of the purchaser and the intended use of the property.

The former "slab system" of SDLT, where tax was paid at a single rate on the whole value of the property, has been abolished and replaced with a marginal rate system where each rate will apply on the portion of the purchase price falling within each band. This new system applies to sales of residential property completed on or after 4 December 2014 unless there was an unconditional contract entered into before that date in which case a buyer may, in certain circumstances, choose which regime should apply.

Non-Natural Persons (**"NNPs"**) pay a higher rate of SDLT when they purchase UK residential property. NNPs include certain companies, partnerships with company members and managers of collective investment schemes which own UK residential property with a value of more than £500,000. For NNPs purchasing properties over £500,000, the SDLT rate is 15%.

The rates are set out in the table below:

£0 - £125,000	0%
£125,001 - £250,000	2%
£250,001 - £925,000	5%
£925,001 - £1,500,000	10%
Over £1,500,000	12%
Over £500,000 (for purchases by NNPs where no relief available)	15%

There is an element of relief for the higher charge; the 15% SDLT rate does not apply to a transaction where the relevant property is acquired exclusively for one or more of the following purposes:

- Exploitation as a source of rent or other receipts (other than excluded rents) in the course of a qualifying rental business.
- Development (or redevelopment) and resale in the course of a property development trade.
- Resale in the course of a property trading business (where the property is stock of the business).

The property is not treated as being acquired exclusively for one of the above purposes if it is intended that a non-qualifying individual (essentially someone connected with the owner) will be permitted to occupy the building whether or not that person pays a market rent.

All of the reliefs are subject to clawback. A clawback applies if, within three years of the effective date of the transaction, the property is no longer used for the purpose for which relief was available, or the property is used personally or for family occupation, broadly by someone connected with the owner.

2. Annual Tax on Enveloped Dwellings (“ATED”)

- ATED was introduced with effect from 1 April 2013 and applied to any interest in a single dwelling having a taxable value of more than £2m which is held by a non-natural person or NNP. As with SDLT, NNP includes a company, a partnership of which a company is a member and a collective investment scheme. ATED applies to both UK and non-UK resident NNPs. Trustees are not regarded as NNPs for these purposes.
- The rate of charge is increased in accordance with the Consumer Prices Index (**“CPI”**) each year. (Although the December 2014 Autumn Statement included an announcement that the charges for property worth over £2m would be increased by 50% (plus CPI) from 1 April 2015).

- The ATED regime is being extended to properties valued at more than £1m with effect from 1 April 2015 so that properties worth between more than £1m and £2m will be liable to ATED with effect from 1 April 2015. The charge will be £7,000. ATED will also be extended to properties valued at more than £500,000 to £1m with effect from 1 April 2016. The charge will be £3,500. The rates of charge are set out in the following table:

Value of UK residential property	Annual Charge for the period ended 31 March 2015	Annual Charge for the period ended 31 March 2016	Annual Charge for the period ended 31 March 2017
Over £500,000 to £1million	-	-	£3,500
Over £1million to £2million	-	£7,000	£7,000 + CPI
Over £2million to £5million	£15,400	£23,350	£23,350 +CPI
Over £5million to £10million	£35,900	£54,450	£54,450 + CPI
Over £10million To £20million	£71,850	£109,050	£109,050 + CPI
Over £20million	£143,750	£218,200	£218,200 + CPI

Where the charge applies, the owner needs to file an ATED Return with HMRC every year; usually on 1 April, but special rules apply if a property becomes chargeable part way through the year. Similarly, the tax is usually payable on 1 April in advance; again special rules apply if the property is not chargeable for the whole year.

Valuations

For ATED, broadly speaking, the value of the dwelling is its value:

- on 1 April 2012, if the property was held at that date;
- when the property is bought or acquired, if that is a later date; or
- if the dwelling is a new property or an existing building that has been converted to a dwelling when it is capable of being occupied if that date is later than 1 April 2012.

Properties will be revalued on 1 April 2017 for the charges to apply with effect from 1 April 2018.

Reliefs

- There are reliefs from ATED, which can only be claimed by filing an ATED Return with HMRC every year.

The most common forms of relief relate to:

- Those dwellings which are let to a third party on a commercial basis and which are not, at any time, occupied (or available for occupation) by anyone connected with the owner.
- Part of a property trading business which is not, at any time, occupied (or available for occupation) by anyone connected with the owner.
- Part of a property developer's trade where the dwelling is acquired as part of a property development business and the property was purchased with the intention to re-develop and sell it on and it is not, at any time, occupied (or available for occupation) by anyone connected with the owner.

At present, a Return needs to be filed for each property but, with effect from the 2015/2016 chargeable period, i.e. 1 April 2015 to 31 March 2016, businesses which hold more than one property and are eligible for a relief (such as property rental businesses) will generally only be required to deliver one Return for all such properties.

3. ATED related Capital Gains Tax

In addition to ATED, a Capital Gains Tax (**"CGT"**) charge will apply where the NNP disposes of any interest in the UK residential property for a consideration in excess of £2m. This applies to tax any post 6 April 2013 gains on the disposal of such a property at 28%. The threshold at which ATED related CGT applies will be reduced to £1million from 6 April 2015 and to £500,000 from 6 April 2016. In addition, it is worth noting the following:

- The definition of a NNP is exactly the same for the ATED related CGT charge as for ATED and includes both UK and non-resident companies but not trusts.
- The same reliefs apply as for the ATED regime but these would not be relevant if the property is occupied by someone connected with the owner.
- The CGT charge will only be chargeable on the disposal by the NNP of the property itself and not, for example, on the disposal of shares in the company.
- The charge will not apply to any gains made (or accrued) before 6 April 2013.

4. Capital Gains Tax ("CGT") for Non-UK Residents

The UK government had already announced that a CGT charge would be introduced from April 2015 on gains made by non-UK residents disposing of UK residential property. Following a consultation, draft legislation and guidance has been released as part of the draft Finance Bill 2015.

CGT accruing post 6 April 2015 will be taxable on all disposals of residential property located in the UK.

Residential property is defined as property suitable for use as a dwelling. Property of any value is within these new rules (i.e. there is no minimum value of property below which the charge will not apply). Unlike the ATED related CGT regime there are no reliefs for genuine businesses, however individuals and trustees may be able to claim Principal Private Residence (**"PPR"**) relief.

There will be no change to the taxation of non-UK residents owning UK commercial property, or holding UK property as trading stock, and therefore these categories will not be subject to the new CGT regime.

Rebasing

The new charge only applies to the increase in value after 5 April 2015. The default position will be to re-base the property to its market value at 6th April 2015 so that only the gain realised above that value (after deduction of any allowable costs incurred after that date) is subject to the charge.
Should the owner not wish to rebase, they will have the option to time apportion the whole gain over the period of ownership. This option will not be available if a disposal is also subject to ATED related CGT (see paragraph 3 above).

Owners will also have the option to neither rebase nor time apportion the gain and, instead, to compute the gain (or loss) over the whole period of ownership.

Interaction with anti-avoidance rules

Where a gain is subject to tax under these new rules, it will not be subject to tax again under existing anti-avoidance rules that can attribute gains of a non-UK resident trust to UK resident settlors/beneficiaries or gains of a non-UK resident company to UK resident participators. The new charge will therefore take precedence. For properties purchased before 6th April 2015 by non-UK resident trustees/companies, the pre-April 2015 element of a capital gain can still be taxed under existing anti-avoidance rules.

If a gain is potentially subject to both ATED related CGT and the new CGT charge for non-residents, then the ATED related CGT charge will take priority.

The categories of non-UK resident owners who will be affected by the new charge are set out as follows:

Type of Seller	Tax Rate	Other Matters
Non-UK resident individual (and personal representatives of deceased individual)	18% or 28%	Tax rate depends on level of other UK source income/ chargeable gains in the tax year of disposal. CGT annual exempt amount available; £11,100 for 2015/16. Losses are only available to be offset against gains on disposals of UK residential property in the same or subsequent tax years. Could be eligible for PPR relief.
Non-UK resident trustees	28%	CGT annual exempt amount available (£5,550 for 2015/16). Losses are the same as for individuals (see above). Takes priority over existing anti-avoidance legislation that taxes trustee Capital Gains on UK resident settlors/ beneficiaries. Could be eligible for PPR relief.
Non-UK resident company (not widely held)	20% 28%	Subject as below, tax rate is 20%. No exemption from the CGT charge, unlike ATED related CGT (i.e. if the company is a property investor/developer). Indexation allowance will be available. A form of group relief will be available to allow losses to be utilised against gains on disposals of UK residential property in the same group. If already within the scope of ATED, ATED related CGT takes preference so the rate is 28%.
Non-UK residents owning residential property through a partnership	Depends on identity of the partner/ individual, trust, or company – rates apply as above	For non-UK resident entities that are classified as partnerships that are treated as transparent for UK tax purposes when taking into account the application of the law in the local jurisdiction, the individual partners will be chargeable to CGT accordingly. Non-transparent non-UK partnerships are taxed in the same way as companies.

Who is unaffected?

The government has indicated that it does not wish to harm genuine institutional investment in UK residential property. Therefore, it has included some specific exemptions from the charge:-

- Specific classes of qualifying institutional investors will be exempt provided they meet genuine diversity of ownership tests; and
- All other non-UK resident companies and funds will be subject to a "narrowly controlled" test (similar to existing close company tests) to determine whether they can potentially fall outside the scope of the tax charge.

The aim of the exemption is to ensure that the new charge applies only to private and family ownership structures, whilst at the same time limiting avoidance opportunities through the use of funds as ownership vehicles.

Reporting the disposal to HMRC

The reporting process and method for payment has not been finalised, but the current proposal is as follows:

Seller already has an established relationship with HMRC through an existing self assessment record	Obligation to report disposal within 30 days of disposal	Submission of tax return showing computation of gain/loss	Payment of tax
Yes	Yes	Disposal reported on self assessment return and return submitted by 31 January following the tax year of disposal	Payment of tax due by 31 January following the tax year of disposal
No	Yes	Tax Return submitted within 60 days following the date of disposal (i.e. 30 days after the first obligation to report)	Payment of tax within 60 days following the date of disposal (i.e. 30 days after the first obligation to report)

5. Income Tax

Income tax (and corporation tax on income) is typically payable on rental profits or development profits, but may also apply in other circumstances. If rent is paid to a non-resident, the tenant has an obligation to deduct 20% income tax and pay the tax to HMRC; however, an application may be made by the non-resident owner to HMRC for rental income to be paid with no tax deducted in accordance with the Non- Resident Landlord Scheme. Non-resident landlords can apply to HMRC for approval where:

- their tax affairs are up to date; or
- they have never had any UK tax obligations; or
- they do not expect to be liable to UK tax for the year in which the application is made.

6. Inheritance Tax ("IHT")

IHT can apply at up to 40% on death, where an individual owns UK residential property directly and on certain lifetime transactions, such as gifting of property to trusts. These charges apply regardless of where the individual is resident or domiciled. Debt may reduce the value of the property which is subject to IHT, but this will depend on the circumstances.

For those holding or planning to acquire high value residential properties, directly or through trust and company structures, advice should be taken on the appropriate way to hold such properties in light of the above. It will be necessary to consider the aims and requirements of the property owner and to what extent the property is intended, for example, as a long-term family home or perhaps as a short-term investment.

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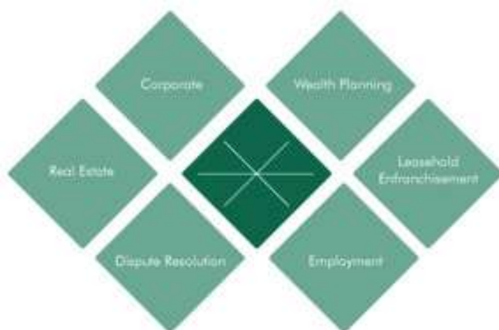

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