Non-resident CGT changes in relation to UK real estate – non-resident individuals and trustees

The scope of the UK tax for non-residents has been extended with effect from 6 April 2019 to catch gains realised on direct disposals of UK commercial properties and gains on disposals of interests in "property-rich companies".

This Briefing Note focuses on the impact of some of these changes on non-UK resident individuals and trustees with interests in UK real estate, whether held directly or via companies. The changes for collective investment vehicles and corporate taxpayers are set out in a separate Briefing Note (entitled *Tax on UK Real Estate Gains for Non-UK resident Companies and Funds).*

What's new?

The latest changes introduced by the Finance Act 2019, represent the next steps towards parity in the tax treatment of UK residents and non-UK residents holding UK real estate and bring the rules on the taxation of residential and commercial property gains into broad alignment.

Residential Property Disposals

One of the significant changes is that whilst the ATED (Annual Tax on Enveloped Dwellings) regime still continues generally in terms of the annual ATED charge, ATED-related CGT has been abolished. Property gains realised by non-resident companies have been transferred out of the CGT (Capital Gains Tax) regime and into the Corporation Tax Regime. At the same time, the government has taken the opportunity to simplify the "rebasing" rules, which determine what proportion of the economic gain is subject to tax when a non-resident person disposes of UK real estate.

The cumulative effect of these changes is something of a bonus for non-resident companies disposing of UK residential property:-

- Under the former ATED–related CGT Regime, such companies were typically liable to tax on the increase in the value of the property since April 2013. However, under the new regime, any increase in value between April 2013 and April 2015 is generally exempt from tax (unless the gain is caught by one of the Anti-Avoidance Rules relating to overseas trusts and non-resident companies).

- Under the ATED-related CGT Regime, tax on residential property gains was payable at 28%, and up to 5 April 2019 non-resident companies disposing of commercially let property had generally been subject to NRCGT at 20%. Gains realised by such companies are now subject to Corporation Tax, currently charged at 19% and expected to fall to 17% in 2020/2021.

- Non-resident individuals and trustees disposing of UK residential property are still subject to NRCGT (Non-Resident CGT) at the higher rates applicable to residential property gains (18%/28%).

Commercial Property Disposals

Non-resident investors in commercial real estate in the UK have been largely unaffected by the tax changes to date. However, the April 2019 changes have brought the treatment of UK residential property and commercial property into alignment, at least where capital gains are concerned.

Non-residents making direct disposals of UK commercial property are now chargeable to tax on any resultant gains, although the property will, by default, be rebased to its market value on 5 April 2019 when calculating the gain.

Non-resident individuals and trustees are subject to CGT at the normal rates (10%/20%), whereas non-resident companies are now within the scope of Corporation Tax (currently 19%).

Disposals of Interests in "Property-Rich Companies"

One of the most significant changes introduced by the Finance Act 2019 is that there is now a tax charge on a disposal by a non-resident of an indirect interest in UK land, whether that land is residential or commercial.

This new tax charge essentially applies to disposals of shares in companies that either themselves own UK land or own interests in other companies that own UK land whether directly or indirectly. The tax charge, where applicable, is on the increase in the value of the shares that have been disposed of, rather than the increase in the value of the underlying land.

Again there is rebasing as of 5 April 2019. In other words, tax will (by default) only be charged if and insofar as, the proceeds of disposal of the shares exceed the market value of the shares on 5 April 2019. Where shares are disposed of by way of gift or at an undervalue, the market value of the shares will be treated as proceeds of the disposal, in accordance with normal CGT principles.

Non-resident companies disposing of shares that are caught by these new rules will be subject to Corporation Tax on any resultant gain (currently 19%). Non-resident individuals and trustees will pay NRCGT. This will be charged at normal rates (i.e. 10%/20%), rather than the elevated rates applicable to residential property disposal. This is so even if the underlying property is residential.

The legislation does not itself refer to interests in “property-rich companies”. However, this term is a convenient short hand for companies whose value is substantially derived from UK land, whose shares are, if disposed of by a non-resident, capable of giving rise to a UK tax charge on any resultant gain.

For a disposal to be caught under the new rules, there are two conditions which must be satisfied. In essence:-

1. At least 75% of the company’s assets must be or derive their value from UK real estate. Such derivation may be very indirect, via any number of other companies or entities; and

2. An interest in the company of at least 25% must be held at the time of the disposal, or must have been held at any time in the two years prior to the disposal. For this purpose, the interests of any other persons who are connected with the provider can be attributed to the provision, and the 25% test is applied to the interests on an aggregated basis.

De-enveloping difficulties

The new rules which tax non-residents on a disposal of an interest in property-rich companies represent a major enlargement of the scope of UK tax. This change is likely to be most commonly encountered (a) on sales of companies that hold enveloped “UK real estate”, and (b) in “de-enveloping” scenarios, i.e. exercises to extract UK real estate from a company into direct ownership.

Under the new regime there may be two layers of UK tax on a de-enveloping, charged by reference to the same economic gain:

- a Corporation Tax Charge at company level on the disposal of the UK property and

- a NRCGT charge at shareholder level on the disposal of shares in a property-rich company. A disposal of the shares at a time when the company is property-rich may be avoidable by means of an in-specie dividend of the property, before the company is put into liquidation; but for various reason this will not always be practical.

Where UK land is held within a multi-tiered corporate structure that is being wound up, there may in fact be a risk of the UK tax being charged many times over on the same economic gain, although this unfortunate outcome should be avoidable through careful structuring.

Shareholder loans now need very careful consideration. In the context of a de-enveloping, such loans should not be waived prior to liquidation of the company, as doing so will increase the value of the shares, without increasing the shareholders base cost in them – unnecessarily inflating the chargeable gain realised by the shareholder on the disposal of the shares.

Capitalisation of loans (i.e. conversion of them into the shares) may be the solution but this may entail SDLT (Stamp Duty Land Tax) risks. This is now more than ever a highly technical area in which expert advice should be sought.

Compliance issues

The reporting regime for individuals and trustees who have made a disposal falling within the NRCGT rules typically requires a tax return to be filed within 30 days of the disposal, even where no gain has been realised. There are very limited exceptions, e.g. for a no gain/no loss transfer between spouses.

Non-resident companies holding UK land are now within the Corporation Tax Reporting Regime and will need to register with HMRC accordingly. The Corporation Tax Regime was not designed with non-resident companies in mind and this extension of the regime is likely to result in unexpected compliance burdens for such companies.

Rates and dates

The tax rates and rebasing dates can be summarised as follows.

Rebasing can in all cases be disapplied by election where it is preferable for the actual base cost to be used in computing the chargeable gain, instead of the market value of the assets on the rebasing date.

1. Disposals by Companies

Type of Disposal:	Corporation Tax (2019/2020)
Direct disposal of residential property:	19% on gain (decreasing to 17% for 2020/2021) since 6 April 2015
Direct disposal of commercial property:	19% on gain (decreasing to 17% for 2020/2021) since 6 April 2019
Disposal of shares in a property rich company:	19% on gain (decreasing to 17% for 2020/2021) since 6 April 2019

2. Disposals by Trustees

Type of Disposal:	NRCGT (2019/2020)
Direct disposal of residential property:	28% on gain since 6 April 2015
Direct disposal of commercial property:	20% on gain since 6 April 2019
Disposal of shares in a "property rich company":	Tax at 20% on gain since 6 April 2019

3. Disposals by Individuals

Type of Disposal:	NRCGT (2019/2020)
Direct disposal of residential property:	18%/28% on gain since 6 April 2015
Direct disposal of commercial property:	10%/20% on gain since 6 April 2019
Disposal of shares in a "property rich company")	10%/20% on gain since 6 April 2019

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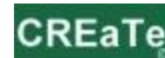

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