

ATOZ TAX ALERT



The UK tax reform: Taxing gains realised by non-residents on UK immovable property

07 December 2017

From a tax point of view, the UK was long known for being a favourable place for real estate investments by non-UK tax residents. But times are changing. The UK government announced at Autumn Budget 2017 that from April 2019, tax will be charged on gains made by non-residents on disposals of all types of UK immovable property ("UK Reform"). These changes will align the tax treatment of non-UK resident owners of UK immovable property with that of UK residents, and reduce the incentive for international investors to hold UK property through non-UK vehicles. On 22 November 2017, the UK government launched a public consultation to invite comments and feedback on particular questions still open and which will impact some of the finer details of the UK Reform.

Please find hereafter the main current features of the planned UK Reform:

Who is in scope and to what extent?

The UK Reform on real estate tax is expected to directly affect:

- Non-resident individuals, trusts, personal representatives and closely held companies who will be brought into capital gains tax ("CGT") on gains for both direct and indirect disposals of UK immovable non-residential property; and
- Non-resident companies and collective investment vehicles ("CIVs") who will be brought into corporate tax ("CT") on gains for both direct and indirect disposals of UK immovable property.

The UK Reform will also affect UK funds, REITs and CIVs as disposals by non-residents of interests in UK funds will now potentially be within scope of UK tax under the rules covering indirect disposals.

Those who are exempt from all UK capital gains, or otherwise not in the scope of UK tax for reasons other than being non-resident, will continue to be exempt or out of scope. This would apply for example to certain overseas pension schemes.

Many of the UK double tax treaties include a 'securitised land provision' which will allocate the taxing rights to the UK on disposals of shares in UK-property rich companies. Where such a provision is not included in the relevant treaty, the general rule is that the territory of residence of the vendor entity will have taxing rights such that an indirect disposal would not be caught by the new rules.

What are the direct disposals and indirect disposals of UK immovable property in scope?

A direct disposal includes situations where a non-resident disposes of an interest in UK immovable property from their own ownership. All direct disposals are in scope.

An indirect disposal includes disposal of interests in an entity that holds the immovable property. However, an indirect disposal of UK immovable property is in scope only if the following two tests are met at the date of disposal.

- Indirect disposal rules will apply where an entity is 'property rich', which is broadly where 75% or more of its gross asset value at disposal is represented by UK immovable property. Where the transaction includes a disposal of a group of companies or trusts, or a structure of both companies and trusts, the property richness test would be applied to the totality of entities being disposed of in the transaction.
- Indirect disposal will trigger the charge only where the person holds, or has held at some point within the five years prior to the disposal, a 25% or greater interest in the entity sold. Any interests held by related parties to the non-resident at the date of disposal or within the prior five years will also be taken into account when calculating whether the 25% test is met.

How will the capital gain realised by UK non-resident taxpayers be taxed?

UK non-resident will be taxed using (so far as possible) normal capital gains rules and giving effect to any exemptions, exclusions, etc. that are conferred other than by reason of not being UK resident.

The rate of tax will be the same as for an equivalent disposal by a UK resident:

- For corporate bodies this will be the normal UK corporation tax rate which is currently 19% (falling to 17% in April 2020); and
- For individuals, trusts, and personal representatives the same as the appropriate CGT rates (10%, 18%, 20% or 28% depending on the taxpayer and the type of property) and including any personal allowances.

It should be noted that the government has not yet determined how the existing regime that taxes gains on enveloped dwellings will be harmonised with the new rules.

For indirect disposals, the gain will be computed by reference to the gain on the interest in the entity that derives its value from immovable property, rather than by reference to any increase in value of the property itself. Under the expanded substantial shareholdings exemption (SSE) rules, it is possible, in limited circumstances where shares are held by Qualifying Institutional Investors, for the SSE to apply to disposals of property rich companies or groups of companies.

Allowable losses within CGT and allowable losses within CT will be available for offset against taxable gains.

Certain UK advisers who are aware of the conclusion of the sale process will be required to inform HMRC of the transaction.

What is the commencement date?

Only the gains attributable to changes in value from April 2019 will be subject to UK Reform rules. However, an anti-forestalling rule will apply to certain arrangements entered into on or after the 22 November 2017. This rule aims to counteract arrangements that seek to avoid the new charge on non-residents described in this document by exploiting provisions in some double tax treaties in a way that is contrary to the object and purpose of those provisions.

In the light of the above, we highly recommend taxpayers who hold (or plan to hold), directly or indirectly, UK real estate, to seek advice from their tax adviser in order to assess the impact of the UK Reform on their (planned) UK investments. In particular, over the years, Luxembourg companies have been used extensively to hold UK property and these structures will need to be analysed.

*The article contains only general information and does not constitute advice in any way.
Readers should seek individual specialist advice on their business matters.*

Can we help? Do you have further questions?



KEITH O'DONNELL
Managing Partner
keith.odonnell@atoz.lu
T +352 26 940 257



MARIE BENTLEY
Knowledge Manager
marie.bentley@atoz.lu
T +352 26 940 903

We would like to thank Jonathan Hornby, Managing Director with Alvarez and Marsal (Taxand UK), for his help during the preparation of this article.