

Budget 2012 and buying property in the UK

Briefing note

Date: March 2012

Updated: May 2012

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Speed read

- 7% SDLT on the purchase of UK residential property valued at over £2m by anyone except a “non-natural person”, effective from 22 March 2012
- 15% SDLT (rate to be confirmed) on the purchase of UK residential property valued at over £2m by a “non-natural person” (including companies), effective from 21 March 2012
- No changes to SDLT rules where the property is valued at less than £2m
- Capital gains tax likely to be extended to gains on disposal of UK residential property by a non-UK resident, non-natural person from 6 April 2013
- Government to consult on the introduction of an annual charge on UK residential property valued at over £2m and shares or interests in such property owned by non-natural persons, with the charge likely to be effective from 6 April 2013

The Budget announcements

In his Budget on 21 March 2012 the Chancellor made two announcements affecting the taxation of residential property

- first, stamp duty land tax (“SDLT”) on purchase of a residential property in the UK will be at the rate of 7% of the chargeable consideration where this is over £2 million. Previously, the top rate of SDLT was 5% for properties worth over £1 million. The new rate will apply where the effective date of the purchase (normally completion) occurs on or after 22 March 2012. Under transitional provisions the old rate of SDLT will continue to apply to contracts entered into before 22 March but completed without any variation of the contract after that date.
- second, a much higher rate of SDLT of 15% will apply if the purchaser of a residential property in the UK worth over £2 million is a non-natural person such as a company and certain kinds of partnerships. This new rate applies from 21 March 2012 onwards. There will be exclusions from the higher charge for property developers and corporate trustees in certain circumstances. There will be transitional rules where contracts were exchanged on or before 20 March 2012 which mean that the old rate of SDLT applies provided the contract has not been varied after 20 March 2012.

In addition the Chancellor announced consultations on the following points affecting residential property

- first, the Government is going to extend capital gains tax to gains on disposal of UK residential property and shares or interests in such property by non-UK resident, non-natural persons, such as companies (and it is worth noting that the announcement in the Budget did not specify that this change would only apply to properties above a certain value). The Government is to consult on the measure with a view to the change becoming effective from April 2013.
- second, the Government will consult on the introduction of an annual charge on residential property and shares or interests in such property owned by non-natural persons. The Government’s figures suggest this charge is likely to begin at £15,000 per year for properties worth between £2 and £5 million, rising to £140,000 per year

for properties worth over £20 million. The Government aims that legislation to implement this will come into effect in April 2013

These measures are clearly targeted at wealthy property owners and are aimed at discouraging individuals from buying and owning more valuable property (especially in Central London), through non-UK companies in order to avoid SDLT, and perhaps also inheritance tax.

Why buy a UK property through a new non-UK company?

There were a number of reasons why a prospective purchaser of UK property, instead of holding the property in his own name, would instead incorporate a company in a jurisdiction outside the UK, funding the company (for example by way of loan or capitalisation) to hold the property in his stead.

First, he could achieve confidentiality. In England, there is a public registry which shows who owns land. If the property is bought in the name of a company, and in the country where the company is incorporated there is no public register of members of the company, then his ownership is not public knowledge.

Secondly, if he was not domiciled in the UK, then ownership of the company meant that the value of the property did not form part of his estate for inheritance tax purposes. Although this is not the only way in which inheritance tax could be mitigated for a temporary UK property owner, it was certainly convenient and cheap, with minimal administrative inconvenience. Care had to be taken to ensure there was no tax in the country where the company was incorporated, which made jurisdictions like the British Virgin Islands, Jersey and the Isle of Man popular. Of course, there would be probate duties in these countries if the shareholder died and the shares were passed to his heirs by will. A trust could avoid this necessity, but would have significantly increased the costs and administrative complexity.

If a company did buy a property, then great care would have to be taken if the shareholder or his family used the property rent free to ensure that he was not treated as a director of the company and so liable to income tax in respect of the benefit he was getting as a result of that use.

Why buy an existing company instead of a UK property?

If the owner of a UK property was a non-UK company, then there were two ways in which the shareholder could dispose of the property, assuming that the directors would be willing to take his wishes into account. First, the company could sell the property itself. The purchaser would buy as from any other vendor, doing his due diligence on the property, taking appropriate warranties as to title, and paying SDLT and HM Land Registry fees at the appropriate rates.

Secondly, as an alternative, if both parties agreed, and the only asset of the company was the UK property, then the purchaser could instead buy the shares in the non-UK company. In this case, the purchaser would still have to do his due diligence on the property and he would also have to undertake due diligence on the company. The risk to the purchaser is that the company has liabilities which pass to him, and which it is very hard for his lawyers to ascertain. This is because in many countries there is no requirement that the company produces accounts, let alone that these accounts are

audited. To some extent this risk can be managed through appropriate warranties by the shareholder. If the purchaser is prepared to take this risk, the benefit to him is that he does not have to pay UK SDLT on the transaction, nor does he pay HM Land Registry fees. There could be taxes and fees to pay in the country where the company was incorporated in order to transfer ownership of the shares in the company. It is likely that these would be at a much lower rate than the 5% which a purchaser of a property for more than £1 million would otherwise have to pay in the UK, however.

So why didn't everyone do this? The two main reasons why this was not widespread are first that not everyone has the appetite for the risk that buying a company on which it is very hard to undertake due diligence entails. If the vendor was also from a country in which it is hard to enforce unsecured warranties, this was a very real risk. Secondly, the costs of undertaking due diligence meant that the property price had to be in excess of about £2 million in order to it to be worthwhile for the purchaser to even contemplate taking the risk. The purchaser was in effect paying not only the usual fees he would have to pay for a property purchase (including VAT), but also the legal costs of a corporate transaction.

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How will the changes announced by the Chancellor affect the situation for property purchasers?

The main effect of the Chancellor's Budget announcement for UK based individuals purchasing property worth over £2 million will be that they pay an additional £20,000 of SDLT for every £1 million of value on a property purchase. Such individuals would not normally have used a company for such a purchase in any event.

A non-UK domiciliary might well have contemplated purchasing a UK property through a non-UK company for inheritance tax mitigation purposes, as explained above. However, the new SDLT charge at 15% on doing so, together with a possible annual charge on which the Government is to consult, will make this too expensive. Where the purchaser is a non-UK resident individual (and so under the current rules is outside the scope of capital gains tax) the prospective capital gains tax charge on disposal by a non-UK, non-natural person would be a further disincentive to structure a purchase through a non-UK company. Non-UK domiciled and non-UK resident individuals will have to find other ways of dealing with the risk of an inheritance tax charge on their death arising from owning a valuable UK property. This might be way of insurance or mortgage lending secured on the property.

Interestingly, where UK residential property is held in an existing non-UK company, it is still possible to buy the shares in that company without an SDLT charge. However, the other risks outlined above continue to apply.

Purchasers who are individuals wishing only to protect their confidentiality may be able to make use of corporate nominees, which in most circumstances will be taxed as if the beneficial owner, not the nominee, owned the property.

It remains to be seen how these changes will affect sentiment in the London property market.