

Proposals for taxation of UK residential property worth over £2 million

Briefing note

Date: 13 June 2012

Summary

On Budget Day 2012 (21 March) the Chancellor announced a three-pronged strategy ostensibly aimed at eliminating the use of companies to avoid stamp duty land tax (“SDLT”) on the purchase of residential property in the UK. In practice the measures he announced are likely to affect many arrangements which were put into place for reasons other than SDLT avoidance. The measures announced were

- a new SDLT rate of 15% for single residential properties purchased for over £2 million by companies and certain other entities (referred to as “non-natural persons”) and applicable to transactions from Budget Day
- a new “annual charge” on single residential properties worth over £2m held by companies and other “non-natural persons”
- a new capital gains tax (“CGT”) charge on disposals by non-UK resident companies of such UK residential properties

These announcements have been followed up with publication of a consultation paper on 31 May 2012 which focuses specifically on the annual charge and CGT charge referred to above.

The consultation provides some clarity about how the new annual charge and CGT charge will work. The consultation period ends on 23 August 2012. This briefing is based on the contents of the consultation paper but the final form of the new tax charges will depend on the outcome of the consultation. Draft legislation has been promised for the autumn.

The main points arising in the consultation paper are:

Annual charge

- Confirmation that the new annual charge will apply in bands, as follows:

Property value	Annual charge
£2 million to £5 million	£15,000
£5 million to £10 million	£35,000
£10 million to £20 million	£70,000
£20 million plus	£140,000

The charge will be increased each year in line with the Consumer Prices Index but the bandings will not – a classic example perhaps of “fiscal drag”.

- The annual charge will apply to residential properties held by (i) companies

(ii) partnerships in which one or more members are companies and (iii) collective investment vehicles. There will be an exclusion for companies holding land solely as trustee, although where the property is held as bare trustee, applicability of the new charge will depend on the identity of the beneficial owner. Exclusions will also be available for charities and property development companies provided certain conditions are satisfied. The categories of chargeable persons, and the exclusions, are the same as for the 15% SDLT charge. This means among other things that the annual charge will not apply to relevant properties held directly by trustees (other than bare trustees for a beneficiary who is a “non-natural person”).

- The annual charge will also apply in respect of any qualifying properties held jointly with a “non-natural person”.
- Properties may move into or out of the annual charge during a year, for example, if it is converted into, or from, residential use. The annual charge would then apply pro-rata for the proportion of the year for which the property interest and the person is liable.
- For the five years from April 2013 the annual charge will be based on the market value of the property in April 2012. The value will be self-assessed by the taxpayer although valuation by a suitably qualified valuer is likely to be advisable in most cases. Property owners will be allowed to submit their proposed valuations to HMRC for checking and if a value is not accepted the Valuation Office will advise the taxpayer and enter discussion to try to agree an appropriate band.
- An annual self-assessment return must be completed by 15 April in each year, with separate information provided for each property owned by a relevant non-natural person. Payment must be made by the same date, except for the first year (ie for the year beginning 1 April 2013), where the due date will not be before 1 October 2013 (owing to the need for Finance Act 2013 to obtain Royal Assent). This means that where the charge applies valuations will have to be obtained well before the start of the first year of charge.

CGT charge

- The new CGT charge will apply to disposals of residential properties for over £2m. Confirmation that the charge will not apply where the consideration for the disposal is less than £2m is welcome as it will relieve non-resident owners of companies holding lower value UK residential property of the potential need to restructure to take the property out of the CGT net.
- The CGT charge will also apply to the whole of any gains that accrue on the disposal of assets (of whatever form) that represent directly or indirectly relevant UK residential property. This will include shares in property owning companies where more than 50% of the value of the asset is derived from UK residential property. It is interesting that the Government is seeking to tax these non-resident companies

to CGT having not sought to impose a 15% SDLT charge on transfers of shares in “property rich” companies in the Budget.

- The charge will apply at least to the categories of “non-natural person” caught by the annual charge and 15% SDLT charges (except that only non-UK resident companies will be caught, since UK companies are already subject to corporation tax on their gains) – in other words to:
 - non-UK companies
 - partnerships with at least one “non-natural person” partner
 - collective investment schemes
- HMRC had previously indicated that the charge would also apply to non-resident trusts, but the consultation paper invites comments on whether trustees and other potential “non-natural persons” such as clubs and associations, personal representatives, and certain types of foreign entity, should be caught; so this point appears to remain open.
- The rate of the new CGT charge is to be announced in the UK’s Budget 2013.
- The new CGT charge will apply to gains accrued both before and after introduction of the charge in April 2013. Thus there will be no “re-basing” of historic gains, as some had hoped.
- Principal private residence relief will not be available (except to properties directly held by trustees and personal representatives, if they are included within the scope of the charge).
- A non-resident charity that would meet the conditions for CGT exemption if it were UK-resident will continue to be exempt.
- There is no guidance given on the important issue of how the new charge will interact with existing anti-avoidance rules designed to impose CGT charges on the UK resident owners of non-UK resident companies, or certain UK resident settlors and beneficiaries of offshore trusts. This is most unhelpful.

Conclusion

Where residential properties are owned by companies and are potentially within the new annual charge, consideration will need to be given to whether such properties should be removed from the company before April 2013. Where the company is based in the UK the process of extraction could be expensive in tax terms. Where the company is non-UK resident the tax treatment on dismantling it will depend on the UK tax status of the shareholders. Consideration would also need to be given to whether tax arises in any other jurisdiction on dismantling structures. Tax costs of dismantling structures will need to be weighed against other considerations, such as the desire for privacy and family succession issues. There will be no generic “right answer”: for each structure, it will be a

case of taking an informed decision having taken appropriate advice.

Unfortunately the consultation paper does not address some important questions, particularly in relation to the CGT charge. Wherever possible, it will be better to await the draft legislation before undertaking any restructuring. Clients and their advisers should however consider their potential options now as it is likely to be necessary to move swiftly in the autumn.

Clients about to purchase UK residential properties worth over £2m, and indeed properties close to the £2m “cliff edge” which may be expected to increase in value, need however to consider the impact of the likely new rules now. Thought will need to be given to alternative structures to achieve the objectives (privacy, succession planning and so forth) afforded by company structures. For non-domiciliaries aiming to purchase residential property in the UK alternative means of dealing with inheritance tax will need to be considered, such as borrowing to reduce the net value of the property, or life assurance to cover the inheritance tax charge likely to arise if the individual were to die whilst owning such property in his own name.

Charles Russell will be contributing to the consultation process. If you have any observations you would like us to consider, or if you have any questions about the new rules, please get in touch with your usual Charles Russell contact.

More information

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