

UK PROPERTY TAXES

COMMERCIAL AND RESIDENTIAL UPDATE
NOVEMBER 2018



TIMELINE OF TAX CHANGES

The last few years have seen a transformation in the landscape for the taxation of property ownership in the UK with further changes taking place (or being phased in) over the next few years.

Most owners of property, whether the property is held as trading stock or for investment, whether individuals or corporates or whether UK resident or non-UK resident will be affected by at least some of the changes. There is a clear trend - many more owners of UK property, particularly those based outside the UK, will be liable to UK tax on the profits they make from those properties.

LOANS AND INTEREST RISK

A number of key tax considerations arise from financing the acquisition of UK property through loans, in particular, the tax deductibility of the interest and whether or not any tax might need to be withheld on payment of the interest.

Where interest is paid between connected parties, for example from a subsidiary company to a parent company, it is necessary to consider whether the amount of interest on the loan would be payable were the loan to be made between independent third parties bargaining at arm's length. In the first instance, a restriction in the deduction for interest may arise where the amount paid exceeds what would arise at arm's length. In particular circumstances, where the interest is paid cross-border or to an individual, there may be an obligation to deduct UK withholding tax at 20%.

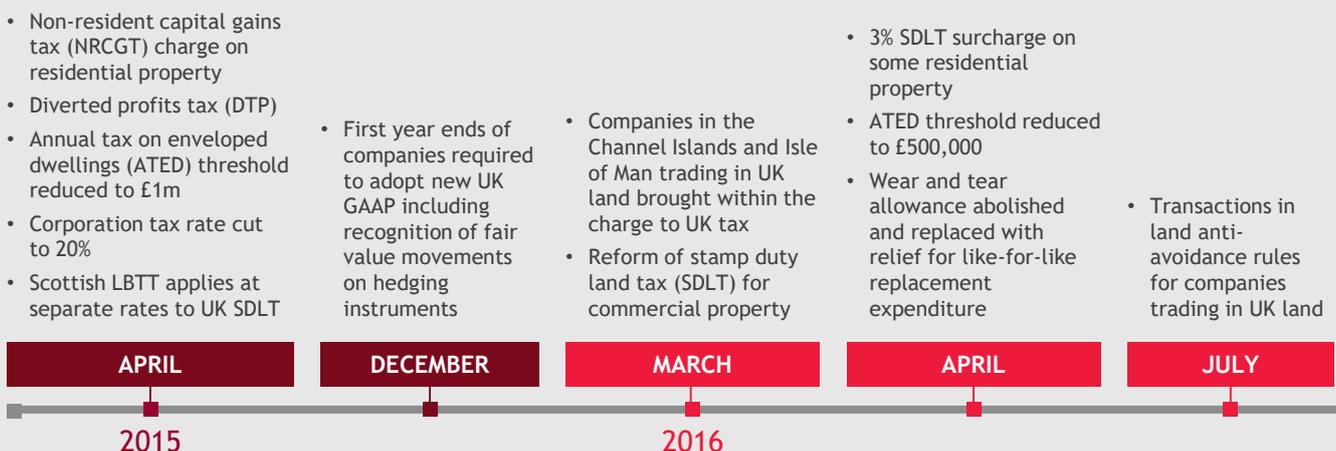
Since April 2017, companies and groups chargeable to corporation tax face a restriction in the deductibility of interest. The rule applies for groups on an aggregated UK basis to restrict net interest deductions to the higher of:

- £2m net interest
- 30% of 'tax-EBITDA'
- 'Tax-EBITDA' multiplied by the group's ratio of external interest to EBITDA.

Companies renting property to unconnected third party tenants and which are financed by loans from unconnected third parties may in some circumstances, and subject to certain conditions, be able to elect to be excluded from these rules for restriction in interest deductibility.

The new regime is complex and still evolving and operates on a group-wide basis. Companies currently chargeable to income tax will be brought within the charge to corporation tax from April 2020 so that the restriction will also apply to them from that date.

Where the taxpayer is an individual within the charge to income tax, the basis for tax relief is being reformed over four years from April 2017: instead of interest on loans being a tax deductible expense, it will instead give rise to a tax credit at the basic rate of tax. This is being phased in over four years, with the proportion of interest being treated as giving rise to a tax credit increasing by 25% each year. This will give rise to a significant extra tax burden for higher-rate taxpayers.



NON-RESIDENT CAPITAL GAINS TAX (NRCGT)

Since 5 April 2015, non-resident individuals (including partners with a share of a partnership gain), trustees and personal representatives of a non-resident individual, specifically defined closely-held companies (normally, those held by five or fewer participators), and certain unit trusts, have been liable to pay CGT on gains realised on the disposal of UK residential property. Broadly, this means UK buildings in use or being constructed or adapted for use as a dwelling, and rights or options to acquire an interest in such property. Unlike ATED-related CGT (see below), there is no de minimis value, and commercially let property is caught.

CGT is charged on the rise in value between 6 April 2015 and the date of disposal, with indexation (up to December 2017) for companies, but no ATED-type reliefs. The vendor can elect to calculate the gain by straight-line apportionment since the purchase date, or for the entire gain since 6 April 2015 or the purchase date to be taxed. Private residence relief is available in limited circumstances.

The filing obligations are strict: a NRCGT return must be filed for each disposal of a UK residential property, 30 days after conveyance of the property, even if the disposal is chargeable to ATED-related CGT or does not result in a NRCGT gain. Any tax due is payable 30 days after conveyance, unless the vendor files self-assessment returns, in which case tax can be paid on the normal self-assessment due date.

Gains of corporate entities will be brought within the charge to corporation tax instead of NRCGT, and ATED-related CGT will be abolished, from April 2019. Further complexity appears when property is held within a non-UK resident trust as gains on disposal may be taxed in more than one way. The order of precedence for CGT on a gain on disposal of a UK residential property by a non-resident is:

1. ATED-related CGT
2. NRCGT
3. CGT under pre-2013 anti-avoidance legislation such as that which attributes gains to UK resident settlors and/or beneficiaries.

INDEXATION ALLOWANCE

Companies within the charge to corporation tax have historically been entitled to a relief ('indexation allowance') calculated by reference to the Retail Prices Index ('RPI') to reflect the impact of inflation over the period during which they have held chargeable assets such as investment properties. The RPI for the purposes of this calculation has been frozen at the RPI for December 2017 meaning that assets already held on that date will no longer benefit from further indexation allowance and assets acquired subsequently will not benefit from indexation allowance at all. This is likely to result in significant amounts of additional tax in future years as the impact of this restriction increases over time.



- Election to rebase offshore assets to market value for non-domiciliaries acquiring a deemed UK domicile
- Abolition of business premises renovation allowance
- Corporation tax rate cut to 19%
- Rebasing of ATED valuations
- Restrictions of corporate interest deductions under BEPS 4
- Restriction of 25% of interest deductions for individual landlords to the basic rate
- Inheritance tax (IHT) family home allowance
- IHT charge on UK residential property owned by non-resident companies
- Freezing of RPI for calculation of indexation allowance given against corporate gains
- Restriction of 50% of interest deductions for individual landlords to the basic rate
- Land Transaction Tax replaces SDLT for purchases of property in Wales
- Structures and Buildings Allowance introduced

APRIL

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TAXING PROFITS FROM DEALING IN AND DEVELOPING UK LAND

Historically, for trading profits arising to non-UK residents from dealing in or developing UK land to be chargeable to UK tax, the activity would (in most cases) need to be attributable to a UK permanent establishment (PE) or represent UK source income. However, a number of double tax treaties between the UK and other jurisdictions enabled developers resident in certain jurisdictions to escape a charge to UK tax on such profits.

New double tax treaties with the Channel Islands and the Isle of Man mean that profits arising from disposals of land derived from a trade of dealing in or developing UK land have been chargeable to UK tax for residents of those jurisdictions from 16 March 2016. For taxpayers resident elsewhere, new rules are effective in relation to such profits from 5 July 2016 irrespective of the residence status of the landowner and regardless of whether or not the activity is conducted through a PE.

OFFSHORE INVESTMENT IN UK LAND

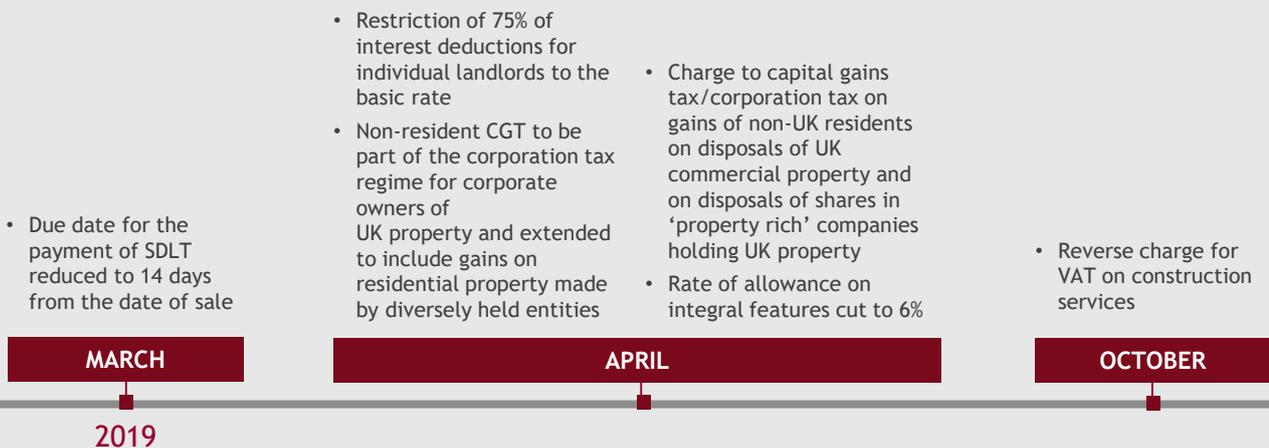
Gains on residential property held by non-residents have, in many cases, been within the scope of NRCGT since April 2015. The charge to UK tax will be extended to commercial property held by non residents and to residential property previously not within the scope of NRCGT (such as disposals by diversely held companies) from April 2019. This will be a charge to CGT for individuals and a charge to corporation tax for corporate entities.

Gains of corporate entities currently falling within the scope of NRCGT are, therefore, likely to be brought within the charge to corporation tax instead. It is expected that properties not currently within the charge to NRCGT will be rebased to market value in April 2019 for the purpose of calculating the gain chargeable to tax.

In addition to gains on the disposal of assets, non-UK residents will be charged to UK tax on gains on the disposal of shares in ‘property rich’ companies. ‘Property rich’ companies are expected to be companies deriving at least 75% of their value from UK land for this purpose.

Some disposals of shares are already within the charge to UK tax, for example, shares in companies trading in and/or developing UK land as a result of the changes implemented in 2016. However, from April 2019 gains on shares in companies holding UK property for the purpose of investment will be chargeable to UK tax for the first time.

Shares are expected to be rebased to their market value in April 2019 for the purpose of calculating future gains on disposal. An exemption from the charge on the disposal of shares by non UK residents may be available for shares in companies that are not closely held and which are not collective investment vehicle.



EXTENSION OF CORPORATION TAX TO NON-RESIDENT COMPANIES

Currently, non-UK resident companies undertaking a trade in UK land are chargeable to corporation tax on their trading profits. Non-UK resident companies holding UK property for the purposes of investment, by contrast, are chargeable to UK income tax on their rental profits rather than UK corporation tax.

The Government has been consulting on whether the UK rental income of non-UK resident companies should be brought within the charge to corporation tax (to put them in a similar UK tax position as UK resident companies) from April 2020. There are significant differences in the tax rules between income tax and corporation tax. Therefore, from April 2020 non-UK resident companies which rent property in the UK will need to establish whether the advantages of being liable to corporation tax (eg a lower tax rate, certain elections and reliefs) are outweighed by the greater restrictions under corporation tax (eg the new interest restrictions).

STAMP DUTY LAND TAX (SDLT)

There have been three fundamental reforms to SDLT. Firstly, the charge on commercial property has been reformed since 17 March 2016 such that tax is now charged on the amount of the purchase price falling within progressive rate bands rather than at a single rate for the band in which the total consideration falls. Although the tax rates are different, this reform has aligned the system for taxing purchases of commercial property with that which has existed for residential property for some time.

However, the adjustment of the rate bands to give effect to the reform resulted in additional SDLT charges for acquisitions of commercial property at values above £1.05m.

Secondly, from April 2016 a supplement of 3% applies to the SDLT rates chargeable on the acquisition of residential dwellings. In the case of companies, this applies to all such purchases. In the case of individuals, subject to certain exceptions, it applies only to the acquisition of a second (or subsequent) dwelling where more than

one dwelling is owned (anywhere in the world) at the end of the day of acquisition. In January 2019, there will be a consultation on whether a further additional 1% supplement should be applied to acquisitions by non-UK residents.

From April 2018, Wales introduced its own version of SDLT (Land Transaction Tax) and separate rates now apply to purchases of property in Wales in a similar way to the Land and Buildings Transaction Tax regime in Scotland that has applied since 1 April 2015.

The SDLT return filing and payment deadlines are to be reduced from 30 days to 14 days, for land transactions from 1 March 2019.

- Corporate non-resident landlords likely to be brought within the corporation tax regime
- Corporation tax rate cut to 17%
- Enhanced capital allowances on energy efficient technology abolished

- Restriction of 100% of interest deductions for individual landlords to the basic rate
- Due date for payment of CGT on residential property gains likely to be accelerated to 30 days from completion

- Public register likely to be introduced recording the beneficial ownership of UK property where it is held by non UK residents

APRIL

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2021

INHERITANCE TAX (IHT)

New rules also apply since April 2017 to charge IHT on UK residential property held in offshore structures. This is a major change for non-domiciliaries, making it more difficult to manage IHT exposure on UK residential property.

In the past, a non-domiciled individual wishing to acquire UK property would typically hold the property via a non-resident company which in turn was held by a trust. The trust's asset was the shares of the non-resident company. This was 'excluded property' and effectively 'exported' the UK property so that it was outside the UK IHT net.

The definition of 'excluded property' was changed from 6 April 2017 so that the shares of an offshore company are not 'excluded' to the extent that the company derives its value from UK residential property. Therefore, the shares will be liable to UK IHT.

Similar rules will apply where UK residential property is owned via offshore partnerships or other vehicles. The new rules apply to all chargeable events (eg a death or a trust 10 year anniversary) from 6 April 2017. No exemption is available for commercially let properties and no incentives are offered to encourage the removal of UK properties from offshore structures. The new rules also mean that loans used to acquire UK residential property, or assets used as security or guarantees for such loans, may also be treated as UK assets which are liable to IHT for the lender.

REVALUATION OF GAINS

As shown above, UK properties may need to be valued at 5 April 2015 to calculate the NRCGT. Further valuations may be needed at 6 April

2017 for non-UK properties and other assets owned by non-domiciliaries who are long-term residents of the UK. Further valuations may also be necessary at 1 April 2019 in respect of UK properties and shares in companies holding UK properties owned by non residents for the purpose of the proposed charges for property rich companies.

Non-domiciled individuals who had already been resident in the UK in at least 15 tax years on 6 April 2017, were deemed UK-domiciled from that date for all taxes.

Capital gains made on the disposal of offshore assets will then be liable to CGT. However, in some cases, the pre-6 April 2017 proportion of the gain will not be taxable. To achieve this, assets held personally outside the UK will be revalued for CGT purposes as if they were acquired on 6 April 2017, effectively exempting earlier gains.

Assets held within overseas structures such as trusts or companies will not benefit from rebasing but in some cases may be rebased in April 2019 under the proposed charges for property rich companies.

CAPITAL GAINS TAX PAID BY INDIVIDUALS

Tax payable by individuals on gains arising on the disposal of UK property is typically due by 31 January following the tax year. In some cases, for example a property sold on 6 April, this can mean a delay of over 21 months before the tax payable on a property disposal becomes due for payment. Subject to consultation, it is proposed that capital gains tax due on the disposal of residential property will become payable 30 days after the date of completion for disposals on or after 6 April 2020.

ANNUAL TAX ON ENVELOPED DWELLINGS (ATED)

Since April 2013, ATED has applied an annual tax charge on 'enveloped' UK residential properties held by non-natural persons, typically where the property is held within a non-resident company (although a corporate partner in a partnership or LLP, or a collective investment vehicle such as a unit trust is also caught). ATED does not apply to properties held directly by individuals or trustees, or which are commercially let. There are other reliefs for employee - or partner - occupied properties, social housing, farmhouses, and dwellings open to the public.

Originally, ATED applied only to properties valued at £2m or more on 1 April 2012. Property valuations for this purpose were rebased on 1 April 2017. The threshold was reduced to £1m from April 2015 and to £500,000 from April 2016. The annual tax charge is £3,600 for a property worth between £500,000 and £1m, rising to £226,950 for a property valued at over £20m.

ATED-related CGT is charged on the rise in value from 1 April 2013 (or later acquisition date) to disposal, subject to time-apportionment for periods where ATED is either not chargeable, or a relief is available. Alternatively, the charge may be based on the full gain, with relief for days when ATED does not apply. A tapering relief may be given where a property is disposed of for a consideration marginally over the chargeable level. There is no indexation allowance for ATED-related CGT. An ATED-related CGT return must be filed and tax paid by the usual self-assessment filing deadline. ATED related CGT is expected to be abolished for gains accruing from April 2019 on account of the reforms bringing most gains on property within the charge to UK tax.

STRUCTURES AND BUILDINGS ALLOWANCE

A new relief from income tax and corporation tax has been introduced for construction expenditure on commercial buildings that does not represent qualifying plant and machinery or integral features where those buildings are held as capital assets.

This is currently subject to future legislation but applies to expenditure contracted for on or after 29 October 2018 at a rate of 2% per annum on a straight line basis.

As the relief applies for a 50 year period there will be complexity where properties on which the relief has been claimed are bought and sold as the purchaser is likely to inherit the entitlement to relief and the vendor may need to take account of any amount claimed to date in calculating their gain on disposal. Further complexity will arise where expenditure has been incurred in relation to interests in land with a life of less than 50 years such as a lease of less than 50 years duration.

REVERSE CHARGE FOR VAT ON CONSTRUCTION SERVICES

For supplies of construction services made in the UK from 1 October 2019 by a VAT registered business to another VAT registered business, suppliers will be required to issue VAT invoices stating that the service is subject to the reverse charge. The recipient will then be required to charge themselves VAT under the reverse charge mechanism and recover this VAT to the extent that they are eligible to do so.

REGISTER OF BENEFICIAL OWNERSHIP

Various methods already exist for the registration of legal title to land in both England, Wales and Northern Ireland and separately in Scotland. However, it is proposed, albeit currently subject to public consultation, that a register will be established from 2021 which will record the identity of offshore beneficial owners of UK property and those who control them, for example non UK resident companies and their shareholders.

Registration is expected to be enforced through the land registration process for transfers of UK property which take place after the register comes into operation. Existing owners of property will be given a period of time within which they are required to comply, currently expected to be at least a year from the date the register comes into operation. Further obligations will apply to update the register on changes in beneficial ownership, for example, when the shares in an offshore company change hands under a sale or inheritance.

MAKING THE BEST DECISIONS

UK property taxes are complex and can add considerable costs to transactions. Professional advice should be sought to understand the implications of the new rules and how these may affect property investments now and in the future.





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