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Taxation of High-Value Residential Property

There have been significant changes to the taxation of residential property in the UK since 2012, which have potential implications across the globe from acquisition, during the period of ownership and on the eventual disposal.

We have seen the introduction of a new annual tax on high value dwellings held by companies, considerable increases to taxes payable on the acquisition of property and perhaps most significantly, an extension of UK Capital Gains Tax to non-residents on the disposal of UK residential property.

Any potential purchaser or owner of a UK property should now consider the tax implications throughout the life cycle of ownership.

Purchasing a property

Stamp Duty Land Tax (SDLT)

SDLT is paid by the purchaser on acquisition of a property. From March 2014, the way that SDLT is charged was changed from a single rate applied to the full value of a property within a specific band, to a system where the rate gradually increases, as shown below:

Property value	SDLT Rate
Up to £125,000	Zero
The next £125,000 (up to £250,000)	2%
The next £675,000 (up to £925,000)	5%
The next £575,000 (up to £1.5M)	10%
The remaining amount (above £1.5M)	12%

Example: Property is bought for £2.2M	
0% on the first £125,000	£0
2% on the next £125,000	£2,500
5% on the next £675,000	£33,750
10% on the next £575,000	£57,500
12% on the remaining	£84,000
Total	£177,750

However, if the property is acquired by a company at a value exceeding £500,000, 15% SDLT is charged on the value of the property. A range of reliefs is available for SDLT for companies acquiring properties, similar to those available for the ATED charge described below.

Funding – 'Collateral' Loans

Until August 2014 HMRC's view was that using overseas assets as collateral for a commercial loan which is brought to the UK to help fund a UK property, did not give rise to a remittance and in relying on this view, many remittance basis taxpayers had used overseas income and/or capital gains for this purpose.

When HMRC suddenly announced a change of approach, such arrangements gave rise to a deemed remittance of the underlying income and/or capital gains, which would be taxable, unless steps were taken to repay the loans before April 2016.

In addition, the government introduced provisions restricting the extent to which debt can be set against the value of assets for the purposes of UK Inheritance Tax (IHT).

Generally, IHT is charged on the 'net' value of UK assets at 40% (unless exemptions or reliefs apply). Typically, a loan secured on a UK property is deductible from the value of the property to create, the 'net' amount. However, previously the funds did not have to be used in connection with the UK property, so now there are restrictions on the extent to which that debt can be deducted, namely:

- If a foreign domiciled owner borrowed against the property to invest outside the UK or to hold the borrowed money outside the UK, the loan is not deductible
- In all other cases, the loan must be repaid after death from the estate of the deceased, which, in certain cases, may require the sale of the property to settle the loan.

Period of ownership of the property

Annual Tax on Enveloped Dwellings (ATED)

The ATED charge applies primarily to companies, whether UK resident or not, but also applies to partnerships which include a corporate partner and some other more obscure entities. As the vast majority of cases will involve properties held by companies, this memorandum will refer only to companies. Properties held personally or by trusts are not within the scope of this tax.

The ATED is charged where the property is:

- is a residential property (a 'dwelling') ;
- is situated in the UK ;
- was valued at more than £2million on 1 April 2012, or at acquisition if later for 2013-2014 onwards;
- is owned by a company, or a partnership where one of the partners is a company or by a collective investment vehicle, e.g. a unit trust.

The rates of charge are as follows:

Property value	Annual charge (2014/15)	Annual charge (2015/16)
Over £1m up to £2m	N/A	£7,000
Over £2m up to £5m	£15,400	£23,350
Over £5m up to £10m	£35,900	£54,450
Over £10m up to £20m	£71,850	£109,050
Over £20m	£143,750	£218,200

From 2016-17, there will be an additional band of £500,001 to £1M for which charging rates have yet to be announced.

HMRC has introduced a 'pre-banding' service to confirm into which of the above categories the property falls, where the company's own valuation is within 10% of the threshold.

Significant reliefs apply for businesses carrying out genuine commercial activity and the following would be relieved from the ATED:

- Property rental businesses
- Property development businesses
- Property trading businesses
- Properties which are run as a business – properties open to the public as a venue, or to provide accommodation or other services
- Properties held to provide employee accommodation
- Charities
- Farmhouses
- Certain other diplomatic, publically owned properties, or property conditionally exempt from IHT.

The company is required to complete and submit an annual return. Companies wishing to claim one of the above reliefs will need to submit a 'nil-charge' return. A separate return will be required for each property for which the ATED is to be paid.

Returns

An ATED return period runs from 1 April and lasts for one year.

For periods commencing from 1 April 2014, the return and the payment are due by 30 April in the return period (i.e. 30 days into the period).

However, for the 2015-16 chargeable period, returns for properties falling in the new £1M to £2M band are due by 1 October 2015 and payment by 31 October 2015 instead of the usual 30 April filing date.

Where a residence is purchased by a company during the course of a return period, the charge is time apportioned and the necessary return and payment are due within 30 days of the purchase date, or 90 days where the dwelling is one which is newly built. The 30 day period is particularly short so care should be taken as there is a penalty regime for late ATED returns similar to that in place for self-assessment tax returns.

Selling property

Capital Gains Tax (CGT) on Companies

All companies, wherever resident, disposing of UK residential property for more than £2 million are subject to an 'ATED related' CGT charge. From 6 April 2015 disposals of properties over £1M are chargeable and from 6 April 2016, the threshold drops to £500,000.

The legislation attempts to align the ATED, SDLT and CGT rules, with the result that similar reliefs will apply for CGT and the charge will not apply for properties held by individuals, trust or qualifying partnerships.

ATED related CGT is charged at the rate of 28% on gains accruing on or after the date that the property falls or fell into the ATED regime, effectively enabling tax-free rebasing of allowable cost to Market Value at that date.

As the property is owned by a company, Principal Private Residence Relief will not be available. For UK companies, corporation tax is charged on gains not within the ATED regime. Losses are available to offset against gains of the same kind in the same year and unused losses may be carried forward and used similarly.

Offshore companies controlled by five or fewer people are charged non-resident capital gains tax at a rate of 20% on gains not within the ATED regime. This is only relevant, however, for the period of ownership falling after 5 April 2015.

ATED related CGT is payable on the 31 January following the end of the tax year of disposal.

Non Resident Capital Gains Tax

From 6 April 2015, disposals of UK residential property by non-resident persons are chargeable to Non-resident Capital Gains Tax (NRCGT). Non-resident persons include individuals, trusts and companies controlled by five or fewer individuals. Partnerships are taxed through the individual partners. Where companies are also caught under the ATED CGT charge, the ATED takes priority. Unlike for ATED, there is no relief for commercial letting. The rate of tax for non-resident companies is 20% while for individuals the rates are 18% and 28%.

NRCGT returns are due 30 days after completion of sale of the property and the NRCGT payable by the seller the same day. If the individual is required to submit a self-assessment tax return, the disposal must also be included on that return.

The charge only applies to periods after 5 April 2015 so a valuation would need to be sought for that date. If a smaller gain is calculated by using an earlier acquisition date, an election can be made to calculate the gain using the usual method. Any losses arising from this election are ring-fenced and can only be used against future gains on residential property by that individual.

The annual exemption for CGT is allowable against the gain and Principal Private Residence Relief for tax years in which the property was occupied for at least 90 nights is also available.

What now?

For existing arrangements, there is no single answer for all structures and each individual situation will need to be considered on its own unique set of circumstances and the costs involved in maintaining against dismantling the structure.

When considering issues related to the ATED, the alignment of the rules for the three taxes provides simplification. The exclusion of Trusts from many of the provisions, coupled with the extension of reliefs to property rental and other businesses, enables scope for continued planning possibilities and in many cases no action is required.

An area where there may be cause for concern is where the property held by a company is occupied by the beneficial owner or their family, even where rent is paid on commercial terms, as reliefs will not apply in these circumstances.

Often, UK properties were held through an overseas company as a means of mitigating exposure to UK IHT. However, following announcement in the 2015 summer budget, the government has proposed that from April 2017, it intends to bring all UK residential property held directly or indirectly by foreign domiciled persons into charge for IHT purposes, even when the property is owned through an indirect structure such as an offshore company or partnership. HMRC intends to consult on the administration of implementing this arrangement and on its impact on the ATED legislation and the other charges outlined above.

With the extension of capital gains tax to residential property for non-resident individuals and companies, further taxation issues arise with residential property ownership. This new development brings an extra layer to planning as it impacts and interacts with the same issues and conditions that give rise to the ATED when holding property.

The changes outlined above, coupled with the impending changes to the UK taxation of non-UK domiciliaries announced in July 2015, that are due to come into force from April 2017, give property owners a chance to re-assess their situation and their requirements.

For more information, please contact your normal member of the Jeffcote Donnison LLP team or:

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