THE NEW CAPITAL GAINS TAX CHARGE FOR NON-RESIDENTS DISPOSING OF UK RESIDENTIAL PROPERTY

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In this podcast Daniel Ugur discusses the outcome of the consultation and the new rules.

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Transcript

I am talking about the new CGT changes that are going to apply to non-residents in respect of residential property. These rules are going to apply from 6 April 2015, so this is in respect of disposals from this date. An important thing to bear in mind in respect of disposals of property is this generally will be the date of the contract so, if you have clients who can try and exchange prior to this date, then the current rules will apply.

Touching on what the current rules are because there has been a departure from these; a non-resident is not liable, as it currently stands, to capital gains tax on a disposal of any UK asset including UK residential property. Draft legislation has been published and this has been after a consultation process. We do not expect the rules to change markedly; there may be some small changes but the substance is likely to stay the same.

I am going to cover today:

1. to whom do the rules apply?
2. what do the rules cover?
3. how the gain is calculated and reported;
4. the application of principal private residence relief; and
5. a summary of the position and maybe what next steps will be.

Firstly, to whom do the rules apply? The rules will apply to the following non-residents: individuals, non-resident trustees and non-resident companies. In respect of individuals, the capital gains tax rate will be the rates that are currently applying in the UK which is either 18% or 28%. This is the top slice of income so if you have a non-resident with no taxable UK source income their gain will be split between the 18% rate and a 28% rate. Trustees will have a top rate of tax, which is 28%, and companies will have a rate of 20% so there is a variation between different tax rates which may dictate which structure is used to hold residential property.

In respect of the companies, I would add that the rules only apply to closely held companies. They are very long-winded rules as to what a closely held company is, but, generally, this is one which has five or few participators or shareholders. So this makes sure that widely held companies or listed companies will fall outside of these rules. There are certain non-UK resident entities or arrangements which will not be covered and these include funds which are widely marketed, so this would not include a privately held family fund. Pensions and real estate investment trusts are also excluded.

It is also important to note that a non-resident company at the moment may fall within ATED (the Annual Tax on Enveloped Dwellings) and, as a result of that, the company may have an ATED-related gain which is subject to CGT at 28%. If that is the case then that ATED-related gain takes precedence so it will be taxed at 28% not 20%.

What do the rules cover? The rules are covering residential property and this includes any property which is suitable for or is used as a dwelling. So, this includes property that is already available as a dwelling, or could be used as a dwelling, and obviously it covers anything that is going to be constructed for use as a dwelling. What is quite interesting is that the contract for purchase of off plan property has been expressly included. I think all in this room know that a lot of clients outside the UK like to buy off-plan property. I do a lot of work in Asia and that seems to be the asset of choice. So what is quite interesting is when we come to planning, a lot of the time clients have already made a decision to buy, but they have not yet decided what their structure is going to be. So commonly we will talk about including assignment provisions in the contract so that you can assign the contract to a different entity. These new rules are going to attribute a CGT charge to non-resident in this circumstance.Something that we are going to have to be careful of; is will that assignment create a disposal which will then be subject to CGT? This is going to be relevant to those off-plan purchases and equally those off-plan purchases where people are just buying it as an investment and may be looking to sell it prior to completion to a third party.

There are some differences to the ATED rules. There are exemptions in the ATED rules for property which is let out and there is a threshold amount. What is important with these new capital gains tax rules is there are no exemptions. So a non-resident company holding a property which is for commercial use and let out would fall outside of ATED but they are going to fall into these rules, so there is no exemption. Whatever the use of the property, the non-resident is going to be liable to capital gains tax, and equally there is no threshold amount. For ATED the threshold currently is £2 million which is dropping to £1 million. Again, whatever the gain and whatever the disposal price, it is going to fall within these new rules.

There are some exemptions and this is for properties used for communal use. How relevant will this be to our clients? I think this is very probably going to be on a case by case basis. So things which are not covered are boarding schools, nursing homes and purpose-built student lets. The definition of student lets is it has to have at least 15 bedrooms and it has to be occupied by students for at least half a year so that is purposefully covering those purpose-built units, not a house that has been converted to allow students to live in it.

How is the gain calculated and reported? The default position, and this is a positive for the clients, is that it is only the gain from 6 April 2015. So the rules are not being backdated in that sense. It would probably be worth all non-resident clients who hold UK property to get a valuation as at 6 April to ensure they know what their base cost is. There are other ways of calculating the gain and this can be done on a time-apportionment basis and the other alternative option is that you can calculate your gain over the entire period. I think, on balance, it is probably going to be the market value at 6 April 2015 which will give the client the best position on their liability. As I say, I think a point to take away is definitely to start getting valuations of properties as of that date. The advantage is that the route by which the client calculates their gain does not need to be decided until they report their gain So at that point you look at each of the scenarios, do the calculations and report it on your best case position.

Losses can be used, so if you have a client who has a number of properties they can offset their losses. If they remain non-resident they can only offset the losses against other UK residential property gains. If the client subsequently becomes a UK resident, those losses can then be used in a wider class against all their gains.

The process by which the gains are reported is one aspect which is yet to be clarified. There is no guidance on this aspect yet but, pursuant to the consultation, the indication is that if the non-resident individual is already registered with the Revenue they need to report the gain within 30 days of disposal, but they do not need to pay the tax until they do their necessary self-assessment tax return. The flip side is if the client is not registered with the Revenue they need to report and pay the tax within 30 days of disposal. So from a cash flow perspective there is merit to registering with the Revenue.

As a result of the extension of the capital gains tax rules to apply to non-residents, the Revenue has allowed for the application of principal private residence relief. Just to recap, if principal private residence relief applies then that part of the gain is exempt from capital gains tax. So how does this apply to a non-resident? The non-resident individual has to have spent 90 days at the property in a tax year for the rules to apply to that specific tax year. In respect of the 90 day rule, there is a slight ambiguity as to what this actually means. The rules state that the individual has to be present at the property at the end of the day and if you have read the various articles that have been published on these rules there is a lot of discussion as to what 'presence' actually means. Do they physically have to be present at the property at midnight or is it just a concept of presence i.e. they will be the property at some point? My personal view is that the Revenue would take a slightly relaxed view on this because the other point is evidentially how are you going to evidence that you are physically present at the property at midnight? We will have a better understanding as and when some more guidance comes out in respect of the rules.

Occupation by spouses will add to your 90 days but you cannot have double counting. So if you had a client who has a spouse in a property for a number of days, and then leaves, and then the client goes there, you can add those days together. If both husband and wife are in the property at the same time that will only count as one day. If the client has a number of UK properties, their days spent in each of those properties can be aggregated together. I think in reality this is probably a rare scenario, but it is important to know that if they do have, for example, a country property and a town property that time spent in both can add to the 90 days.

An important point to note is, although these rules are coming in from 6 April 2015, the rules do state that periods of occupation prior to this date can be allowed. So if you had a client who currently owns a property and, for example, has spent 90 days in that property in a previous tax year that will ensure that you satisfy PPR. The advantage of this is that if PPR applies for one year, the last 18 months of ownership automatically qualify. So if you have a client who in tax year 2012/2013 did spend 90 days, that also means that the last 18 months of the period of ownership will qualify for PPR, so you are getting a better benefit of the relief. PPR does not need to be claimed until you report the gain so there is no advance action that needs to be taken. The review and the action and determination will be done as and when the property is sold.

The big question is where does that leave us now?. When ATED was introduced there was a big move away from corporate ownership. So the question with these CGT rules is there going to be a flip back to corporate ownership of residential property. I think personally there is no set answer to this. It is very much going to be determined by what the property is being used for. Is it being used personally? Is it corporate let? Is borrowing being used?

I think if you look very briefly at the sort of scenarios that arise, if you have a non-resident who is buying a property purely from an investment perspective; that they want to commercially let out, I think, and as was the case before, it is going to probably be a corporate ownership. Yes, they will suffer 20% capital gains tax when they sell it, but that is not the end of the world. I was in Hong Kong last week speaking to clients about this and a lot of the clients' main concern was investment return; what is the net investment return? So, yes, the CGT rules are going to reduce their net return, but the question is are they still making more money than sticking it in the bank account? I think it very much depends on what the purpose is, which will determine what the structure is.

If you are looking at non-residents who are going to use the property personally, I think you are still probably going to look to personal ownership. That is only because the ATED rules with the charges increasing make corporate ownership expensive, With personal ownership you have the ability as a non-resident to claim PPR. Yes, as I state in the slides, PPR is a good relief but equally the fact that you have to be there for 90 days may impact on your non-residence status. You may inadvertently become a UK resident so that is something to be wary of in respect of managing your day counting.

Funds are quite interesting now because, again, if you have non-resident clients who are purely interested in investing in UK property from an investment perspective, i.e. they do not want the bricks and mortar, then funds are a tax-efficient way of doing it. I was speaking to a developer out in Asia and they were saying they have already had quite a lot of questions from clients saying why would they we want to buy the physical property when they have stamp duty and now have the CGT issues. These new CGT rules do not apply to certain funds. There are reasons why clients physically want to invest in the asset, perhaps because they may be coming from jurisdictions where they consider the UK as a safe haven.

In summary, I do not think these CGT rules will drastically change why clients buy UK property. It is important from a structuring angle to be aware of them, but in respect of capital gains tax, it is a tax on profit. So you have to be making money before you get taxed. Yes, it is a departure from what the existing rules are, but it is not the end of the world and, depending on the taxpayer's rate, the top rate is 28%.

This is a transcript of a talk given by Daniel Ugur at the Private Capital Breakfast Seminar on Tuesday 27 January 2015

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