

Capital gains tax for non-residents disposing of UK residential property: Final Rules

Legal Alert

May 2015

The United Kingdom (UK) Finance Act 2015 received Royal Assent on 26 March 2015. This included final legislation for the introduction of a capital gains tax (CGT) charge on non-residents who dispose of UK residential property. The new charge applies to such disposals made on or after 6 April 2015.

In this note, we outline the Government's new rules for the taxation of "NRCGT gains" made by non-residents disposing of UK residential property and consider potential issues and planning considerations arising from the new tax.

Summary of new CGT rules

- The new CGT charge on a disposal of a UK residential property interest by a non-resident (a "non-resident CGT disposal") focuses on "property used or suitable for use as a dwelling" (or in the process of being adapted or constructed for such use). Unlike the ATED-related CGT charge applicable to properties subject to the Annual Tax on Enveloped Dwellings (ATED), it includes residential property used for letting purposes.
- There are exclusions for certain types of property in communal use, e.g. boarding schools, residential accommodation for members of the Armed Forces, residential homes for children, nursing homes and certain types of student accommodation.
- All residential properties within the definition are potentially within scope, regardless of their value. This distinguishes the new charge from the ATED-related CGT charge, which limits the charge to properties for which the consideration for disposal exceeds a specified "threshold amount". This decreased from £2 million to £1 million with effect from 6 April 2015 for gains accruing after that date.
- The charge applies to "NRCGT gains" made by individuals, trustees and closely held non-resident companies and funds that are not widely marketed. Companies that are



not closely-held and funds that are widely marketed are not caught and neither are most institutional investors.

- Principal private residence relief (PPR) is available in appropriate circumstances. However, there is a new rule for PPR, applicable both to non-UK residents in relation to residential property in the UK and UK residents in relation to property overseas.
- Broadly, PPR is not available for a tax year unless either:
 - the person making the disposal (or their spouse or civil partner) was tax resident in the country where the property is located for that tax year; or
 - the person (or their spouse or civil partner) spent at least 90 days in that property in that tax year – the “day-count test”. If a person (or their spouse or civil partner) has more than one property in a country in which they are not tax resident, he or she may aggregate the number of days spent in any of those properties in the relevant tax year in order to meet the day count test. One of those properties may then be nominated for PPR.
- Under the new CGT charge, the rates for individuals are either 18% or 28% according to their status as basic or higher/additional rate taxpayers respectively. The rate for trustees is 28%.
- The rate for companies within the charge is 20%, mirroring that for UK resident companies.
- Under the new rules, there is a mechanism for declaring “NRCGT losses” and offsetting them against gains from the sale of UK residential property, where appropriate. Limited indexation allowance and “pooling” arrangements are available to non-resident companies and groups.
- A reporting and payment regime is being introduced with a deadline of 30 days for reporting the disposal using an NRCGT return and, for persons who do not otherwise complete a tax return, also to make payment.
- ATED-related CGT continues to apply, where relevant, and the rate continues to be 28%. Where both CGT charges potentially apply, ATED-related CGT will take precedence, and any remaining gains will be taxed under the new rules.
- The new rules do not apply to gains relating to periods before 6 April 2015. Taxpayers have three options, as follows:
 - rebase to 6 April 2015 (in which case, any post-6 April 2013 gain may be liable to ATED-related CGT, if relevant for that period);
 - time apportionment of the gain unless the property is also subject to ATED-related CGT;
 - elect to compute the gain or loss over the entire period of ownership, mirroring the option under ATED-related CGT.

New CGT rules in detail

The Government reviewed and took into consideration the responses it received to the consultations on the original proposals and the subsequent draft legislation published in December 2014. As a result, it has made a number of changes to the original proposals.

What is in scope of the new charge?

The new CGT charge on non-residents is focussed on “property used or suitable for use as a dwelling”, i.e. a place that currently is, or has the potential to be, used as a residence. This includes property in the process of being constructed or adapted for such use, in line with the definition in the Stamp Duty Land Tax (SDLT), ATED and ATED-related CGT regimes. Disposals of building land are outside the scope of the charge, until a residential building is under construction.

A disposal of rights to acquire a UK residential property “off plan” before construction is treated as if it was a disposal of an interest in a completed property.

Residential property used for letting purposes is included in the charge, as would be the case for UK residents. In this way it differs from the ATED-related CGT charge which (among others) provides a relief for property let to third parties on a commercial basis.

There are exclusions for residential property with a communal use, such as boarding schools, residential accommodation for members of the Armed Forces, residential homes for children, nursing homes, etc. Purpose built (including converted) residential accommodation for students (including halls of residence, flats etc) with at least 15 bedrooms is excluded from the new CGT charge on non-residents provided it is occupied by students on more than half the days in the tax year. However, smaller establishments, such as family homes converted or otherwise let out to students are within the scope of the new charge.

Who is in scope of the new charge?

- **Individuals** – non-UK resident individuals who own and dispose of UK residential property directly are liable to the new CGT charge.
- **Partnerships** – although partnerships are to remain tax transparent, the new CGT charge applies to disposals of UK residential property made by non-resident partners within the new CGT regime to the extent that gains are attributable to them, as is currently the case for UK resident partners.

- **Trustees** – non-UK resident trustees are subject to CGT on post-5 April gains made on disposals of UK residential property. The new CGT charge takes precedence over existing CGT anti-avoidance provisions that seek to attribute trust gains to settlors and/or beneficiaries of non-resident trusts to the extent that such gains are NRCGT gains arising on a non-resident CGT disposal.
- **Non-resident companies** – the new charge applies to gains made on disposals of UK residential property by closely held non-resident companies.

“Closely held company” test

A “closely held company” test has been introduced to limit the scope of the new charge to non-resident companies that are the private investment vehicles of individuals, families or small groups of individuals or families. This should ensure that the extension of CGT will not apply to disposals of UK property made by widely held or listed companies.

A “closely-held company” is defined in the legislation as one which is under the control of five or fewer participators, or one in which five or fewer participators together possess or are entitled to acquire, in appropriate circumstances, rights to the greater part of the company’s assets on a winding up.

The legislation provides for a number of situations in which companies which otherwise would be regarded as closely-held are not to be so regarded. Amongst others, these include where it is only possible to do so by including as a participator a company which is itself a diversely-held company or “qualifying institutional investor” (QII).

A QII is a widely-marketed unit trust or open-ended investment company, the trustee or manager of a qualifying pension scheme, a company carrying on life assurance business or a person that is not liable to tax on grounds of sovereign immunity.

The definition of a QII may be amended by HM Treasury by regulations.

For protected cell companies, the test is applied to each cell or division of the company, rather than just at the level of the company.

Anti-avoidance provisions are also included to prevent arrangements which manipulate the control of a company at the time of a relevant disposal.

ATED-related CGT

Despite many responses to the initial consultation suggesting that ATED-related CGT would effectively be redundant once the new CGT charge on non-UK residents was introduced and that it should be scrapped in favour of the new charge, the UK Government decided that the two charges target different issues and has retained the ATED-related CGT charge. It continues to apply at 28% rather than 20%, the rate applicable to companies under the new CGT charge.

To the extent a gain is ATED-related, ATED-related CGT applies in preference to the new charge. If any part of a gain post-6 April 2015 is not within ATED-related CGT (perhaps because the property was rented out for a period) that part of the gain will be potentially subject to the new CGT charge on non-residents.

Interaction with anti-avoidance provisions

Like the ATED-related CGT charge, the new CGT charge takes precedence over existing anti-avoidance provisions that attribute gains to UK resident members of non-resident companies.

Who is out of scope?

Persons that are classed as “eligible persons” for the purpose of the new rules will be able to make a claim not to be chargeable to CGT on NRCGT gains. These include the following:

- A diversely-held company (i.e. one which does not fall within the meaning of a closely-held company);
- A widely-marketed unit trust scheme, open-ended investment company (OEIC) or foreign equivalent to an OEIC;

Widely-marketed scheme – a “widely-marketed scheme” is one which meets three conditions, as follows:

- The scheme produces documents, available to both HMRC and investors which specify the intended categories of investor, and undertakes that the scheme will be widely available and marketed accordingly;
- The specification of categories of investor, or any other terms or conditions of investment does not have a limiting or deterrent effect; and

- the units in the scheme are marketed and made available sufficiently widely to reach the intended categories of investor and in such a way as to attract the relevant categories of investor, and a potential investor within the relevant categories is able to obtain information about the scheme and acquire units in it.

- A scheme is not regarded as failing to meet this condition because it has no capacity to receive additional investments, unless its capacity to do so is fixed by the scheme documents and a pre-determined number of specific persons or groups of connected persons make investments which exhaust all, or substantially all, of the investment capacity.
- A unit trust scheme or OEIC (or foreign equivalent) with a “qualifying investor”; or
- A company carrying on life assurance business where the UK land being disposed of was held for the purposes of providing benefits to its policy holders

Principal Private Residence Relief

Under the rules prior to 6 April 2015, PPR (principal private residence relief) was available where a property was an individual’s main residence (this included trust beneficiaries in appropriate circumstances).

The Government was concerned that, under the then existing terms of the relief, non-residents would have been able to make an election for their UK property to be their main residence for the purposes of PPR, and thereby avoid a CGT charge. Accordingly, to avoid this, a new rule has been introduced for properties located in a jurisdiction in which the individual is not tax resident.

This applies both to non-UK residents disposing of UK residential property and UK residents disposing of properties located outside the UK.

Under this rule, a residence is not eligible for PPR for a tax year unless:

- the person making the disposal, or their spouse or civil partner, is tax resident in the country where the property is located for that tax year; or
- the person, or their spouse or civil partner, spends at least 90 days in that property in that tax year – the “day count test”. If a person (or their spouse or civil partner) has an interest in more than one property in a country in which they are not tax resident, he or she may aggregate the number



of days spent in any of those properties (or “qualifying houses”) in the relevant tax year in order to meet the day count test. One of those properties may then be nominated for PPR.

A nomination of a property by a non-UK resident individual is not effective unless the individual meets the day count test for that tax year. If the day count test is not met the person is regarded as absent from the property for that tax year.

A day counts as a day spent by an individual (whether the person seeking to claim PPR or their spouse or civil partner) in a qualifying house for the purposes of the test if either the individual is present in the house at the end of the day (i.e. midnight), or is present for some part of the day and the next day has stayed overnight in the house. The second alternative avoids the requirement for presence in the property at exactly midnight which was a concern raised about earlier proposals.

Whilst occupation of a residence by one spouse or civil partner counts as occupation by the other, double-counting of days is not permitted.

PPR is available to trusts where a beneficiary meets the relevant criteria for residence or the day count test. This applies to both UK resident and non-resident trusts.

Subsidiary features of PPR, such as absence relief, lettings relief and final period relief, continue to be relevant. A transitional rule has been introduced in relation to absence relief for disposals by non-UK residents. Under this, if a period of absence began prior to 6 April 2015, that prior period of absence is deducted from the amount of absence available for periods after 6 April 2015.

For non-residents, a notice to treat a residence as their only or main residence is to be made at the time of disposal in the NRCGT return.

Tax rates

The rates of tax for the new CGT charge on non-residents are the same for non-UK resident individuals as for UK residents who pay CGT at their marginal rate of income tax.

So for taxpayers paying at basic rate, the rate is 18% and for those liable at higher/additional rate, it is 28%. For non-residents, the rate depends on their total UK income and gains. The annual exempt amount for gains (£11,100 for tax year 2015/16) is also available to non-residents.

For trustees, the rate is 28% and the annual exempt amount is available at half the rate for individuals.

The tax rate for companies is 20%, mirroring the rate paid by UK resident companies. Non-resident companies also have access to limited indexation allowance and group companies can enter into “pooling” arrangements to aggregate gains and losses on UK residential property across a group. There is a “de-pooling charge” for companies that leave a pooling arrangement.

Calculation of gains

The new rules do not apply to gains relating to periods prior to 6 April 2015. There are three options available, as follows:

- the default option is rebasing to market value as at 6 April 2015 (in which case, any post-6 April 2013 gain may be liable to ATED-related CGT, if relevant for that period);
- time apportionment of the gain is available unless the property is also subject to ATED-related CGT;
- taxpayers may also elect to compute the gain or loss over the entire period of ownership. This mirrors the position under ATED-related CGT.

With regard to changes in use, where there are consecutive changes in use, straight line time apportionment applies. For concurrent mixed use of property, the legislation provides for “a just and reasonable apportionment” to be made, which will be dependent on the facts of each individual case.

Losses

Losses on disposals of UK residential property are ring-fenced for use against gains on such properties arising to the same non-UK resident in the same tax year, or carried forward to later years.

If a person's residence status changes from non-UK resident to UK resident, unused UK residential property losses are transferable and available to be used as general losses against other chargeable gains.

Where a UK resident becomes a non-UK resident, he or she may transfer unused losses relating to UK residential property so that they are available to set against future UK residential property gains.

Reporting and payment

A non-UK resident disposing of UK residential property must file an “NRCGT return” with HMRC within 30 days of completion of the disposal to which the return relates. A single return is required where two or more disposals are made on the same day.

Generally, an NRCGT return must include an “advance self-assessment” of the amount that is notionally chargeable for the tax year, or additional amount if a previous NRCGT return for the year has been made. Payment of any tax due will be required on or before the relevant filing date.

However, such an assessment will not be required where the person is required to make a self-assessment return for the tax year in which the disposal takes place, or the previous year, or if they have made an ATED return for the previous period (i.e. the period up to the preceding 31 March).

A taxpayer may amend an NRCGT return within 12 months following the normal self-assessment filing date for the tax year in which the disposal is made.

An NRCGT return and, in appropriate cases a self-assessment return, will need to be filed where there is a loss, or no gain, or if any gains are made that are covered by the applicable annual exempt amount. A PPR nomination will also be made by way of the NRCGT return.

Planning considerations

- For UK residents disposing of UK residential property (and other assets), CGT has always been an issue and since the introduction of the ATED-related CGT charge it has also become a consideration for non-residents disposing of such property, albeit until now limited to companies and certain other non-natural persons.
- With the introduction of the new wider CGT charge for non-residents with effect from 6 April 2015, it is now much harder for non-resident individuals, trustees or closely-held entities to avoid a potential CGT charge on a disposal of UK residential property, except where such property may qualify as the main residence of an individual for the purposes of PPR.
- The new PPR rules mean that some non-residents may find it difficult to claim PPR in respect of a tax year without becoming UK tax resident for that tax year. This is because of the requirement to spend at least 90 days in their UK property or properties in a tax year in order to make the claim.
- Depending upon the application of the statutory residence test to an individual's circumstances, some individuals may be able to spend this length of time in the UK and remain non-resident under the test whilst doing so. Furthermore, where an individual has a spouse or civil partner who may spend different periods of time in their UK properties over the course of a year, it may not be necessary for the individual to spend the entire 90 days in their UK properties

themselves. However, care will still need to be taken in respect of counting days and ties with the UK.

- Where this may be an issue, it will be important for an individual to ensure they spend sufficient days in a home overseas to avoid becoming automatically UK resident under the relevant automatic residence test.
- If a property is likely to qualify for PPR under the new rules, this may make it preferable for an individual (or trustees) to hold it directly rather than via a company. On an acquisition of a property directly by an individual or trustees, SDLT will be at standard residential rates. ATED will not be an issue. However, the property will be within the IHT net unless other forms of IHT mitigation are put in place.
- Lower value properties may fall within a couple's joint nil rate bands (currently £325,000 each or £650,000 jointly). If there are no other significant UK assets to consider, no additional IHT planning may be necessary and such a property could be held directly unless there are other considerations. SDLT on an acquisition of a property within this range is also likely to be lower under the new rules.
- For IHT mitigation purposes, a property may be purchased with a mortgage to reduce its value in a non-domiciled individual's estate. Legislation introduced in 2013, which restricts the deductibility of liabilities for IHT purposes in certain circumstances, may limit the effectiveness of such a strategy where it applies. However, in such circumstances, other options for IHT mitigation, such as insurance, may still be available.
- For an individual wishing to invest in UK residential property generally rather than in any specific property, investing in a diversely held fund or non-resident company investing in property, may be an alternative tax-efficient option.
- For non-UK resident individuals wishing to invest in a specific residential property for business purposes, it will generally be preferable to set up a non-resident company to make the investment because of the lower rate of tax on gains (20%) compared with that for individuals (28%).
- Non-residents may also wish to register with HMRC for self-assessment in order to defer payment of the tax due on disposal until the self-assessment return date (which could be up to 18 months later).
- Whilst there is no requirement in the legislation for a non-resident owner of UK residential property to have it valued as at 6 April 2015, it may be sensible to consider doing so, in order to establish a base cost for tax purposes for a future disposal.

Conclusion

Subject to the application of a relief where available, the new CGT charge for non-residents disposing of UK residential property after 5 April 2015, catches gains on disposals of UK residential property of any value by individuals and most other closely-held entities not within the scope of ATED – related CGT.

The overall tax costs of holding a UK residential property for private use through a corporate envelope continues to be greater than doing so directly to the extent that higher rate SDLT, ATED and (at least for individuals taxable at 18% under the new CGT charge) ATED-related CGT may apply to an enveloped property.

However, the distinction between the respective tax costs of acquiring and owning high-value residential property through a company rather than directly has been reduced with the **increase in the top rates of residential SDLT since December 2014**.

While higher rate SDLT for properties over £500,000 acquired for private use through companies and certain other entities applies at 15% for the whole of the purchase price, at the higher end of the property market, even standard rates of SDLT are likely to result in a significant SDLT charge.

The fact that CGT potentially applies at rates of up to 28% to post-5 April 2015 gains on any disposal of UK residential property by a non-resident individual or trustee may further tip the balance back towards a corporate holding structure where there are other advantages to such a structure.

These might include the inheritance tax advantages of holding a property through an offshore company, possible privacy reasons and practical advantages, such as avoiding probate on the death of a property owner. Of course, careful consideration of all the relevant circumstances will be required to determine whether this may be the case.

It should also be borne in mind that the **new rates of ATED which came into effect from 1 April 2015**, are a significant increase from the previous rates. Over time, if these annual rates continue to rise significantly, they will begin to reinstate, and possibly widen, the previously substantial differential in tax cost between acquiring and holding residential property directly and through a corporate vehicle.

For more information about this subject,
please contact:

Anthony Thompson

Partner

T: +44 (0)20 7759 6543

E: anthony.thompson@wragge-law.com

Catharine Bell

Partner

T: +44 (0)20 7759 6727

E: catharine.bell@wragge-law.com

Nick Jacob

Partner

T: +44 (0)20 7759 6409

E: nick.jacob@wragge-law.com

Daniel Ugur

Partner

T: +44 (0)20 7759 6483

E: daniel.ugur@wragge-law.com

Elliot Weston

Partner

T: +44 (0)20 7759 6722

E: elliot.weston@wragge-law.com

+44 (0)870 903 1000 | www.wragge-law.com