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New Tax Regime for High Value UK Residential Property

With the stated aim of ensuring the "fair taxation of residential property transactions", the UK Government announced in the March 2012 Budget, three measures targeting at discouraging the purchase of high value UK residential property through companies and other "non-natural persons" (**NNPs**).

The first of these measures was an immediate introduction of a new 15% rate of Stamp Duty Land Tax (**SDLT**) on the purchase of any UK residential property worth more than £2 million by an NNP.

The two other proposed measures did not take immediate effect but were subject to a period of consultation:

- the introduction of an Annual Residential Property Tax (ARPT) on UK residential property worth over £2 million and owned by NNPs; and

- the extension of the UK capital gains tax (CGT) regime to cover gains realised by non-resident NNPs disposing of UK residential property worth over £2 million.

The consultation period for these new measures has ended and draft legislation to bring them into effect has now been published.

Who will be affected by these new measures?

The new measures will apply to companies, partnerships and collective investment schemes if the relevant "ownership condition" is met:

- a company meets the ownership condition if it is beneficially entitled to the interest in the property other than as a member of a partnership;

- a partnership meets the ownership condition if a corporate member of the partnership is beneficially entitled to the interest; and

- a collective investment scheme meets the ownership condition if the interest is held for the purposes of the scheme.

Trustees, nominees and personal representatives are not therefore NNPs even if they are corporate entities. An individual cannot be an NNP.

The property in question must be a “dwelling” which is worth more than £2 million on 1 April 2012. The definition of dwelling includes:

- a building which is used or is suitable for use as single residential dwelling – hotels and halls of residence, for example, fall outside this definition;

- land occupied or enjoyed with a dwelling as a garden or grounds; and

- land that “subsists for the benefit of the dwelling”.

Each separate dwelling is assessed individually for the purpose of assessing whether the value exceeds the £2 million threshold. However, if there is an “associated dwelling” (broadly a dwelling in the grounds of the main dwelling which does not have its own direct access to the road) then its value will be aggregated with the value of the main dwelling.

The draft legislation also contains various reliefs to exclude “genuine businesses carrying out genuine commercial activity” from the new measures, which include:

- property rental businesses, where the property is let to a third party on commercial terms (nb this relief will not apply if the property is let to a connected person, even if a full rent is being paid);

- property development businesses, where the property in held in the course of a trade for the purpose of redeveloping and then either reselling or letting on a commercial basis (nb it was originally proposed that this relief would only apply if the trade has been carried on for at least two years but since many new developments are carried out through new special purpose vehicles, this condition has been dropped from the draft legislation);

- property interests exploited in the course of a trade, where a significant part of the interior of the property is opened to the general public on a commercial basis for at least 28 days per year;

- employee accommodation, where the property is held to provide accommodation for employees or partners who own less than 5% of the company or partnership, provided that the company or partnership is carrying on a commercial business;

- farming businesses, where the property is occupied by a genuine farm worker, provided that the NNP is carrying on a farming business and the property forms part of and is of a character appropriate to the land being farmed; and

- charities, where the property is held for charitable purposes.

It is important to stress that these reliefs will not be automatic – the NNP will need to complete an annual return to claim the relief.

The Annual Residential Property Tax

If none of the reliefs above are applicable, then from 1 April 2013, the new ARPT will be charged in any year (which for these purposes runs from 1 April to 31 March) where the conditions set out above are satisfied.

The ARPT charge is geared to the value of the property as follows:

Value of Property on 1 April 2012 (sic)	**Annual Charge**
More than £2m up to £5m	£15,000
More than £5m up to £10m	£35,000
More than £10m up to £20m	£70,000
More than £20m	£140,000

<u>The extension of the CGT regime</u>

The extension of the CGT regime will affect both non-UK resident and UK resident NNPs.

Currently, gains realised by non-UK residents are outside the scope the UK CGT. From 6 April 2013, non-UK resident NNPs will be liable to CGT at a flat rate of 28% on disposals of property subject to the ARPT regime.

The regime will also change for UK resident companies which are currently subject to corporation tax rather than capital gains tax. From 6 April 2013, profits realised on the disposal of property subject to the ARPT regime will instead be liable to CGT at a flat rate of 28%.

This new CGT regime will only tax gains realised by NNPs from 6 April 2013 onwards – in other words, the base cost will be the value of the property as at 6 April 2013 (although there is an option to elect to substitute the original base cost in place of the 6 April 2013 value – this would obviously make sense if the original base cost is higher).

UK resident companies will however still be liable to corporation tax on gains accrued before 6 April 2013. In addition, gains of non-resident NNPs accrued before that date could still be taxable in the UK under existing anti-avoidance rules where, for example, the owners of the NNP are UK resident or where the NNP is held in a trust structure and the settlor is UK resident or UK resident beneficiaries receive benefits from the trust.

The new regime caters for the fact that the property in question may not have been within the ARPT charge for the whole of the relevant period because of the availability of one of the reliefs. If relief has applied for the whole of the relevant period, then the new CGT charge will not apply at all. If the relief applied for part of the relevant period, then the gain is apportioned and it is only the portion of the gain which relates to the period when the relief did not apply that is taxable.

For example, suppose that an offshore company acquired a residential property on 6 April 2010 for £2 million which is worth £3 million on 6 April 2013 and is sold on 5 April 2015 for £4 million. The property was occupied rent-free by a connected person until 5 April 2014 but then let to a third party on a commercial basis until the sale a year later.

The taxable gain on the sale is £1 million (i.e. the difference between the sale price and the value of the property on 6 April 2013). However, relief from ARPT applied for one year out of the two years of ownership between 6 April 2013 until the date of sale. Only one half of the gain - £500,000 – will therefore be liable to CGT.

Where a property is sold for just over £2 million, the gain is tapered to avoid any “cliff edge effect” that would otherwise result in it being more profitable to sell at just under £2 million. The tapering formula is 5/3 x A = B, where A is the amount of the sale proceeds which exceeds £2 million. If B is less than the actual gain arising, B is the figure which is used to calculate the gain.

What to do with existing structures

Provided that one of the reliefs applies and will continue to apply, existing NNP structures can be left in place since they will not be caught by the new tax charges (although the relevant relief must be claimed).

In situations which will otherwise be caught by the new charges, it may be possible to restructure the existing arrangements to avoid these – for example, a property held by an offshore company could be transferred into personal ownership.

However, care must be taken as the restructuring process could itself have adverse UK tax consequences depending on the circumstances. If the ultimate owners of the structure are non-UK resident, it should be possible to collapse an existing structure without triggering an immediate UK tax charge (although if a UK property is taken into an individual’s direct ownership, it will then be exposed to UK inheritance tax which is often the main reason for purchasing the property in a structure in the first place). The position is more complex for UK residents and in many cases it may prove more efficient in the long term to keep an existing structure in place.

Future purchases of high value UK residential property

Again, provided that the property is being acquired for a purpose which will qualify for one of the reliefs, there will be no difficulty in holding the property through an NNP other than the requirement to claim the relief.

For other purposes, personal ownership or ownership through a trust (without an intermediate holding company) are likely to be the best options. The property will be exposed to UK inheritance tax but there are a number of ways in which this exposure can be mitigated.

If you would like advice upon your particular situation, please contact one of our specialist trust and tax lawyers in our Private Client team:

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