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Client Alert

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A Guide to UK Tax on Commercial Real Estate: Non-Residents

1. Introduction

This client alert provides a summary of key UK tax considerations when a non-resident invests into UK commercial real estate. There are a number of holding structures for investment into UK real estate by non-UK tax resident investors. The most commonly used vehicles (companies and limited partnerships) are considered below. While UK tax is not the determinative factor when considering UK real estate investment, it will be important to understand the tax implications for acquiring, holding and disposing of UK commercial real estate prior to its acquisition.

For the purposes of this alert, it is assumed that the real estate will be held as an investment. Profits of a trade carried on by a company are subject to UK tax where the company is dealing in UK land or developing UK land with a view to disposing of that land (as distinct from developing commercial real estate to let it out with an objective to realise it after a fixed period).

There is a special UK tax regime for residential real estate owned by certain non-residents. In these circumstances, specialist UK tax advice, again, will be required.

2. Overview

Investment in UK commercial real estate can be made either directly or indirectly through different investment vehicles. UK tax considerations for the most common investment structures are described below.

3. A UK Company

A UK company is subject to UK corporation tax (currently 20 per cent, reducing to 17 per cent by April 1, 2020) on the net profits arising from any rental income received and on any gains realised on the disposal of commercial real estate assets. Because of UK tax charges on gains, UK tax resident companies are not commonly used by a non-UK tax resident for holding UK commercial real estate. Other main UK tax issues:

- Stamp Duty Land Tax or SDLT (see 6 below) will generally be payable by Buyer on the acquisition of UK commercial real estate;

- there is no UK withholding tax on dividends;

- there is no UK withholding tax on rent paid to a UK resident company;

- there is UK withholding tax on interest at the rate of 20 per cent (although the UK has an extensive double tax treaty network which may reduce this to 0 per cent). The taxation of non-UK resident shareholders will be governed by the legislation of the jurisdiction in which they are resident; and

- UK stamp duty or stamp duty reserve tax is payable at the rate of 0.5 per cent on the sale of shares in a UK company.

4. A Non-UK Company

Non-UK companies (located in low tax jurisdictions, such as the Channel Islands, Cayman Islands or the BVI) are commonly used to hold UK real estate by non-UK residents. There is usually no, or only minimal, local taxes charged in the jurisdiction of incorporation. It will be important to ensure that the company and its board of directors are not UK-based (for example, board decisions must be taken outside the UK) so that the company does not become UK tax resident.

The main UK tax issues are as follows:

- SDLT (see 6 below) will generally be payable on the acquisition of UK commercial real estate;

- UK rental income received by a non-UK company (after deduction of allowable expenses including interest) is subject to UK income tax at the basic rate (currently 20 per cent);

- the person paying the rental income to a non-UK resident landlord can pay without UK tax deduction provided the non-UK company is registered with HM Revenue & Customs (HMRC) as a ‘non-resident landlord’, otherwise a withholding of 20% (currently) is required. The company will remain liable to UK tax on its net rental income;

- non-UK resident companies are exempt from paying UK tax on capital gains made on disposal of UK commercial real estate held as an investment;

- shareholder owners of the non-UK property holding company will not generally be liable to any UK taxes on financial returns they receive from it;

- the non-UK tax treatment of any non-UK resident shareholders will be governed by the legislation of the jurisdiction in which they are resident; and

- it is generally possible to dispose of the shares in a non-UK company without incurring UK stamp duty or stamp duty reserve tax.

Debt can be introduced into the real estate structure, if required. This can be done in a number of ways; for example, by creating an associated lender/borrower non-UK finance company (‘FinCo’)which lends to the non-UK real estate holding company (usually the holding company of the non UK real estate holding company). FinCo would, typically, issue equity which would then be on contributed by means of a mixture of debt and equity. Interest paid on this debt should be deductible in computing the liability to UK tax on rents (the debt should be ‘arm’s length’). Additional structuring may be required to eliminate or mitigate UK withholding taxes on the interest. Provided that the FinCo owns 100% of the shares in the non UK real estate holding company, the use of interest bearing loans in shari’ah compliant real estate structures is very typical.

5. Limited Partnerships/Limited Liability Partnerships/JPUTS

Limited partnerships and other similar entities or arrangements are ‘transparent’ for UK tax purposes, which means that there is no UK tax at the partnership level on any income or gains but there may be on the holders of interests in the same. English, Jersey and Guernsey law governed partnerships are commonly used.

The main UK tax issues are:

- SDLT (see 6 below) will generally be payable on the acquisition of UK commercial real estate;

- if a UK resident general partner is used, it will be subject to UK corporation tax on its share of the partnership profits (such profit share is usually nominal);

- non-UK corporate limited partners will be subject to UK income tax at basic rate (currently 20 per cent) on their share of the partnership’s net income of the partnership;

- non-UK individual limited partners will be subject to UK income tax at the appropriate rates of income tax (currently 0 per cent, 20 per cent, 40 per cent and 45 per cent, the rate depending on the overall level of UK income in any particular tax year);

- non-UK partners will be exempt from UK tax in respect of capital gains on UK commercial real estate;

- the payer of rental income to a non-UK resident landlord can do so without UK tax deduction provided the partners/partnership is registered with HM Revenue & Customs (HMRC) as a ‘non-resident landlord’- they will remain liable to UK tax on net rental income; and

- partners are treated as directly owning their share of the underlying real estate. Where partnership interests are realised, SDLT may be payable on the acquisition of that interest (as it is treated as if the purchaser is buying a proportion of the underlying interest in land) but this analysis may vary for other arrangements and thus advice should be sought.

6. SDLT

SDLT is charged on the acquisition of interests in UK commercial real estate. The SDLT rate depends upon the value of that real estate.

SDLT – Non-residential or mixed

Part of relevant consideration	**Rate**
So much as does not exceed £150,000	0%
So much as exceeds £150,000 but does not exceed £250,000	2%
The remainder	5%

7. Value Added Tax ('VAT')

The UK applies VAT on the supply of certain 'goods and services'. Supplies of UK real estate are, generally, exempt from VAT so that no VAT is charged when it is bought/rented. However, VAT paid in respect of the real estate ('input tax') cannot be recovered, representing additional cost. An owner of UK commercial real estate can make an election to 'opt to tax' that real estate which means that the real estate will be subject to VAT but also that the owner can then recover related input VAT incurred on costs. A UK commercial real estate rental business can be registered for VAT which will, typically, reduce overall VAT costs.

Where services are supplied involving 'offshore' structures, it will be important to determine whether those structures are to be VAT registered (since VAT may not be recoverable where the structures are not VAT registered). An example would be advisory fees charged to an offshore property holding company.

8. Diverted Profits Tax (DPT) and other anti-avoidance legislation

DPT applies to profits which are identified as having been 'diverted' from the UK to a non-UK company. The rate of DPT is 25 per cent, and it is payable in advance, following assessment by HMRC.

Generally, where UK property is held as an investment by a non-UK company, and leased to a wholly unconnected tenant on arm's length terms, it is considered that DPT should not be relevant.

Development properties and cross border connected party leasing structures may be within the scope of DPT and advice should be taken in respect of such transactions.

There are other targeted anti-avoidance rules in the UK tax code aimed at preventing UK residents from investing in UK real estate through off-shore vehicles. These should be taken into account when structuring funds where the fund may have a UK manager.

9. UK Corporation Tax for offshore developers and traders in UK real estate

The UK has extended the scope of UK corporation tax to offshore developers and traders of UK real estate. The disposal of 'development' real estate will be subject to Income Tax rather than CGT where that real estate was purchased, developed/renovated and then disposed of with the intention of making trading profit (as distinct, for example, from developing a commercial building to let it out with an objective of realising the building after a fixed period of time).

If in doubt as to the application of these provisions, then UK tax advice should be sought.

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