UK CAPITAL GAINS TAX FOR NON-UK RESIDENTS

GOVERNMENT TO GO AHEAD WITH PLANS TO IMPOSE CGT ON SALES OF RESIDENTIAL PROPERTY FROM APRIL 2015

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The government has published detailed proposals for imposing a capital gains tax (CGT) charge on non-UK residents who dispose of UK residential property. The new charge will take effect from April 2015 and will apply to all residential property, no matter what its value. As well as affecting private individuals, the new CGT charge will potentially affect non-resident businesses (companies, partnerships with non-UK resident entities and trusts) which hold let residential property (including some developers who build to let). Acknowledging the importance of protecting large scale institutional investment to support housing development in the UK, the proposals outline exceptions for disposals by institutional investors and widely held funds and companies. In addition, the new charge will not apply to traders in UK property or to disposals of most communal residential property such as student accommodation, care homes and boarding schools.

Following its initial announcement at the 2013 Autumn Statement and a consultation period beginning in March 2014, the government has now published its summary of responses to its consultation and its proposed way forward.

KEY POINTS OF THE PROPOSALS:

WHO IS CAUGHT?

As announced by the government in its consultation update of 31 July 2014, to ensure that the new charge is targeted at individuals and companies that are the private investment vehicles of small groups of individuals/families, there will be exclusions from the charge for non-resident institutional investors, widely held funds and widely held companies. To be eligible for this exclusion, the non-resident disposing of the property will have to show either that:

- it is not a 'narrowly controlled company'; or
- in the case of a fund, it meets a 'genuine diversity of ownership' test.

The key features of these two tests are set out below:

Features of the 'narrowly controlled company' and 'genuine diversity of ownership' tests	
Narrowly controlled company	**Genuine diversity of ownership**
based on 'close company' test (control by five or fewer persons) with interests of connected people such as family members aggregated but members of a partnership will not be treated as connected	based on the existing 'genuine diversity of ownership' (GDO) test that exists for Authorised Investment Funds
layers of investment structure will be able to be 'looked through'	the collective investment scheme must meet the GDO test for the shorter of: (i) the period for which the asset has been held; and (ii) at least five years before the disposal.
will exclude any 'qualified institutional investor' such as pension funds, sovereign wealth funds and widely held collective investment schemes from the scope of the new CGT charge	a collective investment scheme which satisfies the GDO should be treated as a 'qualified institutional investor' for the purpose of the 'narrowly controlled company' test
will exclude non-resident companies which can be controlled by five or fewer persons if at least one of those persons is a 'qualified institutional investor'	
partnership structures will be looked through	

We do not yet have draft legislation for these tests and it will be necessary to wait until we do to ascertain whether, for example, a fund, the majority share of which is held by an ultra-high net worth individual, may be caught by the charge. At present, it seems that a disposal of residential property by a Jersey Property Unit Trust with a small number of unit holders would be caught by the new charge.

The government's proposals confirm that non-residents investing into UK residential property through UK REITs will not be affected by the new charge and that foreign REITs will not be subject to the new charge where they are 'equivalent to' UK REITs.

Non-resident partners of partnerships and non-resident trusts will be persons within the scope of the new charge, subject to the other exceptions mentioned in this alert. For non-resident partners (including partners of tax-transparent foreign partnerships), this means that they will be charged to CGT on gains attributable to them subject to any exemption which may be available.

WHAT PROPERTY IS CAUGHT?

- As expected, the new charge will apply to residential property only and there will be an exemption for residential property that is primarily for communal use such as student accommodation, boarding schools and nursing homes. In response to consultation submissions, the government will introduce a new definition of 'purpose built student accommodation' for this exemption. This will include:
    - A building that is purpose built (or converted) for use by students, consists of at least 15 bedrooms (which can be either standalone units or within 'cluster flats' or a mixture) and is occupied for more than 50 per cent of a tax year by students for the purpose of attending a course of study; or
    - Accommodation that is excluded from registration under the Housing Act 2004 as a house in multiple occupation by virtue of being controlled or managed by a higher or further education establishment with the management being in conformity with an approved Code of Practice for the purpose of that exclusion.
- The new charge will not apply to non-resident traders in UK real estate - i.e. those who buy or develop properties to sell. Such traders may already be within the scope of UK income tax or corporation tax.

WHAT ARE THE RATES OF TAX?

Non-resident individuals and trustees will be taxed at 18% or 28% (depending on their level of income/gains) as with CGT for UK resident individuals. Companies which are caught by the charge will be taxed at 20% (being the main rate of corporation tax from 1 April 2015).

DOES THE PRIVATE DWELLING HOUSE EXEMPTION HELP?

Non-resident individuals and trustees (where a beneficiary occupies the property sold) will be able to rely on principal private residence relief (PPR) to exempt the gain although the rules for PPR are changing: where a person has more than one residence, it is currently possible for them to elect which is to be treated as his main residence for the purposes of PPR. To prevent non-residents from avoiding the new charge by electing to treat their UK home as their main residence, a new condition will be introduced within PPR under which an individual cannot elect to treat a home located in a country in which he or she is not resident as his or her main residence unless he or she has spent 90 midnights in that property in the relevant tax year. Meeting the 90 midnights requirement is likely to have implications for the individual under the statutory residence test. The new rules for PPR will also apply to UK resident individuals.

CONVERSIONS/DEVELOPMENTS ETC

The government document published on 27 November also discusses what property counts as residential for the purposes of the charge:

- Property in the process of being constructed or adapted for use as a dwelling will be within the scope;
- Disposals of building land will be outside the scope of the new charge until such time as a residential building is under construction;
- The period of carrying out works to demolish a dwelling or convert it to non-residential use will be regarded as a period of non-residential use, provided that any necessary planning consent for the works has been given and the taxpayer completes the works before completion of the disposal; and

- Where a change of use occurs over a period of ownership, the gain accruing on disposal will be time apportioned to reflect the time that the building was not used for a residential purpose.

INTERACTION WITH OTHER PROVISIONS

- Unlike the SDLT regime, there will be no exemption for disposals of multiple dwellings.
- While there will be no grandfathering to protect non-residents who already own residential property, the charge will only apply to gains accruing after 5 April 2015. This will be achieved via either an election to rebase to 5 April 2015 (the default position) or a time-apportionment of the whole gain made on the disposal.
- For companies subject to the new charge that are within a group, 'pooling' arrangements will be available (and accessed via an election) to offset gains and losses made by different companies. A group for this purpose will be a group of companies that are or would be required under GAAP to consolidate their accounting results. A de-pooling charge will be levied on companies that leave the pooling arrangement to be calculated on the basis of a deemed disposal of all UK residential property held by that company when it leaves the arrangement.
- There is potential for overlap between this new charge and the CGT aspect of the Annual Tax on Enveloped Dwellings (ATED), introduced in 2013. The government sees the two charges as addressing two separate policies (ATED being directed at corporate 'envelopes' that are not carrying on a business while the new CGT charge for non-residents is, at least officially, about levelling the playing field between residents and non-residents). Where a non-resident falls within both regimes however, the ATED-related CGT charge (currently at 28%) will apply first and any remaining part of the gain will fall to be taxed under the new charge.
- Non-residents within the scope of the charge will have to notify HMRC within 30 days of the property sale completing.

CONCLUSION

The government's stated aim with the extended CGT charge is to remove the differences in treatment of UK and non-UK residents disposing of residential property thereby bringing the UK into line with many other countries where CGT is charged on the basis of location of the property. Of course, the fact that it raises revenue cannot have been far from HMRC's mind. The description of the proposals released would appear to achieve this while providing safeguards for institutional investors which at this stage seem to be broadly satisfactory. It is not however possible to be sure what traps may lurk in the drafting of the proposals, due to be released on 10 December. What seems certain however is that, following hard on the heels of (and interacting with) the introduction of ATED (which is still itself being bedded in), this new charge adds another layer of complexity (and potentially costs) to the already complicated UK regime for the taxation of residential property.

Property traders are exempt from this regime on the assumption by HMRC that those profits are taxable anyway.

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