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CHANCE

TAXING CAPITAL GAINS MADE BY NON-RESIDENTS DISPOSING OF UK COMMERCIAL AND RESIDENTIAL PROPERTY FROM APRIL 2019 - A BOMBSHELL

The Government has announced that from April 2019 tax will be charged on gains made by non-residents on the disposal of all types of UK real estate, extending existing charges that apply to residential property and abolishing an exemption for commercial property that has been in existence since the introduction of CGT in 1965. Investors are likely to face cost and complexity as they try to get to grips with one of the most dramatic changes in the taxation of UK real estate in living memory.

BACKGROUND

To put this announcement in context, the Government says that other major jurisdictions apply CGT to non-residents disposing of local real estate and that there is unfairness between UK and non-UK residents in giving non-residents CGT exemptions. They say it drives the creation of complex offshore structures (often in tax havens) to hold real estate which can facilitate avoidance. Although the Government recently introduced CGT on disposals of residential property by closely-held non-resident companies and did not apply that to indirect disposals, they want to align the taxation of commercial and residential property held by non-residents as much as possible so as to create a cohesive framework, so existing charges for residential property will expand in scope to match the intended rules for commercial real estate.

KEY POINTS

- The new rules will create a single regime for disposals of interests in both residential and commercial real estate under which:
  - There will be a new CGT charge for direct and indirect gains on disposals of commercial property by most non-residents;
  - The existing CGT charges for residential property will be extended to indirect sales and disposals made by widely-held companies;

Changes at a glance

- The Government has announced that it will extend the UK tax base with regards to disposals of UK real estate by non-residents by bringing into the charge to UK tax:

  (i) all UK real estate capital gains they make from direct disposals; and

  (ii) any such gains made via indirect disposals.

- The new rules will apply from **1 April 2019** (for companies) or **6 April 2019** (for other persons) to gains attributable to increases in value from those dates.
- The Government has published a consultation document with more detail on the proposals but is only inviting comments and feedback on particular issues and impacts of the policy. It says that questions such as who is in scope, commencement date and core features of the direct and indirect disposal provisions are fixed.
- The key features are summarised in this briefing, and the full consultation document is available to read here.

- The "indirect disposal" rule will apply where an entity is "property rich" which is broadly where 75% or more of its gross asset value at disposal is represented by UK real estate and the person holds, or has held at some point within the previous five years, a 25% or greater interest in the entity;
- For indirect disposals there will be a reporting requirement on certain third-party advisors who have sufficient knowledge of the transaction.

- It should be noted that non-resident owners of UK residential or commercial property who acquire or develop the property for sale – i.e. "traders" in UK real estate – are already subject to UK corporation tax or income tax depending on the precise facts and subject to the application of any relevant double tax treaty.
- An anti-forestalling rule will apply to certain arrangements entered into on or after 22 November 2017 to counteract arrangements that seek to avoid the new charge on non-residents through exploiting tax treaties. The Government is particularly concerned with countries with treaties that would override the intended "indirect disposal" charge.
- The new rules will also be protected by a targeted anti-avoidance rule aimed at defeating all arrangements entered into the main or one of the main purposes of which is to secure that gains are not subject to the new tax.
- However, the Government say that those who are currently exempt from all UK capital gains tax (for example, overseas pension funds) or otherwise not in the scope of UK tax for reasons other than being non-resident, will continue to be exempt or out of scope.

SCOPE

The Direct Disposal Charge

- Where the non-resident is a body corporate or would otherwise be in scope for corporation tax were they UK resident, the gain will be chargeable to corporation tax (expected to be 19% in 2019 reducing to 17% in 2020). For other persons, the charge will be to capital gains tax, using the normal UK rules (current top rate is 28%).
- Gains on indirect disposals will be computed by reference to the gain on the interest in the entity that derives its value from land, rather than by reference to any increase in value of the land itself.
- There will be no grandfathering for existing owners of UK real estate who come within the scope of the charge other than CGT newly arising will only apply to gains arising after the charge comes in (April 2019). There are complex rebasing rules to deal with different scenarios such as losses and those already within the residential CGT charge.
- Roll-over relief for business real estate assets used for trade purposes will be capable of applying.

The Indirect Disposal Charge

- Two tests must be performed at the date of disposal to establish whether a disposal is in scope:
  - Is the entity being disposed of "property rich"? and
  - Does the non-resident (including related parties) hold a 25% or greater interest in the entity, or have they held 25% or more at some point in the five years ending on that date?
- The "property rich" test will require 75% or more of the value of the asset disposed of to derive from UK land. The test will be made on the gross-asset value of the entity, so not including liabilities such as loan finance. It will take market value at the point of disposal. It will be necessary to trace value if a group of companies are involved.
- The 25% "ownership test" will look at the proportion of interest a non-resident (and related parties) have in a property rich entity at the point of disposal, and include a 5 year look back rule.

- The amount of the gain or loss will be calculated on the basis of the interest being disposed of in the transaction. The normal rules for disposal of shares or other interests will apply as appropriate, including those aimed at preventing depreciatory transactions and similar anti-abuse rules.
- Rebasing of shares for the purposes of the tax calculation will apply as at April 2019.
- The UK Government consultation acknowledges that, following the expansion in the UK's "substantial shareholding exemption" ("SSE") from 1 April 2017, it may be possible for the SSE to apply, subject to strict conditions, to disposals of property rich companies or groups of companies by "qualifying institutional investors" (e.g. certain pension schemes, life assurance businesses, sovereign wealth funds, charities, investment trusts, authorised investment funds and exempt unauthorised unit trusts).
- The Government acknowledges that certain of the UK's double tax treaties include a capital gains article which allocates taxing rights to the share-seller's jurisdiction on a disposal of shares, even if the shares disposed of are in a company which is "property rich". Subject to any future amendments, those treaties should continue to operate to shelter investor share-sellers resident in one of those jurisdictions from the new indirect charge on capital gains from UK land.
- However, this is subject to anti "tax treaty-shopping" avoidance provisions, and the UK Government has indicated that it will seek to deny the benefit of any such treaty if the main purpose, or one of the main purposes of implementing a structure was to be able to use it as a shield against the new indirect charge, where the obtaining of such tax advantage would be contrary to the object and purpose of the relevant double tax treaty. As an "anti-forestalling" measure, this rule will be imposed with effect from 22 November 2017.

Ownership by and through Collective Investment Vehicles

- Disposals by non-residents of interests in UK funds will be within scope of the Indirect Disposal charge.
- REITs are exempt from tax on capital gains on direct disposals but REIT exempt capital gains count as Property Income Distributions upon which 20% UK withholding tax can apply depending on the identity of the shareholder. REITs can be impacted by these changes if a non-resident member disposes of the property or shares in a property rich company. Currently, any distribution of proceeds do not count as a PID subject to potential 20% withholding tax. The technical effect of the new changes may be that all proceeds would count as such a PID distribution.
- Any UK CIV currently exempt would maintain that status but a non-resident who disposes of an interest in that CIV is within the scope of the Indirect Disposal charge. An overseas CIV currently exempt from UK tax only by reason of residence (such as a JPUT) will come within the future charge. The implications of the potential for taxation at a JPUT and unitholder level will require careful analysis.

Reporting and Compliance

- Where a non-resident is chargeable to capital gains tax (whether on a direct or indirect, residential or non-residential disposal), they will need to report that disposal to HMRC within 30 days of the disposal and also make payment within that timeframe (subject to any deferment of payment permitted under the UK's Self Assessment (SA) regime).
- Where a non-resident is chargeable to corporation tax (whether on a direct or indirect, residential or non-residential disposal), they will need to register for CT Self-Assessment with HMRC, and will need to return the gain or loss within that framework, and pay any tax to the corporation tax timescales appropriate for the amount.
- Since the new measures include the imposition of a charge to capital gains from UK land upon an indirect disposal, this may be hard for the UK tax authorities to detect and collect as a matter of practice. The UK

Government therefore proposes a new reporting requirement will be imposed on UK-based third party advisers who have sufficient knowledge of an indirect disposal falling within the new charge, unless they can satisfy themselves that the transaction has been reported to HMRC. It is proposed that the UK-based third party adviser will be required to report to HMRC within 60 days of the relevant disposal taking place, unless they can satisfy themselves that the transaction has already been reported to HMRC.

- It is proposed that, if necessary, HMRC will be able to recover the tax of a non-resident company from its UK representative (if any), or from a related company.
- Existing penalties regimes are proposed to be applied for failure to notify a transaction falling within the new rules, and also for failure to comply with the proposed reporting requirement for third party advisors.

ATED-related Gains

- The Government will consult on harmonising the existing regime for ATED-related gains with the new regime envisaged by the above proposals.

NEXT STEPS

Responses to the consultation documents are requested by 16 February 2018 following which there is likely to be a period of discussion with HMRC / the Treasury during which these proposals will be refined and finalised. Officials are likely to hold working groups over the consultation period to discuss further and we intend to participate in this process.

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