

Dealing With Non-Resident Landlords In 2018 – Capital Gains Tax

(Lecture B1067 – 14.51 minutes)

Before April 2015, individuals who were not tax resident in the UK were (with some very minor exceptions) not chargeable to UK CGT even in respect of assets situated in the UK.

Since April 2015 we have the non-resident capital gains tax (NRCGT) rules which make non-residents liable to UK CGT on disposals of UK residential property.

Unlike the NRL Scheme for income tax, the NRCGT regime only applies to individuals who are non-UK resident for tax purposes under the UK statutory residence rules. For non-resident landlords who are UK resident, gains on property disposals are chargeable to CGT under basic principles with gains being equal to sales proceeds less historic base cost. Special NRCGT returns are not required as the gains are disclosable on the annual SA return in the usual way.

Non-resident capital gains tax (NRCGT)

Since April 2015, non-resident NRLs are liable to UK CGT on disposals of UK residential property under the NRCGT regime.

Gains or losses are normally calculated by reference to the 5 April 2015 value of the property although taxpayers can elect to calculate gains either by time apportionment either side of 5 April 2015 or by a “retrospective method” using historic base cost. Taxpayers with NRCGT gains can claim an annual exempt amount. CGT is charged at the residential property rates of either 18% or 28% (depending on the level of the individual’s UK taxable income in that year). Losses are ring-fenced and can only be set against NRCGT in the same or future tax years.

As a planning point for British NRLs intending to sell a UK property, contracts should ideally be signed while the NRL remains non-UK resident rather than once he has returned home. This way the disposal falls into the NRCGT regime and benefits from April 2015 rebasing. Pre-2015 gains will therefore be eliminated.

The good news is that NRCGT returns coming through seem to suggest that UK property prices were quite buoyant in April 2015 and have flattened a little since then with NRCGT gains being relatively modest (although that could of course be down to clients being bullish with their 2015 valuations). The NRCGT yield will naturally increase as UK property prices rise over time.

PPR relief

PPR relief is available to reduce NRCGT gains where the taxpayer has lived in the property as their only or main residence at some point during the period of ownership. This will apply to NRLs who leave the UK to live abroad, let out their home for a period of time and then sell it whilst still non-UK resident.

PPR is calculated by reference to the period of occupation over ownership with only the post April 2015 period being considered (unless the retrospective method of calculating

the gains is chosen in which case we start counting from the actual date of acquisition). The last 18 months of ownership will always count as a period of occupation for PPR as long as the taxpayer had lived in the property at some point, even if this was before April 2015.

Anti-avoidance legislation exists to prevent non-residents from nominating a UK property to be their only or main residence in order to secure PPR. From April 2015, a UK residential property owned by a NRL will only qualify for PPR relief if the NRL meets the “day count test” in relation to the property. This test requires the individual or their spouse / civil partner to spend at least 90 days in the property in the tax year. These days need not be consecutive and can be fulfilled by either spouse (although naturally the same day cannot be counted twice). If the day count test is not satisfied for a tax year, that year is a non-qualifying year for PPR and the whole tax year is then treated as a period of absence.

In reality the 90-day test is not likely to trouble many NRLs given that a) spending 90 days in the UK will increase the probability of triggering UK residence under the “sufficient ties” arm of the SRT and more practically b) if a NRL has been letting out the property he is unlikely to have been able to spend 3 months a year living there himself.

In reality most NRLs who have been letting out their former homes since April 2015 will be able to claim PPR on NRCGT gains for the last 18 months only. But given that the regime is only 3 years old, this is sufficient in itself to exempt at least half of the gains arising in this period even before deducting the annual exemption (which may go some way to explain the very modest tax yields which have so far been harvested from this regime).

Note also that if a NRL is able to benefit from PPR relief (even for the last 18 months only), extra help may be claimed in the form of lettings relief which exempts gains in the period since April 2015 during which the property was let (up to a maximum of £40,000).

PPR relief must be claimed via the NRCGT return.

NRCGT returns

An online NRCGT return must be filed within 30 days of the completion of the purchase (there is an exception for no-gain-no-loss disposals such as transfers between spouses). The return is required whether or not there is any resulting CGT liability. Therefore even in cases where PPR relief wipes out the post-2015 gains, a return should still be filed.

The NRCGT compliance system is very unpopular. Many commentators (even Tribunal Judges) have said that the NRCGT return system is poorly thought-through by HMRC and not fit-for-purpose. Third-party evidence suggests that up to one-third of all NRCGT returns due since April 2015 have been submitted late or not at all (yes you read this correctly – one in three). That is not indicative of a system which taxpayers understand.

The high failure rate suggests that many NRLs are blissfully unaware of their UK CGT obligations which is hardly surprising given that the target population do not live in the UK and are not likely to be reading the UK tax press or following HMRC on Twitter. More

pertinently not all solicitors and conveyancers dealing with non-resident vendors are as up-to-speed with NRCGT as perhaps they ought to be.

Tax practitioners should be more aware of their responsibilities (and many of course are) but the problem is that our non-resident clients often do not inform us of the disposal until the time comes for preparing their SA return (an annual obligation which is on the client's radar). This could be a full 12 months or more after the due date for the NRCGT return. For example, a property disposal in May 2016 should have been followed by a NRCGT return in June 2016 but our client only tells us about this in January 2018 when the time comes for us to complete his 2016/17 SA return. Already the NRCGT return is a year late. The disclosure of the UK property disposal on the SA return thereby triggers a NRCGT late-filing penalty.

If the individual does not file a self-assessment return, any CGT due has to be paid at the same time as the NRCGT return is filed. Individuals within the SA system have longer to pay the tax - they can wait until the 31 January following the year of the disposal. Not only does this give SA taxpayers a cash-flow advantage over non-SA taxpayers (which cannot be equitable), it also means that a husband and wife (or an unmarried couple for that matter) who have sold a jointly-owned property could have different CGT payment dates, a point which is a) often overlooked and can lead to interest charges and b) plain daft.

Penalties

HMRC's approach to the imposition of NRCGT penalties has come in for much criticism.

The penalties for the late filing of NRCGT returns are in line with late filing penalties for other types of return. The penalties are as follows:

- Initial penalty of £100 in all cases;
- Further penalty of 5% of the tax due or £300 if greater for returns over 6 months late;
- Further penalty of 5% of the tax due or £300 if greater for returns over 12 months late.

The penalties apply regardless of whether there is a CGT liability. These penalties can be appealed if there is a 'reasonable justification' for the return being late. Regular readers will know how easy this one is to prove.

However, taking a wider view for a moment, penalties - like parking tickets - are meant to "encourage taxpayers to comply with their obligations and to act as a sanction for those who don't" (HMRC Powers Review 2015). They are not meant to be a revenue raising tool (like parking fines, at least not officially). "We don't use penalties as a way of raising revenue" is a HMRC statement which is pretty categorical.

Example

Felix, a non-resident client, sells a UK property in November 2016. The sale is arranged by a conveyancer in the UK who gives him no specific tax advice. Felix however is an honest citizen who is aware of his UK self-assessment obligations and duly discloses the details of the sale to you in January 2018 as part of his 2016/17 SA submission. The SA return is filed in January 2018 disclosing the gain.

You ask him whether an NRCGT return has been filed and receive the expected response. This is hastily rectified. No CGT is payable on the disposal due to a combination of factors (ie, the modest increase in value between April 2015 and November 2016, a sprinkling of PPR relief and the annual CGT exemption). There is no attempt by Felix to mislead HMRC or avoid UK tax. There is after all, no tax to avoid.

HMRC duly issues a penalty notice in the sum of £700 as the NRCGT return is over 12 months late. As ignorance of the law is not accepted as a reasonable excuse, any appeals against the penalty notice will fall on deaf ears. So through no real fault of his own – apart from failing to stay up to date with changes in UK tax law as publicised on Gov.uk (incidentally all written in English which is not Felix's first language) – Felix is faced with a penalty which is massively disproportionate to any 'offence' he is deemed to have committed. One could argue that he might have been better off not saying anything to anyone (after all he does live thousands of miles away). Instead he has been penalised for his compliance.

The position could have been worse had HMRC not bowed to representations by taxpayers and the professional bodies and removed the daily penalties for NRCGT return failures which they previously impose. The £10 per day penalties for returns filed between 3 and 6 months late will no longer be issued. If your clients have been charged these daily penalties, you should ask for them to be repaid. This could be worth £900.

To date a substantial proportion of the government's modest NRCGT yield (some have suggested somewhere in the region of 35-40%) has come from penalties, many of which will have been levied on taxpayers who believed (not unreasonably) that it was sufficient to simply include details of their NRCGT gains on their annual SA return.

Instead we need to explain to our non-resident clients that they have incurred a hefty penalty for failing to file a pre-return return returning details of the disposal which at some point later needs to be returned on a different return. If we put it this way, the whole thing seems very British and frankly a little silly.

Rachel McGreevy v HMRC (2017)

The issue of the fairness of NRCGT penalties came to a head in September 2017 in the case of Rachel McGreevy.

The taxpayer (RM) was resident in New South Wales, Australia. She disposed of a UK property on 7 July 2015. The NRCGT return was filed on 7 August 2016. The gain was shown to be exempt because of PPR relief so the CGT payable per the return was nil. This was not disputed.

HMRC subsequently wrote to RM on 6 September 2016 stating that the NRCGT return was late and she was liable for penalties in the sum of £1,600. This was made up of fixed penalties of £700 and daily penalties of £900. The taxpayer duly appealed against the penalty notices on the grounds that she understood that CGT in the UK is payable as part of the annual self-assessment which she makes annually as a non-resident in good faith. It was not until she read the SA section associated with CGT that she became aware that a specific CGT return was due within 30 days of the sale. This had never been advised to her previously. She duly complied without further delay. The penalty charged was therefore grossly unfair.

The taxpayer's appeal was rejected on the grounds that she did not have a "reasonable excuse". It was the taxpayer's responsibility to file a NRCGT return on time and all the relevant information advising taxpayers of this requirement was clearly publicised on the Gov.uk website. HMRC later withdrew the £900 daily penalties (in line with their change in policy) but their Reviewing Officer upheld the decision to charge the fixed penalties of £700 on the basis that information about NRCGT was well within the public domain and widely available on the internet (the Reviewing Officer specifically referenced the Autumn Statement in December 2013 which heralded the introduction of NRCGT). The Reviewing Officer said that the taxpayer should have taken the necessary steps to fulfil her UK tax obligations and that was required to give notice of her chargeability and failed to do so.

The taxpayer appealed to the FTT and the case was heard in September 2017.

As HMRC were clearly relying on the fact that a taxpayer's NRCGT responsibilities were "clearly publicised", the Tribunal took the trouble to research this statement. Forgive my indulgence here but some of the Judge's comments in this regard are worthy of sharing with you and I hope you enjoy them as much as I did. I have shortened them a little in the interests of space. Take it away Judge Richard Thomas:

"I am sure that every December the appellant, like many other inhabitants of Roselle, New South Wales, Australia, has been agog with excitement waiting for the British Chancellor of the Exchequer's Autumn Statement.....The contention by HMRC that the new legislation had been announced in the Autumn Statement and was seriously advanced as a ground for denying that the taxpayer had a reasonable excuse for not knowing about the NRCGT return deadlines, is a prime example of the concept of "nerd-view". Only a small coterie of people obsessed by tax would admit that the Chancellor's Autumn Statement on tax matters is something that should register in anyone's consciousness.

HMRC seem to be suggesting that the appellant should have been knowledgeable about the law in this area, where in my view the subject matter is arcane, difficult to follow and counter intuitive. I consider I have a better than average grasp of tax law and how it is constructed and interpreted. But as I have read Section 7A and 12ZA to 12ZI TMA and the NRCGT provisions in TCGA 1992, my eyes have glazed over and my senses reeled. Do HMRC really think that ordinary taxpayers even, or rather especially, non-residents, should be expected to understand Section 12ZH TMA on the interaction of NRCGT returns and Section 8 returns, or to understand the implications for late filing of NRCGT returns.....? The arguments advanced by HMRC about knowledge of the law are little short of preposterous. To say that information about NRCGT returns is well within the public domain is claptrap.... There is a serious deficiency exhibited here in common sense, proportion and an ability to consider the position of what HMRC calls its customers".

There is more but you get the picture (see UKFTT TC 06109 for the full unabridged judgement).

The Tribunal therefore found that the taxpayer had a reasonable excuse for not filing her NRCGT return on time and no penalties were due.

This decision and Judge Thomas's comments should give some hope to other taxpayers that the courts will give a sympathetic hearing to penalty appeals in relation to late NRCGT returns. So if you find yourself in this position, it is certainly worth quoting this case and asking for some common sense to prevail.

Inheritance tax

Finally, on a lighter note, death.

UK property owned by NRLs will be chargeable to IHT by virtue of its UK situs. NRLs who are not domiciled in the UK used to be able to protect their UK properties from IHT by wrapping them in some sort of offshore envelope – typically a non-UK company or offshore family trust – but this planning is now itself deceased from April 2017.

Claims for BPR by NRLs on let properties are unlikely to be successful as businesses which consist of the letting of land are strictly excluded from qualifying. Even satisfying the criteria for furnished holiday accommodation doesn't improve the BPR outlook following the recent cases of Mrs Pawson and Mrs Ross.

It may be possible to secure BPR if the NRL has a genuine bona fide trading company and that company owns the UK residential property (or properties) which are let out. As long as the company is “wholly or mainly” carrying on a trade (broadly meaning that more than 50% of its activities are trading activities), case law supports the view that the UK residential properties are used in the ‘business’ of the company (‘business’ carrying a different and less restrictive meaning to ‘trade’). This is important as it would not then preclude the full value of the shares (even the bit represented by the UK properties) being eligible for BPR.

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