

Non-UK resident capital gains taxation

(Lecture P1109 – 23.25 minutes)

Background

On 6 July 2018, following a consultation process which started last year, the Government published a draft Finance Bill containing their detailed proposals for extending the scope of the taxation of capital gains from UK property.

Currently, non-UK residents (other than, essentially, non-close companies) are taxed on gains made on the disposal of UK residential property. In addition, companies, corporate partnerships and certain collective investment schemes, wherever resident, are taxed on gains made on the disposal of UK residential property where ATED applies – this is known as the ATED-related CGT charge and is levied at 28%.

Gains on UK commercial property investments made by non-UK residents are, at present, outside the scope of a UK tax charge.

With effect from 6 April 2019, the Government will widen the capital gains charge to encompass all non-UK residents (with very limited exemptions) and to take in:

- all forms of UK property (i.e. commercial as well as residential); together with
- entities such as shares which, directly or indirectly, derive at least 75% of their value from UK property interests.

Draft legislation has also been published to bring non-UK resident corporate landlords within the scope of corporation tax (rather than income tax) in connection with their UK property income. This move is planned to take effect from 6 April 2020 and is primarily intended to bring such taxpayers within the ambit of the corporate tax regimes for loss relief, loan relationships and the recent interest relief restrictions.

Overview of the new measures

The new rules will apply to direct and indirect disposals of UK property interests taking place on or after 6 April 2019, regardless of whether the disposal is by a company or some other person. The existing NRCGT regime for the sale of UK residential property will be subsumed into one overall regime covering disposals of all forms of UK property and so will effectively disappear. The ATED-related CGT legislation is also being abolished. This process will be achieved through a consolidation rewrite of the whole of Part 1 of TCGA 1992 – hopefully, it will not throw out any unintended changes of meaning!

Where the non-UK resident is a company (or some other entity which would be within the scope of corporation tax if they were UK-resident), any gain will be chargeable to corporation tax. For others, the charge will be to CGT.

This will give rise to a noteworthy simplification of the rates of tax applied to the sale of UK property interests:

- the standard corporation tax rate (currently 19%) will apply to companies on the sale of all UK property;
- individuals will pay CGT at 18% or 28% (depending on whether they are basic or higher rate taxpayers) on the sale of UK residential property and at 10% or 20% on the sale of UK commercial property; and
- the ATED-related CGT charge will disappear completely as part of the abolition of those rules.

For disposals which would not have been within the charge to UK tax before these legislative changes (for instance, the disposal of UK commercial property by a non-UK resident), the allowable cost to be set against the sale proceeds will be taken, for property owned as at 5 April 2019, to be the property's market value on that date.

However, a taxpayer will have the facility to elect to use the property's original cost instead of its market value on 5 April 2019, if that would give rise to a loss or to a lower gain than under rebasing.

For disposals already within the charge to UK tax, the current basis of taxation will continue to apply so that, for example, 5 April 2015 will still be the rebasing point for disposals currently within the NRCGT regime. An original cost election is also possible. A further refinement is that such a taxpayer can make a straight-line time-apportionment of the gain so that only the proportion of the gain arising after 5 April 2015 is brought into charge.

Other aspects of the capital gains rules will still be in point, including:

- the offset of losses from other disposals against gains;
- reliefs such as rollover relief and the no gain no loss relief on intra-group transfers;
- exemptions such as the annual CGT exemption or the substantial shareholding exemption (SSE); and
- existing anti-avoidance legislation (e.g. for depreciatory transactions).

The new charges will apply to all non-UK residents other than those who are generally exempt from UK taxation such as qualifying overseas pension schemes. Thus, if a foreign pension fund makes a disposal of a UK property investment held for the purposes of the scheme, any resulting gain would not normally be charged to tax.

A TAAR will seek to counteract any arrangements entered into on or after 6 July 2018, which aim to circumvent this new taxation regime.

Indirect disposals of UK property

In addition to being subject to UK tax on gains made on direct disposals of UK property, non-UK residents are going to be taxed on gains made on the disposal of entities – regardless of where the entity is resident – which themselves, directly or indirectly, hold UK property, unless the entity uses the asset in its trade (or acquired it for such use). This move represents a considerable expansion of the UK's capital gains regime.

The taxation charge will apply to the disposal of shareholdings and other interests in entities where at least 75% of the entity's gross asset value at the date of disposal is derived directly or indirectly from UK property. In most cases, one will be looking at disposals of shares in companies. Where the company whose shares are being disposed of itself holds subsidiaries and other investments, it will be necessary to drill down to the level of the underlying property assets owned by the group in order to see whether or not the 75% test has been met.

Under the original consultation, indirect disposals were subject to taxation even if the company in question used the property in its trade. However, following representations from interested parties, the Government have amended these proposals so that gains on the disposal of the company's shares will be exempt from the new charge where the property held by the company is used for the purposes of its trade (or was acquired for such use). The trade must have been carried on commercially with a view to profit for at least one year prior to the disposal and it must be expected to continue after the disposal for more than an insignificant period of time.

The charge will only apply to persons who held an interest of at least 25% in the company at any time during the two years leading up to the disposal. It should be noted that this 'look-back' period represents a change from the Government's original proposals where a five-year period was mooted. In assessing the percentage owned by the relevant person, interests held by connected parties must be aggregated. The definition of 'connected' does not include partners in a partnership, but it will cover the situation where two or more persons are 'acting together' to secure or exercise control of a company.

As with direct disposals, rebasing to market value on 5 April 2019 will apply for shares held as at that date. There is also an option to use original cost. However, unlike direct disposals, any loss arising from an original cost election will not be an allowable loss.

It should be noted that indirect disposals could potentially qualify for the SSE. It is possible that 'property-rich' companies, which are not regarded as trading for the purposes of this new capital gains charge, may still be regarded as trading companies for SSE purposes (especially following the relaxations brought in by F(N02)A 2017). In such cases, an indirect disposal could be eligible for the relief.

Finally, there is an anti-forestalling rule which aims to counteract arrangements entered into on or after 22 November 2017 seeking to make use of double taxation treaties to avoid the new charge if any tax advantage obtained is 'contrary to the object and purpose' of the relevant treaty. This operates in addition to the TAAR referred to above.

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