

CGT Planning For Non-UK Residents

(Lecture P1114 – 11.12 minutes)

The Client Scenario

A friend of mine recently shared with me his plans to return to live in the UK after a decade or so living and working in the Middle East. His contract has, somewhat unexpectedly, not been extended so he finds himself in a position where he will be coming back to the UK in 4 to 6 weeks.

On moving abroad, he had sold his family home and used the proceeds to invest in two properties; a buy-to-let property (Property A) to generate a UK income stream to utilise his and his wife's UK personal allowances and a small house (Property B) to use as a base on his return visits to the UK. Both properties are in joint names with his wife. There is a small joint mortgage on Property B.

His family never properly lived in Property B but he figured that;

- a) This would give him space to store family belongings that they wished to keep but did not want to ship overseas;
- b) It would be cheaper and more relaxing than staying in hotels when they visited family in the UK; and
- c) Any capital growth on the property would escape capital gains tax because he was living abroad and even if this property was sold after he resumed residence in the UK he would be able to claim private residence relief.

I liked the sound of a) and b). His assumption at c) on the other hand raises eyebrows.

He intended to sell Property B and use the proceeds from this property – and his termination payment from his overseas employment – to buy a larger family home in the UK. He wanted my confirmation that the substantial capital growth on Property B would not be charged to CGT (and if it was, could he do anything about this?). He may well decide to sell Property A as well but the gains are insignificant on this property.

Residence issues

Before we can do any sort of planning, the residence position needs to be determined.

The temporary occupation of Property B on his occasional return visits to the UK is not currently enough to trigger residence in the UK. He might be automatically non-resident under the “full-time work abroad” (depending on an analysis of his average working hours). If not, the UK “home” test would not apply as his main home is overseas (the fact that this is owned by his employer is immaterial).

Property B would constitute available accommodation for the purposes of the “sufficient ties test” but as he had no other UK ties, this alone can never trigger residence under this test no matter how many days he spends in the UK.

The client's return to the UK will undoubtedly trigger UK residence at some point, but the crucial question is "from when?"

He will be UK resident in 2018/19 as he will spend more than 183 days in the UK. The split-year rules are then considered. We will need to access at least one of these as otherwise he is treated as UK resident from 6 April 2018, thereby bringing his foreign income in 2018/19 within the scope of UK income tax. As he is currently working in a low-tax environment thereby offering no double-tax relief, this is something we must avoid.

Case 6 splits the tax year for employees coming back to the UK after ceasing full-time work abroad. However, Case 6 is ruled out because he has not been resident in at least one of the previous 4 tax years. This is extremely helpful as otherwise UK residence would be triggered under Case 6 not from the date of his return to the UK but from the day after the overseas contract ended. By ruling-out Case 6 we can extend the overseas part of the tax year and give more time for some CGT planning.

Case 5 splits the year when a taxpayer starts full-time work in the UK. At the moment his work plans are open-ended so this is discounted.

The year of return will therefore have to be split either under Case 4 (Starting to have an only home in the UK) or Case 8 (Starting to have a home in the UK). It doesn't matter which one of these applies as both trigger residence from the day the client starts to have a UK home.

Moving back into Property B is likely to be the UK-residence trigger date unless we can argue that the taxpayer is occupying Property B as "temporary accommodation" and that Property B is not a "home" within the context of the SRT. After all, not all houses are "homes".

It is not out-of-the-question for the client to come back and live in Property B without having a "home". A "home" is defined in the SRT as a place which is used as a home with a degree of permanence or stability as opposed to somewhere a person stays for occasional short periods and which provides a change from ordinary day-to-day life.

So, it would be possible to move into Property B on a temporary basis without laying down any roots and while still actively marketing the property for sale. We would then argue that he is not living there with any "permanence or stability". He is simply guarding it and preparing the property for onward sale. For example, when engaging the services of an estate agent to sell the property, sending them an email explaining he is "living temporarily in Property B until sale but is actively looking for a home elsewhere" wouldn't hurt. Neither would taking photos of it looking empty and unloved with a sleeping bag on the floor....

This is however a question of fact and degree and HMRC might take a different view.

A new permanent home would then have to be acquired by next 5 April. This in turn brings in an extra worry as within both Case 4 and Case 8 there is the requirement that for the part of the tax year before the taxpayer meets the UK home test, he should not have sufficient ties to the UK. This gets more difficult to satisfy as UK days accumulate.

It is therefore prudent for us to proceed on the basis that moving into Property B will trigger UK residence and that will be in 4-6 weeks. Which isn't long.

CGT on sale of Property B

The chargeable gain depends on whether the property is sold in a UK-resident period or a non-UK resident period.

a) Sale while UK resident:

If the sale takes place while he is UK-resident, the gain is proceeds less historical base cost. This is quite substantial.

Given that we will be splitting the tax-year under Case 4 or Case 8 on the basis that Property B is his "home", it should follow that the gain is eligible for PPR relief. This will exempt the gain arising in the final 18 months of ownership (it will be difficult to argue that PPR applies in any previous period as his occupation was occasional and sporadic). No "deemed occupation" periods are relievable as these must have been preceded and followed by actual occupation.

The gateway to PPR relief is not whether the property is a "home" under the SRT but whether the quality of the occupation is sufficient to conclude that the taxpayer had an intention to occupy the property as a permanent home. So, while this and the SRT definition do not sit exactly square, in most instances one will follow the other. HMRC would surely struggle to win an argument that a property is a "home" under the SRT but is not one for PPR.

Can we increase the PPR element? This is possible by a carefully timed inter-spouse transfer.

If the husband (H) transfers his 50% interest in the property to his wife (W) she will inherit his CGT base cost. If W subsequently lives in Property B as her home, she will get PPR relief on the sale. In our case, W's PPR relief would be the final 18 months of ownership.

However, if H's 50% interest is transferred to W before they move back and occupy the property - i.e. the inter-spouse transfer takes place at a time when Property B is not their only or main residence - W does not inherit H's PPR relief history. This is helpful because H's PPR history is such that he doesn't qualify for any PPR. The inter-spouse gift can therefore erase this history. Instead W's PPR relief on the part acquired from H is based entirely on her occupation of Property B since the date of the inter-spouse transfer. This means if the inter-spouse gift takes place immediately before they reoccupy Property B, half the gain is eligible for full PPR relief. The other half is chargeable (apart from the final 18 months).

All this helps particularly as W's UK income is covered by personal allowances so a decent chunk of the taxable gain would be at 18%.

Do however note that it is important to get the paperwork right if this option is to successfully play-out, so a properly documented transfer of registered title would need to take place.

There is also the practical difficulty of dealing with the mortgage as H's half of the loan would either need to be repaid or (if that is not possible) the bank would need to be persuaded to transfer the mortgage wholly across to W which:

- Might be difficult to arrange given that W's has no taxable income and no obvious means of repaying the loan; and
- The transfer of debt (even between spouses) is consideration for Stamp Duty Land Tax and will trigger a SDLT charge.

b) Sale while non-UK resident:

If the sale takes place before UK residence is triggered, the disposal falls into the NRCGT rules. In this case the gain is calculated by replacing the historic base cost with the 5 April 2015 value of the property. This duly removes the capital appreciation between purchase and April 2015 from the CGT charge. [Time apportionment is another option but this is less advantageous here.]

Advice from estate agents seem to be that houses prices were quite perky in April 2015 and have plateaued a little since, so the post-April 2015 gain is attractively low. The CGT thereon is certainly far more palatable than the CGT due under the first option (even with a successful inter-spouse transfer).

However, selling in the non-resident period brings its own practical problems in that:

- It gives the family nowhere to live on their return (which is inconvenient but easily surmountable); but more importantly;
- Given how slow the wheels turn in the UK housing market, it can't be guaranteed that they would find a suitable buyer and exchange contracts before their return to the UK. Remember here that it is the exchange of unconditional contracts that will trigger the CGT disposal (not the completion of the transaction) but nevertheless 4-6 weeks is very tight.

The Trust Solution

The solution to this problem comes in the form of a trust. The process is as follows:

1. Husband and wife as joint settlors set up a discretionary trust. The trust is established with a token amount. A solicitor will be able to do this quickly and cheaply using a standard template. The beneficiaries are the settlors and their children (and their wider family in case of disaster).
2. The natural Trustees are the settlors (client and spouse). This (technically) makes this a non-resident trust as all Trustees would be non-UK resident. While this is not a serious problem from a tax perspective (the trust will be UK resident in a matter of weeks), it does mean that when the trust is registered with HMRC and questions are ever asked as to whether the trust is, or has ever been, non-UK resident, the Trustees will be obliged to answer "yes" and that answer waves a flag (as nobody trusts offshore trusts). The appointment of a UK family member (or agent or solicitor) as temporary co-Trustee to make the trust UK resident on creation avoids this issue. The co-Trustee can later step-down. [Note that the non-resident Trustees need to be UK-dom which in our case they are.]

3. The settlors then each transfer their 50% interest in Property B to the trust. This involves a simple transfer of registered title by the solicitor. If the unconditional contract for the transfer takes place before residence is triggered, we have a NRCGT disposal.

The tax implications of this arrangement are as follows:

- CGT will be payable under the NRCGT rules. Two NRCGT returns – one for each owner – must be filed within 30 days of completion. Given that the return will contain 2 estimated values – one at transfer, the other at April 2015 – there is an increased chance that HMRC might query one or other of the values, so advice from a couple of local estate agents before filing the return is recommended. Once professional valuations have been obtained, it is fair to then discount a 50% interest to reflect the open market value of a part share. This is the case even where the joint owners are spouses as there is no ‘related property’ principle for CGT (as there is for IHT). Note that this will only be of marginal assistance as the April 2015 value of a 50% interest must also be discounted by the same amount. There is some case law support for a 10% discount in these circumstances and I would suggest that this is very reasonable and should not be disputed by HMRC.
- If they are not required to file an annual SA return – and many non-residents will not if they don’t have UK rental income – the tax is paid along with the filing of the NRCGT return. Not only does this accelerate payment, but it also requires some crystal-ball gazing as he may not know his UK taxable income for the year and will not therefore be sure of how much of the gain will fall into the basic rate band and be taxed at 18%. If they are in the SA system, the tax will be paid on the normal CGT due date (by which time no guessing will be required). Note that despite the transfer being to a trust, there is no possibility of deferring the tax charge as CGT holdover relief is not available on a transfer to a settlor-interested trust.
- The trust acquires the property at its market value at the date of the transfer, thereby giving a healthy base-cost uplift for the price of a small (ish) CGT charge. The added benefit of the trust arrangement is that the discretionary Trustees can exercise their powers to permit the beneficiaries to occupy the property. [Most trusts have this clause within the standard list of Trustee powers but it is worth reviewing the trust deed just to make sure this point is covered.] The advantage of this (aside from giving the settlor somewhere to live) is that any subsequent gain made by the Trustees would be eligible for PPR relief. There is little point in the trust charging rent for the use of the property as this would create an unnecessary income tax charge in the trust. However, a tenancy agreement which makes the tenants liable for all outgoings in relation to the letting is recommended as this prevents the need for the settlor(s) to added cash to the trust to help it meet its repair and maintenance bills.
- The transfer is immediately chargeable to inheritance tax. In the case of the transfer of a jointly owned property, two nil bands are available meaning a zero IHT charge on values transferred up to £650,000 (effectively £662,000 as donors tend not to use their annual IHT exemptions). For extremely high-value properties, the 20% IHT entry-charge may make the planning prohibitive. [In this case this was a reason for not transferring Property A in at the same time as this would generate an IHT charge for a minimal CGT saving.]

- The transfer is also caught by the 'gifts with reservation' rules as the donor is a beneficiary of the trust. The house is still therefore within the settlors' death estates for IHT. However, there is nothing 'lost' here as the property was in their estates anyway and the primary objective is to mitigate CGT.
- There is no SDLT liability for the trust as there is no consideration. However, as mentioned already, the outstanding mortgage means that the bank has a charge on the property which would block its transfer to the trust until the charge is lifted. If the bank agrees to transfer liability for the mortgage to the trust (unlikely anyway), this would be consideration for SDLT. Bear in mind here that the trust would be liable for SDLT at the higher rates so a 3% SDLT surcharge would apply (and this would make a big hole in any CGT saving otherwise obtained). The simple solution is to repay the mortgage before the transfer to the trust. In this instance the couple were in a position to do this by cashing in some investments (free of CGT as these are disposals in a non-resident period). This avoids any SDLT liability on transfer.

Banks are however minded to drag their feet a little here and apart from the obligatory early redemption penalties on repaying the mortgage, we were duly informed that it would take 6 weeks for the charge to be released (despite this being done electronically on the push of a button once the money required to repay the mortgage is cleared). While a little irritating, this is not a problem for CGT purposes as the disposal takes place when the contract to transfer the property to the trust is signed (not the date when the land transfer is registered). The solicitor will simply wait for the bank's charge to be cleared before registering the transfer.

Then what...?

The plan is for the Trustees to sell Property B and distribute the proceeds to the settlors to help them fund the purchase of a new UK family home.

The Trustees gain on sale will be covered by PPR relief. A trust tax return will however need to be filed.

The cash appointment to the settlors will – in theory – give rise to an IHT exit charge. However, where the original transfer fell within the settlors' nil rate bands, the rate of tax on the subsequent capital appointment will be nil.

Even in cases where there is an IHT entry charge, exit charge rates are very low, especially where there are relatively few completed quarters which have elapsed between creation and the capital appointment. So, while IHT issues must be explained and dealt with, unless the property being transferred to the trust is of high value, IHT charges should not be prohibitive.

At this point the trust will have served its purpose and can be wound up.

In summary

Clients may be in a position where – either for business or personal reasons – they will be coming back to the UK and resuming residence at short notice. The window of opportunity to take advantage of their non-resident status to access the NRCGT regime will then close. Using a trust to hold and then sell UK property is simple to organise and can achieve CGT savings.