

CGT and non-UK residents

(Lecture P1135 – 28.35 minutes)

Background

The UK did not tax capital gains generally until 1965 and so, when CGT was first introduced, it represented a significant change and was operated on a relatively narrow basis. Over the years, many of the original idiosyncrasies were ironed out, but one of the most important was retained, namely that the UK did not impose a tax charge on non-UK residents even where the property being disposed of was situated in the UK.

The majority of jurisdictions around the world (including the USA and most of Europe) have always taxed disposals of their own real estate and the fact that the UK did not was therefore something of an oddity, but one that has undoubtedly enhanced the UK real estate sector and made it doubly attractive to overseas investment. In the words of one commentator, 'as international flows of capital have increased over the last 20 years, this advantage has boosted cash flows and investments into the UK and may have had a greater role in the prosperity of the UK than other factors that are more widely appreciated'.

On the other hand, the inflation in UK property prices has clearly been a social downside, certainly as far as the residential sector is concerned, but, from the overseas perspective, one might look at that state of affairs as the largest and most effective tax incentive ever created.

Unfortunately, serious tax incentives are always expensive and so the Government have recently turned their fiscal attention to the real estate industry. They have decided to bring the party to an end on 6 April 2019.

Of course, there were rules for gains on UK residential property held by non-UK residents (other than, essentially, non-close companies) that were introduced in 2015, but that regime did not apply to commercial property and so it did not affect the real estate investment market more widely. In addition, companies, corporate partnerships and certain collective investment schemes, wherever resident, have hitherto been 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%. However, the provisions in FA 2019, which have now come into effect, represent a major change of direction.

What is happening and when?

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

- all forms of UK property (ie. 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.

The new legislation is found in S13 and Sch 1 FA 2019 and runs to over 100 pages. It applies to direct and indirect disposals of UK property interests taking place on or after 6 April 2019, regardless of whether the disposal is by an individual, a company or some other person. The NRCGT regime for the sale of UK residential property has been subsumed into one overall regime covering disposals of all forms of UK property and so has effectively disappeared. The ATED-related CGT charge has been abolished. This whole process has been achieved through a consolidation rewrite of, inter alia, Part 1 of TCGA 1992 which explains the length of Sch 1 FA 2019!

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

This has simplified the rates of tax which now apply to the sale of UK property interests by non-UK residents:

- (i) the standard corporation tax rate (currently 19%) is payable by companies on the disposal of all UK property;
- (ii) individuals pay CGT at 18% or 28% (depending on whether they are basic, higher or additional rate taxpayers) on the disposal of UK residential property and at 10% or 20% on the disposal of UK commercial property; and
- (iii) trustees' gains are charged to CGT at 28% on UK residential property disposals and at 20% on other UK property disposals.

Rebasing

Para 17 Sch 1 FA 2019 introduces new Sch 4AA TCGA 1992 which deals with the rebasing rules. For disposals which would not have been within the charge to UK tax prior to these legislative changes (eg. the sale of UK commercial property by a non-UK resident), the allowable cost to be set against the property's sale proceeds is taken, for property owned as at 5 April 2019, to be the property's market value on that date.

Where a significant gain is at stake, it will clearly be sensible for taxpayers to procure a full red book valuation (ie. an asset valuation which adheres to the 'red book' of mandatory rules and best practice for professionals as published by the Royal Institution of Chartered Surveyors) as at 5 April 2019.

However, taxpayers 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 by non-UK residents that were previously within the charge to UK tax, the old arrangements will continue to apply so that, for example, 5 April 2015 will still be the rebasing point for disposals covered by the NRCGT regime from the outset. An original cost election is possible. A further refinement is that such a taxpayer can have a straight-line time-apportionment of the gain so that only the proportion of the gain accruing 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 rules;
- exemptions such as the annual CGT exemption or the substantial shareholding exemption (SSE); and
- existing anti-avoidance legislation.

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 gain that results will not normally be charged to tax.

Indirect disposals of UK property

If the tax only applied to direct interests in UK real estate, it would be relatively easy to avoid a charge. One would simply use a company to acquire the property and then, instead of selling the property, it would be the company's shares that were disposed of. In order to prevent this and to ensure that the value of UK property is efficiently taxed, a capital gains charge is to be levied on non-UK residents who dispose of shares in 'property-rich' companies (see Sch 1A TCGA 1992 (as inserted by Para 14 Sch 1 FA 2019)). This move represents a considerable expansion of the UK's capital gains regime.

The charge applies to the disposal of shareholdings – and certain other interests – where at least 75% of the company's gross asset value at the date of disposal is derived, directly or indirectly, from UK real estate. Where the company whose shares are being disposed of itself holds subsidiaries and/or other investments, it will be necessary to drill down to the level of the underlying property assets owned by the group or the company in order to see whether or not the 75% test has been met. Because this rule applies at the point of sale, precise values on the date of disposal may be crucial if the company's UK land holding is hovering around the 75% mark.

It was originally proposed that indirect disposals would be subject to taxation even if the company used the property in question for its trade. However, following representations from interested parties, the Government amended the rules so that gains on the disposal of the company's shares are exempt from the new charge where at least 90% of 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 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. Thus non-UK resident companies owning public houses, care homes, hotels and the like should normally be outside the scope of the charge. This is, of course, subject to the proviso that the property is traded from by the company rather than being let out.

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 intentions where a five-year period was mooted. In assessing the percentage owned by the relevant person, interests held by connected parties must – unsurprisingly – be aggregated. However, the definition of 'connected' does not include brothers and sisters or partners in a partnership.

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

It should be noted that some indirect disposals may qualify for the SSE. It is possible that 'property-rich' companies which are not regarded as trading in normal circumstances will now be regarded as trading companies for SSE purposes (especially following the relaxations brought in by F(No2)A 2017). In such cases, an indirect disposal can be eligible for the exemption.

Anti-avoidance

Para 11 Sch 1A TCGA 1992 (as inserted by Para 14 Sch 1 FA 2019) sets out two anti-avoidance rules which apply where a person has entered into arrangements, the main purpose of which is to obtain a tax advantage as a result of:

- any provision in Sch 1 FA 2019 applying or not applying; or
- double taxation arrangements having effect where the advantage is contrary to the object and purpose of the double taxation treaty.

The tax advantage is to be counteracted by HMRC making any adjustments which they consider to be 'just and reasonable'.

This provision applies to:

- arrangements entered into on or after 22 November 2017 in a treaty shopping case (it should be noted that some double taxation agreements, eg. the UK – Luxembourg treaty, have hitherto provided protection for the non-UK resident against a UK tax charge); and
- any other arrangements entered into on or after 6 July 2018 which aim to circumvent the legislation in Sch 1 FA 2019.

The 30-day deadline

Finally, by virtue of Para 1(1)(a) Sch 2 FA 2019, the 30-day deadline for submitting returns and making CGT payments on account applies from 6 April 2019 for all non-UK residents who directly or indirectly dispose of UK property. This means that non-UK residents, even if they are registered for self-assessment, must now satisfy the 30-day time limit for payment of the tax. Two points should be emphasised:

1. this new rule takes effect from 6 April 2019, whereas the equivalent provision for UK residents only comes into operation on 6 April 2020; and
2. as far as UK residents are concerned, the legislation in Sch 2 FA 2019 is restricted to gains on residential property, while, for non-UK residents, both residential and commercial property are covered (together with indirect disposals).

Contributed by Robert Jamieson