SQUIRE PATTON BOGGS

Beware the Ides of April

Real estate practitioners have been repeatedly told to "Beware the Ides of March" on account of the reduction in the Stamp Duty Land Tax (SDLT) filing date from 30 to 14 days, which takes effect from 1 March.

However, we need to be aware of the Ides of April too. This is because, from 6 April 2019, real estate practitioners will have to fight their way through not only the aggressive SDLT filing deadline, but also will have to meet the challenges brought about by Parliament's decision to reboot how the UK taxes non-UK residents on their capital gains from UK real estate.

What Is Going On Now and After 6 April 2019?

Currently all non-UK residents are subject to tax on the income that they derive from UK land, regardless of whether they have a UK presence. Further, all non-UK residents are subject to UK tax on any trading profits derived from UK land, again, regardless of whether they have a UK presence. However, the taxation of capital gains is subject to a series of different rules and exemptions. Broadly speaking, non-UK residents are subject to UK taxation on gains deriving from residential real estate, although there are special rules for non-UK investment funds. Under current rules, non-UK residents are, however, exempt from UK tax on gains derived from non-residential property. This has made the UK a welcome destination for commercial property investors.

However, the rules change with effect from 6 April 2019 – to bring all non-UK residents within the charge to gains on UK real estate. Therefore, the current divide between residential (broadly taxable) and non-residential (exempt) real estate will no longer be maintained.

The rules are designed to bring within the charge to tax gains, which accrue after 5 April 2019. In order to achieve this objective, the relevant real estate asset will be treated as having been disposed of and re-acquired on 5 April 2019 for market value before the new rules kick in.

Land Rich Companies

Parliament has taken the view that the new rules could be easily avoided if they just applied to the disposal of UK real estate. For example, an investment property could be held by a corporate vehicle and the shares of the corporate vehicle could be sold by non-UK residents without there being a charge to tax.

In order to plug this gap, the legislation has come up with the concept of a "land rich company". A non-UK resident will be subject to tax on gains on the disposal of its rights in a company (regardless of where it is incorporated) if two conditions are met:

- The non-resident disposes of an interest or a "right" (note, this is broader than a share) in a company and at the time of the disposal 75% of the company's gross asset value is derived from UK real estate.
- The non-UK resident has had at any time in a two-year period prior to the disposal of the interest or right a substantial investment in the company. For these purposes, a substantial investment means an investment of 25% or more. The 25% investment test is more subtle than just looking at the ownership of the company's share capital – it covers certain types of loan note, the control of voting power, and future and current ownership rights.

The land rich company concept is clearly designed to catch sales to third party purchasers where substantial actual capital gains may accrue. However, the legislation also applies to family transactions and group reorganizations where shareholdings and interests are transferred. These transactions are often treated for the purposes of taxing capital gains as taking place at market value, with the result that non-resident taxpayers would be subject to tax on deemed (rather than actual) gains as a result of the new rules.

Is This Something Which We Can Bury Our Heads in the Sand About?

It is only human nature to hunker down in the case of a storm in the hope that it passes over. Unfortunately, we cannot ignore the reach of these new rules.

This is because Parliament has decided that a tax return recording the disposal of the UK real estate and the payment of any tax must be made, in many but not all, circumstances, on or before the 30th day following completion of the disposal. This treatment applies whether the disposal is of real estate or an interest or a right in a land-rich company in which the non-resident has a substantial investment.

To double up on the mischief, Parliament has enacted different rules and different time limits on filing the returns and paying the tax for individuals and trusts (who are subject to capital gains tax) than those for companies (which are subject to corporation tax on their chargeable gains).

Funds

Funds have their own bespoke rules, which are a trap for the unwary (i.e. they will do to you what Brutus and Cassius did to Caesar, "Et tu Brute?")

There are at least two highly problematic areas for funds that derive at least 75% of their gross asset value from UK real estate:

- Fund structures often use more than one vehicle to hold the UK real estate which creates the risk of multiple charges at the level of the fund.
- A non-resident will be treated as having a taxable interest in a fund regardless of the actual size of the interest. In other words, the 25% investment test does not apply to funds with the result that a charge will arise when an investor disposes of its interest, no matter how small.

The legislation allows funds to take a number of planning steps to minimize the risk for multiple charges. However, these steps are highly fact-specific and they are not suitable for a general overview such as this one.

At this stage you may be thinking "Infamy, Infamy they've all got it in for me", as Julius Caesar reputedly said! However, for some advice on avoiding another dagger thrown in your direction by Parliament, please contact a member of our Tax Strategy & Benefits team.

Contacts

Timothy Jarvis
Partner, Tax Strategy & Benefits
T +44 113 284 7214
E timothy.jarvis@squirepb.com