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Ownership of UK dwellings by non-UK domiciliaries

Changes to the UK tax regime

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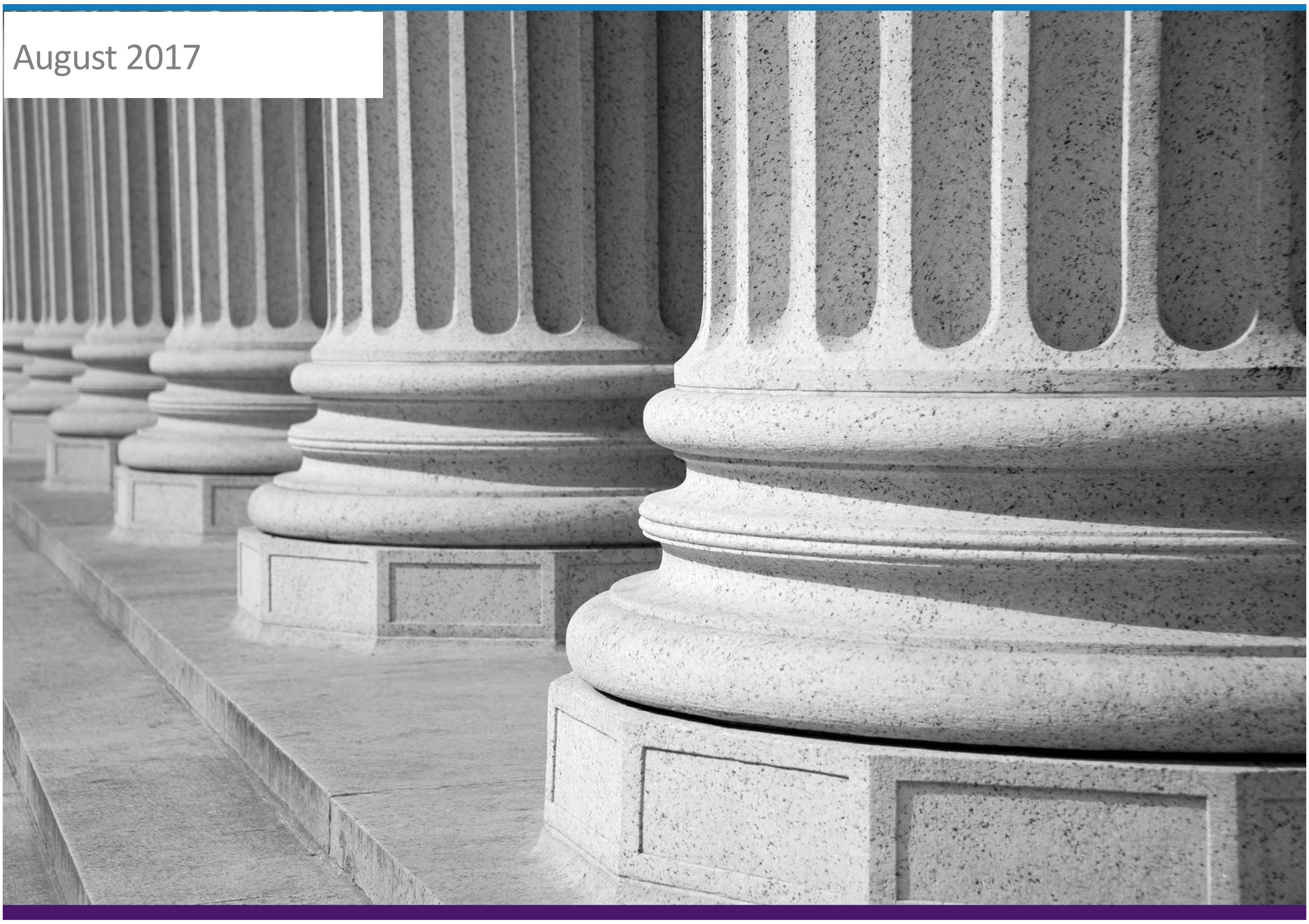

Ownership of UK dwellings by non-UK domiciliaries

Introduction

Historically it was possible for non-UK domiciled individuals to structure the way that they hold their UK properties to take advantage of available tax exemptions so that little or no UK tax was payable in respect of the properties, either on sale or on transfer during lifetime or on death.

Successive UK Governments have sought to reduce these tax advantages so that non-UK domiciled individuals have to pay more UK tax. As a result offshore holding structures used to hold UK dwellings may now result in the payment of more tax than direct ownership. In addition, with the possibility of the introduction of beneficial ownership registers, there may no longer be confidentiality advantages in holding property through a corporate structure.

It is therefore important to review the manner in which your UK property (UK dwellings in particular) is held to ensure that you are holding it in the most tax efficient way and to continue to keep your property ownership and succession arrangements under review.

This briefing paper provides an overview of the tax regime applicable to UK resident and non-UK resident non-domiciled individuals. It includes the Government's proposed reforms which were dropped from Finance Bill 2017 before the election and then reintroduced in Finance Bill (No. 2) 2017 and will take effect retrospectively from 5 April 2017 once the Finance Bill receives Royal Assent which is expected to be in the autumn of 2017. It provides only a brief summary of this complicated area of law and you should obtain specialist advice on your property ownership and succession arrangements.

We explain below the operation of Capital Gains Tax ("CGT"), Inheritance Tax ("IHT") and Stamp Duty Land Tax ("SDLT") both before and after the introduction of the new tax regime. We also explain the introduction of the new property tax Annual Tax on Enveloped Dwellings ("ATED"). We also mention the new Statutory Residence Test and provide an overview of the proposed new Domicile rules. You should review your financial affairs taking account of these new rules .

Planning for future investment in UK property

In view of the tax reforms it is now likely to be more tax efficient for non-domiciled individuals to invest in commercial property rather than residential property in the UK because:

- SDLT rates are lower;
- there is no CGT if the individual is non-UK resident;
- there is no ATED; and
- there will still be no IHT if the commercial property is held by an offshore company.

ATED

Persons affected and tax amounts

ATED has been introduced to discourage ownership of high value dwellings via corporate vehicles and applies whether the individuals with ultimate ownership of the structure are UK or non-UK resident (including individuals who are UK and non-UK domiciled or deemed domiciled). ATED is an annual tax payable each year for the period from 1 April to 31 March. It has been in effect since 1 April 2013 and is imposed on UK and non-UK resident corporate beneficial owners (individuals, trustees of settled property and personal representatives of deceased persons are outside the scope of the charge) of dwellings over a specified value. This value was originally £2 million but reduced to £1 million for chargeable periods beginning on or after 1 April 2015. The value was reduced again to £500,000 for chargeable periods beginning on or after 1 April 2016. The amount of ATED to be charged depends on the band into which the value of the dwelling falls and is determined as follows:

Value of the dwelling	***ATED amount payable***				
	2013/14	***2014/15***	***2015/16***	***2016/17***	**2017/18**
Over £500,000 to £1 million	N/A	N/A	N/A	£3,500	£3,500
Over £1 million to £2 million	N/A	N/A	£7,000	£7,000	£7,050
Over £2 million to £5 million	£15,000	£15,400	£23,350	£23,350	£23,550
Over £5 million to £10 million	£35,000	£35,900	£54,450	£54,450	£54,950
Over £10 million to £20 million	£70,000	£71,850	£109,050	£109,050	£110,100
Over £20 million	£140,000	£143,750	£218,200	£218,200	£220,350

For example, if the dwelling is valued at £7 million, the corporate owner will have to pay £35,000 for the 2013/14 tax year, £35,900 for 2014/15, £54,450 for 2015/16 and 2016/17 and £54,950 for 2017/18. If the dwelling is owned for only part of a year, or the use of the dwelling is changed so that it moves into or out of ATED, then ATED applies on a proportionate basis.

Valuation

The value of the dwelling used to determine the amount of ATED payable in a tax year is currently the market value as at 1 April 2012 in respect of properties owned at that date. The 2012 valuation applies for the first five chargeable periods from 1 April 2013 until 31 March 2018. A new valuation has to be obtained every five years. The next valuation date (for properties held at 1 April 2012) is 1 April 2017 and this 2017 valuation will apply for the chargeable periods from 1 April 2018 to 31 March 2023 and so on.

Professional valuation is not obligatory but should be considered if the dwelling is very high value, unusual, or the value is close to a band limit. Where the dwelling was acquired after 1 April 2012, the relevant value is the market value as at the date of the acquisition subject to re-valuations on every five year anniversary of 1 April 2012.

Reliefs and exemptions

There are certain reliefs designed to prevent ATED from applying to genuine commercial activities. Such reliefs apply, in particular, to property rental businesses, property developers and property traders. There are also exemptions for charities, public and national bodies and dwellings conditionally exempt from inheritance tax.

Reporting obligations

Returns and payments must generally be made by 30 April at the beginning of each chargeable period. When the dwelling is acquired, the corporate purchaser is required to make an ATED return and payment within 30 days. If the dwelling otherwise newly comes within the charge the return must be made within 90 days of the relevant date.

ATED-related CGT

This charge has been in force since 6 April 2013 and applies to disposals of residential properties chargeable to ATED. In broad terms, if a corporate owner of a dwelling had to pay ATED during some or all of its period of ownership, it will have to pay ATED - related CGT on all or part of the gain it makes on the disposal of the dwelling.

Calculating ATED-related gains

Normally, only gains (or losses) attributable to periods after 5 April 2013 (for dwellings worth over £2 million as at 1 April 2012), 5 April 2015 (for dwellings worth between £1 and 2 million) or 5 April 2016 (for dwellings worth between £500,000 and 1 million) are ATED-related. This means that the ATED-related gain (or loss) is calculated as if the dwelling was acquired on one of the above dates (depending on the value of the dwelling) for consideration equal to its market value on that date. The amount of the gain (or loss) subject to the ATED-related CGT is then in proportion to the days for which the dwelling was chargeable to ATED. The rate applicable to ATED-related gains is 28%.

It is possible to make an election to calculate the gains or losses based on the whole period of ownership rather than after 5 April 2013, 2015 or 2016 (as applicable). This may be beneficial in cases where the dwelling is sold at a loss.

Reliefs and exemptions

The charge is tied in with ATED and therefore the same reliefs and exemptions as for ATED apply to ATED-related CGT. Given the nature of the charge, Private Residence Relief is not available.

Reporting obligations

A liability to ATED-related CGT must be reported to HMRC by completing the ATED-related capital gains summary form on or before 5 October following the end of the tax year in which the disposal occurred. Currently the tax must be paid no later than 31 January following the end of the tax year in which the disposal occurred. The Government, however, has announced that from April 2019 a payment on account of any CGT due on the disposal of a dwelling will be required to be made within 30 days of completion of the disposal.

Non-resident CGT

Who is affected?

Before the introduction of the new regime CGT was payable by UK resident individuals, trustees and personal representatives (but not companies or other corporate bodies) on the gain made on the disposal of an asset subject to certain exemptions and reliefs. Non-UK residents did not have to pay CGT when disposing of UK assets (subject to some exceptions). However, with effect from 6 April 2015, this favourable CGT treatment has been restricted with the introduction of the new "non-resident CGT" ("NRCGT") which applies to disposals of UK dwellings by non -UK residents. The new charge applies without exception to individuals, corporate entities, trustees and personal representatives.

Dwelling for the purpose of NRCGT means a property suitable for use as a dwelling or in the process of being constructed or adapted for such use (but excludes a number of categories of building including certain categories of residential accommodation).

Rates of tax

The same rates which apply to UK residents apply to non--residents. This means that non-resident companies pay NRCGT at the rate of tax applicable to UK companies (i. e. at the corporation tax rate of 20% which will be reduced to 17% in 2020) and non-resident individuals at the rates applicable to UK resident individuals (i.e. 18% and/or 28%) in relation to residential property, depending on the non-resident individual's total UK income and gains in the year of disposal. The rate applicable to trustees is 28% in relation to residential property.

What is meant by a "disposal"?

Disposals include gifts and transfers of property to former spouses following divorce, for example, and not only sales on an arm's length basis. This means that a liability to NRCGT may arise even if no money or asset is received in return for the dwelling.

Calculating your gain

The new charge only applies to gains arising post-5 April 2015. The taxable gain can be calculated either by working out the difference between the value of the dwelling as at 5 April 2015 and the date of disposal ("re-basing" method) or by apportioning the gain over the period of ownership ("straight-line time apportionment" method) depending on which method is more advantageous. It is also possible to carry out calculations over the whole period of ownership. This option may be useful where the dwelling is sold at a loss as losses can be offset against gains from disposals of other UK dwellings in the same and future years.

Interrelation with ATED-related CGT and old CGT

Where the disposal is within the scope of NRCGT and/or old CGT as well as ATED-related CGT, ATED-related CGT at 28% takes precedence. The NRCGT and/or old CGT rules will only apply if only part of the gain is ATED-related (for example, a relief from ATED applied during a part of the period of ownership) and only to the non-ATED related part of the gain. NRCGT will apply to any post-April 2015 gain of non-residents which is not an ATED -related gain. Any balancing gain (i.e. the part of the gain which is neither ATED-related nor NRCGT gain) will be subject to the old CGT rules, including rules that in certain circumstances attribute gains of small non-UK resident companies to their UK resident owners/shareholders.

How much was the dwelling worth on 5 April 2015?

Professional valuation is not obligatory and owners can value the dwellings themselves. It may, however, be a good idea to instruct a professional surveyor particularly where the dwelling is high value. HMRC is less likely to question professional valuations if the disposal is not on an arm's length basis (for example, a sale to a relative at a discount or a gift). It will also be necessary to establish the market value as at the date of the disposal.

Private Residence Relief

The relief is available to non-resident individuals but the rules are more restrictive than those applicable to UK resident individuals.

For a non-resident to be able to rely on the relief for the year of ownership, he/she must have spent at least 90 days in the dwelling in that year. This may be difficult or impracticable and may affect the individual's non-resident status. The relief does not apply if the dwelling is rented out throughout the whole period of ownership. If, for example, the dwelling was used as a residence first and then rented out, an additional lettings relief may be available to reduce the gain further.

Double tax treaty relief

Some double tax treaties allow for relief from tax on capital gains in the non-resident's country of residence for the tax paid on the gain abroad. This means that the non-resident tax payer only pays tax once and the amount is the higher of the two countries' tax bills. If the tax due in the individual's country of residence is lower than their tax liability in the country where the gain arises, no additional tax is due. If the tax liability in the country of residence is higher, the tax payer has to pay the difference. Residents of the countries which tax their residents' worldwide gains but which do not have double tax treaties with the UK (or relevant provisions in the treaties) are at a significant disadvantage.

Reporting obligations

Disposals of UK dwellings by non-residents must be reported to HMRC within 30 days from the date of the conveyance. If there is a tax liability, it must be settled within the same time frame. Currently a return is required even if no tax is due, but the Finance Bill 2016 makes the submission of such a return optional when statute provides that no gain or loss arises (for example on a disposal between spouses who live together) or on the grant of an arm's length lease for no premium to a person who is not connected to the grantor.

It is important to distinguish between the date of the transfer of the title to the property (i.e. the conveyance) and the date of the disposal for CGT purposes as these are not the same in most cases. For example, where a dwelling is sold at arm's length, the parties will often enter into a contract first and the seller will execute a transfer deed to convey the dwellings to the buyer at a later date. The date of the disposal for CGT purposes is the date of the contract (provided the contract is unconditional) and not the date of the transfer deed. If, for example, the contract is signed on 25 March 2015 and the transfer deed is executed on 15 April 2016, it is necessary to remember that the disposal relates to the 2015/16 year and the tax liability must be calculated using the rates and allowances for that year.

IHT

IHT on UK dwellings held by non-domiciled individuals directly or indirectly through offshore structures from April 2017

Before 6 April 2017 non-domiciled individuals who held UK residential property indirectly (i.e. through an offshore company, trust or other structure, such as a partnership) were not liable for IHT on that residential property.

In the 2015 Summer Budget, the Government announced that it intended to make changes so that non-domiciled individuals who hold residential properties which fall under the definition of a "dwelling" either directly or indirectly will be liable to IHT on the value of those residential properties. Other property, such as non -UK assets and UK commercial property, owned indirectly by an offshore company, trust or partnership, will not be affected by the changes.

The Government has confirmed that the new rules will apply to UK dwellings held through overseas close companies, trusts and partnerships. The proposed new rules were temporarily withdrawn as a result of the UK Election but were reintroduced in the Finance Bill 2017 which was updated and republished on 13 July 2017. The new rules will be introduced by the Finance Act

2017 and will take effect from 6 April 2017.
The Government has confirmed that UK dwellings will be removed from the definition of excluded property for IHT purposes so it will be within the scope of IHT even if held indirectly through an offshore structure.

Under the new rules a UK dwelling will be within the charge to IHT only where it is used as a dwelling at the point at which a transfer of value is made. The UK dwelling will be valued for IHT purposes at open market value. The legislation also contains rules relating to more complex structures including shared and multiple ownership. It has also been confirmed that for the purpose of the new IHT charge "dwelling" will be defined in the same way as for the purpose of non-resident CGT (see above).

The Government has also announced that where UK dwellings continue to be held through an overseas company HMRC will require expanded powers to impose IHT directly on the property or on the legal owners of the property when it is sold. The Government has confirmed that it does not now propose to impose liability on the directors of companies which hold such properties and alternative approaches are under consideration to ensure that the IHT charge can be enforced.

New IHT charges for lenders and borrowers

Initially the Government proposed that loans between people connected with each other should no longer be used to achieve a deduction from the value of UK residential property for IHT purposes. In December 2016 the Government published unexpected new proposals for loans which may apply even where the lender is unconnected with the borrower. These proposals were also temporarily withdrawn due to the UK Election and reintroduced in the Finance Bill 2017 to take effect from 6 April 2017. Under the new proposals very significant new IHT charges may arise for lenders and borrowers where loans are made for the purchase, maintenance or enhancement of UK residential property to non-domiciled individuals, trustees of settlements created by non-domiciled settlors, close companies and partnerships, The new charges are summarised as follows:

- ***Loans to acquire UK residential property – a charge on the lender***

  Loans made to a non-UK domiciled borrower to buy, maintain or enhance UK residential property will continue to be deductible by the borrower for IHT purposes but may now give rise to a charge to IHT for the lender if the lender is within the scope of IHT (i.e. where the lender is an individual, partnership or a close company owned by a small number of participants). This charge potentially applies to loans by a lender unconnected to the borrower, including a commercial loan made by a Bank if the Bank is within the scope of IHT.

- ***Security provided for loans to acquire UK residential property – a charge on the borrower***

  Assets which a non-UK domiciled borrower makes available as security, collateral or guarantee for a loan to buy, maintain or enhance UK residential property, (which is sometimes known as "back to back lending" and which we refer to here as "Collateral Security") will be treated as property subject to IHT in the hands of the borrower to the extent of the value of the loan. This will bring within the scope of IHT foreign Collateral Security up to the value of the loan (UK assets are already within the scope of IHT). The implications of this are far reaching. Borrowers may have pledged significant foreign assets which may become subject to an IHT charge at the rate of 40% when the borrower dies.

  For example, assume X, a non-domiciled individual, purchases a UK residential property for £1m with the assistance of a £0.5m loan from Bank Y, and Bank Y requires that X makes his property in Doha (worth £2m) available as security for the loan. Here the property in Doha up to the value of the loan (i.e. £0.5m) will become subject to IHT. If the loan is outstanding on X's death, X's executors can deduct the value of the loan outstanding from the total value of the UK residential property and the property in Doha. The remaining value will be subject to IHT. Therefore X's estate will be liable for IHT on assets valued at £1m (being the Doha assets equivalent to the value of the loan (£0.5m) plus the UK property worth £1m less the deductible loan of £0.5m).

- ***Rights of participators in close companies and partnerships – charges on participators and partners***

  Rights and interests that a participator has in a foreign close company, or that a partner has in an offshore partnership, which are directly or indirectly attributable to a relevant loan (i.e. to a loan to buy, maintain or enhance UK residential property) or to the Collateral Security for such a loan will now come within the scope of IHT.

The main residence nil rate band

Each individual currently has a maximum basic nil rate band amount of £325,000. This is the amount which is chargeable to IHT at 0%.

Changes introduced by the Finance Act 2015:

Individuals who die on or after 6 April 2017 will be able to benefit from an additional nil rate band – a main residence nil rate band ("RNRB") provided they leave their interest in their home to their direct descendants. In addition, it will be possible to transfer any unused RNRB to a surviving spouse or civil partner, where the surviving spouse or civil partner dies on or after 6 April 2017.

If the deceased had an interest in more than one dwelling, their personal representatives will be able to nominate to H M Revenue and Customs which dwelling should benefit from the RNRB (provided it had been occupied by the deceased at some point).

The RNRB will be £100,000 for 2017/18, increasing in stages to £175,000 in 2020-21.

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There is also a tapered withdrawal of the RNRB where the value of the deceased's estate is £2 million or more.

The Finance Bill 2016 includes a provision which covers the situation where individuals "downsize" but still leave their assets to lineal descendants. The draft provisions provide that an additional RNRB can be claimed when the deceased "downsized" or sold all his/her residential property after 8 July 2015 and some part of the deceased's estate is left to a lineal descendant. The main RNRB used and the additional RNRB used together will not exceed the total RNRB that would have been available if the deceased had not downsized or sold his/her residential property. Estates valued at over £2 million will suffer from the tapered withdrawal of the additional RNRB.

Stamp Duty Land Tax

SDLT has undergone significant changes which affect both UK and non-UK residents.

New system

Up until 4 December 2014 SDLT was charged at a single rate on the full amount of the chargeable consideration. With effect from 4 December 2014 the Government introduced a new "progressive" system which applies to purchases of UK dwellings. Under the new system SDLT is charged at increasing rates for each portion of the consideration falling within each rate band. This results in an SDLT saving for the buyers of dwellings up to £937,500 and in a higher SDLT bill if dwellings are worth over that

Property or lease premium or transfer value	SDLT rate
Up to £125,000	Zero
The next £125,000 (the portion from £125,001 to £250,000)	2%
The next £675,000 (the portion from £250,001 to £925,000)	5%
The next £575,000 (the portion from £925,001 to £1.5 million)	10%
The remaining amount (the portion above £1.5 million)	12%

amount. The following rates apply:

Purchases by corporate entities

The above rates do not apply to purchases of UK dwellings worth over £500,000 by corporate bodies for occupation by the shareholder or family members. Since 21 March 2012 such purchasers have paid SDLT at a higher single rate of 15% on purchases of dwellings over a certain value (initially £2 million, reduced to £500,000 with effect from 20 March 2014) and this rule continues to apply.

Purchases of additional dwellings

Another change came into force on 1 April 2016. Higher rates of SDLT have been introduced on purchases of a dwelling by a company or where purchased by an individual (directly or through a nominee company) if this is of an additional dwelling such as a second home or buy-to-let property for a chargeable consideration of £40,000 or more. A dwelling already owned by the individual anywhere in the world is taken into account in determining whether the dwelling being purchased is an additional dwelling.

The higher rates are as follows (3 percentage points above

Property or lease premium or transfer value	SDLT rate
Up to £125,000	3%
The next £125,000 (the portion from £125,001 to £250,000)	5%
The next £675,000 (the portion from £250,001 to £925,000)	8%
The next £575,000 (the portion from £925,001 to £1.5 million)	13%
The remaining amount (the portion above £1.5 million)	15%

normal SDLT residential rates):

The higher rates do not apply if the dwelling is purchased as a replacement of the individual's main residence. Where the residence which is being replaced is sold after the purchase of the replacement dwelling it will still be necessary to pay SDLT at higher rates and claim a refund at a later stage.

Filing and payment

Currently the purchaser has 30 days from completion to file the SDLT return and pay the tax due.

New Statutory Test of Residence

A new statutory test of residence was introduced with effect from 5 April 2013 and you should ensure that all of your financial and tax planning arrangements take account of the new rules.

Domicile rules

The Government has announced a number of reforms to the taxation of individuals who are not domiciled in the UK which will take effect from 6 April 2017. It is proposed that:

1. Born in the UK with UK domicile of origin.

   An individual who was born in the UK with a UK domicile of origin, but acquires a domicile of choice elsewhere, will be treated as deemed UK domiciled for all tax purposes for any tax year during which they are resident in the UK. A period of grace is allowed in respect of IHT where an individual with a UK domicile of origin will be deemed domiciled and charged to IHT for years of UK residence only where they have been resident in the UK in at least one out of the previous two tax years.

2. Deeming UK domicile for long term residents.

   An individual who has been resident in the UK for at least 15 out of the past 20 tax years will be treated as deemed UK domiciled for all UK tax purposes. Therefore, from the 16th tax year of residence in the UK, a foreign domiciliary will become deemed UK domiciled (so an individual continuously UK resident since 2002/3 will become deemed domiciled from 6 April 2017. In calculating the 15 tax years of UK residence, any tax year during which the individual was under 18 will be included.

   IHT tax tail - If a foreign domiciliary who is deemed UK domiciled leaves the UK they will lose deemed domicile status for the purpose of IHT at the start of the fourth tax year of non -residence.

   Income tax and CGT tax tail - For income tax and CGT a six year period of non-residence is required before the remittance basis can be claim on return to the UK.

It should be noted that the new deemed domicile provisions will apply for tax purposes only, and will not affect the individual's domicile status for other purposes, such as the application of succession rules. Also the domicile status of parents under these new deeming rules will not apply to their children whose domicile status will be separately assessed.

The Government has also confirmed that UK resident non-domiciliaries will be allowed to treat the base cost of their personally held foreign assets as the market value of the asset as at 6 April 2017 for CGT purposes. Rebasing will not be available for individuals who become deemed domiciled after April 2017 or who become deemed domiciled because they were born in the UK with a UK domicile of origin and then become UK resident.

Income tax

Non-UK residents are liable to income tax on their UK source income. However, UK tax liabilities for non-UK residents are limited.

A non-UK resident individual or company which owns any type of property in the UK (residential or commercial) which is rented out, will be liable to income tax on the rental income received (less any deductible expenses).

For an individual, the rate of tax depends on his or her total income in the UK during a tax year. For the 2017/18 tax year the income tax rate for rental income up to £33,500 is 20%, the rate from £33,501 is 40% and the rate above £150,000 is 45%.

If you are a citizen of a European Economic Area country (including British passport holders) or you have worked for the UK Government at any time during the tax year you will benefit from the Personal Allowance of tax free UK income. The standard Personal Allowance for 2017/18 is £11,500. The Personal Allowance decreases by £1 for every £2 of income above £100,000. You may also benefit from a Personal Allowance under the terms of a Double-Taxation Agreement.

The rate of income tax for a company is 20%.

A non-UK resident landlord will need to apply to HMRC so that HMRC can authorise the tenant to pay the rent gross (i.e. without deducting tax). This authorisation is routinely given upon the landlord undertaking to file tax returns in respect of the rent. (This procedure is known as the non-resident landlord scheme.)

Conclusion

If you are a non-domiciled individual who owns dwellings in the UK you should seek advice on the way you structure your property holding arrangements and also the succession of your property during lifetime or on death to take account of the significant recent changes in the UK tax legislation and the proposed future reforms.

In view of the reforms non-domiciled individuals who wish to invest in UK property in future may wish to consider the possibility of investing in commercial property for which the UK tax liabilities are less onerous.

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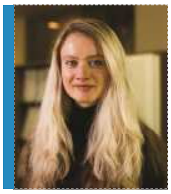

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