



UK Residential Property Update

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The below provides a general overview of the key considerations for individual, trust or corporate ownership of UK residential property.

This overview is designed to help you to consider which ownership option may be most suitable, however the position will ultimately depend on your individual circumstances.

Summary of the recent announcements affecting the future taxation of UK residential property

• **Inheritance tax (“IHT”)**

From April 2017, it is intended that inheritance tax will be payable on all UK residential property owned by non-domiciles, regardless of whether they are UK resident or not. This will include property held indirectly through an offshore company.

The key points to note are:

- The proposed changes will not happen until April 2017
- There will be a consultation process during 2016.
- Where a company is held by an individual the IHT position would be the same as for a non-UK domiciled individual holding UK property directly (20% lifetime charge on transfer into a trust or 40% on death)
- Where the company is held by a trust the IHT position would be the same as for a trust holding UK property directly (up to a 6% charge every 10 years on the value of the UK property, or on an exit from the trust).
- If the settlor is a beneficiary or potential beneficiary of the trust, on the settlor’s death there would also be an exposure to a 40% IHT charge.

In order to mitigate the Inheritance Tax exposure, the following planning may be available:

- Settlor excluded trusts
- Debt financing (although this is increasingly restricted)
- Multiple settlors or owners in order to split the value of individual ownership to utilise multiple nil rate bands (currently £325,000)
- Insurance to cover unexpected early deaths

A full detailed consultation from the UK Government will follow later this year. Once further details are known we will be able to comment on these changes further.

• **Main residence nil rate band**

The government will introduce an additional nil rate band when a residence is passed to direct descendants on a death. This will be £100,000 in 2017-18, £125,000 in 2018-19, £150,000 in 2019-20, and £175,000 in 2020-21.

Any unused nil rate band will be transferred to a surviving spouse or civil partner. A tapered withdrawal of the additional nil rate band is proposed for estates with a net value of more than £2 million. This will be at a withdrawal rate of £1 for every £2 over this threshold.



- **Restricting finance cost relief for landlords**

Loan finance relief will be restricted to the basic rate of tax for individual landlords of residential property. The restriction will be phased in over 4 years, starting from April 2017. There will be no change for corporate landlords who will still get full relief.

- **Offshore property developers**

The government will introduce legislation in Finance Bill 2016 to ensure offshore structures cannot be used to avoid UK tax on profits that are generated from developing UK property. This measure ensures that profits from trading in UK land are always subject to UK tax even if there is no UK permanent establishment. The double taxation agreements with Guernsey, the Isle of Man and Jersey are being amended. Legislation for this measure will be introduced at a later stage of Finance Bill 2016, following a brief consultation.

Current property structuring options

Direct ownership by a non-UK resident individual

- **Income tax (“IT”)**

An individual in receipt of rents from a UK property will pay tax based on the level of taxable income at rates of 20%, 40% and 45%.¹

Certain non-UK resident individuals² in receipt of rental income will be able to claim the UK personal allowance, currently £11,000 from 6 April 2016.

The basic rate band for individuals will be £32,000 for 2016/17 so rental profits between £11,000 and £43,000 will be subject to 20% tax (provided the individual has no other income).

Commercial interest payable on a loan used to acquire the property, as well as other allowable expenses, will reduce taxable rents thereby reducing the IT charge (although see the point above relating to the restriction of finance cost relief for landlords).

- **Capital Gains Tax (“CGT”)**

The UK Government recently extended the UK CGT regime to tax gains on UK residential property made by non-UK resident investors. This affects disposals of residential properties made by all qualifying non-UK resident individuals, companies and trusts.

The rate of tax for non-resident individuals will be the same as the CGT rates for UK individuals, currently 18% or 28% depending on the person’s total UK income and chargeable gains for the tax year. Non-resident individuals will have access to the annual exempt amount of taxable gains, in line with UK residents.

This charge will only apply to the amount of gain relating to periods after 6 April 2015. The government will, in most cases, allow either rebasing to 5 April 2015 or a time-apportionment of the whole gain.

The non-resident disposing of UK residential property will need to report the disposal and pay any tax to HMRC within a set timeframe of the completion. Where a person has an existing relationship with HMRC, they will be able to make a payment as part of their self-assessment return instead. However, in both cases the non-resident disposing of UK residential property will need to notify HMRC that the disposal has occurred within 30 days of the property being conveyed.

¹ In practice HMRC may accept a 20% withholding tax on the gross rental income.

² EEA nationals, residents of the Channel Islands or the Isle of Man and employees (past and present) of the British Crown.

- **Inheritance tax (“IHT”)**

Individuals are subject to UK IHT on directly held UK situs assets, regardless of domicile. IHT is charged at 0% on the available nil rate band (up to £325,000) and the balance will be subject to 20% on chargeable lifetime transfers or 40% on death.

The value of the property may be reduced for IHT purposes by securing debt against the property. However, care must be taken in respect of the new rules on the deductibility of debts for IHT.

It may also be possible for an individual to take out Inheritance Tax insurance against unexpected early death.

- **Annual Tax on Enveloped Dwellings (“ATED”)**

Properties owned directly by individuals will not be subject to the ATED.

- **Stamp Duty Land Tax (“SDLT”)**

SDLT is due on the acquisition of UK real estate and is based on the consideration provided for the transfer. If the property is received as a gift there will usually be no SDLT to pay.³

With effect from 4 December 2014, the government announced that SDLT on purchases of residential property had been reformed. SDLT will be payable at each rate on the portion of the purchase price which falls within each band, rather than at a single rate on the whole transaction value. The rates and thresholds have also been amended as part of this reform.

- The portion of the transaction value up to £125,000 will be charged at a rate of 0%,
- The portion between £125,001 and £250,000 will be charged at a rate of 2%,
- The portion between £250,001 and £925,000 will be charged at a rate of 5%,
- The portion between £925,001 and £1,500,000 will be charged at a rate of 10%, and
- The portion over £1,500,001 will be charge at a rate of 12%.

Higher rates for additional properties

From 1st April 2016, the UK Government introduced higher rates of SDLT on purchases of additional residential properties. The higher rates will be 3 percentage points above the current SDLT rates. Purchasers will have 36 months to claim a refund of the higher rates if they buy a new main residence before disposing of their previous main residence.

Where the property is held by a non-UK company, if the shares in the company are sold to the purchaser rather than a sale of the underlying property, there will be no SDLT to pay by the purchaser. In this case it may be possible that the purchaser and vendor can both share in the saving.

Please note however that the accrued capital gain in the company will be passed to the purchaser.

Properties owned directly by individuals will not be subject to the enhanced rate of SDLT for non-natural persons of 15% (see details below). An individual may also use a nominee company to hold the UK real estate without being subject to the enhanced rate of SDLT.

³ As long as there is no outstanding mortgage on the property or any other form of consideration.

Direct ownership by a non-UK resident Trust

- **Income tax**

A trust in receipt of UK property rental income will pay UK tax on that income. Assuming that the trust is a discretionary trust, the tax rate will be 45%.⁴

Commercial interest payable on a loan used to acquire the property, as well as other allowable expenses, will reduce taxable rents thereby reducing the IT charge.

- **Capital Gains Tax**

The UK Government recently extended the UK CGT regime to tax gains realised by non-resident investors in residential property. This affects disposals of residential properties made by all qualifying non-resident individuals, companies and trusts.

In line with the treatment of UK resident trustees, the rate of tax for non-resident trustees will be 28%, with the annual exempt amount being half that available to individuals.

This charge will only apply to the amount of gain relating to periods after 6 April 2015. The government will, in most cases, allow either rebasing to 5 April 2015 or a time-apportionment of the whole gain.

The non-resident disposing of UK residential property will need to report the disposal and pay any tax to HMRC within a set timeframe of the completion. Where a person has an existing relationship with HMRC, they will be able to make a payment as part of their self-assessment return instead. However, in both cases the non-resident disposing of UK residential property will need to notify HMRC that the disposal has occurred within 30 days of the property being conveyed.

- **Inheritance Tax**

Where UK property is held directly by a trust, this would form relevant property within the trust that would be subject to periodic and exit charges. Trust IHT equates to a maximum charge of 6% every 10 years. If the property is distributed from a trust there is also an exit charge of up to 6%. However, please note that if the property is sold, the proceeds are held in a non-UK bank account and these non-UK funds are then distributed, for example, there would be no exit charge.⁵

The value of the property may be reduced for IHT purposes by securing debt against the property. However, care must be taken in respect of the new rules on the deductibility of debts for IHT.

- **Annual Tax on Enveloped Dwellings**

A trustee (including a corporate trustee) does not fall within the definition of a non-natural person for the purposes of the ATED. Trust structures may also use nominee companies to hold the UK real estate without being subject to the ATED.

⁴ The first £1,000 of gross trust income will be taxed at the basic rates.

⁵ Provided the settlor was domiciled outside of the UK (and not deemed UK domiciled) at the time the trust was created.



- **Stamp Duty Land Tax**

The SDLT position will be largely the same as for a non-UK resident individual, however the higher rate of SDLT for purchases of additional properties will work differently in some cases where there is a trust. Purchases by trustees where beneficiaries have no interest in possession over the property will be liable to the higher rates even on the first purchase of a property by the trust.

Properties owned directly by trusts will not be subject to the enhanced rate of SDLT for non-natural persons of 15% (see details below). Trustees may also use a nominee company to hold the UK real estate without being subject to the enhanced rate of SDLT.

Direct ownership by a non-UK resident company

- **Income tax**

A non-UK resident company is the most tax efficient vehicle to receive UK rents. A company will pay only 20% on rental profit.⁶

Commercial interest payable on a loan used to acquire the property, as well as other allowable expenses, will reduce taxable rents thereby reducing the IT charge.

- **Capital Gains Tax**

Where a property is worth in excess of £2 million and it is liable to ATED throughout the relevant periods, any capital gain arising after 5 April 2013 is taxable at 28% (i.e. gains accrued up until 5 April 2013 will not be taxable, it is only the increase in value after 6 April 2013 that will be liable to tax).

For properties worth between £1 million and £2 million and where the property is subject to ATED, ATED related CGT applies to any capital gain arising after 6th April 2015. For properties worth between £500,000 and £1 million where ATED is also chargeable, the ATED-related CGT charge will apply to any capital gain arising after 6th April 2016.

Where ATED is not applicable, Non-Resident Capital Gains Tax ("NRCGT") is now charged on the disposal of UK residential property, on any capital gain arising after 5th April 2015.

The rate for companies will mirror the UK corporate tax rate, currently 20%. However, this charge will remain at 28% on disposals of property subject to ATED-related CGT. To prevent potential double taxation, where part of the gain could be subject to both ATED-related CGT and the new CGT charge the ATED-related CGT charge will take precedence.

The new CGT charge will only apply to the amount of gain relating to periods after 6 April 2015. The government will, in most cases, allow either rebasing to 5 April 2015 or a time-apportionment of the whole gain.

Where the non-resident disposing of UK residential property does not have an existing relationship with HMRC they will need to pay any tax to HMRC within 30 days of the completion. Where a person has an existing relationship with HMRC, they will be able to make a payment as part of their self-assessment return instead. However, in both cases the non-resident disposing of UK residential property will need to notify HMRC that the disposal has occurred within 30 days of the property being conveyed.

⁶ When the ultimate beneficial owner (or where a trust holds the company, the settlor or in some cases a beneficiary) is UK resident, additional UK tax will generally be payable if that person is a higher rate tax payer.

- Inheritance Tax**

If a property is held through a non-UK resident company acting beneficially, there is currently no liability to UK tax on death provided that the shares in the company are held either by a non-UK domiciled individual⁷ or by a trust that has been settled by a non-UK domiciled settlor.⁷

However, please note the proposed changes to the UK IHT rules as outlined at the beginning of this document.

- Annual Tax on Enveloped Dwellings**

The ATED is an annual UK tax charge on UK residential property. Properties worth more than £500,000 as at 1 April 2012 that are owned by a non-natural person are within the charge.

Essentially a non-natural person is a company, a partnership with a corporate partner or a collective investment scheme. This includes both UK resident and non-UK resident entities.

The first ATED charges applied from 1st April 2013 to properties worth over £2 million.

Properties worth between £1 million and £2 million were included within the charge from 1st April 2015 (£7,000).

Properties worth between £500,000 and £1 million were included within the charge from 1 April 2016 (£3,500).

Chargeable amounts for 1st April 2016 to 31st March 2017:

Property Value	Annual charge in 2016/17
More than £500,000 up to £1m	£3,500
More than £1m up to £2m	£7,000
More than £2m up to £5m	£23,350
More than £5m up to £10m	£54,450
More than £10m up to £20m	£109,050
More than £20m	£218,200

Corporate ownership where no ATED relief is available, would therefore result in an annual tax on high-value residential property of between £3,500 and £218,200 per year (at current levels) depending on the value of the property.

Reliefs for genuine commercial activity such as property development or commercial letting can apply to remove the ATED charge.

The return and payment of the ATED charge, where applicable, is due by 30th April in the year in which applies. The ATED year runs from 1st April to the following 31st March.

- Enhanced rate of stamp duty land tax**

Residential properties costing in excess of £500,000 that are purchased by a company will be subject to the enhanced rate of SDLT of 15%, unless a relief applies. If a relief applies, the purchase will be subject to SDLT at the progressive slice system as outlined in the section for non-UK resident individual ownership, however, the higher rates for the purchase of additional residential properties will apply on the first purchase of a residential property by a company.

The transfer of ownership to a connected company may also be chargeable and, if chargeable, the SDLT charge will be based on the market value of the property. If the property is received as a gift by an unconnected company there will usually be no SDLT to pay.⁸

⁷ Nor deemed UK domicile.

⁸ As long as there is no outstanding mortgage on the property or any other form of consideration.

Direct ownership by a UK resident company

- **Corporation Tax (“CT”)**

A UK resident company will pay corporation tax on its rental profit, the current rate for 2016/17 being 20%.

Commercial interest payable on a loan used to acquire the property, as well as other allowable expenses, will reduce taxable rents thereby reducing the CT charge.

- **Capital Gains Tax**

Where a property is worth in excess of £2 million and it is liable to ATED throughout the relevant periods, any capital gain arising after 5 April 2013 is taxable at 28% (i.e. gains accrued up until 5 April 2013 will not be chargeable to ATED-related CGT, it is only the increase in value after 6 April 2013 that will be liable to ATED-related CGT).

This includes both UK resident and non-UK resident entities.

For properties worth between £1 million and £2 million, ATED-related CGT applies from 6th April 2015 to gains arising on or after this date. For properties worth between £500,000 and £1 million, ATED-related CGT applies from 6th April 2016 to gains arising on or after this date.

Where ATED is not applicable, a UK resident company will pay corporation tax on gains at the existing CT rate, currently 20% for 2016/17. Indexation allowance may be available to reduce the gain.

- **Inheritance Tax**

A UK company owned directly by a UK domiciled individual, non-UK domiciled individual or a trust would be subject to UK IHT, as the shares in the company would be treated as a UK situs asset.

If the shares in the UK company are held via a non-UK resident company acting beneficially, there is currently no liability to UK tax on death provided that the shares in the non-UK company are held either by a non-UK domiciled individual⁹ or by a trust that has been settled by a non-UK domiciled settlor.⁹

However, please note the proposed changes to the UK IHT rules as outlined at the beginning of this document. It is not currently known what the position will be where a non-UK company owns the shares in a UK company which owns the UK property beneficially. The HMRC note on the proposals only refers to non-UK companies.

- **Annual Tax on Enveloped Dwellings**

The ATED is an annual UK tax charge on UK residential property. Properties worth more than £500,000 as at 1 April 2012 that are owned by a non-natural person are within the charge.

Essentially a non-natural person is a company, a partnership with a corporate partner or a collective investment scheme. This includes both UK resident and non-UK resident entities.

The first ATED Charges applied from 1st April 2013 to properties worth over £2 million.

Properties worth between £1 million and £2 million were included within the charge from 1st April 2015 (£7,000).

Properties worth between £500,000 and £1 million were included within the charge from 1 April 2016 (£3,500).

⁹ Nor deemed UK domicile.

Please see previous section for 2016/17 charges.

Corporate ownership where no ATED relief is available, would therefore result in an annual tax on high-value residential property of between £3,500 and £218,200 per year (at current levels) depending on the value of the property.

Reliefs for genuine commercial activity such as property development or commercial letting can apply to remove the ATED charge. The return and payment of the ATED charge, where applicable, is due by 30th April in the year in which applies. The ATED year runs from 1st April to the following 31st March.

- **Enhanced rate of stamp duty land tax**

Residential properties costing in excess of £500,000 that are purchased by a company will be subject to the enhanced rate of SDLT of 15%, unless a relief applies. If a relief applies, the purchase will be subject to SDLT at the progressive slice system as outlined in the section for non-UK resident individual ownership, however, the higher rates for the purchase of additional residential properties will apply on the first purchase of a residential property by a company.

The transfer of ownership to a connected company may also be chargeable and, if chargeable, the SDLT charge will be based on the market value of the property. If the property is received as a gift by an unconnected company there will usually be no SDLT to pay.¹⁰

Summary

It is proposed that the rules for charging UK inheritance tax will change significantly from April 2017 for UK residential properties held through offshore structures. Following the consultation that is due later in the year we will be able to assess the impact that these changes will have on our clients.

The ownership of UK residential property continues to be complex, and the optimal structure to own the property will depend on the particular circumstances.

SMP Accounting & Tax can advise on residential property acquisitions and disposals and can work with clients and their advisors to mitigate the tax costs.

SMP Accounting & Tax can also deal with the various tax compliance matters such as:

- Annual ATED returns
- ATED/CGT returns on disposals
- Non-resident landlord returns
- Stamp Duty Land Tax returns
- Personal UK Tax returns
- Inheritance Tax Returns (on death and also 10 year/exit charges for Trusts)

¹⁰ As long as there is no outstanding mortgage on the property or any other form of consideration.



We would be happy to provide further advice on your particular circumstances.

If you should have any queries in relation to this, or any other tax or structuring queries please contact your usual SMP adviser or one of the contacts below.

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