WILLKIE FARR & GALLAGHER LLP

CLIENT ALERT

Taxing All Gains Made by Non-Residents on UK Real Property: HMRC Consultation

November 27, 2017

AUTHOR

Judith Harger

The UK government has launched a public consultation on proposals to bring gains realized by non-residents on the disposal of all UK real property, including commercial property, within the scope of UK tax law. This represents a significant expansion of the scope of UK tax law and will bring the UK tax system more into line with the approach of the United States and other major jurisdictions.

The consultation closes on 16 February 2018. The consultation paper states that the proposed scope, commencement date and core features are fixed; the consultation process relates only to the detailed implementation of those broad strokes. The new measures will take effect from April 2019.

It is proposed that the charge to UK tax will be extended to cover the following:

- Gains realized by non-residents on disposals of commercial property (currently, the UK taxes non-residents, unless they are carrying on a business in the UK, only in respect of gains on residential property);

- Gains realized by widely held non-resident companies on disposals of residential property (currently, only closely-held companies, as well as certain other non-resident persons, such as individuals and trusts, are within the scope of non-resident capital gains tax);

- Gains realized by non-residents on certain indirect disposals of UK real property interests via a disposal of an interest in an entity, such as shares or a partnership interest, which substantially derives its value from UK real property, whether commercial or residential. The entity must be “property rich”, meaning that 75% or more of the gross asset value of the entity derives from UK land, and the non-resident (together with related parties) must hold, or at some point in the previous five years have held, a 25% or greater interest in the entity. Value can be traced through multiple layers of ownership. A gross asset value test for determining "property richness" means that the entity's loan liabilities will be ignored. Holdings of non-UK land will not count towards the 75%. Even though property richness is tested at the level of the entity's assets, the taxable gain will be calculated by reference to the gain realized on the shares or other interest in the entity, using general UK tax principles.

These measures will apply to both corporation tax (for corporate bodies) and capital gains tax (for other persons). Those exempt from UK capital gains (such as overseas pension funds) or outside the scope of UK tax for reasons other than residency (such as sovereign immunity) will be unaffected. Commercial property and residential property owned by widely held non-resident companies will be rebased to April 2019, as will entities deriving their value from UK land (in relation to indirect disposals). April 2015 will remain the rebasing point for direct disposals of residential property by closely-held companies, as already applicable for the purposes of non-resident capital gains tax.

The substantial shareholding exemption (SSE) for disposals of certain shareholdings may still apply to exempt the non-resident from UK tax. This may be relevant to the disposal of certain property rich trading companies (for example, in the hospitality sector). In addition, earlier this year, the SSE was extended to cover the disposal by a UK holding company of certain substantial shareholdings in non-trading companies (including in property rich companies) where the UK holding company is owned by "qualifying institutional investors", meaning investors who, if they had held the underlying shareholding directly, would have been exempt from UK tax on capital gains, including pension funds, charities, investment trusts, sovereign wealth funds and life insurance companies. This extension of the SSE will remain in place.

However, the consultation document makes clear that no special exemption is intended for fund vehicles.

An anti-avoidance rule will be introduced (with immediate effect from 22 November 2017) in respect of arrangements where (one of) the main purpose(s) is to obtain a UK tax advantage for any person in relation to tax for which that person would otherwise have become liable under the new regime and where that advantage arises by reason of any provisions of a double tax treaty and is contrary to the object and purpose of those provisions. Most UK treaties (in line with the OECD Model Convention) allocate taxing rights to the UK in respect of UK immoveable property. However, in some cases, indirect disposals generally, or certain kinds of indirect disposals (such as a disposal of a non-share interest, including a partnership or trust interest, or a disposal of shares in a pure holding company parent of a property-rich subsidiary), would currently be taxable only in the country of residence. The intention is to negotiate amendments to the relevant treaties to broaden the scope of the UK's taxing rights. Meanwhile, the anti-avoidance rule will challenge any attempt at "treaty shopping" to take advantage of such treaties.

These proposals will affect many long-established property holding structures.

If you have any questions regarding this client alert, please contact the following attorneys or the attorney with whom you regularly work.

Judith Harger
+44 20 3580 4705
jharger@willkie.com