Drawing the strands together (again) – a guide to the new UK property tax regime

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Over the past 4 years the government has:

- introduced new taxes on high value residential property held by companies (whether UK or offshore);
- significantly increased certain taxes on UK residential property; and
- introduced an extension of capital gains tax (**CGT**) to non-residents disposing of residential property.

More recently, the government has also published consultation documents on introducing a new 3% additional charge to stamp duty land tax (**SDLT**) from 1 April 2016; and bringing all UK residential property, however held, into the scope of inheritance tax (**IHT**) from 6 April 2017.

The purpose of this briefing is to draw the strands together, again.

The changes only affect UK residential property (not commercial property) so this briefing only considers residential property and is structured around the lifecycle of property ownership: first buying a property, then keeping it and finally selling it.

It is assumed that the ultimate owner has a foreign domicile.

Buying a property

SDLT

SDLT is paid by the buyer on the purchase price. The rates of SDLT have been increased in recent years. From 4 December 2014 the actual and effective rates changed significantly and further changes are due to come into effect on 1 April 2016.

First properties and main residences

For completions on or after 1 April 2016, for SDLT purposes, it will be necessary to distinguish between purchases of first properties or main residences (on the one hand) and second (or subsequent) properties, including buy to let properties (on the other).

Broadly, for purchases not made through a company, the rates are as follows:

Current rates	
Purchase Price	Rate % Charged as part of purchase price within each band
£0 – 125,000	0
£125,000 – 250,000	2
£250,000 – 925,000	5
£925,000 – 1,500,000	10
>£1,500,000	12

Each part of the purchase price in a particular band is taxed at the relevant rate.

Since 21 March 2012 15% SDLT has been charged on companies acquiring high value property (subject to certain exceptions). From 20 March 2014 the threshold was lowered so that properties acquired for over £500,000 are caught. Where the 15% rate applies, it applies to the entire purchase price (i.e. it is not banded). The government is considering an exemption for corporates making a substantial investment in residential property.

Where a relief applies under the annual tax on enveloped dwellings regime (e.g. where the property is rented out, but see further below), the company may pay SDLT at the normal rates as long as the property qualifies for relief throughout the first three years of ownership. If it fails to qualify throughout this period the difference between the 15% and the SDLT actually paid is clawed back. Following the April 2016 changes it is unclear how the relief from the 15% SDLT charge will apply where the property is a buy to let. Presumably, in the unlikely event it is a first purchase, the standard rates in the above table will apply but if it is a second property then the additional 3% will apply to the standard rates (see below).

Second properties

As mentioned above, a new additional 3% SDLT charge will apply to purchases of second properties which complete on or after 1 April 2016. Where contracts were exchanged on or before 25 November 2015 and completion occurs on or after 1 April 2016, the additional charge will not apply. The rate applies to properties situated in England, Wales and Northern Ireland as Scotland has its own rules under its devolved powers.

Broadly, for purchases not made through a company, the position is as follows:

“A new additional 3% SDLT charge will apply to purchases of second properties which complete on or after 1 April 2016”

Band	Additional SDLT rates
£0* - £125,000	3%
£125,000 - £250,000	5%
£250,000 - £925,000	8%
£925,000 - £1,500,000	13%
£1,500,000+	15%

*Purchases below £40,000 are not subject to SDLT, even if they are second properties. If the purchase is £40,000 or more, the 3% additional rate will apply to the whole purchase price, including the first £40,000.

> The purchase of a property by trustees of a discretionary trust will attract the additional SDLT charge

What is a second property?

The consultation document sets out a variety of scenarios concerning second properties. We confine our comments to the most significant issues for the foreign domiciled purchaser.

- Spouses and civil partners are treated as a unit, so if the husband owns a property, the purchase by the wife of a property in England, Wales or Northern Ireland will attract the additional 3% charge. Spouses and civil partners will cease to be treated as a unit if they are separated under a court order or by a formal deed of separation (but apparently not if they are simply separated in circumstances likely to be permanent).

- Residential properties situated outside England, Wales and Northern Ireland will be relevant for the purposes of determining whether a purchase is of a second property. So, if the purchaser owns a home in, say, Hong Kong, the purchase of an English property is necessarily a second property, even if the purchaser is resident outside the UK.

- The purchase of a property by trustees of a discretionary trust will attract the additional charge. If a beneficiary of a discretionary trust occupies the trust property, it is not taken into account if the beneficiary buys his or her first property (whether as a residence or a buy to let).

- Where the trust confers a life interest or an interest in possession on a beneficiary (the life tenant), that beneficiary is treated as if he owned the property for SDLT purposes. So, if the trustees hold a property and the life tenant purchases another property, that purchase will be subject to the additional charge. By the same token, if the life tenant already owns a property, the trustees will pay the additional charge if they purchase a property.

- A bare trust is also treated as a look-through, so the beneficial owner is treated as owning the property subject to the bare trusts.

- If the property being acquired is a replacement main residence, generally the additional charge will not apply even if the purchaser has a second property. In most cases the existing main residence is sold at the same time as the replacement main residence is acquired. The government is proposing that if the original main residence is sold no more than 18 months after the acquisition of the replacement main residence then the additional charge can be reclaimed (but it would have to be paid on the purchase of the replacement main residence in the first place). Whether a property is a main residence will be determined on the facts, not by election.

- In the case of a joint purchase, it seems that if any of the joint purchasers has a property, then the additional charge will apply to the joint purchase. This suggests that the joint purchaser who does not have any other property will be penalised.

- The new additional 3% SDLT charge will apply to purchases of second properties by companies. Where it does, then it appears that a punitive 18% SDLT will be charged on the total purchase price.

"The new additional 3% SDLT charge will apply to purchases of second properties by companies"

Funding the purchase

On 4 August 2014, HMRC announced a change of interpretation relating to loans secured on offshore income and gains. This change only affects borrowers who are resident in the UK, with a foreign domicile (so-called "non-doms"). Non-doms may take advantage of the remittance basis of taxation, which allows them to pay UK tax on their foreign income and gains only to the extent that they are remitted (brought) to the UK, whether directly or indirectly. Formerly non-doms were able to borrow against the security of foreign income and gains and bring the sums lent to the UK without the loan being treated as a remittance of foreign income and gains. Many such loans were used to purchase UK property.

However, from 4 August 2014 onwards, new loans secured on foreign income and gains and brought to the UK will give rise to an income tax or CGT charge (or both). Loans made and brought into the UK before 4 August 2014 are not subject to this change in the law.

Aside from these remittance issues, the government introduced anti-avoidance provisions restricting the extent to which debt can be set against the value of assets for the purposes of IHT.

Generally, on the death of the owner the net value of UK property will be subject to IHT at 40% (unless exemptions or reliefs apply). So in principle a loan secured on a UK property is deductible from the value of the property on the death of the owner. From 17 July 2013 the government has imposed restrictions on the extent to which that debt can be deducted, namely:

- If the foreign domiciled owner borrowed against the property to invest outside the UK or to hold the borrowed money outside the UK (thereby taking it outside the scope of IHT), the loan is not deductible (this prevents foreign domiciled owners sheltering the property from IHT by subsequent borrowing);

- In all other cases, the loan must be repaid after death from the estate of the deceased, which, in certain cases, may necessitate the sale of the property to discharge the loan.

Keeping the property

From 6 April 2017, all UK residential property however held, will be exposed to IHT

Annual tax on enveloped dwellings (ATED)

ATED has applied since 1 April 2013 to high value properties held by companies, partnerships with a corporate partner and collective investment schemes ("companies", for short), whether UK or non-UK resident.

"High value" initially meant properties over £2m but, from 1 April 2015, properties over £1m were included and from 1 April 2016 properties over £500,000 will also be included.

The rates of ATED increased by 50% from 1 April 2015 and are now as follows:

Property value	ATED
	1 April 2015 – 31 March 2016
£500,000 – 1,000,000	£0[1]
£1,000,000 – 2,000,000	£7,000
£2,000,000 – 5,000,000	£23,350
£5,000,000 – 10,000,000	£54,450
£10,000,000 – 20,000,000	£109,050
>£20,000,000	£218,200

[1] £3,500 from 1 April 2016

There are exemptions and reliefs from ATED. The reliefs most likely to apply relate to the commercial use of high value properties, namely if the properties are rented out, being developed or traded, in each case provided they are not occupied by a person connected to the company.

IHT

Directly held UK residential property has always been exposed to IHT. From 6 April 2017, it appears that all UK residential property, however held, will be exposed to IHT (with the exception of certain diversely-held vehicles). The government will treat "opaque" (foreign) companies as transparent for IHT purposes. It is to be assumed that trusts directly holding UK residential property where they are funded by "soft" debt will also be caught.

The draft legislation has not been published yet but the changes are bound to have wide ranging implications. In particular, it is not clear to what extent debt incurred by a non-UK holding company can be set against the value of the underlying residential property. However, it is reasonably certain that trusts holding UK residential property through a non-UK company will need to be reviewed and in many cases restructured. The government are considering whether tax relief should be available to allow structures to be collapsed but we do not have any details.

Selling property

Historically, the UK has not generally taxed non-residents on any gain realised on the disposal of UK assets. Since 6 April 2013, this principle has been eroded by the introduction of ATED–related CGT and from 6 April 2015 by the extension of CGT to disposals of UK residential property by non-residents (including individuals and trustees, not just companies).

ATED–related CGT

Since 6 April 2013 ATED–related CGT has applied on the disposal of high value properties which are within the ATED net (i.e. broadly high value properties not rented commercially or being developed).

For these purposes, high value properties owned by companies before 6 April 2013 are rebased (tax-free) to their value on that date, so that, on disposal, only the increase in value after 5 April 2013 is subject to ATED–related CGT. The rate is 28%, and applies to companies resident in the UK and abroad.

To the extent that ATED reliefs apply (for instance, on renting commercially), the gain on disposal is also relieved from ATED-related CGT.

ATED-related CGT does not apply to a disposal of the shares in the company holding the high value property, so it may be more tax-efficient for the shareholder to dispose of the shares rather than for the company to dispose of the property.

Extension of CGT

From 6 April 2015 CGT applies to all non-residents on the disposal of residential property (subject to exceptions beyond the scope of this briefing).

Where properties exposed to the extended CGT charge were held before 6 April 2015, they will be rebased (tax-free) to 5 April 2015, thereby removing the earlier gains from the new charge. Taxpayers may opt for one of two alternative bases for computing the gain (depending on which outcome is more advantageous).

The rates of CGT will be 18% or 28% for individuals (depending on total UK income and gains) 28% for trustees and 20% for companies. Where a company is subject to ATED-related CGT as well, ATED-related CGT takes precedence (at the higher rate of 28%).

There are a number of exceptions but the one most likely to apply to individuals holding high value residential properties is the main residence relief. This relief from CGT may apply where the property is owned by a non-resident individual who occupies it as his only or main residence. To qualify the individual must satisfy the "day count test", being in the property for at least 90 days in a tax year. For each tax year that the individual satisfies the day count test the gain on the property will be relieved from CGT.

The main residence relief may also apply where the property is in trust and a non-resident beneficiary is able to satisfy the day count test.

“From 6 April 2015 CGT applies to all non-residents on the disposal of residential property”

Beware, though. By meeting the day count test, the individual risks becoming UK resident for tax purposes.

What to do

Existing structures

Given the recent changes (including the substantial increase in ATED), it would be advisable to review existing arrangements. In some cases the substantial increase in ATED will prompt a re-examination of whether holding the property via a company is the best long-term option particularly as the IHT protection provided by the company will be removed from 6 April 2017. However, if the shareholder is contemplating a sale of the property, it may be advisable to sell the shares (not subject to SDLT) rather than the company sell the property (potentially exposed to a marginal rate of SDLT up to 15% depending on the circumstances of the buyer), leaving the parties to split the SDLT saving.

"it would be advisable to review existing arrangements"

Future purchases

Broadly, where the would-be purchaser has a foreign domicile there are three main options for acquiring property in the UK individually, through a company, or through a trust.

Which option is appropriate (particularly in relation to tax) will depend on a variety of factors. Given the recent changes and the political climate, as a general proposition it would be more straightforward to acquire property individually if it is going to be occupied by that individual or his family. It would generally be best to acquire the property with the aid of a loan, consider life assurance and have suitable wills to mitigate the potential IHT liability.

If the property is being acquired for rental purposes, an offshore company funded by debt may be the most tax-efficient arrangement, though the additional SDLT charge would need to be brought into consideration.

Whether it is advisable to acquire a property through a trust will be very fact-specific and the purchase would need to be properly structured on a bespoke basis. Again, the additional SDLT charge would need to be brought into account.

The table overleaf sets out some of the considerations relevant to each option (assuming a property is worth over £500,000):

Structure	Direct ownership	Offshore company	Offshore trust
SDLT	12% top rate/15% if second property	15% SDLT, unless ATED relief applies for 3 years/18% if second property	12% top rate/15% if second property or discretionary trust
ATED	No ATED	£3,500-£218,200 annually ATED reliefs	No ATED
IHT	IHT on net value of property May be reduced or mitigated by borrowing, spouse exemption and life insurance	No IHT until 6 April 2017, then exposed to IHT	IHT on net value of property May be reduced by borrowing
CGT	Rebasing of property to 5 April 2015 value. Any future gains will be taxed at 18%/28% Main residence relief may apply for gains	Post 5 April 2013 ATED-related gains will be taxed at 28%, subject to available reliefs. 20% CGT for gains not subject to ATED-related CGT	Rebasing of property to 5 April 2015 value. Any future gains will be taxed at 28% Main residence relief may apply
Income tax on rent	45% top rate; may be reduced by cost of borrowing	20% top rate; may be reduced by cost of borrowing	45% top rate; may be reduced by cost of borrowing

We will update this briefing once the position on the additional SDLT rate and extension of IHT becomes clearer.

If you require further information on anything covered in this briefing please contact Nick Dunnell (nick.dunnell @farrer.co.uk; +44 (0)20 3375 7573), Russell Cohen (russell.cohen @farrer.co.uk; +44 (0)20 3375 7144); Holly Jones (holly.jones@farrer.co.uk; +44 (0)20 3375 7304) or your usual contact at the firm on +44(0)20 3375 7000. Further information can also be found on the Tax page on our website.