

## UK real estate tax update

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### CATEGORY:

[ARTICLE](#)

### Extension of the Annual Tax on Enveloped Dwellings ('ATED')

The ATED is an annual charge to UK tax of up to £143,750 on UK residential property worth £2m or more, which is held by certain non-natural persons ('NNPs'). It applies (broadly) where the property is used by an individual connected with the owner rather than being rented out to a third party. Where the NNP has been subject to the ATED on a property it is also subject to the 'ATED-related' UK capital gains tax charge on a disposal of that property.

The ATED is to be extended to properties of lower values, so that as of 1 April 2015 residential properties owned by NNPs worth £1,000,000 – £2,000,000 will be subject to the ATED, and from 1 April 2016 this will be further extended to properties in the £500,000 – £1,000,000 price bracket.

Capital gains tax will also apply to disposals of these properties from 6 April 2015 for properties worth £1,000,000 – £2,000,000 and from 6 April 2016 for properties worth more than £500,000.

The 15% UK SDLT rate that applies to purchases of UK residential property by NNPs has also been extended to properties worth £500,000 or more with effect from 20 March 2014.

### Capital gains tax for non-UK residents

#### What is happening?

Historically, non-UK resident individuals, companies and trusts were not liable to UK capital gains tax ('CGT') in relation to UK properties. As mentioned above, the ATED – related CGT charge now applies to certain UK residential properties owned by NNPs.

The UK Government has now issued a consultation paper (28 March 2014) on a wider extension of CGT on UK residential properties to all non-UK residents. The consultation period closes on 20 June 2014.

There is no proposal to extend CGT to non-UK residents holding commercial properties or other assets in the UK.

#### What will it apply to?

The proposed charge will relate to all UK residential properties (that is, properties used or suitable for use as dwellings) regardless of value, whether they are used by connected individuals or are rented out.

The new charge will not replace the existing ATED-related CGT charge but will operate in conjunction with it, taxing properties to which the ATED-related CGT charge does not apply. Given that the ATED-related CGT charge can apply to part of a gain, the interaction will inevitably be complex.

#### Are there any exemptions?

It is proposed that there will be some exemptions to the definition of residential property including certain types of student accommodation and care homes. Generally, the exemptions will be restricted and in particular they do not include the '*genuine businesses*' that were exempted under the ATED charge. This means that the new CGT charge will apply to residential properties rented out on a commercial basis to third parties.

#### What about the main residence relief?

Presently, gains on the disposal of a UK property that has been an individual's main residence will be exempt from CGT under the 'principal private residence' relief ('PPR'). Broadly, the part of the gain relating to the period the property was the main residence will not be subject to CGT. Where a taxpayer has more than one residence, it is possible to elect for any one of them to be treated as the 'main' residence.

The consultation paper makes it clear that although non-UK residents will be able to claim PPR, the government does not wish non-residents simply to be able to elect for their UK property to be their main residence and proposes two possible approaches:

1. for the 'main' residence simply to be determined as a general question of fact; or
2. for the 'main' residence in any year to be the residence in which the taxpayer has spent the most time.

Both the proposed alternatives will raise considerable difficulties in implementation and will be difficult to prove.

It seems that these changes will apply to UK residents as well as to non-UK residents, and they are likely to be highly controversial.

Who will be chargeable?

The new rules will apply to non-UK resident individuals, partners companies and trusts.

Widely held non-UK resident funds are likely to be exempt (as is the case for certain types of UK fund), but the position will be considered further as part of the consultation. Pension funds will not be affected.

What will the rate be?

Individual non-UK resident taxpayers will pay CGT at the same rate as UK residents – a maximum rate of 28% (an 18% rate applies for basic rate taxpayers) and non-UK resident individuals will also receive an annual tax-free CGT allowance (currently £10,900).

Companies owning UK residential property will not simply be brought within the general charge to corporation tax (charged at a maximum rate of 21% from 6 April 2014) in respect of property, but a specific CGT regime (the *'tailored charge'*) will be applied to them, at a rate of tax to be announced. Companies (UK resident or otherwise) subject to the ATED-related CGT charge are taxed at 28%, but benefit from an indexation allowance.

When will it apply?

The consultation paper states that *"The charge will come into effect in April 2015 and apply only to gains arising from that date."*

There is no reference to a rebasing of property values as at that date and it remains to be seen whether "arising from that date" refers to all gains on disposals from April 2015, or only gains accrued from April 2015. It is unfortunate that this is not made clear in the consultation document.

For comparison, it was originally proposed that the ATED-related CGT charge was to have applied to the total gain accrued during the whole period of ownership, but following consultation this was rejected due to the difficulty of establishing purchase costs and other relevant information. Under the ATED-related CGT gains are allocated to pre- ATED and post- ATED periods, and pre- ATED period gains are exempt from CGT.

How will it be levied?

While the consultation paper notes that some other jurisdictions rely on self-reporting, it is envisaged that a withholding tax will need to be applied in the UK to ensure compliance. As proposed, this would require the actual tax due to be paid by the seller within 30 days to avoid the withholding which would presumably be applied to the gross sale proceeds. This will impose a significant compliance burden on non-UK resident sellers' representatives and make the conveyancing process more complex and costly.

There is no proposal to include sales of shares in companies that own UK residential property within the new CGT charge.

What should I do?

For the moment, nothing.

The consultation is open until 20 June 2014 and a detailed response and draft legislation is unlikely to be published before the Autumn Statement in December 2014.

The proposed new legislation will be complex and, as with the ATED-related CGT charge, there are likely to be considerable changes during the process. One of the key considerations will be whether there will be a rebasing of property values for the purposes of the new charge.

However, it is unlikely that the new CGT charge will be either deferred or abandoned and all non-UK resident owners of UK residential property (other than widely held funds) should prepare themselves for the payment of tax on disposals after April 2015.

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