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Taxation of High Value UK Residential Property: Home and Dry?

01 February 2013

Private Client partner Robert Brodrick and Private Client Associate Frederick Bjørn guide you through the complexities of the legislation.

The Finance Act 2013, which received royal assent on 17 July 2013, included the final legislation intended to dissuade individuals from holding UK properties through non-natural persons by introducing a capital gains tax charge on those 'persons', an annual tax charge based on the value of their properties and introduced various reliefs on the new rates of Stamp Duty Land Tax.

Stamp Duty Land Tax

- With effect from 21 March 2012 a new Stamp Duty Land Tax ("**SDLT**") band of 7% was introduced on the purchase of UK properties where the price paid exceeds £2 million (high value residential properties ("**HVRPs**")).

- In the event that HVRPs are purchased by non-natural persons ("**NNPs**") (i.e. companies, collective investment schemes or partnerships where a company is one of the partners - but not companies acting solely as trustee or nominee) the SDLT rate on purchase increases to 15%.

- However, the Finance Act 2013 confirms that the rate of SDLT will remain at 7% where one of the reliefs discussed below (in relation to the Annual Tax on Enveloped Dwellings ("**ATED**")) applies. This is provided that the property continues to satisfy the relevant qualifying conditions throughout the following three years. If it does not, additional SDLT will become payable.

- The 15% charge and accompanying reliefs apply both to UK and non-UK NNPs.

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These measures were originally introduced to dissuade people from purchasing HVRPs through corporate vehicles on the basis that this would then enable them at some later date to sell the shares (rather than the property itself) without triggering SDLT. Although there is no additional tax charge on a sale of shares, the new rules do make holding an HVRP through a NNP less attractive in certain circumstances.

Annual Tax on Enveloped Dwellings

The ATED applies from 1 April 2013 to NNPs that own interests in dwellings which are valued at more than £2 million at a valuation date.

There are a number of reliefs from the ATED which are designed to exclude genuine businesses carrying out genuine commercial activity. These include reliefs for property developers and for properties rented to unconnected third parties.

- Whether the dwelling is within the ATED, and what rate of tax applies, depends on the band its value fell within at 1 April 2012 (and on subsequent five year anniversaries of that date), if it was owned on that date by the NNP, or its value on acquisition or completion of construction or conversion if afterwards. The bands referred to are as follows :

Property Value	***ATED***
£2m to £5m	£15,000
£5m to £10m	£35,000
£10m to £20m	£70,000
Greater than £20m	£140,000

- The ATED will be indexed to the Consumer Price Index ("**CPI**") 'uprated' in April of each year based on the CPI of the previous September.

- The first self-assessment return of the ATED for the tax year 2013/14 must in most cases be made by 1 October 2013 and payment made by 31 October 2013. Thereafter returns and payments must be made by 30 April each year.

Capital Gains Tax Charge

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A new capital gains tax ("**CGT**") charge applies to ATED-related gains made on disposals of HVRPs on or after 6 April 2013 by both UK resident and non-resident NNPs where the proceeds of sale exceed £2 million. However, the tax applies only to that part of the gain that is accrued on or after 6 April 2013 by way of a rebasing, which will happen automatically. Where there are losses an election can be made not to apply the rebasing. Other notable points include the fact that:

- There is no CGT charge on the disposal of shares in NNPs holding HVRPs;
- The definition of NNP for CGT purposes is the same as for the ATED, with similar reliefs. Consequently the charge does not apply to trusts that directly hold UK residential property
- The rate of the CGT charge on these disposals is 28%, with a tapering relief for gains where the property is worth just over £2 million.
- The CGT regime is extended to apply to disposals of HVRPs held by UK NNPs (which would otherwise be subject to corporation tax).

Comment

UK residential property is often held by NNPs to protect the value of the property from UK inheritance tax ("**IHT**"). The NNP may be held directly by an individual or, perhaps more commonly, by a trust of which a settlor and/or his/her family are beneficiaries. Prior to the new rules it was possible for these properties to be used by family members without a tax charge (depending on their UK tax profile) and for the properties to be sold without a CGT charge (on the basis that the seller was a non-UK resident entity and therefore not within the UK tax net). However, these types of structure will now result in:

- payment of the ATED by the NNP (unless one of the reliefs applies); and
- a CGT charge on sale (on post 6 April 2013 ATED-related gains).

Consequently those affected need to decide whether or not to retain their existing holding structures.

We anticipate that HM Revenue & Customs will take an unwelcome, but keen, interest in NNPs that continue to hold UK residential property. Therefore NNPs, and those connected with them, should beware of the increased risk of HMRC scrutiny and decide whether they are prepared to accept this risk.

Restructuring

There is no 'one size fits all' solution to mitigate the new charges. If a holding structure is to be unravelled the result is likely to be the property being held directly by an individual (whether in their personal name or through a nominee company for reasons of privacy and bank lending regulations) or directly through a trust, in each case bringing the property within the scope of IHT. However, it is important to remember that whilst there is a 40% tax charge on the death of anyone who owns UK situated property – regardless of whether they are UK domiciled or not (subject to the usual reliefs and exemptions), if the property is held in a fully discretionary trust the maximum IHT charge would be only 6% of the value of the property every 10 years (provided that the gift with reservation of benefit rules do not apply) and for non-UK domiciliaries this can in certain circumstances be further mitigated using borrowing.

Whilst the Finance Act 2013 also introduced a General Anti-Avoidance Rule and rules limiting the deductibility of debts used to mitigate IHT, there are still structuring opportunities available, both where HVRP are already owned and where a purchase is being contemplated. Therefore we would suggest that advice is sought at the earliest opportunity to weigh up the pros and cons of paying the ATED versus IHT and to establish what the tax consequences are of winding up the holding company, for example.

If you are concerned by the new rules and would like advice, we would be happy to review any property owning structures which may be affected. We have extensive experience in advising on both UK and cross border tax and estate planning for high net worth individuals, their family offices and trustees.

September 2013

In the event that you do not have a usual private client advisor at Payne Hicks Beach please contact the authors Robert Brodrick (rbrodrick@phb.co.uk) or Frederick Bjørn (fbjorn@phb.co.uk).
