Budget 2016
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Contents

1 Introduction

Chancellor George Osborne today delivered his eighth Budget.

Against the backdrop of a weaker-than-expected economy and an upcoming EU referendum, there were a number of new announcements that directly impact the property sector, in particular, changes to SDLT on commercial property.

The Government confirmed its intention to introduce restrictions on interest deductibility from 1 April 2017 in line with OECD recommendations, and announced a further detailed consultation will take place during the Summer of 2016.

Other measures introduced included changes to how offshore property developers are taxed on trading profits in the UK. Residential property has also been excluded from the reduction in capital gains tax rates.

For detailed coverage and comment on the Budget visit Deloitte’s dedicated website at **www.ukbudget.com**.

2 SDLT on commercial property

The Government has announced a change to the SDLT rates applying to the acquisition of mixed use and non-residential property. The rates will be reformed from the current slab system (which charges a single rate of tax of up to 4% on a transaction where the consideration exceeds £500,000) to a slice system so that SDLT will be chargeable on the portion of the purchase price which falls within each tax band as set out below.

Relevant consideration	New rates
Up to £150,000	0%
More than £150,000 to £250,000	2%
More than £250,000	5%

Purchasers of commercial property for up to £1,050,050 should pay the same or less SDLT, while purchasers of commercial property worth in excess of £1,050,050 will see their SDLT liability increase.

A new 2% SDLT rate will also apply in respect of the grant of a lease of mixed use or non-residential property where the net present value (NPV) of the rent exceeds £5m. The 1% lease duty charge which currently applies will continue to apply to the NPV exceeding £150,000 but not exceeding £5m.

The new rates will apply to transactions with an effective date on or after 17 March 2016, subject to transitional provisions for those who have already exchanged contracts before that date. A purchaser who has exchanged prior to that date will have the ability to make an election to apply the old rates.

3 Interest deductibility

Consistent with the recommendations of the OECD's BEPS Action 4, it was announced today that new rules will be introduced with effect from 1 April 2017 to limit the corporation tax deductibility of interest expenditure. These proposals are of particular concern to property developers and investors as high levels of gearing are a typical feature of most commercial property ventures, and so restrictions on interest are likely to have a significant impact on the real estate industry.

The introduction of these rules represents a significant shift in the way in which the amount of deductible interest is calculated in the UK (i.e. currently, deductions are based on an 'arm's length' standard that relies on an assessment of the fundamentals of each business). The key elements of the new rules will be:

- a fixed ratio rule, limiting corporation tax deductions for net interest expense to 30% of a group's UK EBITDA;
- a group ratio rule, based on the external net interest to EBITDA ratio for the worldwide group (which will replace the current worldwide debt cap regime with a more limited net interest cap); and
- a de minimis group threshold of £2 million net UK interest expense.

The Government also announced that the rules will include provisions to address volatility in earnings and interest, as well as exclusions so that the restriction does not impede the provision of private finance for certain public infrastructure projects in the UK.

The announcements did not include any specific comments for the real estate industry or REITs, but a detailed consultation will be undertaken in the Summer of 2016.

4 Corporation tax rate change

Legislation will be introduced in the Finance Bill 2016 to reduce the main rate of corporation tax to 17% from 1 April 2020 (superseding the 18% rate effective from that date introduced in Finance (No.2) Act 2015).

5 Corporation tax loss relief

Under the current rules, corporation tax losses carried forward can only be used by the company that incurred the loss, and some losses carried forward can only be set against profits from certain types of income. Increased flexibility is being introduced, meaning that businesses will be able to use carried forward losses against profits from other income streams, or from other companies within a group.

In addition, companies can currently offset eligible taxable profits against corporation tax losses carried forward from earlier periods. It was announced that the amount of profit that can be offset against losses carried forward will be restricted to 50% of the profits in excess of £5 million. Where the company is in a group, the £5 million allowance will apply to the group.

The increased flexibility in the use of carried forward losses will apply to losses incurred from 1 April 2017. The 50% restriction on the offset of carried forward losses will also apply from 1 April 2017, and there will be consultation on the measure in 2016.

6 Offshore property development

The Government has concerns that certain property developers use offshore structures to avoid UK tax on their trading profits from developing property in the UK. Legislation will be introduced at Report Stage to extend the corporation tax charge to any non-resident who trades in or develops UK land with a view to sale. The charge will apply to existing developments in the course of construction and will, it seems, tax the whole of the profit derived from the UK development activity to UK corporation tax.

The Government have protected the extended corporate tax charge by immediately amending the Tax Agreements with Jersey, Guernsey and the Isle of Man to ensure that companies based in those jurisdictions can no longer claim protection from UK tax under those Agreements. In addition, if developers take steps to mitigate the charge between today and the introduction of the legislation, for example by seeking to rebase the assets by transferring them to a related company, then the rules will counteract such actions and ensure the tax charge is on the whole of the economic gain from the development activity. The charge could also be applied to a sale of shares in the property company owning the development in certain circumstances.

The new charge will apply to the profits of both commercial and residential development. For affected residential developers, in addition to a softening market due to external factors and significant increases in the SDLT rates payable by their customers, they will now have to factor in corporation tax on their projected profits.

HMRC will create a task force to target relevant offshore structures. The Government has also announced a short consultation on the changes that will close on 29 April 2016.

7 SDLT on additional properties

As previously announced, higher rates of SDLT will apply from 1 April 2016 to purchases of additional residential properties in England, Wales and Northern Ireland, such as second homes and buy-to-let properties.

The higher rates will levy an additional 3% on the total price paid for the property - such that, as shown below, the nil rate band will increase to 3% and so on up to the top slice of SDLT (which increases to 15%).

Relevant consideration *(where above £40,000)*	**Current rates**	**Additional property rates**
Up to £125,000	0%	3%
More than £125,000 to £250,000	2%	5%
More than £250,000 to £925,000	5%	8%
More than £925,000 to £1,500,000	10%	13%
More than £1,500,000	12%	15%

Following consultation, the Government has announced changes to the design of the rules, as originally proposed. In particular, purchasers will not incur the additional charge if they replace a main residence which has previously been sold within 36 months (rather than the originally proposed 18 months). The 36 month period will also apply so that a purchaser may claim a refund in circumstances where they purchase a new residence prior to selling their existing main residence. The 36 month period can apply from 25 November 2015 (the date of the announcement of the additional 3% charge in the Autumn Statement) instead of the disposal date.

Surprisingly, there will be no specific exemption for companies and funds which make significant investments in residential property, as had originally been proposed in the consultation. The higher rates will apply to all acquisitions made other than by individuals. The only 'relief' of sorts will be the continued ability to apply the commercial rates (as revised from 17 March) where six or more dwellings are purchased in a single transaction.

8 Seeding relief for property investment funds

The Chancellor has provided an update on the proposals for seeding relief on the transfer of property into Property Authorised Investment Funds and Co-ownership Authorised Contractual Schemes.

Technical changes are to be made to the manner in which the relief can be clawed back. This will only, it seems, affect situations where different classes of units are issued or the seeding is made by companies in a group. It will also now be possible to bring the 18 month seeding period to an early close through an election, rather than relying on outside investment.

It appears therefore that substantial changes will not be made to the clawback rules. Nor will changes be made to the minimum portfolio requirement. Further, it appears that the transfer of partnership interests will remain ineligible for relief.

The relief will be introduced by the Finance Act 2016 and so more detail will be available when the Finance Bill is released on Wednesday 23 March.

9 ATED and 15% SDLT charge: extension of scope of reliefs

It has been confirmed that from 1 April 2016, the scope of reliefs available from Annual Tax on Enveloped Dwellings (“ATED”) and the 15% higher rate of SDLT for acquisition of residential properties by non-natural persons will be extended.

This will affect acquisitions of properties occupied by certain employees, i.e. employees of a qualifying property rental business and caretakers in multiple occupancy buildings; purchases under Equity Release Schemes, such as Home Reversion Plans, and acquisitions by businesses for demolition or conversion for non-residential use. The change will coincide with the lowering of the ATED entry threshold to £500,000.

10 Capital gains rate changes

The rate at which individuals, trustees and personal representatives pay capital gains tax (‘CGT’) will be reduced. At the moment, all of these pay CGT at 28%, except individuals who are basic rate income tax payers, who pay CGT at 18%. The new rate will be 20%, or 10% for basic rate tax payers. The new rates will apply to gains accruing on or after 6 April 2016.

The existing rates will continue to apply to gains from disposals of residential property (including disposal by companies and non-residents) and from carried interest investments.

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