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Capital Gains Tax and UK residential property

On 27 November 2014 the UK government published its response to the consultation on extending Capital Gains Tax (‘CGT’) to non-UK residents who dispose of UK residential property. The proposals contained in the consultation response will affect both UK residents and non-UK residents, as the UK government intends to make changes to the availability of Principal Private Residence (‘PPR’) relief, which applies where individuals or trustees dispose of a residential property which has been used as the individual or trust beneficiary’s main residence. The consultation response sets out further detail on the UK government’s proposals, which are due to be enacted with effect from 6 April 2015.

The CGT payable by non-UK residents will broadly mirror that payable by equivalent UK residents, though there are some variations, and the interaction with existing tax legislation needs to be considered. Non-UK residents will be brought within the extended scope of CGT (‘extended CGT’) for disposals from 6 April 2015 and the default position will be that gains will be calculated based on the uplift in value of the property since 6 April 2015. In some cases the gain can be time-apportioned between pre and post 6 April 2015 periods on a straight-line basis, or an election can be made to use the original cost of the property, at the option of the taxpayer.

An overview of the key points in the consultation response is set out below. The information in the consultation response is relatively high-level; further information on the proposals is expected to be available when draft clauses for Finance Bill 2015 are published on 10 December 2014. Changes may be made to the legislation before enactment.

Non-residents within the extended scope of CGT

The UK government have reiterated that they intend to extend CGT to the following:

- Non-UK resident individuals
- Non-UK resident trustees
- Personal representatives of deceased non-UK resident individuals
- Non-UK resident companies which are not otherwise within the scope of CGT (see below).
- Non-UK resident partners in partnerships which are transparent for UK tax purposes may be subject to CGT on their proportionate entitlement to partnership capital. Transparent partnerships will not be subject to extended CGT.
- Certain funds (see below).

As previously announced, the UK government does not intend to extend CGT to non-UK resident pension schemes, foreign Real Estate Investment Trusts ('REITs') which are comparable to UK resident REITs, nor to non-UK resident investors in REITs.

Companies

It is intended that extended CGT at the normal corporation tax rate of 20% will apply to companies which are 'narrowly-held'. This is similar to the existing closely held company concept and is, broadly, intended to include companies which are owned or controlled by a small group of individuals or by members of the same family. Companies will not be within extended CGT merely because they are owned by a partnership (or by individuals whose only connection is that they are partners in a partnership).

Certain non-UK resident companies which have been subject to the Annual Tax on Enveloped Dwellings ('ATED') at any point since April 2013 are already within the scope of CGT when they realise gains on disposal of UK residential property ('ATED-related CGT').

ATED-related CGT applies at a higher rate (28%) than extended CGT and will apply in priority to extended CGT. A wider range of companies may be within the scope of ATED-related CGT than will be within the scope of extended CGT, as ATED-related CGT is not restricted to ‘narrowly-held’ companies. However, there are a number of reliefs and exemptions from the ATED, as below, meaning that the circumstances in which each tax might apply are complex.

ATED was introduced with effect from 1 April 2013 and imposes an annual tax charge on companies and certain other entities which own ‘high-value’ UK residential property unless a relief or exemption is available. ATED initially applied to properties worth more than £2million (on 1 April 2012 or purchase if later), but the tax will apply to properties worth in excess of £1million from 1 April 2015 and £500,000 from 1 April 2016. Relief from ATED is available for certain businesses, including property rental businesses where the property is rented to third parties on commercial terms, and in some cases an exemption is available (such as for charities). No ATED is payable where an exemption is available or a relief is claimed.

ATED-related CGT applies to the uplift in value of properties within the scope of the ATED from 5 April 2013, on a pro-rata basis where the property has moved into and out of ATED. ATED-related CGT applies at a 28% rate and no relief for inflation is available (compared to a 20% CGT rate and an allowance for inflation for non-UK resident companies within the scope of extended CGT). The table below illustrates the extent to which CGT will be payable by non-UK resident companies from April 2015, depending on whether or not the company is narrowly held or subject to ATED:

	ATED payable	ATED relieved/exempt
Narrowly held	ATED-related CGT	Extended CGT
Not narrowly held	ATED-related CGT	**Not** subject to CGT

Extended CGT will not apply where companies dispose of residential property which is held as ‘trading stock’; existing tax provisions will continue to apply in such cases.

Funds

The UK government does not intend that institutional investors should be liable to extended CGT on disposal of UK residential property and so intend to introduce ‘genuine diversity of ownership’ and ‘narrowly controlled company’ tests to limit the scope of extended CGT. These tests are intended to limit the scope of extended CGT to non-resident entities that are the private investment vehicles of individuals, families or small groups thereof.

Properties used as a residence

As part of the consultation, the UK government considered reforming PPR relief for all taxpayers, both UK resident and non-UK resident. Under the current rules it is possible for an individual with more than one residence (properties actually occupied by the taxpayer) to elect which residence he or she would like to be treated as his or her main residence for the purpose of PPR relief. The original consultation considered abolishing PPR elections and using a fact-based test. However, many expressed concern over potential unfairness and administrative complexity.

The UK government has now decided to retain the PPR election but its availability will be restricted. From April 2015 an individual's residence will not be eligible for PPR relief for a tax year unless either:

- The individual making the disposal was tax resident in the same country as the property for that tax year; or
- The individual spent at least 90 midnights at that property (or all properties they own in that country) in that tax year. Occupation by the individual's spouse or civil partner will count towards this total.

For UK residents whose residences are only in the UK, the current position that an election can be made in appropriate circumstances appears to have been preserved, although the UK government response is not explicit on this point. A UK resident with a home outside the UK will need to satisfy the 90 day rule in respect of the overseas home or he or she will be regarded as absent from the property for that tax year and it will not attract relief.

This is a new requirement for UK resident taxpayers and they will need to consider carefully whether their visits to an overseas property are sufficient in each tax year to ensure relief. If this is not the case, varying the election to a property where the requirements are satisfied might be appropriate, assuming that this opportunity continues to exist. Overseas tax implications would also be relevant.

For non-UK residents who own a residence in the UK, satisfying the 90 day test for the UK property may have wider consequences with regard to residence status. Days on which the individual is present in the UK at midnight are counted as days of presence for the Statutory Residence Test. Spending additional nights in the UK property in a tax year to meet the above 90 day test could therefore render the individual UK resident in some cases. It could also affect residence status in the subsequent two tax years, as 90 days of presence triggers a “UK tie” that may need to be taken into account in those years.

Non-UK residents will make PPR elections at the time of disposal, rather than within two years of moving into a second or subsequent residence. Any tax years in which the 90 day rule was met, including those prior to April 2015, will be taken into account when determining whether the property should attract relief. It is not clear whether the timing of elections will change for UK residents. The impact on internationally mobile individuals is also unclear.

Gains realised by trustees on disposal of residential property are also eligible for PPR relief where the property is used by a beneficiary of the trust as a main residence. Provisions will be introduced so that, broadly, trustees will only be eligible for PPR relief on a gain realised on disposal of a residential property if the individual occupying the property as a residence would have been eligible for PPR relief under the new rules if the property were owned personally.

Rental properties

Rental properties which have not been used as a residence are not eligible for PPR relief, and therefore any gain realised on disposal by a non-UK resident individual or by non-UK resident trustees will be subject to extended CGT.

For rental properties held by companies, ATED-related CGT may apply although companies which let rental properties on commercial terms to third parties are usually able to claim relief from the ATED, in which case ATED-related CGT does not apply for the relieved period. If this is the case, any post April 2015 gain may be subject to extended CGT instead of ATED-related CGT if the company is narrowly held.

If no ATED relief/exemption applies then in some circumstances companies may be liable to pay ATED-related CGT instead of extended CGT where ATED has been paid at any point since April 2013. ATED-related CGT applies at a higher rate than the proposed rate that will apply to companies subject to extended CGT.

Calculating the tax payable

Rebasing

Extended CGT will only apply to gains realised on disposal of residential properties from 6 April 2015. The default position will be that gains will be calculated based on the uplift in value of the property since 5 April 2015, but most taxpayers will be able to elect to time-apportion the gain on a straight-line basis, or use the original cost, if they would prefer to do so. Companies within the scope of ATED-related CGT will not be able to opt to time-apportion the gain arising.

Individuals

Non-UK resident individuals will be eligible for the CGT annual exemption (£11,100 in 2015/16) and CGT will only apply to gains realised in excess of this amount. The rates of CGT for individuals will be either 18% or 28%, depending on the level of the individual's taxable income. For non-UK resident individuals, only UK source income will be relevant when determining the rate of CGT which applies.

Trustees

Trustees will be subject to 28% CGT to the extent the capital gain arising exceeds the trustee's annual exemption. The annual exemption available to trustees is 50% of that available to individuals (£5,550 in 2015/16). This mirrors the tax position for UK resident trustees.

While under existing legislation non-UK resident trustees are not generally subject to CGT, UK resident settlors or beneficiaries of non-UK resident trusts may be subject to tax on gains realised by the trustees (or by underlying companies owned by the trustees). The consultation document acknowledges that the interaction of the existing anti-avoidance legislation which applies to UK resident individuals and extended CGT which will apply to non-UK resident trustees needs to be considered, but no further details are included in the consultation response. Further detail may be available when the draft Finance Bill 2015 is published on 10 December 2014.

Companies and other vehicles

As is the case for UK resident companies, non-UK resident companies which are within the scope of extended CGT will be subject to 20% CGT on gains realised on disposal of UK residential property. The UK government has stated that a 'limited' indexation allowance (relief for inflation) will be available, though have not expanded on how this allowance will be calculated.

As noted above, certain companies may already be within the scope of ATED-related CGT. The rate of ATED-related CGT is 28% and no relief for inflation is available. ATED-related CGT applies based on the uplift in value of the property since 5 April 2013. The tax position of companies which move in and out of UK residence and/or ATED will be complex.

Losses

Relief will be available for losses realised on disposal of UK residential property by non-UK residents, but losses will be ring-fenced and only relievable against gains realised on disposal of UK residential property by the same person in the same or a future tax year. Although UK residents are able to relieve capital losses against any gains within the scope of UK CGT, typically a non-resident would not have any other gains liable to UK CGT. For UK resident and domiciled individuals, this means that capital losses can be realised on disposal of assets situated anywhere in the world. The position for UK resident, non-UK domiciled individuals is more complex depending on what claims and elections have been made but, broadly, if the individual pays tax under the remittance basis of taxation, they are only subject to UK taxation on UK source gains and foreign gains to the extent remitted to the UK. Where a non-UK resident individual later becomes UK resident, it will be possible for brought forward losses realised on disposal of UK residential property to be relieved against any gains within the scope of UK CGT.

Similarly, if a UK resident ceases UK residence, any unused losses realised on disposal of UK residential property will be available for offset against future capital gains realised on disposal of UK residential property.

Under existing legislation, UK resident individuals who cease UK residence, dispose of an asset they held prior to departure while abroad and then return to the UK within 5 years of departure may be subject to CGT on gains realised in their absence. The consultation response does not refer to the interaction between extended CGT and the existing temporary non-UK residence provisions; further detail may be available in the draft Finance Bill 2015 to be published on 10 December 2014.

Companies which are not part of a group of companies will only be able to relieve losses against future gains realised on disposal of UK residential property. Companies which are part of a group will be able to operate ‘pooling’ arrangements to offset gains and losses. Pooling will only be available where companies are able to provide ‘clear information’ about the ownership structure. Tax charges may arise where a pooling arrangement has been entered into and a company leaves the group.

Reporting and tax payment

The proposal for tax to be withheld at source by those dealing with the sale of the property has not been pursued. Instead, the UK government intends to introduce a payment on account process, to apply to non-UK residents who do not already have a relationship with HMRC. The mechanism by which payments on account will be collected is still being designed, but the UK government expect that all non-UK residents will need to notify HMRC that a residential property has been sold within 30 days of completion, regardless of whether or not a payment on account is due. If a payment on account is due, it must be paid within 30 days of completion. The UK government has not yet provided details of how the payment on account should be calculated.

The consultation response states that payments on account will not need to be paid by taxpayers with a ‘live self-assessment relationship’, and so presumably non-UK residents who file annual tax returns will not be required to make payments on account. Non UK resident landlords are likely to be filing annual tax returns, in which case it seems that payments on account will not be required.

Individuals who own a property personally and occupy it themselves are generally not required to pay tax in respect of the property on an ongoing basis, and therefore, if a taxable gain arises on disposal, may be required to make a payment on account on disposal of their residence unless they file tax returns to disclose other income or gains arising. It is possible that PPR relief may be wholly or partially available, which could potentially reduce the chargeable gain on disposal of the property to nil. No payment on account will be required where PPR relief is available in respect of the entire gain arising, though HMRC will still need to be notified that a residential property has been sold by a non-UK resident.

Non-UK residents who are not required to make a payment on account because they have an ongoing self-assessment relationship with HMRC will need to file a tax return as usual after the end of the tax year of disposal of the property. Non-UK residents who are required to make a payment on account will be deemed to make a self-assessment tax return when the payment on account is made and will then be able to adjust the return (and so tax due) within the usual time limits for amending a tax return. For individuals and trustees, the time limit will therefore be the first anniversary of the 31 January following the tax year of disposal (so 31 January 2018 for disposals in 2015/16).

Lawyers, conveyors and other persons involved in the property transaction will not be required to assist in the collection of payments on account or notifications of disposal of properties, but the consultation response states that the UK government considers that such persons may wish to provide a service to assist clients with the process.

Find out more

This note reflects the law in force on 28 November 2014 and relates to the consultation response published on 27 November 2014. The consultation response sets out the UK government's proposals which are anticipated to take effect from 6 April 2015, though the proposals may change before enactment. Please note that this note does not cover all aspects of this subject. To find out more about any aspect of the above, please contact the people below or your usual Deloitte contact.

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