Non-residents and real estate Budget 2017: extension of capital gains – topics for debate

Following on from our initial publication on these proposals, we have been engaging with both clients and industry bodies on the issues the market is facing. Whilst it is expected that the changes will come into force, ideally, a balance should be struck between honouring Government policy and safeguarding the future of the UK real estate industry. In our response to the consultation, our focus will therefore be on what can be done to protect stakeholders in the real estate market.

Timing

The commencement of these rules should be moved from April 2019 to April 2020 to coincide with the extension of the corporation tax rules to non-residents.

The concern is that if the capital gains extension comes into effect in April 2019, non-resident landlords will face a considerable compliance burden in getting to grips with the new rules, followed by a further compliance overhaul the following year. There is also widespread concern that Brexit will depress valuations, which will result in lower rebasing as at April 2019.

Indirect disposals – the 25% test

The Government intends to exempt from charge indirect disposals by investors owning <25% of a property rich entity. The rationale for such an exemption is that such investors may not even be aware of the nature of the underlying assets, and are unlikely to have control or influence over the activities undertaken in respect of the property rich entity.

A number of restrictions were proposed in the consultation document, which risk undermining the premise behind the exemption.

The 25% test must be applied over a five year look-back period. It aggregates holdings of related parties, by using established concepts of "connected parties" and persons who are "acting together". So in many circumstances the exemption would not be available due to arrangements entered into by investors before these new rules were announced. There is also material uncertainty around how the acting together provisions should be interpreted, particularly in the context of widely held funds.

The Government should be asked to confirm that the following arrangements will not preclude availability of this exemption:

- arrangements entered into by investors prior to the Budget 2017 announcement;
- reduction or fragmentation of interests (which result in a holding of less than 25%) where none of the main purposes is the avoidance of the charge;
- investment in widely held funds where a fund manager effectively acts on behalf of all investors; and
- investors that are connected solely by virtue of being partners in a partnership.

Restructuring

In addition to various other changes (such as bringing non-resident landlords within the scope of corporation tax, and bringing non-residents owning residential property within the scope of capital gains tax), one of the Government's main aims in terms of these changes seems to be bringing offshore investments onshore.

For many existing structures, under current rules there is risk that investors will suffer an SDLT charge on the value of all or part of their property portfolios if they move properties into new onshore structures. We will be asking the Government to consider providing relief from SDLT in respect of this restructuring.

Exempt investors

The new rules could severely impact exempt investors such as pension funds, charities and sovereign wealth funds who invest through funds and other pooled investment arrangements.

Such investors would continue to be outside the scope of capital gains tax on disposals of properties they hold directly, but often invest through funds to access the benefit of pooled investment and the expertise of fund managers. We will be asking the Government to include appropriate reliefs or exemptions for such investors. As a practical matter, how that relief is provided will be a matter for discussion, and it is likely to require additional work from fund managers in monitoring the tax status of their investors.

"Property rich"

The new rules will apply to indirect disposals where at the time of disposal, 75% or more of the value of the asset derives from UK land. Whilst that determination is simple where the only asset the entity holds is UK real estate, there is considerable uncertainty amongst investors as to how they will value the non-UK land elements of their business, such as goodwill and intangibles.

If the entity being disposed of is "property rich" the entire gain (rather than the proportion that relates to the underlying UK land) is subject to tax. This outcome gives the proposed rules a broader scope than the Government appears to be aiming for. We will be asking the Government to exclude from charge the proportion of any gain that does not relate to the UK land.

Rebasing

We will also be asking the Government to align rebasing options for direct and indirect disposals. The Consultation document provides that for direct disposals, the taxpayer can choose the higher of the acquisition cost of the property, and the value at April 2019, which allows for scenarios where assets have reduced in value since acquisition. Conversely, for indirect disposals, the only option for investors is rebasing their interest as at April 2019 regardless of historic acquisition cost.

Have your say

We are preparing a formal response to the Government consultation on these changes, so please let us know if you have any other thoughts in relation to the proposed rules, and how they may impact on your business, or any comments on the issues we have highlighted.

Get in touch

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