Briefing

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Tax

Proposed extension of capital gains tax regime to non-resident individuals

On 28 March 2014, the government issued a consultation paper setting out how it intends to implement an extension of capital gains tax (CGT) to gains made by non-residents disposing of UK residential property.

The introduction of the new charge from April 2015 appears not to be open for discussion. The consultation document makes clear that the government is seeking views on how, and not whether, the new charge should be introduced.

The closing date for comments is 20 June 2014.

The following summary of the extended CGT regime is based on the government's existing proposals, as set out in the consultation document, and may be subject to change.

When will the extended CGT regime apply and to what gains?

The extended CGT charge will come into effect from April 2015 and will apply "only to gains arising from that date". As a number of commentators have noted, this statement is ambiguous as it could mean that the new charge will apply to:

- All gains (both pre- and post- April 2015) realised on a disposal of a UK residential property taking place on or after the commencement date in April 2015.
- Only post-April 2015 gains realised on a disposal of a UK residential property taking place on or after the commencement date in April 2015.

It is hoped that the government will adopt the second alternative, in line with its approach to the recently introduced Annual Tax on Enveloped Dwellings (ATED) - related CGT charge.

What type of property will be caught?

The government intends that the extended CGT charge will catch disposals of UK immovable property (of any value) that is, or has the potential to be, used as a dwelling or residence. This will include residential property that is let on a commercial basis. (This type of property is excluded from the scope of the ATED and the ATED-related CGT charge).

Also caught by the extended CGT charge will be disposals of multiple dwellings in a single transaction (there will no equivalent to the Stamp Duty Land Tax (SDLT) exemption that applies where there is a single transaction involving six or more separate dwellings).

In the consultation document, the government uses the terms "dwelling" and "residence" interchangeably. Given that the ATED, the ATED-related CGT charge and SDLT all use the term dwelling, it is to be hoped that the extended CGT charge adopts the same language in order to avoid confusion as to whether the terms residence and dwelling have a different meaning.

What type of property will not be caught?

The extended CGT charge will not catch the following types of property:

- Commercial property that cannot be used as, and is not in the process of being converted for use as, a dwelling (for example, offices and industrial buildings).
- Residential property that has been developed as part of a trade and where any gains would therefore be taxable as income (if made by an individual) or income profits (if made by a company).
- Residential property that is primarily for communal use. The government has identified the following types of property that would be excluded on this basis:
    - Property used as a home or other institution providing residential accommodation for children.
    - Property providing residential accommodation for school pupils.
    - Property used as a hall of residence attached to an institution for students in further or higher education (but not student accommodation in general, so privately-owned student accommodation would be caught).
    - Property used as a home or other institution providing residential accommodation with personal care for persons in need of personal care and nursing by reason of old age, disablement, past or present dependence on alcohol or drugs, or past or present mental disorder.
    - Property used as a hospital or hospice.

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- Property used as communal residential accommodation for members of the armed forces.
- Property used as an institution that is the sole or main residence of at least 90% of its residents. Examples of this exemption would probably include monasteries, convents and flats within a warden-assisted residential complex.
- Prisons or similar establishments.

What type of property ownership structure will be caught?

Direct ownership

Non-resident individuals owning (or treated as owning) UK residential property directly will be liable to CGT on gains realised on a disposal (subject to the availability of Principal Private Residence Relief (PPR)). PPR is a relief from CGT on the disposal of an individual's only or main residence.

Ownership through a partnership

Partnerships will continue to be treated as transparent for CGT purposes and so a non-resident partner will become liable to CGT on his share of any gains realised on a disposal of UK residential property held by the partnership, in the same way that a UK resident partner is currently liable.

Ownership through a trust

Trustees who, as a single person, are not UK resident will be chargeable to CGT on any gains realised on a disposal of UK residential property. The government will consider how the extended CGT charge will interact with existing anti-avoidance provisions that attribute gains of non-resident trusts to UK resident settlors and beneficiaries.

Ownership through a fund

Non-resident investors disposing of shares or units in a fund will remain outside the scope of CGT, but a fund-level charge (whose form and rate is yet to be decided) will be introduced to catch gains on UK residential property made within funds that are closely held and so do not pass either of the following tests:

(a) A new genuine diversity of ownership (GDO) test

(b A second-stage test which, if introduced, would exempt from the new charge funds which fail the GDO test but whose portfolio comprise only a very small proportion of residential property (presumably UK residential property).

Non-resident pension funds will be excluded from the scope of the extended CGT charge.

Ownership through a Real Estate Investment Trust

A real estate investment trust (REIT) is a corporate entity that buys, develops, manages and sells real property. A REIT allows participants to invest in a professionally managed portfolio of real property that is held for long-term benefit.

The following will not be within the scope of the extended CGT charge:

(a) Foreign (non-resident) REITs, provided that they operate in an equivalent way to UK REITs (HMRC is currently preparing guidance on what constitutes a foreign-REIT equivalent).

(b) Non-residents holding shares in UK REITs and foreign-REIT equivalents when disposing of their shares in those vehicles.

Ownership through a company (other than a REIT)

Both non-resident companies holding UK residential property on behalf and for the personal use of individuals (so-called corporate envelopes) and non-resident companies investing in UK residential property (including rental property) will be subject to a specific tax charge (referred to as the "tailored charge") on any gains realised on a disposal of UK residential property, insofar as those gains are not already subject to either corporation tax or the ATED-related CGT charge. The form and rate of the tailored charge is still to be decided, although only losses from disposals of UK residential property will be available to reduce the gains of non-resident companies caught by the tailored charge. The detail of how the tailored charge will interact with the ATED-related CGT charge (particularly where the ATED-related charge applies to only part of the gain realised on a particular disposal) has yet to be set out.

The government has not suggested that it intends to tax non-resident individuals on gains from disposals of shares in companies holding UK residential property. This would fit with the liability for ATED-related CGT, which remains at company level.

How will the extended CGT regime interact with PPR?

At present, non-resident individuals holding UK residential property directly are generally outside the scope of CGT and so do not claim PPR on a disposal. Once the extended CGT regime comes into force, the government recognises that there will be certain (albeit limited) situations in which it will be appropriate for a non-resident individual to claim PPR on the basis that their main residence is or was in the UK (an example is given in the consultation document of an individual emigrating and then, having become non-resident, selling the UK residential property that had been their main residence prior to emigration). However, in order to prevent abuse of the relief by non-residents who own both UK and foreign residential property, the government is considering removing (for both non-residents and UK residents) the ability to elect which of two or more residences is an individual's main residence for PPR. Instead, an individual's main residence would be determined either:

- As a matter of fact, balancing all of the available evidence (as is currently the practice where an individual with two or more residences has not made a PPR election).
- On the basis of a fixed statutory rule (for example, the property in which the individual has been present for the greatest amount of time in any given tax year).

What rate of tax will be charged and what allowances will be available?

In calculating the CGT liability of a non-resident individual who realises (or is treated as realising) a chargeable gain on UK residential property, the government intends that:

- The CGT annual exempt amount (currently £11,000 for individuals) will be available to reduce the gain.
- Any remaining gain will be taxed at the rates applicable to UK resident individuals (at present, this would be 18% if the non-resident individual's total taxable UK income and gains did not exceed the upper limit of the income tax basic rate band (currently £31,865) and 28% if the total exceeded that limit).

The government will confirm the rates of tax that will apply to other non-resident entities under the extended CGT regime at a later date.

How will the tax be collected?

In order to ensure compliance with the new CGT charge for non-residents, the government's preference is to introduce a form of withholding tax that operates alongside an option to self-report the tax due.

The government suggests that the withholding tax mechanism could operate in a similar way to SDLT, where the buyer (or the buyer's agent) must submit a land transaction return and payment of the SDLT due within 30 days of the effective date of the property transaction (typically the date of completion).

It is not clear how this would translate to a non-resident individual disposing of UK residential property. Would the individual have 30 days in which to self-assess and pay the actual CGT liability or suffer the withholding tax charge (which is likely to be based on the market value of the property at the time of its disposal)? Assuming that the CGT liability depends on the non-resident's total taxable UK income and gains for the tax year of the disposal, it is hard to see how this could be calculated accurately within the 30-day period unless the disposal happened to occur in the final month of the tax year or the individual had no other sources of UK income or gains. If the withholding tax is levied, there would presumably need to be a mechanism by which it could later be offset against the non-resident's actual self-assessed CGT liability (with an appropriate adjusting payment or repayment being made).

If a withholding tax mechanism is to be introduced to collect the extended CGT charge, it might make sense to see if it could be incorporated into the existing withholding tax arrangements that apply to UK rental income paid to non-resident landlords under the Non-Resident Landlords Scheme (NRLS). Under the NRLS, non-resident landlords (including individuals, companies and trusts) can apply to HMRC for approval to receive UK rental income without deduction of tax, provided that they satisfy certain conditions, including a requirement that their UK tax affairs are up-to-date. Otherwise, withholding tax at the income tax basic rate (currently 20%) is applied to their UK rental income at source, either by the tenant(s) or, more commonly, by a UK agent acting on behalf of the non-resident landlord.

Next steps

The current consultation closes on 20 June 2014. Having considered the responses, the government will confirm the scope and structure of the extended CGT regime and may hold a further consultation on more detailed and technical aspects of its design. No timing is given on the government's response to the current consultation, but with the measure due to be included in the Finance Bill 2015, it is likely that draft legislation will be available by the time of the 2014 Autumn Statement.

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