To de(-envelope), or not to de(-envelope); that is the question

Numerous changes in recent years to the tax regime applying to residential properties have given headaches to those who hold property through corporate entities. Those people are now faced with an impossible decision along the lines of "damned if I do, damned if I don't" when treading the tightrope between Inheritance Tax, Capital Gains Tax and ATED and considering whether to de-envelope those corporate holding structures. Unfortunately, the 3% surcharge that is being added to Stamp Duty Land Tax ("SDLT") rates from 1 April 2016 will only serve to make the decision process more unpleasant.

Amongst the UK government's announcements in 2015 of sweeping changes to the UK tax regimes affecting international individuals – notably changes to "deemed domiciled" rules, the imposition of an effective 'compulsory arising basis' for long-term resident individuals and anticipated new rules for taxing offshore trusts established by non-UK domiciled settlors – the SDLT 3% surcharge on rates for purchases of 'second' properties has perhaps been overlooked for immediate consideration. However, individuals may need to look more closely and more urgently at how they may be affected with 1 April 2016 fast approaching, and in particular may need to bear this change in mind when considering changing their property-holding structures with the other changes to tax treatment in mind (such as the Annual Tax on Enveloped Properties ("ATED"), ATED-related CGT, non-resident CGT on residential properties, and the application of Inheritance Tax ("IHT") to companies holding UK residential property from April 2017).

By way of a reminder, the ATED regime was introduced in 2013, imposing annual ATED charges, higher SDLT rates and tax on capital gains where residential properties over specified value thresholds are held by non-UK resident companies. In 2013, a partial restriction on the deductibility of loan finance, affecting international individuals in particular, for IHT was also introduced. Subsequently, CGT was introduced in 2015 for non-UK residents (including companies not already affected by the ATED regime) making disposals of UK residential properties. Most recently, the government has announced that IHT be charged on offshore companies holding UK residential properties. All of these have added up to an unattractive position for corporate holding structures, with ATED, ATED-related CGT and IHT all potentially being in context.

The main proposals

In November 2015, the Chancellor of the Exchequer announced that SDLT rates would be increased by 3% when charged on purchases of residential property purchased in addition to an individual's principal residence. The new charges will primarily affect purchases of second properties (such as holiday homes or out-of-town residences) and of properties purchased for investment (buy-to-let).

Under the current rules, property purchases of up-to-£125,000 are not chargeable to SDLT. The stamp duty system was changed in December 2014 when a progressive approach to the tax was introduced, the rates of which (the "normal SDLT" rates) are shown below. From 1 April 2016, the rates applied to all affected purchases the ("Surcharge SDLT" rates) will be as follows:

Purchase price	Normal SDLT rate	Surcharge SDLT rate
Up-to-£40,000	0%	0%
£40,001 to £125,000	0%	3%
£125,001 to £250,000	2%	5%
£250,001 to £925,000	5%	8%
£925,001 to £1,500,000	10%	13%
£1,500,001 and more	12%	15%

Purchases below £40,001 are to be exempt from the expanded SDLT 'surcharge' rate and from the new regime's reporting requirements. Importantly, the government's announcements included the information that the additional 3% SDLT surcharge will not be payable by corporate property developers, although the final details of this exemption are still awaited alongside the other final details that have been consulted on. The consultation process is due to close on 1 February 2016.

Reasons to think about SDLT now

These changes have, broadly, made the structured ownership of UK residential property tax neutral at best, and often unattractive, and our experience shows that many international individuals are considering de-enveloping their UK residential property holdings as a result. However, in many cases, such people have been awaiting the publication of the details of new rules to be introduced, in the anticipation of some form of relief for people who have been repeatedly affected by the changes in legislation.

In many cases, this 'wait and see' approach may be entirely appropriate. However, with the impending introduction of the additional 3% SDLT surcharge, individuals should at least consider whether more immediate changes should be made: on the balance of things, it may still be appropriate to 'wait and see', but an additional 3% of SDLT may colour the decision if potential purchasers are likely to be put off buying investment properties or if re-structuring would give rise to SDLT.

Further thoughts

Points for further detail

Important points that we hope will be clarified after the consultation process has been concluded include how joint purchases (e.g. by two persons, one with another property and one without) will be treated, what precisely will be the meaning of "main residence" for the purpose of these rules, and what characteristics will rental arrangements need in order to make sure the tenant is outside the surcharge if he or she buys a property.

Gifts and mortgaged property

Typically, SDLT is charged on the value of the purchase price involved in a transfer of property. Where there is no purchase price (because the transfer is made as a gift or within a not-for-consideration re-structuring, for example) there may be a charge to SDLT.

However, where outstanding finance remains at the time of the transfer (e.g. a mortgage), SDLT may be charged on the value of the mortgage because the recipient of the transfer has effectively accepted the obligation to repay the loan and not that acceptance may be effective consideration. Therefore, thought will need to be given to SDLT and the new surcharge even where it appears that transfers of property may be not-for-consideration and therefore – on the face of it – outside the SDLT charge.

Trusts

The relative positions of trustees and their beneficiaries will need to be considered where UK residential property forms a part of the trust fund. The indications are that, where a beneficiary has a right to occupy a property (notably, under an interest in possession trust, as a "life tenant"), any subsequent purchase of a property by that beneficiary would constitute a purchase of a 'second' home under the rules, attracting the SDLT surcharge. Where trusts hold UK residential property, the situation will need to be reviewed if future SDLT implications are to be clear for trustees and beneficiaries.

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