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UK TO TAX GAINS OF NON-RESIDENTS ON UK REAL ESTATES

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The UK Government has announced that, from April 2019, a UK tax charge will arise on gains made on direct and certain indirect disposals of UK real estate by individuals and companies that are not resident in the UK.

While perhaps not surprising given the recent direction of travel in the UK tax treatment of UK real estate (a similar change was recently introduced for certain non-residents investing in residential property), this still represents a significant change in the UK tax landscape for non-resident investors in UK commercial real estate who have historically been able to escape the UK tax net on exit.

OUTLINE OF CHANGES

The UK Government has opened a consultation process which will close on 16 February 2018. Details at this stage are scarce but the key features of the new charge are expected to be as follows:

- Where a non-UK resident directly disposes of UK land, a charge to:
    - UK corporation tax for bodies corporate (which is currently 19% and is expected to be 17% from April 2020); or
    - UK capital gains tax for other persons (currently charged at 20% in most circumstances and at 28% for residential property), is expected to arise.

- Where a non-UK resident disposes of an interest in an entity that holds UK land (e.g. by way of a share disposal), a UK tax charge may also arise where:
- 75% or more of the gross value of the entity being sold is derived from UK land (the property richness test); and
- the non-resident person (with its related persons) holds at least a 25% interest in that entity (or did at some point over the previous five years).
- It is currently intended that the interests of partners in a partnership will be aggregated to meet this 25% This means it is likely that the new rules will impose UK tax charges on non-UK resident investors in UK commercial real estate funds – potentially both in respect of disposals by the fund and disposals of fund interests by investors.
- Some good news is that non-resident investors should receive an uplift in their base cost in UK commercial real estate (and in indirect interests therein) to market value at the beginning of April 2019.

It is not, however, clear at this stage how wide the definition of “land” will be – this will be of interest given the unexpected breadth of the equivalent definition in the recently introduced “transactions in land” rules.

DOUBLE WHAMMY?

Historically, UK corporates (but not, in recent times, individuals) have been protected from the impact of inflation on chargeable gains by indexation allowance. The UK Government has, however, also announced the abolition of indexation allowance for corporates (including non-residents) from April 2019. Therefore, a non-resident could, on exit, be taxed on inflation-linked gains in UK land from April 2019.

ANY HELP FROM DOUBLE TAX TREATIES?

Although some of the UK’s tax treaties may override this new tax charge in some circumstances, most modern treaties may not. And anti-forestalling measures will apply to prevent structuring designed to take advantage of beneficial treaties.

Further, investors should not assume that a beneficial treaty will apply in any event given the curbing of treaty benefits as a result of BEPS Action 6 and the “multi-lateral instrument”.

SO IS THAT THE END FOR NON-UK INVESTORS EXITING BY SHARE SALES?

There is still an advantage of an exit by share sale as opposed to asset sale – the latter is subject to Stamp Duty Land Tax (SDLT) at up to 5% of the sale price. While strictly a liability on a purchaser, SDLT is typically factored into what a purchaser will pay for an asset – so non-resident sellers may still prefer to exit by a share sale to maximise their sales proceeds. But how long until SDLT is charged on sales of land- rich corporates?

It may also be that the UK’s participation exemption (the substantial shareholding exemption) applies to exempt some share disposals for qualifying institutional investors – but we will need to wait for further details.

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