UK Autumn Budget - Real Estate

United Kingdom: November 2017

In Brief

There were announced a number of changes on 22 November 2017, the most significant of which apply to non-residents investing in UK real estate. In light of the proposal to bring all income and gains of non-residents in relation to UK property within the charge to UK corporation tax, the other proposals relating to UK corporation tax will affect UK and non-UK companies alike in the future.

Taxing gains made by non-residents on UK immovable property

The government announced that from April 2019 tax will be charged on gains made by non-residents on disposals of all types of UK immovable property, extending existing rules that apply only to residential property.

Unlike most other major jurisdictions, the UK does not currently exercise its full taxing rights where non-residents dispose of non-residential UK immoveable property. The UK also does not currently tax 'widely-held', non-resident companies on disposals of interests in UK residential land, or indirect disposals of UK residential land.

The proposals represent a significant change to the rules for taxing gains on immovable property (e.g. property held as an investment). This follows other recent changes extending the scope of UK taxation in relation to profits on the direct or indirect disposal of UK immovable property which are 'trading' in nature.

The proposals will apply to direct and indirect disposals. Indirect disposal rules will apply where an entity is 'property rich', which is broadly where 75% or more of its gross asset value at disposal is represented directly or indirectly by UK immovable property. Such disposals will trigger the charge only where the person holds, or has held at some point within the five years prior to the disposal, a 25% or greater interest in the entity.

Special provisions will apply to aggregate holdings in certain circumstances.

For indirect disposals there will be a reporting requirement on certain third-party advisors who have sufficient knowledge of the transaction.

With respect to non-residential property, and residential property not currently within the charge, only the gains attributable to changes in value from 1 April 2019 (for companies) or 6 April 2019 (for other persons) will be chargeable, which will be achieved by rebasing property values at April 2019 in the case of a direct disposal. There will also be the option (for direct disposals only) to compute the loss or gain on disposal using the acquisition cost as the base cost of the property. Special provisions may apply in relation to residential property which is already within the charge.

An anti-forestalling rule will apply to certain arrangements entered into on or after the publication of the consultation document on 22 November 2017. The rule will counteract arrangements that seek to avoid the new charge on non-residents by exploiting provisions in some Tax Treaties in a way that is contrary to the object and purpose of those provisions, particularly with respect to arrangements designed to frustrate the operation of the charge on indirect disposals.

A targeted anti-avoidance rule will also apply from April 2019.

Whilst some aspects of the reforms are fixed, such as who is in scope, commencement date, and core features of the direct and indirect disposal provisions, the government has published a consultation document to ensure that the legislation is effectively targeted and does not place unnecessary burdens on affected taxpayers. The government is also exploring harmonising the various tax regimes applicable to UK residential property and the treatment of residential and non-residential property. The deadline for responses to this consultation is 16 February 2018.

Bringing non-resident companies chargeable to income tax and Non Resident Capital Gains Tax within the charge to corporation tax

Following the consultation published in March 2017 it was announced that, from April 2020, income that non-resident companies receive from UK immovable property (currently subject to UK income tax) will be chargeable to corporation tax. Also from that date, gains that arise to non-resident companies on the disposal of UK property will be charged to corporation tax rather than CGT (e.g. certain gains on the disposal of UK residential property which are currently within the charge to capital gains tax, will come within the charge to corporation tax).

The government's detailed responses to that consultation are expected to be published shortly after the Autumn Budget.

There are differences in the way taxable profits are calculated depending on whether the profits are subject to corporation tax or income tax. As a consequence of bringing non-UK tax resident companies within the charge to corporation tax there will therefore be, amongst other things, additional restrictions on the deductibility of interest, deductions related to hybrid mismatches and restrictions on the amount of losses brought forward from earlier periods that can be offset. Transitional provisions will also be required.

In a separate announcement, all capital gains on non-resident disposals of UK immovable property will be brought within the scope of UK tax (see further comments above). This will apply to gains accrued on or after April 2019. Further clarification is expected on how this will interact with the aforementioned changes in relation to the application of corporation tax to non-resident companies, which do not take effect until April 2020.

Removal of indexation allowance for chargeable gains subject to corporation tax

The indexation allowance on chargeable gains subject to corporation tax will be frozen from 1 January 2018.

Corporate Interest Restriction and hybrids

The new interest restriction rules, which apply for the purposes of corporation tax, broadly restrict each group's net interest deductions for interest to 30% of the EBITDA, subject to specific reliefs, exemptions and alternative bases for calculating the restriction.

One such exemption is the 'Public benefit Infrastructure Exemption' ('PIE') which applies to certain interest payments by Qualifying Infrastructure companies (which can include property letting companies). Changes to the rules have been announced in this Budget to deal with a number of practical issues which have been identified during the consultation process, the main one being that the PIE election will not now follow an asset when it is transferred to non-related parties.

Other detailed technical changes were made to address other practical issues identified in respect of the hybrid rules.

Accounting changes for leasing

IFRS 16 changes the way that leases (including property leases) are accounted for. The accounting treatment of leases from a lessor's perspective will not change to any significant extent.

However, lessees will need to recognise a lease liability on the balance sheet reflecting the net present value of future lease payments. A corresponding "right of use asset" will also be recognised on the balance sheet. The income statement will reflect the depreciation of the right of use asset and a finance charge.

As this represents a significant change to the way in which accounting profits are determined, and those accounting profits form the basis on which the taxable profits are calculated, the government will publish two consultations on 1 December 2017.

The first consultation is on the legislative changes required by the new accounting standard to ensure that the income and corporation tax rules for leased plant and machinery continue to work as they do currently, and on the wider impact of the accounting change for income and corporation tax.

The second consultation considers options for the corporation tax treatment of lease payments (which will now include a finance charge) under the new corporate interest restriction rules.

Stamp duty land tax ('SDLT')

A relief for first time buyers of residential properties costing no more than £500,000 has been introduced with effect from 22 November 2017. First time buyers will pay no SDLT on the first £300,000 of the purchase price, with the remainder being charged at 5%. No relief will be available where the total consideration exceeds £500,000.

The proposed SDLT filing and payment window reduction from 30 days to 14 days will be delayed until or after 1 March 2019.

Minor amendments have been made to provide relief from the further 3% applicable to additional residential properties in certain cases including:

- where a divorce related court order prevents someone from disposing of their interest in a main residence,
- where a spouse or civil partner buys property from another spouse or civil partner,
- where a deputy buys property for a child subject to the Court of Protection,
- where a purchaser adds to their interest in their current main residence.

Annual Tax on Enveloped Dwellings ('ATED')

The ATED annual charges will rise 3% from 1 April 2018 in line with the September 2017 Consumer Prices Index.

Business rates

A number of measures to support business have been announced, including:

- Bringing forward to 1 April 2018 the planned switch in indexation from RPI to CPI.
- Retrospective legislation to address the so-called "staircase tax". Affected businesses will be able to ask the Valuation Office Agency (VOA) to recalculate valuations so that bills are based on previous practice backdated to April 2010.
- Continuing the £1,000 business rate discount for public houses with a rateable value of up to £100,000, for one year from 1 April 2018.
- Increasing the frequency with which the VOA revalues non-domestic properties by moving to revaluations every three years following the next revaluation, currently due in 2022.

Council tax

Local authorities are to be given the power to impose a 100% on council tax premium on unoccupied property.

Our view

The Government has gone further than initially expected, and capital gains on commercial real estate held by non-residents will now be subject to UK capital gains tax on gains accrued on, or after, April 2019.

This is a fundamental change and could have a significant impact on the market as commercial real estate brings billions of pounds of investment into the UK each year. There will be targeted exemptions for institutional investors, such as pension funds.

Contact

Uwe Stoschek
Global Real Estate Tax Leader
Phone: +49 30 2636-5286
uwe.stoschek@de.pwc.com

Jeroen Elink Schuurman
EMEA Real Estate Tax Leader
Phone: +31 88 792-6428
jeroen.elink.schuurman@nl.pwc.com

United Kingdom

Rob Walker
National Real Estate Tax Leader
Phone: +44 20 7212 2324
robert.j.walker@pwc.com

Juliet Minford
Senior Manager
Phone: +44 28 9041 5192
juliet.minford@uk.pwc.com

Germany

Sven Behrends
Partner, München
Phone: +49 89 5790-5887
sven.behrends@de.pwc.com

Helge Dammann
Partner, Berlin
Phone: +49 30 2636-5222
helge.dammann@de.pwc.com

Marcel Mies
Partner, Düsseldorf
Phone: +49 211 981-2294
marcel.mies@de.pwc.com

Dr. Michael A. Müller
Partner, Berlin
Phone: +49 30 2636-5572
mueller.michael@de.pwc.com

Josip Oreskovic-Rips
Partner, Frankfurt am Main
Phone: +49 69 9585-6255
josip.oreskovic-rips@de.pwc.com

Uwe Stoschek
Partner, Berlin
Phone: +49 30 2636-5286
uwe.stoschek@de.pwc.com