Publication of measures to be included in Finance Bill 2018/2019 - Impact on the taxation of UK real estate

United Kingdom: July 2018

In Brief

On 6 July 2018 the Government of the United Kingdom published draft legislation and supporting documents for Finance Bill 2018/2019. There will be a consultation on the draft clauses, which closes on 21 August 2018, and the final contents of Finance Bill 2018-19 will be subject to confirmation at Budget 2018.

Timeline for the changes

- **November 2017**:
  Announcement of proposals at Autumn Budget 2017 and start of consultation period.
- **July 2018**:
  Consultation response and draft legislation.
- **Late 2018**:
  Publication of remaining legislation expected followed by further consultation period.
- **April 2020**:
  Legislation expected to be effective and majority of rules in force.

Capital Gains Tax and Corporation Tax on gains for non-residents on UK property

As announced at Autumn Budget 2017, and following a consultation, this measure extends the scope of the UK's taxation of gains accruing to non-UK residents to include gains on disposals of interests in non-residential UK property. It also extends the charge on gains on disposals of interests in residential property to diversely held companies, those widely held funds not previously included, and to life assurance companies. The measure also taxes non-UK residents' gains on interests in UK property rich entities (for example, selling shares in a company that derives 75% or more of its value from UK land).

The measure will have effect for disposals made on or after 6 April 2019.

An anti-forestalling rule detailed in a technical note published at Autumn Budget 2017 has effect for arrangements entered into on or after 22 November 2017. A targeted anti-avoidance rule relating to indirect disposals will have effect for arrangements entered into on or after 6 July 2018.

The indirect disposal rules will apply where a person makes a disposal of an entity that derives 75% or more of its gross asset value from UK land. There will be an exemption for investors in such entities who hold a less than 25% interest.

The gains on indirect disposals will be calculated using the value of the asset being disposed of, rather than the value of the underlying UK land.

The 75% property richness test will look at the gross assets of the entity being disposed of. Where a number of entities are disposed of in one arrangement, their assets will be aggregated to establish whether the 75% test is met. Any assets that are the counterpart to a liability in another entity in the arrangement will not be included – for example, an intra-group loan credit balance in an entity would not be considered where the debtor is disposed of in the same arrangement.

The 25% ownership test will look for situations where the person holds at the date of disposal, or has held within two years prior to disposal, a 25% or more interest in the property rich company. This holding may be directly, or through a series of other entities. Interests in the entity held by certain persons connected with the person making the disposal will be aggregated in establishing whether the 25% threshold is met. This will use a modified version of existing tests but will be more limited than originally proposed.

There will be a trading exemption so that disposals of interests in property rich entities that are trading before and after the disposal will not be chargeable disposals where the land is used in the trade. This is likely to apply where, for example, a non-UK resident disposes of shares in a retailer which owns valuable premises.

All non-UK resident companies, including close companies, will be charged to Corporation Tax rather than Capital Gains Tax on their gains. The provisions relating to ATED-related Capital Gains Tax will be abolished.

Existing reliefs and exemptions available for capital gains will be available to non-UK residents, with modifications where necessary. Those who are exempt from capital gains for reasons other than being non-UK resident will continue to be exempt.

Losses arising to non-UK resident companies under the new rules will be available in the same way as capital losses for UK resident companies. Capital Gains Tax losses will follow the existing rules for non-resident Capital Gains Tax losses.

There will be options to calculate the gain or loss on a disposal using the original acquisition cost of the asset or using the value of the asset at commencement of the rules in April 2019. Both options will be available for both direct and indirect disposals. Where the original cost basis is used to calculate an indirect disposal and this results in a loss it will not be an allowable loss.

Special rules will apply to collective investment vehicles investing in UK real estate who agree to certain conditions including reporting to HMRC, these rules will look to address concerns raised in the consultation over taxation of exempt and similar investors and multiple tax charges on funds.

These rules are being explored in consultation with relevant stakeholder groups. Regulations may be used to define the reporting requirements.

Key changes from original consultation

- In the case of indirect disposals of "property rich entities" there will be a trading exemption where the property is used in the trade (e.g. in the case of a retailer).
- The option of using original cost rather than April 2019 value will be available for indirect disposals also, but no capital loss would arise.
- The circumstances in which interests will be aggregated for the purposes of the 25% are to be more narrowly targeted than originally suggested. For example, partners in partnerships will not be connected with each other for the purpose of this test.
- The five-year look back in respect of the 25% ownership test will be reduced to two years (which should prevent many 'seed' investors being caught).
- The ATED gains regime will be repealed.
- Special rules will apply to collective investment vehicles investing in UK real estate who agree to certain conditions including reporting to HMRC, these rules will look to address concerns raised in the consultation over taxation of exempt and similar investors and multiple tax charges on funds. HMRC continues to consult on these provisions.
- However, the 25% exemption will not be available for collective investment vehicles investing in UK real estate, with the definition to be decided in further consultation.

Corporation Tax on UK property income of non-UK resident companies

Following announcement at Autumn Statement 2016, the government consulted in March 2017 on the case and options for bringing non-resident companies' UK property income and gains (previously chargeable to Income Tax and Non-Resident Capital Gains Tax respectively) into Corporation Tax.

As a result, from 6 April 2020, non-UK resident companies that carry on a UK property business, or have other UK property income, will be charged to Corporation Tax, rather than being charged to Income Tax as at present. This change will align with the end of the tax year 2019-20, which ends on 5 April 2020. The position regarding capital gains is dealt with separately (see comments above).

This will mean that the UK property income profits chargeable to Corporation Tax will be calculated in accordance with ordinary Corporation Tax principles.

A non-UK resident company which carries on a UK property business will also be chargeable to Corporation Tax in respect of its profits that arise from loan relationships or derivative contracts that the company is a party to for the purpose of that business. Inter alia, the provisions restricting interest deductions will apply.

Various transitional measures were proposed as part of the consultation paper and are now included in the proposed measures. In particular, the change from Income Tax to Corporation Tax will not create a disposal event for the purposes of the Capital Allowances Act 2001, and there will be provisions to ensure that income is neither taxed twice nor falls out of account, and that an expense is only relieved once.

Also, provision will be made for the grandfathering of existing Income Tax losses so that it will be possible to carry them forward to the Corporation Tax regime. They can be offset against future UK property business profits that are chargeable to Corporation Tax but they will not be available for offset against other types of income receivable by the non-UK resident company that are also within the charge to Corporation Tax. It will not be possible to surrender these losses as group relief.

Other transitional provisions will apply in relation to derivative contracts and expenditure on contaminated or derelict land.

Tax treatment of transitional adjustments for lessees adopting IFRS 16

The change to lease accounting under IFRS16 applies to companies accounting under IFRS and FRS101 and applies for accounting periods commencing on or after 1 January 2019.

These primarily impact on lessees and will require a new asset (a Right of Use asset) and a liability (equating to the net present value of lease payments) to be included on the balance sheet. The income statement going forward will reflect expenditure relating to depreciation of the right of use asset and a finance charge associated with the liability instead of rent.

A number of amendments are required to parts of the tax legislation to accommodate this change. In relation to leases of real property, a particular area of focus in the consultation has been the way in which relief would be available to lessees, and in particular, the tax treatment of any accounting adjustment on transition.

In broad terms the measures announced will require a lessee to spread any transitional adjustment recognized on adoption of IFRS 16 over the average remaining length of the leases which have given rise to the transitional adjustment.

Changes to the corporate interest restriction rules

The government has previously consulted on the options for legislative changes required to ensure that these rules work as intended following the adoption of the new lease accounting standard IFRS 16, particularly in relation to lessees, who will be required to treat a proportion of their rents as a finance charge for accounting purposes.

The government has decided to adopt an approach that broadly maintains the status quo – i.e. lessees will be required to continue to classify leases as either finance leases or operating leases for tax purposes and only those leases classified as finance leases will result in the finance charge being restricted under the corporate interest restriction rules.

Additionally, a number of technical amendments are proposed to the corporate interest restriction rules to ensure the regime works as intended.

Extension of offshore time limits for the assessment of tax

These measures increase the tax assessment period in relation to “non-deliberate offshore non compliance” to up to 12 years, and may potentially apply to non resident companies who are currently subject to UK income tax on income from UK immoveable property.

VAT grouping eligibility criteria changes

Following an earlier consultation legislation will be introduced to allow a non corporate entity (e.g. a partnership or individual) to join a VAT group with its body corporate subsidiaries if it controls all the entities within the VAT group.

Changes to the Stamp Duty Land Tax filing and payment time limits

The time limit for submission of SDLT returns and payment of SDLT is being reduced to 14 calendar days.

The new time limit will apply to transactions with an effective date on or after 1 March 2019. (The effective date is usually the date of completion but can be brought forward where the price is paid or possession of the property is taken before the date of completion).

Currently SDLT returns must be submitted, and the SDLT paid, within 30 calendar days of the effective date of the transaction.

International Tax Enforcement disclosable arrangements

This measure provides legislation to allow regulations to be made to give effect to international rules (EU and OECD) on the mandatory disclosure of cross boarder tax arrangements.

In the case of the EU mandatory disclosure provisions, these came into force on 25 June 2018 and require disclosure to be made by no earlier than August 2020. These provisions include a number of widely drafted “hallmarks” and can apply to transactions involving inter alia real estate even where the obtaining of a tax advantage is not the, or one of the main benefits.

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@pwc.com