Response to the HM Revenue & Customs and HM Treasury Consultation Document Taxing Gains made by Non-Residents on UK Immovable Property

Overview

Whilst we appreciate that many other jurisdictions currently tax the growth in value of commercial property which is located in their jurisdiction and that the current proposal to do so will not therefore make “UK plc” unique, we nevertheless query the timing of the proposed introduction i.e. 1 April 2019 (for corporation tax) and 6 April 2019 (for income tax) in light of the impending date of Brexit. Given the potential ramifications of Brexit, we consider that perhaps now is not the best time to introduce a fundamental change to the structure of taxation of UK commercial property investment in the UK as surely we want to be demonstrating that “UK plc” is open for business. As has been said: “the UK corporate tax regime exists partly to collect revenues to fund our public services but it also has another important function – to help business and the economy thrive by encouraging support and investment”.

We are concerned that the constantly changing tax regime as it affects real property will be a disincentive to investment in the UK with a deleterious effect on job creation, investment in capital expenditure and generally keeping "UK Plc" open for business. More particularly, these rules will mean that businesses will have to spend more time engaged with their professional advisors and on compliance. In no other area of tax law, recently, have so many complicated rules been devised and revised as in the taxation of real property. The consequences of this state of flux will be far reaching.

Turning to the specific questions:

Question 2 – Do you see any issues or complications arising with respect to rebasing which need to be addressed?

We consider that the complications are encapsulated in paragraph 2.14 of the Consultation paper where it demonstrated that a number of rebasing points may be required.

Furthermore there appears to be disparity as sellers of real property can choose either historic or April 2019 values, whereas sellers of shares may only rebase to the April 2019 value.

Question 3 – Do you agree with the basic principle that gains on direct business disposals within these new rules should be computed using the same rules as other chargeable gains?

Whilst in principle we agree with this, we consider that it is unreasonable to withdraw indexation allowance for companies as of 1 January 2018 and to introduce the proposal to tax gains made by non-residents as surely the policy objective should be to tax true gains and not gains that arise simply by reference to the movement in prices.

Question 4 – Further to the specific modifications identified are any other changes needed to recognise differences in how the tax system applies to non-residents?

Consideration will be needed to identify situations where there is tax charged in the non-residents home jurisdiction as well as the UK.

Question 5 – For businesses: will the proposals for direct disposals lead to an increase in your administrative burdens or cost?

Yes, we anticipate that our corporate clients will need to analyse and keep track of tax allowable costs and more significantly will have to enter the corporation tax arena in 2019/2020 (if a relevant disposal is made in that tax year) and yet the changes to the taxation of rental income only come into effect from 6 April 2020. Consideration should be given to moving the capital tax reform date to coincide with the date for the change to corporation tax to rental income, ie 6 April 2020.

Furthermore, in terms of administrative burdens, we draw your attention to the following scenario, a residential property was acquired in 2010 and rented out to independent third parties but in 2012 the property is occupied for a month by a person connected with the property owner (thus bringing the property within the charge to ATED-related CGT); the property then is let out to independent third parties (taking the property outside ATED-related CGT) but as from April 2015 bringing the property within the charge to non-resident CGT; the property in 2017 is adapted for commercial use as a hotel and thus would come within the proposed new regime from April 2019 (thus occasioning valuations of both the property as at April 2019 and also the shares in the property owning vehicle as at April 2019).

Question 8 – Do you consider that the rules for indirect transactions are fair and effective?

There are a number of concerns expressed by the British Property Federation (BPF) with which we concur and in particular we agree that:

25% ownership test:

A) We are concerned that the 25% ownership test based on ownership on any day in the 5 years before sale could create some potentially anomalous results which do not reflect an investor's ownership throughout their period of ownership. It would be worth considering an average ownership test to address this.

B) We are particularly concerned about the risk of deterring seed investment capital – as any initial investors in a fund would by default breach the 25% test, regardless of their holdings after the fund is fully seeded. The concept of "final close" is widely recognised in the sector as the period after which a fund is fully seeded and funded. We would recommend that % holdings before this point are excluded from the 5-year look-back test.

Question 13 – Do you consider that it is right to harmonise ATED-related CGT given the changes proposed in this document?

We consider that ATED-related CGT should be abolished now and that there should be only one tax on the growth in value of investment residential property.

Question 18 – Do you agree with the general approach to ownership of non-residential property through CIVs outlined above?

Currently exempt investors may invest collectively through a variety of different fund structures. Fundamentally, an exempt investor should be in no worse tax position if it invests directly in the property or collectively with other investors. We consider deferring the intended date of capital tax reform to 6 April 2020 would allow CISs to reorganise their collective investments in a measured way without triggering a 'fire sale'.

Furthermore, we agree with the BPF's suggestion that CISs such as JPUTS should:

A) allow the fund to pay tax on the full gain if they know all of their investor are non-exempt; or

B) allow the fund to calculate the tax charge based on the proportion of exempt and non-exempt investors in the fund.

Question 25 – Do you foresee any difficulties with the charge on the UK group company?

Many M&A transactions are now backed by Warranty and Indemnity insurance. Typically, the insurers will exclude from cover any secondary tax liabilities. Such exclusions will mean that the investors cannot achieve a clean break when selling shares or other rights in a company associated with a non UK resident property land owner.

Question 28 – For third party advisors: what is the best way to ensure the proposed information and reporting requirements do not lead to an undue increase in your administrative burdens or costs? Please provide details of likely one-off and ongoing costs in respect of any options or proposals.

We consider that this will increase our administrative burdens and costs and in particular we consider that the current proposal of having to report to HMRC where an advisor cannot reasonably satisfy themselves that the transaction has already been reported to HMRC will lead to potential conflicts between our new duties to HMRC and duties of confidentiality, data protection and legal professional privilege vis-à-vis our clients. Strangely enough, it would be easier and cheaper for advisors to comply if there was an obligation to report on all relevant transactions rather than having to form a view as to whether these new rules apply and whether adequate disclosure has been made to HMRC by a relevant party.

Question 29 – What channels and methods should HMRC use to raise awareness of this change in the law, to ensure that affected non-residents will know that they are impacted?

The recent tribunal decision of McGeevey v HMRC [2017] shows the importance of disseminating sufficient and timely information regarding new obligations to relevant tax payers. We consider that this decision supports our key recommendation of deferring the start date for CGT reform to the taxation of commercial investment property to 6 April 2020.

Forsters LLP
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