

Consultation on proposed changes

Xavier Nicholas reviews the proposals for CGT and an annual charge in relation to property held by 'non-natural persons'



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As promised in the Budget in March, HMRC has released its consultation paper on the proposed changes to the taxation of UK residential property owned by 'non-natural persons'. Since the Budget was announced there has been speculation that the changes might be watered down in response to lobbying from professional bodies. Many will be disappointed, therefore, to find that the consultation paper does not deviate significantly from the original proposals and asks as many questions as it offers answers.

The increased SDLT rates have already taken effect. The rate of SDLT payable on the acquisition of residential properties worth more than £2m has increased from 5% to 7% for purchasers who are individuals and to 15% for purchasers who are 'non-natural persons'. The definition of non-natural persons for these purposes includes companies, collective investment schemes (such as unit trusts) and partnerships in which one or more partners is a company or a collective investment scheme. There are to be exemptions for companies acting as trustees of a settlement, and for bare trustees where the beneficial owner does not fall within the definition of a non-natural person. There will also be an exemption for non-natural persons who have carried on a bona fide property development business for at least two years before the purchase of the property and intend to develop and resell the property.

The May consultation paper focusses on the second and third limbs of the government's assault, being:

- the introduction of an annual charge on properties held by non-natural persons; and
- the extension of capital gains tax (CGT) to gains realised on the disposal of properties held by non-UK resident non-natural persons.

The consultation period runs until 23 August 2012. The government will issue a response and publish draft legislation in autumn 2012. Final legislation will be contained in Finance Bill 2013 and take effect from 6 April 2013.

The main features of the proposals as they currently stand are summarised below.

Annual charge

- From 1 April 2013 there will be an annual charge on UK residential properties worth over £2m owned by non-natural persons. The definition of non-natural persons in this context includes:
 - companies and other bodies corporate;
 - collective investment vehicles; and
 - a partner in a partnership if the partner falls within either of the above categories.

- Trustees (other than bare trustees who hold property for the benefit of non-natural persons) and charities will be exempt from the charge.
- There will also be an exclusion for property acquired as part of a 'bona fide' property development business, which has been operating for at least two years if the property is purchased with the intention of re-development and sale. Unfortunately, the consultation does not elaborate further on

1 April 2012 (if the property was owned by the non-natural person on that date) or (if acquired afterwards) the value on acquisition. The next valuation will be due on 1 April 2018, when the relevant valuation date will be 1 April 2017. So a property will be subject to the same level of annual charge for five years, unless it is re-enveloped within that period, in which case a new valuation will be required.

- A formal valuation will not be necessary, but the consultation states that a valuation by a suitably

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Capital gains tax

- Disposals of UK residential properties by non-UK-resident non-natural persons which take place after 5 April 2013 will be subject to CGT, but only if the consideration received is more than £2m.
- The definition of non-natural persons in this context includes:
 - companies and other bodies corporate;
 - trustees (whether corporate or individuals) other than bare trustees;
 - personal representatives;
 - clubs and associations;
 - charities;
 - entities that exist in other jurisdictions that allow property to be held indirectly; and
 - a partner in a partnership if the partner falls within any of the above categories.

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the conditions that need to be satisfied for this relief to apply.

- The rate of the annual charge will depend on the value of the property. The initial bands and rates are set out in the table below. The consultation states that the charging bands will remain the same going forward but the rates will be linked to the Consumer Price Index.
- An updated valuation will be required every five years. For the first five years (starting on 1 April 2013) the value will depend on the value of the property on

qualified valuer 'would normally protect the taxpayer from possible penalties should it be subsequently established that their property has been significantly undervalued', whereas 'a self-valuation would bear a higher risk of not providing such protection'. Taxpayers should expect HMRC to take a keen interest in valuations which are just below a particular charging band. Those with properties thought to be worth just below £2m are also warned that they may be liable to penalties if they fail to take care to establish a correct valuation and the property is found to be worth more than £2m.

The consultation also states (somewhat vaguely) that the definition of non-resident non-natural persons for CGT will 'necessarily have to include those categories that are subject to the annual charge' and that further consideration will be given to 'what additional categories should be included to ensure that non-UK resident persons pay their fair share'.

- The £2m cut-off is a new announcement and brings the CGT changes in line with the annual charge and SDLT provisions. The consultation recognises that this creates a 'cliff edge' between properties that are subject to a punitive tax regime and those that are

Property value charge rates

Property value	Annual charge
£2m or less	No charge
£2m-£5m	£15,000
£5m-£10m	£35,000
£10-£20m	£70,000
Over £20m	£140,000

not, and implies that further thought will be given to whether this situation is open to manipulation and whether safeguards should be introduced to prevent abuse.

- Another elaboration on the original proposals is that CGT will apply to gains accruing on the disposal of 'assets (of whatever form) that represent directly or indirectly relevant UK residential property', including 'shares, interests or securities in a property-owning company where more than 50% of the value of the asset is derived from UK residential property'.
- The rate of CGT will be announced by the Chancellor in the 2013 Budget. The implication is that the rate may not be the same as the rate of CGT applicable to disposals of other assets (currently 28% for higher rate tax payers).
- Principal private residence relief (which wholly or partly exempts gains realised on properties occupied by individuals as their main residence) should continue to be available as at present 'subject to this being practically possible and consideration of any avoidance concerns', so it may be too early to start counting chickens.

Commentary

It is clear from the consultation that the new rules are intended primarily to counter SDLT avoidance by encouraging the 'de-enveloping' of residential property, so that future transfers are subject to SDLT 'and that a fair share of tax is paid on these properties'. It seems that the introduction of the annual charge and the extension of CGT are merely supporting measures aimed at making it as unattractive as possible for individuals to avoid SDLT through 'enveloping', in particular where the property is acquired for the individual's personal use. The government's three-pronged attack will no doubt achieve that objective. The concern remains, however,

that those who wish to structure property ownership for reasons other than SDLT avoidance (in our experience, the great majority of clients) will be hit by measures that are purportedly not targeted at them. Some residual hope may now be pinned on the carve-out for property development, but there will be frustration that the precise scope of this exemption will not be clear until the autumn.

A secondary aim of the new rules is to 'create a more equal treatment between UK residents and non-residents' by ensuring that where a property is de-enveloped to avoid the annual charge and higher SDLT rates, 'a non-resident does not have a clear financial advantage over

hoped that the potential unfairness caused by this omission will be addressed during the consultation period.

As to the future of UK residential property ownership, there has been much debate in some circles about the potential for circumventing the new rules through the use of structures that fall through the gaps of the 'non-natural person' definitions. For the time being at least, any such structures should be viewed with extreme caution. The consultation suggests that the definition of non-natural persons may be extended following consultation, and overall the consultation has the feel of a

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a UK resident'. The logic here is difficult to follow, as the extension of CGT to non-residents will not include non-resident individuals. A non-resident will therefore continue to escape the CGT paid by UK residents. The reason for not extending CGT to non-resident individuals seems to have been that 'any disposal of a non-enveloped property will attract a SDLT charge', but this is equally perplexing given that SDLT is payable by the purchaser and not the seller (ie the 'de-enveloper').

The consultation is also remarkable for its omissions. For example, there is no mention of any grandfathering or rebasing provisions. It seems, therefore, that any disposal of a property by a non-resident non-natural person for more than £2m after 5 April 2013 will be subject to CGT on the whole of the gain accruing since the property was acquired, with annual charges payable in the meantime. Although in many cases it should be possible to dismantle existing structures without triggering tax liabilities, in others it will be more difficult. It is

work in progress, the scope of which could easily be extended if HMRC becomes aware of planning designed to frustrate its aims.

Throughout the consultation, stakeholders are invited to comment on the proposals and to answer specific questions (19 in total) regarding the anticipated impact of the changes and whether they are likely to achieve the desired objectives. In particular:

... the government is seeking views on whether the proposals set out in the consultation will in practice create more equal treatment, and whether there is potential for unintended consequences of the proposals that would be inconsistent with this aim.

The impression is not of a particularly sure-footed proposal, nor one that has been released with complete conviction. On the other hand, an open invitation for feedback can be seen as positive, and means there is clearly some hope of influencing the final content of the legislation. ■