Keep it in the UK

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reviews the new regime for non-resident capital gains tax.

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Even before the April 2015 changes, any type of chargeable UK asset disposed of by non-resident individuals and other entities could be liable to capital gains tax. The new rules from 6 April 2015 will catch disposals of UK residential property by non-resident companies and individuals. This article looks at the current and new rules.

All references are to TCGA 1992 unless indicated otherwise.

Regime before 6 April 2015

When a taxpayer is UK resident, his UK and worldwide assets are subject to CGT (non-domiciles and the remittance basis are ignored for the purposes of this statement). Tax residence used to focus on an individual being in the UK for 183 days or more in the tax year and the "ordinarily resident" test.

Since the new statutory residence test, which applies from 6 April 2013, residency can now cover various combinations of days and the number of UK ties. A company will be caught by UK CGT if it is registered in the UK or if its central management and control are in the UK.

Conversely, the general rule is that a non-UK resident is not subject to UK CGT on the disposal of UK or foreign assets. Despite the headlines given to impending changes to CGT for non-residents from this April there are already a number of other circumstances where a charge can arise on a non-resident, as summarised in ***Key rules already applying CGT to non-residents***.

If there is at least one UK resident trustee a trust will be UK resident if the settlor was UK resident or domiciled when the settlement was created (s 69), or when relevant funds were added.

The requirement that a majority of trustees had to be UK resident for this charge to bite was dropped from April 2007. If they are all UK resident, the settlement is UK resident regardless of the status of the settlor. Incidentally, if a UK trust emigrates from the UK at any point there would be a CGT charge on relevant trust assets under s 80.

KEY POINTS

- New rules from 6 April 2015 render non-residents who dispose of UK land liable to capital gains tax.
- Off-plan purchases are included in the definition of dwelling.
- Calculating the chargeable gain may require an April 2015 valuation of the land.
- HMRC must be notified of a disposal within 30 days of the conveyance.

New rules

The first part of this article applied to any asset, but the remainder is relevant only to disposals of an interest in land relating to a residential property. HMRC have said that they "do not intend to broaden the scope of the charge [to] non-residential property".

The Finance Bill 2015 published on 24 March has grown to 72 pages on the new rules compared with 34 in the December draft. It now has various bells and whistles, including changes to TMA 1970 relating to tax returns and determinations, and corporate groups.

Schedule 7 of the bill covers every non-resident person, company, trust, partnership, or personal representative of a non-resident deceased person, disposing of a UK dwelling property on or after 6 April 2015.

As partnerships cannot be directly taxed, any non-resident partner with entitlement to a share in the property will be directly taxed on their share of gain.

The changes mean that the advantageous split-year treatment of s 2(1B) available after emigration will not apply to the sale of a residential property after 6 April 2015.

The intention is to put non-residents on an equal footing with CGT on residential property for residents, so there are no punitive rates and, for example, companies will receive an indexation allowance and non-resident individuals will receive the CGT annual exemption.

A crucial point is that if a property has been owned since before 5 April 2015, only the portion of the gain falling after that date will be taxed due to re-basing. Hence, there has been no obvious rush to sell before 5 April 2015. The annual tax on enveloped dwellings (ATED)-related CGT rules also have a re-basing point, but at April 2013.

KEY RULES ALREADY APPLYING CGT TO NON-RESIDENTS

TCGA	*Example*
Section 2B (and s 57A and Sch 4ZZA)	Dunlop lives in Guernsey and owns a UK residential property through his Guernsey company. The property is vacant, intended only for occasional use when Dunlop visits the UK. Dunlop's company sold the property for £2.6m in November 2014. His company has to pay 28% CGT on the gain because it falls within the ATED-related CGT rules. ATED covers a property with a value of £2m or more which is owned by a company (or a partnership if there is a corporate partner) and which is not covered by the exemptions, such as if the property is used for a letting or development trade. If ATED applies, in general this will also override the other charging provisions mentioned here. If ATED-related CGT is charged and the property was acquired before April 2013, only the portion of gain after April 2013 is taxed. (But one of the elections under the new rules can also have an impact on that.)
Section 10 and s 10B	Signor Mondo is resident in Italy, but is a member of a UK partnership trading in sports memorabilia. The partnership sells one of its UK retail outlets. Even though Mondo does not meet the UK residence condition, gains on assets used in carrying on his UK partnership trade are still subject to CGT. Section 10B applies the same principle to non-resident companies, though for companies the concept of "branch or agency" was replaced with "permanent establishment" in 2003, and there are some minor differences between the concepts. Note that the company may not be liable to CGT if the permanent establishment is exempt from UK corporation tax under a double tax treaty.
Section 10A	Wilson emigrated permanently from the UK in September 2011, making sure that he sold his antique painting after his day of departure to avoid the CGT. However, after his plane crashed and he spent some time stranded on a desert island, he had a change of heart and returned to the UK three years later. The sale of his painting was charged to CGT on his return in 2014 because he had only been a "temporary non-resident" of fewer than five years. (The painting was originally acquired when he had been in the UK – the position would be different had Wilson acquired it when non-resident.)
Section 13	Spalding Ltd, a British Virgin Islands resident company, sold one of its UK offices which was part of its UK permanent establishment. Spalding Ltd would be considered a close company if it were UK resident because it is under the control of its directors or five or fewer shareholders. Mrs Punt, a 40% shareholder of Spalding Ltd, is charged to CGT on 40% of Spalding's gain because she is a UK resident shareholder and owns at least 25% of the company. Section 13 has had less relevance since April 2013, after the UK responded to EC infringement proceedings that it reduced the free movement of capital. New subsections 13(5)(ca) to (cb) disapply the charge on a UK resident shareholder if there was no tax avoidance motive, or if the asset was used only for the purposes of "economically significant" activities carried on by the company wholly or mainly outside the UK.
Section 25	Note that in the Signor Mondo case, if there was only a single branch/agency, Mondo may decide to close the branch first to cease the UK agency and then sell the asset. However, he would still be subject to CGT under s 25 on the basis that it was a deemed disposal of the property on cessation of the branch itself.
Section 86 and s 87	Gains of a non-resident trust can also be attributed to a UK resident settlor and beneficiaries. This gain could be on the asset if it is transferred to the settlor or beneficiary; but if it has already been sold and there is a stockpiled gain in the trust, a payment of capital from out of the trust could trigger the CGT charge.

Note: These are simplified examples and ignore any double taxation agreements that might be relevant.

Meaning of dwelling

Residential property is defined as a dwelling in new Sch B1 of TCGA 1992. It is a building that is used, or is suitable for use as a dwelling, or is being constructed or adapted for such use. This also includes "land that at any time is, or is intended to be, occupied or enjoyed with a dwelling as a garden or grounds".

Disposals of building land are outside the scope of the extended CGT charge until construction starts on a residential building.

Property developments will continue to be taxed as trading income as before.

The main exclusions from "dwelling" are:

- boarding schools and institutions for children;
- hospitals, care homes and nursing homes;
- hotels, inns and similar; and
- a new category of purpose-built student accommodation. Smaller student buildings, such as family houses that may have been converted or have rooms let out, will still be within the scope of the extended CGT charge.

Off-plan purchases (acquisition of a right to a property before it has been completed) are also immediately within the regime

(Sch B1 para (1)(3)). This has two effects. First, the onward disposal of the contract is caught if the property is sold before possession is ever taken; and second, the start date for any time apportionments of a residential period starts at the acquisition date of the off-plan right rather than completion of the property. In effect, this will also tax the off-plan discount.

Chargeable portion

There are three routes of calculating the tax provided for under Sch 4ZZB:

- Ownership straddles April 2015 – default method: a revaluation at April 2015, and tax only the post-April 2015 gain.
- Ownership straddles April 2015 – election under para 2(1)(a) for straight line time-apportionment. The gain over the whole ownership period is calculated, but time-apportioned to tax only the averaged post-April 2015 segment.
- Post-April 2015 acquisitions, or ownership straddles April 2015 – election for retrospective basis is taken under para 2(1)(b). The gain/loss over the whole period of ownership is taxed. That can be advantageous if there is a loss. Paragraph 9 makes it clear that the acquisition date will be treated as 31 March 1982 if the interest was held before that date.

Where a period of property ownership straddles April 2015, the taxpayer can choose which method of calculating the post-April 2015 portion of gain gives the best result, and it is then a case of crunching the numbers. In all cases, an adjustment will be made for mixed use of the land. When a change of use occurs over the period of ownership an adjustment will be made to reflect the time that the building was not used as a dwelling.

An election for either straight line apportionment or bringing the pre-April 2015 gain/loss into charge on a property is irrevocable. The election is made on each property and is not a global election. Both sub-paragraphs of para 2(1) refer to the election being made on "the" or "that" interest, and para 3(2) states that the irrevocable election precludes any further election "in relation to the same" UK residential property interest.

CGT calculations gives examples comparing the different methods of calculation for a property that has been a dwelling over its entire ownership.

There is the potential for interaction with ATED-related CGT, and "where part of the gain could be subject to both ATED-related CGT and the new CGT charge, the ATED-related CGT charge will take precedence".

CGT CALCULATIONS

Illustrations ignore individual annual exemptions, or corporate indexation allowance. Assumes that the property is a relevant dwelling throughout the period, and that no mixed use apportionments are in point. The red arrows indicate the optimum tax position in each of the three scenarios.

Overall gain, but loss to April 2015

	Date	*Values* £	*Rebased* £	*Straight line* £	*Retro-spective* £
Cost	6/4/08	300,000			
Market value	6/4/15	250,000			
Sold	31/3/16	400,000			
Disposal proceeds			400,000	400,000	400,000
Less revaluation/cost			(250,000)	(300,000)	(300,000)
Total gain			150,000	100,000	100,000
Less time apportioned 7/8			n/a	(87,500)	n/a
Gain/(loss) charged			150,000	12,500	100,000

Overall loss, but a gain since April 2015

	Date	*Values* £	*Rebased* £	*Straight line* £	*Retro-spective* £
Cost	6/4/08	300,000			
Market value	6/4/15	260,000			
Sold	31/3/16	275,000			
Disposal proceeds			275,000	275,000	275,000
Less revaluation/cost			(260,000)	(300,000)	(300,000)
Total gain/(loss)			15,000	(25,000)	(25,000)
Less time apportioned 7/8			n/a	21,875	n/a
Gain/(loss) charged			15,000	(3,125)	(25,000)

Overall gain, but a loss since April 2015

	Date	*Values* £	*Rebased* £	*Straight line* £	*Retro-spective* £
Cost	6/4/11	300,000			
Market value	6/4/15	380,000			
Sold	31/3/20	350,000			
Disposal proceeds			350,000	350,000	350,000
Less revaluation/cost			(380,000)	(300,000)	(300,000)
Total gain/(loss)			(30,000)	50,000	50,000
Less time apportioned 4/9			n/a	(22,222)	n/a
Gain/(loss) charged			(30,000)	27,778	50,000

Looking at ***Key rules already applying CGT to non-residents***, the new rules generally take precedence if both sets could apply.

The choice of which calculation to use will be based on:

- Was most of the gain before or after April 2015?
- If a loss arises only in the post-April 2015 period, the default rebasing method to eradicate the pre-April 2015 gain should be used.
- If there is a pre-April 2015 loss, or there is an overall loss, the taxpayer should think about electing to be taxed over the whole period of ownership through retrospection.

Though the valuation does not need to be physically prepared in April 2015, one is likely to be needed whichever calculation is used to report a gain or loss.

Losses on disposals of UK residential property will be ring-fenced for use against gains on other UK residential properties arising to the same non-UK resident individual or company in the same or future years. If a non-resident becomes UK resident, any unused UK residential property losses will be available as general losses against other types of capital gain from that point.

Non-resident companies

Institutional investors are outside the scope of these rules if their funds are "widely marketed" to investors. "Diversely held" companies – ones that would not be close companies – are also not affected.

New Sch C1 defines a closely-held company that would be within the CGT rules as one under the control of five or fewer participators, though not if one or more was a qualifying institutional investor or diversely held company.

Individual cells within a protected cell (also known as a divided) company are specifically within the new rules if the cell is equivalent to a closely-held company and the gain is primarily or wholly attributable to that cell, and the company as a whole is not caught. (This rule does not apply if the company is a unit trust or open ended investment company.)

HMRC's November 2014 summary of responses to the consultation on the new measures (www.lexisurl.com/nonressor) noted that non-resident companies within the regime will receive "a form of" indexation allowance. The Finance Bill now refers to indexation (the December version did not and obliquely referred to "as if the computation were for corporation tax purposes…") and HMRC have confirmed to me that the "list" at para 21 also implies indexation for the straight line apportionment calculation.

The new rules do not affect companies with a UK permanent establishment because its assets would already be within UK CGT.

There are some pooling rules for a non-resident group's gains and losses, and intra-group transfer reliefs of UK residential properties.

Notifying HMRC

HMRC will need to be notified of a property disposal within 30 days from the day after the conveyance in all cases. If the non-resident is in income tax or corporation tax self assessment or ATED, these liabilities can be paid through the normal filing process. Otherwise the vendor will need to make an "advance self assessment" and pay their tax to HMRC within 30 days. HMRC are expected to make the return form available online at GOV.UK after 5 April.

HMRC had already indicated that the conveyancing solicitor would not be required to deduct withholding tax. Solicitors can breathe another sigh of relief that it is only the person liable to CGT who is responsible for delivering a return to HMRC. However, some duty of care will still apply to flag the issue.

A single return can be filed if two or more disposals are made on the same day: for non-resident intra-group transfers no return is required.

> ***"HMRC will need to be notified of a property disposal within 30 days from the day after the conveyance in all cases."***

Where an advance self assessment is needed an individual must make a "reasonable estimate" of their tax under TMA 1970, new s 12ZF(1)(c):

- it will have to show whether the 18% or 28% rate applies;
- gains or losses on later disposals in the year are ignored, but account is taken of any capital losses in the same year up to the date of disposal;
- particulars must be given of how the estimate has been arrived at; and
- the reasonable estimate would give protection against penalty provisions for errors in FA 2007, Sch 24.

HMRC may still make corrections to obvious errors or omissions (TMA 1970, s 12ZL) within nine months of the receipt of the return or a taxpayer correction.

Summary

The new rules remove one of the tax advantages for non-resident companies and individuals investing in residential property. There are other tax planning areas to consider, for example inheritance tax advantages are available to non-resident individuals investing in UK property who also non-domiciled.

Finally, do not overlook other assets being caught under the pre-April 2015 rules in some cases before and after April 2015. ■

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