www.pwc.co.uk

High value residential property reforms

December 2012

pwc

Agenda

Introduction

Summary of new provisions

Impact on existing structures

Restructuring – considerations and potential routes

Structuring new property acquisitions

Other property related tax issues

Fundamental drivers behind structuring

1. Effective tax rates
2. Commercial need
3. Confidentiality of ultimate owners
4. Foreign taxes
5. Inheritance tax – payment vs probate

Introduction

The 2012 Budget and June consultation document contained various announcements in relation to high value residential property. The results of the consultation and the detail of some of the draft legislation was confirmed on 11 December 2012:

Stamp duty land tax ("SDLT") has increased to 7% on residential property worth more than £2m	Effective 22/03/12
SDLT charge of 15% will be levied on properties worth more than £2m being acquired by corporate entities (and other than non-natural persons, including partnerships with corporate members but subject to exemptions)	Effective 22/03/12
An annual charge levied on properties worth more than £2m already held by non-natural persons (subject to exemptions)	Effective 01/04/13
Introduction of UK capital gains tax on the sale of UK properties for more than £2m by a non-resident non-natural person other than an individual	Effective 06/04/13

The Rules

What is a non-natural person?

It is intended that the legislation will contain a single definition of non-natural persons:

	ARPT	**CGT Extension**	**15% SDLT**
Companies	✓	✓	✓
Other bodies corporate	✓	✓	✓
Collective investment vehicles	✓	✓	✓
Partnerships with corporate partners	✓	✓	✓
Partnerships without corporate partners	X	X	X
Trusts	X	X	X
Individuals	X	X	X

Annual Residential Property Tax – more detail

- ARPT up to 0.7% of value of the property (£15,000 pa for a £2m property and up to £140,000 for properties worth £20m plus)
- Tax burden the highest for those properties valued at just above £2m
- Return required for each dwelling – not each NNP
- Due date for annual filing and tax is 30 April
- For 2013/14 filing is due by 1 October and the tax by 31 October
- Point valuations required – 1 April 2012 in most cases
- Valuations required every 5 years
- Valuation is self assessed, but protection if 'suitably qualified valuer used'
- HMRC offer a prior agreement service, in certain circumstances.

Annual Residential Property Tax
Unusual situations

- Mixed use
- Multiple dwellings
- Staff accommodation
- Unusual accommodation eg. boarding schools, care homes, military accommodation, care homes – exempt
- Freehold and leasehold – if owned separately, taxed separately
- Separation of legal and beneficial ownership
- New constructed – pro-rata
- Buying or selling – pro-rata

Capital gains tax extension – more detail

- Will not apply to trusts
- Final legislation not due until January 2013
- Will likely now apply to only direct disposals
- Pro-rata gains if:
  - Not residential throughout the period of ownership
  - Clearly defined residential and non residential use
- No PPR available
- Rate of 28% will be applied
- Losses will be ring fenced
- Tapering available for companies close to the £2m threshold
- Non-UK companies that already have a PE in the UK – CT rates

Exemptions

The draft legislation contains a number of exemptions for the SDLT, ARPT and CGT:

- Dwellings acquired and held for the purpose of a property development or trading business – must be carried out on a commercial basis, and not be occupied at any time by a connected person
- Dwellings acquired and held for the purpose of rental to third parties on a commercial basis - must not be occupied at any time by a connected person
- Properties which are acquired and held to run as a trade in which the property is open to the public
- Dwelling acquired and held to provide employee accommodation
- Farmhouses where a working farmer occupies the farmhouse connected to the farmland
- Dwellings held for charitable purposes of a charity and certain other diplomatic, publicly owned properties

Exemptions
Administrative Aspects

- Same exemptions apply to the SDLT, ARPT and CGT extension
- Claim must be made on SDLT return for exemption
- Claw back on SDLT if there is a change of use
- Annual ‘nil charge’ return required to claim ARPT exemption

Impact on existing structures

Impact
Non-UK company

Non-UK resident individuals currently hold UK residential property through a non UK resident corporate

Current regime

- No SDLT on purchase of the shares
- No UK CGT on sale of the shares
- No UK tax in extraction of value from the company
- Property value outside the UK IHT net

New regime

- Gain accruing post 6 April 2013 subject to CGT at 28% when property sold.
- ARPT charges of up to £140,000 pa
- Any new acquisitions into company subject to SDLT at 15% unless an exemption applies

Impact
Non-UK trust and underlying non-UK company

UK resident but non-UK domiciled individuals holding UK property through non-UK trusts and non-UK resident corporate vehicles.

Current Regime

- No SDLT on a purchase of the shares
- No UK CGT on disposal of shares or property
- Gains potentially matched with benefits of occupation by beneficiary if no market rent paid
- Outside of the UK IHT net

New Regime

- Gains accruing post 6 April 2013 subject to CGT at 28% when property is sold
- Annual charges of up to £140,000 pa.
- Any new acquisitions into the company subject to SDLT at 15%
- Clarity required in respect of interaction with s13/s87 TCGA 1992
- IHT protection retained

Retaining Current Structure
Key Considerations

- Tax benefit of current structure (eg. IHT protection & CGT rebasing)
- Tax cost of retaining current structure and ongoing costs (eg. ARPT charges, CGT etc)
- Tax consequences of de-enveloping or restructuring (eg. loss of IHT protection)
- Trade off between the above three as well as commercial considerations
- IHT protection important for many clients
- Individual circumstances **must** be considered in all cases.

Unwinding current structures
Specific Tax considerations

- Residence and domicile of the settlor — can he benefit and who occupies the property
- Residence and domicile status of the beneficiary occupying the property
- Are the beneficiaries Remittance basis users ?
- Valuations
- Has a rebasing election been made? Does the structure have a s87 gains pool or unmatched capital payments?
- Is it a pre-March 2006 interest in possession trust? (Potential GWROB / POAT issues).
- If so do not resettle without considerable thought since qualifying interest in possession ends and inheritance tax charge could arise if the beneficiary is the settlor or the settlor's wife and deemed domiciled
- Long term plans for the property?

Unwinding current structures

Tax considerations (cont)

- Liquidation of a company will be the most obvious route to de-enveloping but results in the loss of inheritance tax protection and a likely capital gains tax charge. Potential reservation of benefit issues if the settlor can benefit from the trust and it now holds UK property.
- Exclude settlor before the company is a liquidated to avoid a PET.
- Future 10 year charges for the trust if it holds UK property direct.
- Funding tax liabilities in “dry” structures an issue. Potential to crystallise IHT liabilities upon adding funds to structures.

Potential restructuring considerations

Potential restructuring

Non-UK company owning UK property

Current Structure

Non UK resident company owning a UK residential property.

Potential Actions

- Liquidate non-UK resident company and transfer property into the personal ownership of a non-resident individual OR
- Distribute the property in specie to a non resident/non domiciled individual

Tax Considerations

- Are they within the rules? - consider investment/developer exemption
- Should be no SDLT on liquidation provided no debt is secured on the property and the company itself is not debt financed
- IHT - Property falls within UK estate. Further planning would be required to mitigate this.
- Does the company contain other assets? Are there prior unmatched capital payments? If so the position needs careful consideration.
- Further detail on CGT interaction with ss13/86/87 important

Potential restructuring
Non-UK trust and non-UK company

Current Structure

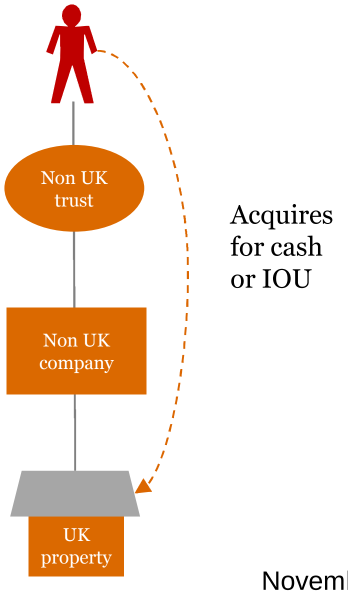
An overseas trust owns the shares in an underlying overseas company The underlying company owns a high value residential property.

Potential Actions – Option 1

The individual purchases the property from the structure. The consideration can be left outstanding.

Tax Considerations

- 7% SDLT will be payable by the individual upon purchase of the property.
- Potential to trigger UK CGT charge is matched to historic benefits / excess capital payments. Future benefits will also be matched to gains within the structure - more detail on CGT reforms required.
- Further IHT planning may be required
- Careful consideration of pre-owned assets rules required
- Application of BIK rules to the loan from company to the individual. Benefit may be taxed annually on the individual
- Application of PPR may exempt any future capital gain. In structure, future gain taxed at 28%.



Potential restructuring
Non-UK trust and non-UK company

Current Structure

An overseas trust owns the shares in an underlying overseas company. The underlying company owns a high value residential property.

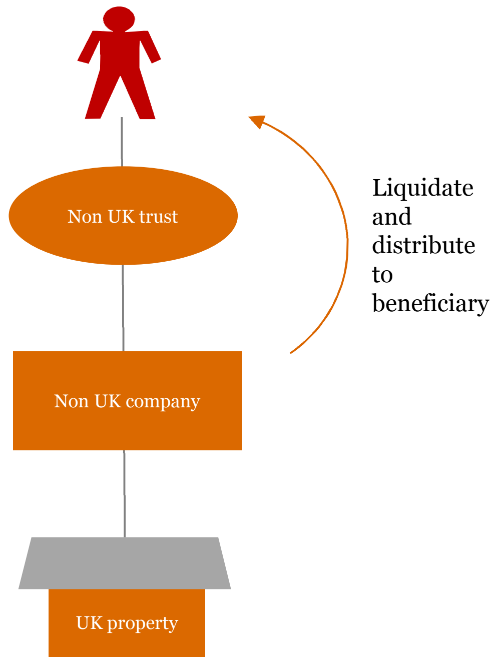
Potential Actions - Option 2

Liquidate the company and distribute the property the beneficiary to avoid any future annual charges and new CGT rules.

Tax considerations

- Provided no debt secured on the property, no SDLT should be payable.
- Gains arising upon liquidation or distribution may be matched with any historic unmatched benefits enjoyed from the structure. Consider CGT exposure. More detail on new CGT provisions required.
- IHT exit charge to consider
- Property value enters a UK IHT estate

- Potential use of PPR or non resident exemption upon personal ownership
- Avoids ARPT and CGT extension



Structuring New Acquisitions

Structuring new acquisitions
Considerations

- IHT — Currently 40%. Most clients want the IHT shelter
- Future plans and likely length of ownership Is paying the annual charge still worthwhile?
- Cost of annual charge vs cost of insurance to cover IHT liability
- Use of the property — personal or third party?
- Privacy — Keeping the legal and beneficial ownership private

New acquisitions
Personal ownership

Overview

The purchase of a UK residential property using debt or insurance.

Tax issues

SDLT:

- SDLT at 7% upon purchases. The 15% rate is avoided.

IHT:

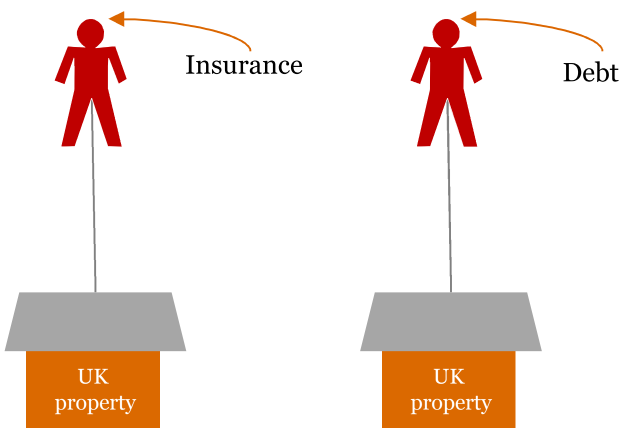
- The value of the property is subject to UK IHT but would be subject to deduction for any debt secured against the property.
- Consider IHT anti avoidance in respect of disallowance of Debt.

CGT:

- The property may qualify for CGT exemption under PPR rules.
- Possible exemption from CGT if shareholder is non UK resident.

Other

- No annual charge
- Use of third party debt or debt from existing structure .
- If insurance rather than debt is used, need to make sure insurance covers increase in value. Compare insurance cost to ARPT.



New acquisitions
Use of nominee companies

Overview

Acquisition of UK residential property through a non UK nominee company.

Tax Considerations

- Nominee company ignored for tax purposes, but provides degree of privacy for the ultimate owners.
- Could be used in conjunction with debt or insurance
- Costs of using a nominee increase cost of structure
- The property value falls within the UK IHT estate

New acquisitions
Use of partnerships

- Generally problematic
- Partnerships will be transparent but watched for abuse
- Only suitable where property is rented out due to "commercial business requirement" If rented, it will likely fall outside of the charging provisions.
- Not generally suitable for owner occupiers as partnership not run on a commercial basis.

Residential Property Reform
What does this mean?

- Full picture still not known – awaiting publication of the draft CGT legislation in January
- No clear motivation to 'de-envelope'
- Optimum structure for future property purchases? Trust, personal, corporate?
- Inheritance tax protection – Comparison between annual charge/ IHT

Other residential property tax issues

Acquiring existing a residential envelope structure
Due diligence

If existing envelope structures are being acquired a far more substantial degree of due diligence will be required at the corporate level before making such an acquisition. Due diligence would include:

- Compliance with UK income tax legislation
- Compliance with annual charge regime
- Valuations of properties – formal valuations taken?
- Management and control issues / review
- Filings

PwC can provide an integrated service offering in respect of any such requirements where the purchase of an existing envelops structure is acquired.

Residential Property tax structuring
General Structuring considerations

- Inheritance tax - obtaining the optimum position
- Availability of Business Property Relief
- Double tax extraction charges from corporate entities
- Base cost uplift opportunities for investment assets
- Costs of restructuring

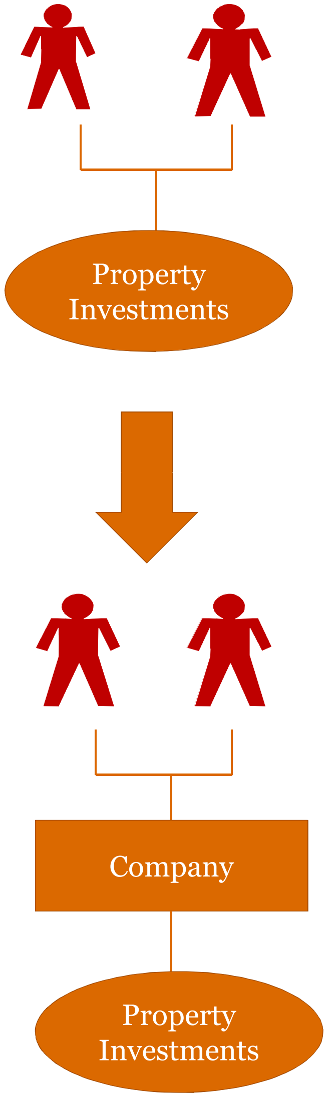
Incorporation of a Buy to Let Residential Portfolio

Planning Strategy

- Incorporate the property rental portfolio that is currently owned directly in personal names(s)
- **Benefits**
- Step up in base cost of properties reduced CGT on future sale (although there is an extraction cost)
- Reduces tax rates on rent roll from 50%/45% to 22% (CT rates)
- Can be implemented with the use of a non-UK holding company structure. This may also provide an inheritance tax advantage (provided domiciled in India for tax purposes)

Other Considerations

- Must be a business to obtain incorporation relief – HMRC clearance?
- SDLT charge on incorporation – mitigate via use of a partnership
- Gearing can be transferred to a corporate – careful consideration required.
- Suitable if it is intended to reinvest profits for the long term.



Obtaining IHT exemption on a residential property portfolio

Steps

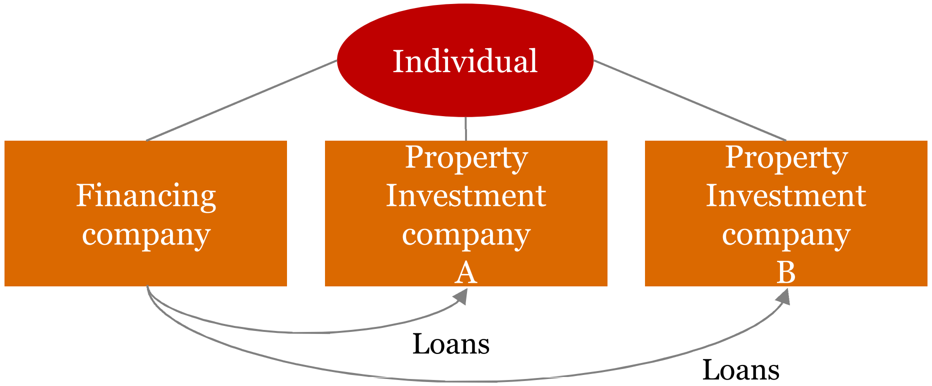
- Financing company lends surplus funds to the entities/ individuals rather than making investments itself
- Investment companies owe debt to the finance providing company
- Loans must not be securities or investments
- Finance company has no interest in the investment companies

Tax analysis

- Shares in the financing company should qualify for BPR as a lending business
- Care re 2 year ownership period, structure and history

Issues

- Not "one size fits all" planning. Potential challenge.
- Full analysis of individuals' situation requires



- Choice of Co,. Or LLP for finance activity
- CGT analysis (eg entrepreneurs relief) of treatment of financing company shares required

Benefits

- BPR should be available on the financing company to 100%
- Value of the companies which will not qualify for BPR is reduced by debt owed
- Can be used within a group for intra-group lending

Stepping up the corporate tax cost of residential properties - Demerger

Planning strategy

- Separate trading, investment(i.e surplus cash/real estate investments)& financing activities

Benefits

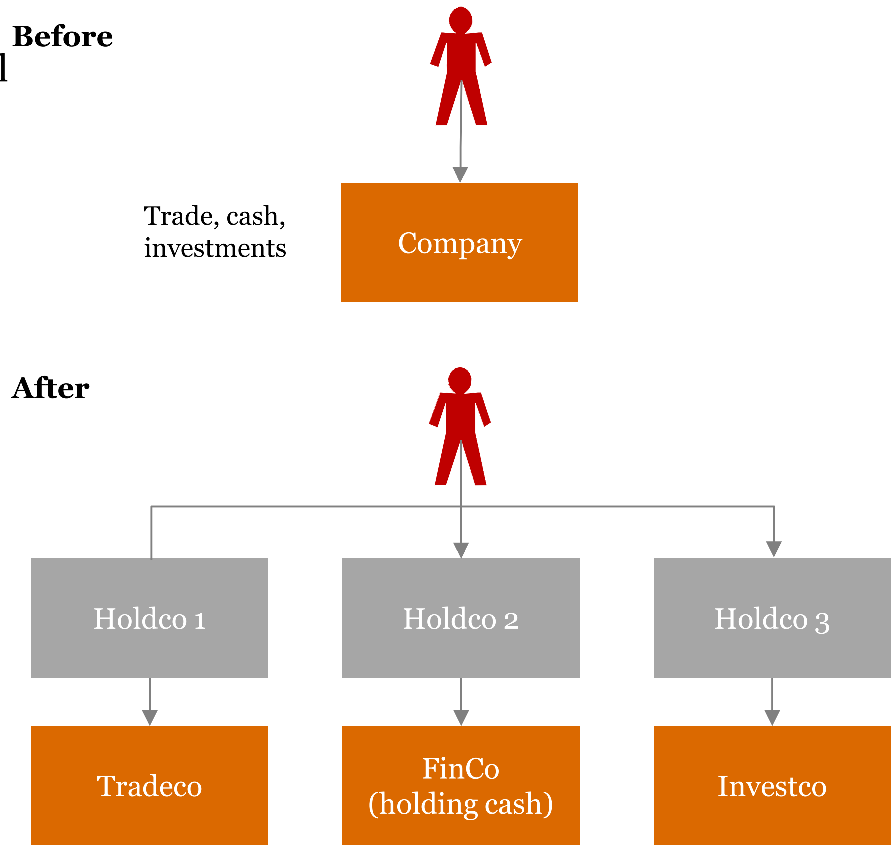
- Asset protection e.g. from trading risks
- Better measurement of returns
- Improve ER, SSE and BPR position
- Tax free step up capital assets
- Further benefits for non-dom shareholders

Tax analysis

- Segmentation is tax neutral under CGT
- HMRC pre-transaction clearance

Other considerations

- Balance sheet strength
- Lender consent
- Other routes (e.g. Capital reduction)
- Stamp duty ort SDLT impact



Any questions?

Nick Hopkin

Tel: 020 7213 1662
Email: nicholas.hopkin@uk.pwc.com

Leonie Kerswill

Tel: 020 7213 8588
Email: leonie.kerswill@uk.pwc.com

Neil Lancaster

Tel: 020 7212 3488
Email: neil.g.lancaster@uk.pwc.com

Alison Hill

Tel: 020 7804 4983
Email: alison.hill@uk.pwc.com