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Taxing UK property gains and income of non-UK residents

Breakfast briefing
6 February 2018

pwc

Key messages

Fundamental change to the tax treatment of non-resident companies confirmed in Budget 2017:

- Introduction of a new non-resident capital gains tax on UK property and shares in UK property rich companies.
- Corporate NRL's become subject to corporation tax from April 2020.

There will be an increased compliance burden due to the complexities of the UK corporation tax regime – including exposure to BEPS (so far 150+ pages of legislation and 800 pages of guidance notes).

The delay in implementation allows us time to assess the impact and restructure if necessary:

- Captive REIT's (right investors only).
- Corporate free structure
- Confirming groups for interest cap de-minimis.

Since the introduction of the NRL regime (20+ years ago) we've seen the following changes implemented which impacted the taxation of non-resident companies:

- Annual Tax on Enveloped Dwellings – introduced in April 2013.
- Annual Tax on Enveloped Dwellings Capital Gains Tax – introduced in April 2013.
- Non-resident Capital Gains Tax on UK residential property – introduced in April 2015.

Outline of proposals and overview of existing capital gains tax exemptions/ special regimes

Paul Emery, PwC UK

Overview

Current position

- The UK does not generally tax non-residents on disposals of non-residential UK investment property (unlike most other major jurisdictions).
- The UK does tax non-resident companies which are not diversely held on UK residential investment property disposals through the non-resident capital gains tax regime ('NRCGT'). The ATED related capital gains regime may also apply to certain residential property.
- All trading profits from dealing in or developing UK land are currently within the charge to UK tax.

The proposal

- From April 2019, UK tax will be charged on gains made by non-residents on disposals of all UK investment property.
- Consultation document published 22 November 2017 (deadline for comments 16 February 2018); draft legislation expected late Summer 2018.

Other changes

From April 2020, UK property income received by non-resident companies will be chargeable to UK corporation tax (rather than income tax)

The proposals in more detail

- Provisions will apply to direct and indirect disposals of UK property by non-UK residents.
- Bodies corporate will be subject to corporation tax; CGT for everyone else.
- Indirect disposal rules will apply where an entity (including a company, partnership or trust) is 'property rich' (broadly **75%** or more of gross asset value represented by UK property) and a person holds (or has held within the five years prior to disposal) a **25%** or greater interest in the entity.
- Provisions will apply to aggregate holdings to prevent fragmentation & staggered disposals; including provisions where investors are 'acting together'.
- Entities exempt from UK tax on capital gains (e.g. overseas pension schemes) or otherwise outside scope of UK tax for reasons other than residence will continue to be exempt/ out of scope.
- Non-UK resident companies may be entitled to the SSE extension (**expanded in 2017** to wholly or partially exempt disposals by companies held by certain investors e.g. Qualifying Institutional Investors).
- Potential changes to existing rules for UK REITs and CIVs to create a coherent and robust regime.
- It's proposed that there will be a reporting requirement on certain third-party advisers.

Calculating the gain

For non-residential property, and residential property not currently within the charge, only the gains attributable to changes in value from

1 April 2019

(for companies) or

6 April 2019

(for other persons) will be chargeable.

For direct disposals this will be achieved by rebasing property values at ***April 2019*** *(with the option to compute the loss or gain on disposal using the acquisition cost as the base cost of the property)*

For indirect disposals, ***April 2019*** *also stated to be rebasing point, but no option to use the acquisition cost*

Anti-avoidance

Anti-forestalling rule

- An anti-forestalling rule will apply to certain arrangements entered into on or after the publication of the consultation document on **22 November 2017.**
- The rule will counteract arrangements that seek to avoid the new charge on non residents by exploiting provisions in some Tax Treaties in a way that is contrary to the object and purpose of those provisions, particularly re arrangements designed to frustrate the operation of the charge on indirect disposals.
- Consultation document refers to 'treaty shopping' arrangements as the sorts of arrangements in scope of the anti-forestalling rule.

Targeted anti-avoidance rule ('TAAR')

- This will apply from **April 2019** to arrangements entered into 'the main purpose or one of the main purposes' of which is to secure that gains are not subject to the new rules.
- To be modelled on TAAR in Trading in/ developing UK land rules.

Taxing investment property

Overview/ principles of fund taxation

Direct holdings

Holding via a tax transparent entity

Holding via a tax opaque entity

“Quasi” tax transparent entities

Special onshore regimes; REITs, PAIFs, CoACS

	REIT	PAIF	CoACS
Fund level taxation	Exempt on property income and property gains	Exempt on property income; gains; interest income	Transparent for income purposes and outside scope for gains
Investor level taxation	PID 'deemed' to be property income but is treated as a dividend for the purposes of double tax treaties	PID 'deemed' to be property income but is treated as a dividend for the purposes of double tax treaties	IT on income as arises
WHT on distributions	20% on PID (including gains)	20% PID and interest	N/A (but NRL scheme may apply)
Legal form	Listed company (UK tax resident)	Open ended investment company (UK tax resident)	Contractual arrangement
Regulation	Listing Authority	FCA/AIFMD	FCA/AIFMD

SI 2017/1204

Extension of CoACS treatment to offshore funds

Offshore unit trusts

- Offshore unit trust schemes (e.g. JPUTs) have historically been taxed as companies for gains purposes.
- The SI means that JPUTs which are 'transparent offshore funds' are treated in same way as CoACSs so investors' interests in fund itself are treated as capital asset and underlying assets disregarded.
- This means there is no taxable capital gain on the disposal of properties held by the JPUT.
- 'Offshore funds' must be mutual funds, i.e. broadly, investors can expect to realise their investments based on net asset value of fund other than on a winding up of the fund.

Certain other offshore funds

- 'Offshore funds' which are not companies, partnerships or unit trusts have also been taxed as companies for gains purposes.
- SI 2017/1204 also treats these in same way as CoACSs.

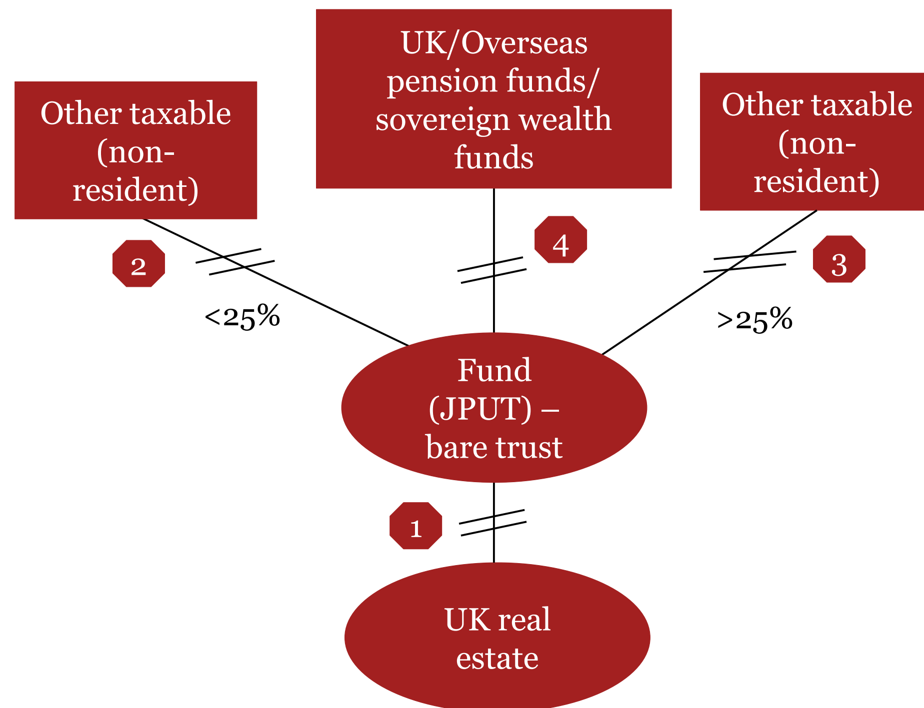
Timing

Change applies from **1 January 2018**.

The continuing application of these provisions from **April 2019** to be considered.

SI 2017/1204

Potential effect on “offshore fund” JPUT after April 2019



Direct charge on Disposal (1)

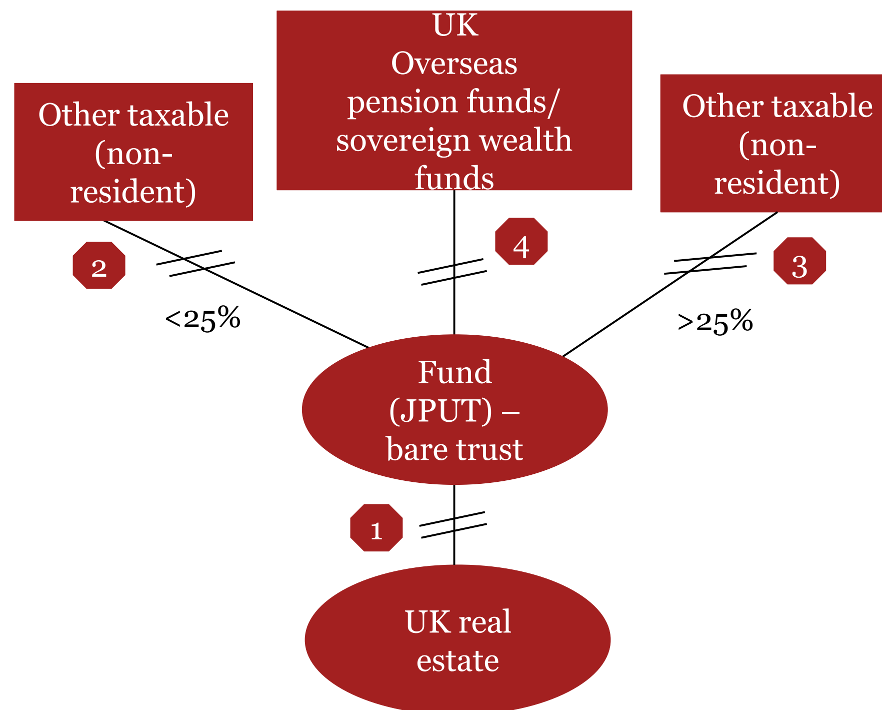
- Corporate treatment of the trust switched off.
- Trust not taxable on Disposal (1) as property treated as held by unitholders.
- But a unit trust treated as an asset for CGT and so unitholder’s interest in fund property is disregarded ∴ No direct charge on Disposal (1).

Indirect charges on Disposals (2), (3) and (4)

- (2) Not chargeable as less than 25%, subject to “acting together” rules.
- Indirect charge on (3), disposal of interest in unit asset is a disposal of interest in an entity holding RE.
- (4) Not chargeable, covered by exemptions.

SI 2017/1204

Potential effect on "non-offshore fund" JPUT after April 2019



Direct charge on Disposal (1)

- Yes, JPUT remains treated as corporate.

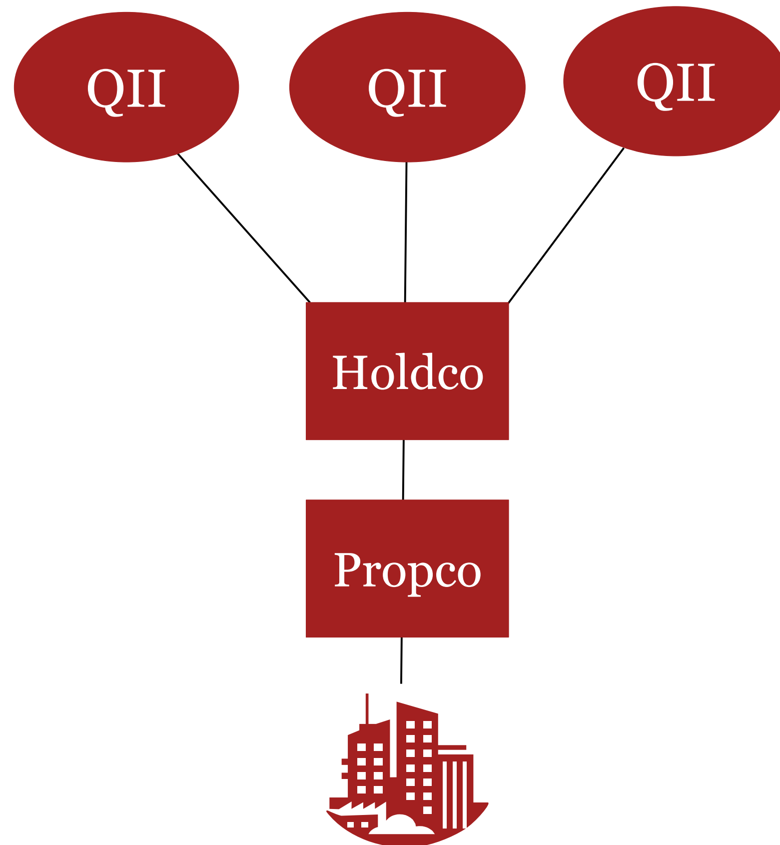
Indirect charges on Disposals (2), (3) and (4)

- (2) Not chargeable as less than 25%, subject to "acting together" rules.
- Indirect charge on (3), disposal of interest in an entity holding RE, units treated as shares in a company.
- (4) Not chargeable, covered by exemptions.

Double taxation

HMRC – no fundamental incompatibility between SI and April 2019 – Is this right?

Substantial Shareholding Exemption ("SSE")



- Extended SSE may exempt new charge on land rich share disposals by non-residents.
- Holdco's disposal of Propco shares potentially exempt if Holdco's investors are Qualifying Institutional Investors (QII).
- Full exemption if Holdco ≥80% owned by QII.
- Partial exemption if Holdco ≥25% <80% owned by QII.
- Holdco must not be listed (unless it is a qualifying UK REIT).
- Can it apply to disposals by quasi-companies (opaque JPUTs)?
- Can it extend to assets?
- How are liabilities shared between QII and non QII?
- QIIs holding through blockers?

Qualifying Institutional Investors for extended SSE

- Trustee/ manager of a registered pension scheme, other than an investment-regulated pension scheme (as defined in ***Part 1 of Schedule 29A of the Finance Act 2004)***
- Trustee/ manager of an overseas pension scheme, other than one which would be an investment-regulated scheme if it were a registered pension scheme
- Company carrying on life assurance business (as defined in ***section 56 of the Finance Act 2012***)
- Tax exempt person on ground of sovereign immunity
- Charity
- Investment trust
- ***Authorised investment fund (as defined in the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964)*** which meets genuine diversity of ownership condition
- Trustee of exempt unauthorised unit trust, where the trust meets the genuine diversity of ownership condition

Other issues and HMRC reactions

25% and the 5-year look-back rule, how deal with fund stabilisation periods to exempt seed investors?

75% test catching non-UK assets

Reporting obligations on advisers and ***30-day*** notification period

- Timing **2019** versus **2020**, why not delay?

Restructuring implications: how easy will it be to get from JPUTs to onshore structures and SDLT implications?

Commercial impacts

Price effect: estimates of 4 to 5%

- Uncertainty - suggestion markets will slow, as people hold rather than sell.
- Unsuitable onshore vehicles for sophisticated investors, highly regulated and with unacceptable liquidity requirements or volatility in the case of REIT.

- Importance of offshore for UK institutional investors and local government authorities (but politics behind regulatory initiatives is to encourage LGAs to invest onshore).
- Regulatory lead time to start new regimes.
- Aggregators of funds for the UK will need access to EU investors either through Lux AIFMD FCP structures or the well-established Jersey models using the private placement regime.

Representations – needed by 16 February

Acknowledge intentions: levelling playing field, simplification, revenue raising.

Work with the grain of the SI and try to reconcile it to an outcome for the consultation?

For JPUTs that stay opaque: an exemption from the direct charge and tax deduction on redemptions with possibility of reclaim of tax by tax-exempt investors? Noting NRL trustees already deduct tax in some cases. Alternatively, accept direct charge but with a tax paid credit that can then be passed through to tax exempt investors and reclaimed

For transparent JPUTs no direct charge on their disposals and agree an interpretation of the 25% “acting together” test that counters abuse, lets small investors enjoy the intended freedom from the indirect charge and for larger investors imposes a withholding tax on redemptions with ability to claim refund by tax exempts

Non-resident Companies subject to corporation tax from April 2020

Katie de Gouveia, PwC UK

Overview of technical differences

Change	Current treatment (income tax)	Treatment under corporation tax

Interest restrictions	• Subject to potential restrictions under:
	  • Transfer pricing rules
	  • The "wholly and exclusively" rule
		• Interest cap – 30% EBITDA/Group Ratio/PIE
		• Transfer pricing and thin capitalisation
		• Other loan relationship anti-avoidance provisions
		• Likely the majority of Jersey cases will be below the de-minimis threshold (£2m)

Anti-hybrid rules	• None - Only applicable to corporation tax	• Will apply in line with rules applicable to UK resident companies • No de-minimis – rules are complex
Taxation of gains	• Capital gains tax on ATED related gains • Non-Resident Capital Gains Tax (NRCGT) apply to direct disposals of residential property • Both are in the capital gains tax regime • From April 2019, disposals of commercial property also subject to CGT	• From April 2019 disposals of UK commercial and residential land and buildings will be subject to corporation tax • Both direct and indirect disposals of UK land and buildings will be caught • Possible application of new SSE rules

Overview of technical differences (cont…)

Change	Current treatment (income tax)	Treatment under corporation tax
Tax losses and group relief	• Unused losses can be carried forward and offset against future profits from the same property rental business • No group relief available	• Loss relief and group relief will apply in the same way as they are applied to a UK resident company with a UK property business • Subject to loss restriction rules which were reformed from 1 April 2017 – profits above £5m (group allowance)
Derivative contracts/ hedging	• Necessary to compute taxable profits in accordance with UK GAAP - hedge accounting can be adopted provided there is a basis for doing this	• Complex rules in relation to derivative contracts, including the "Disregard regulations"
Non-trading loan relationships	• No distinction between different types of losses	• Any credits and debits that are not brought into account as trading income and expenses are termed 'non-trading' profits and deficits • Anti-avoidance provisions, e.g. unallowable purpose

Overview of administrative differences

Change	Income tax	Corporation tax
iXBRL tagging	• No tagging of financial statements or computations is required	• Financial statements and computations must be filed in iXBRL format - commercial software is used to insert XBRL tags
Filing of returns	• Tax return - SA700 • Tax returns are submitted in paper form • Deadline for filing all NRL returns is 31 January following the relevant tax year	• Tax return – CT600 • Tax returns must be filed online • Deadline for filing the CT600 return is 12 months after the end of the accounting period it covers
Tax payer reference	• Unique Taxpayer Reference (UTR)	• Summary of responses to the consultation in Spring 2017 make reference to new corporation tax taxpayer reference

Tax payment dates	• Payments due in two instalments:
	  • 31 January – pay the balance of any tax owed in relation to the tax year for which you are filing a return, plus 50% of estimated liability for next tax year
	  • 31 July – second payment of 50% of estimated liability for next tax year
		• Taxable profits of up to £1.5 million - 9 months and 1 day after the end of your accounting period
		• Taxable profits greater than £1.5 million - corporation tax due in instalments:
		  • Payment dates and the number of payments will depend on the length of your accounting period
		  • For accounting periods of 12 months typically you would make 4 quarterly instalments, 2 of which are due before the end of your accounting period

UK anti-hybrids legislation

Neil Anthony, PwC UK

Hybrid Mismatches

Introduction

BEPS Action 2 *– to prevent tax advantages that exploit differences in the treatment of entities, financial instruments and permanent establishments in different countries.*

For Jersey Structures:

- *Payments made to a Jersey company that is elected/checked transparent for US tax are likely to be non-deductible for UK tax purposes*
- *Payments to fund partnerships treated as companies in investor jurisdiction likely to become non-deductible (UK and EU from 2020).*
- *Where funds and portfolio companies are all transparent for US tax, likely to be a proportionate (to extent of US taxable investors) disallowance of all expenses in taxable portfolio companies unless that entity actually makes a profit based on third party income.*

- *Wide ranging rules – the UK (and EU countries from 2020) can apply disallowances to payments that are just part of the same arrangement as hybrid payments – they do not need to be party to the hybrid payment itself.*
- *Rules Introduced in UK in 2017. EU ATAD II will be implemented in 2020.*

Hybrid Mismatches

Overview

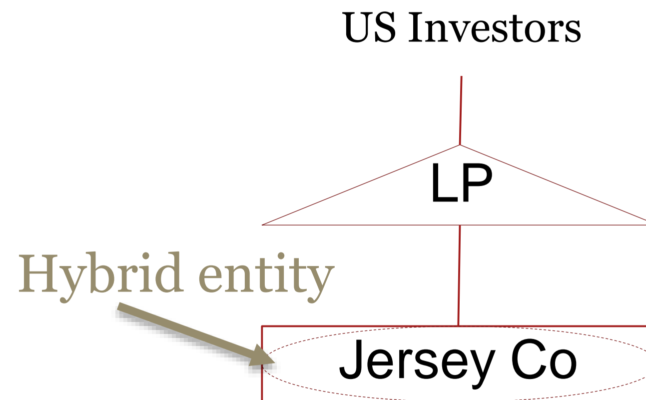
- Complicated (and at times incomprehensible) legislation. Law is still evolving as issues are found.
- Rules can apply to deny a tax deduction for any kind of expenses. To apply, broadly the following need to be in point:
  - There is either a tax deduction with no corresponding taxable income or two deductions in different territories for the same payment.
  - The reason for the non taxation/ double deduction must be either a hybrid entity, hybrid instrument or certain permanent establishment structures.
- Counteraction of a hybrid mismatch payment can occur at 3 levels:
  - Denial of tax deduction for company making the payment.
  - Tax the income for the recipient of the payment (D/NI only).
  - Denial of tax deduction for payments made by third companies (must be related) that fund the hybrid payment further up (“imported mismatch”).
  - Most D/NI rules only apply to intra-group payments. Double deduction rules can apply to all payments (including third party).
- There is no purpose test – if rules are met, counteraction applies regardless of commercial nature of transaction and arms length nature of payment.

What is a hybrid entity?

- Treated as a person/company in one territory.
- Treated as transparent/income charged to tax on another person in second territory.

Companies

Normally non-US companies which have been checked the box to be disregarded/ treated as a partnership for US tax.

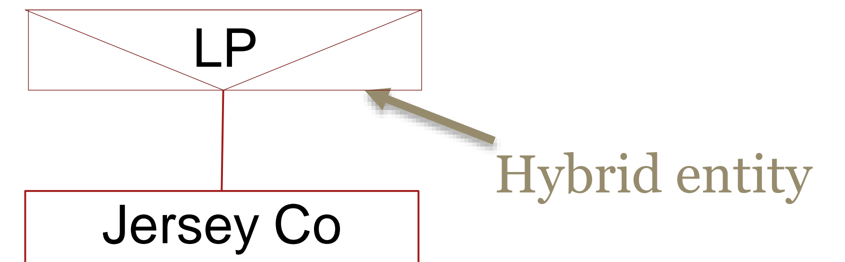


Partnerships

- Either US check the box to treat a partnership as a corporation.
- A number of jurisdictions treat LP/LLP as companies under domestic law.

US Investors (CTB for LP to be a company)

Other countries treating LP as company (e.g. Netherlands, Australia, Korea, Italy, etc)



What is a hybrid mismatch from a financial instrument?

- Tax deduction in one territory.
- Income not taxed/taxed at lower than full marginal rate in second country.
- No/ low tax arises **by** reason of terms or other feature of the financial instrument.

Country 1 (Not taxed at full marginal rates – e.g. equity)

↑ Payment

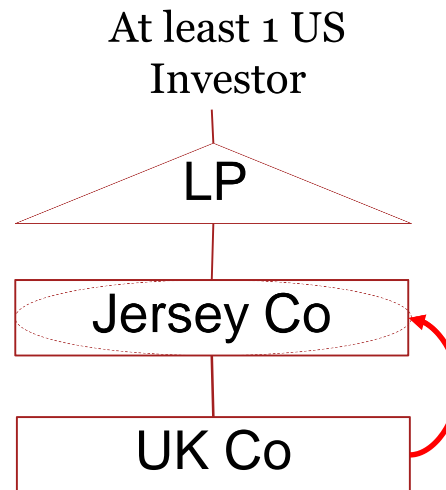
Country 2 (tax deduction – e.g. debt)

- *0% tax rate is not a term of the instrument, so unlikely to apply in Jersey (except possibly banking sector).*

Critical Issue 1

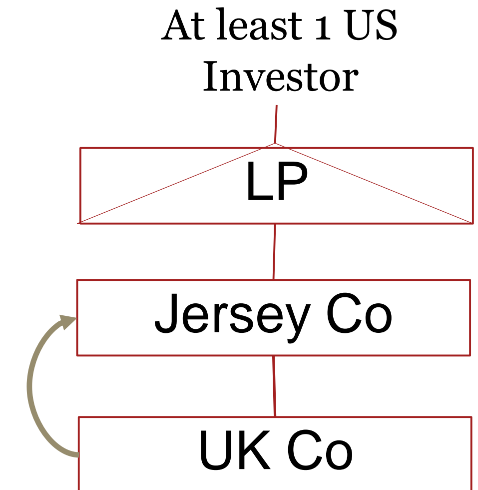
0% tax hybrid entity receives a payment

- UK specific rule where the recipient of a tax deductible payment is a hybrid entity
- If entity is not:
  - Resident anywhere for a tax charged (0% is not a tax charged).
  - Subject to full CFC rules.
  - A taxable PE of another entity.
- All non-taxation is deemed to arise due to hybridity.
- Not proportionate to shareholders to whom the check the box election is relevant unless hybrid entity is a partnership. So is normally an all or nothing answer.



Structure on left – Jersey Co is a hybrid entity. Deeming rule applies – no UK tax deduction

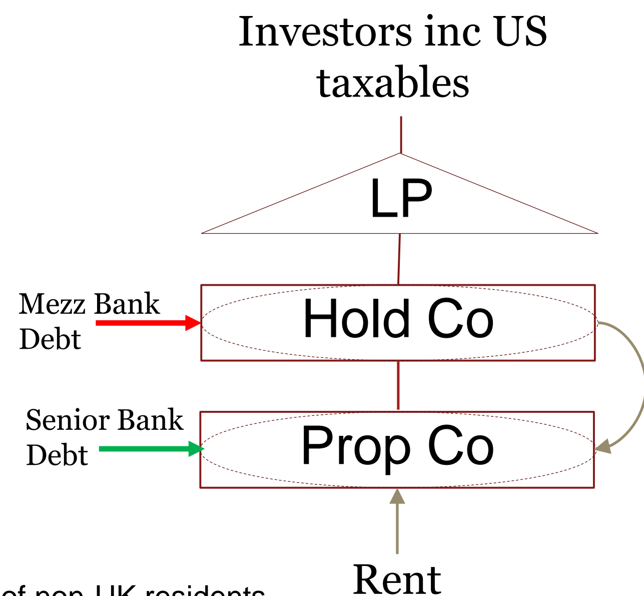
Structure on right – Jersey Co is not a hybrid entity – Full UK tax deduction



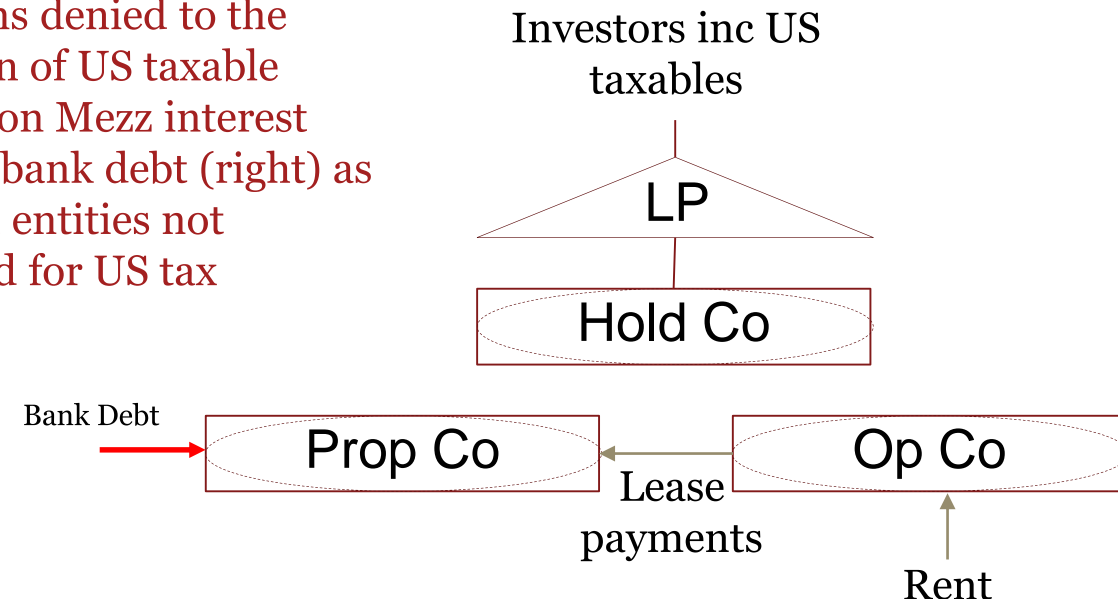
Critical Issue 2

Double Deductions (income and expenses in different companies)

- For US tax, most real estate structures are elected (using check the box) to be tax transparent for US tax. So companies are hybrid entities and all expenses deductible locally and in the US (so double deduction).
- Per OECD,UK rules and ATAD 2, that is OK as long as the income against which deductions are taken is “dual inclusion income” (i.e. taxed on the company making the payment locally and at the investor level where deduction is also taken). However, intra-group payments may not be recognised in the US, and may thus not rank as dual inclusion income.



Deductions denied to the proportion of US taxable investors on Mezz interest (left) and bank debt (right) as income in entities not recognised for US tax



Corporate interest restriction

Katie de Gouveia, PwC UK

Corporate interest restriction

Overview

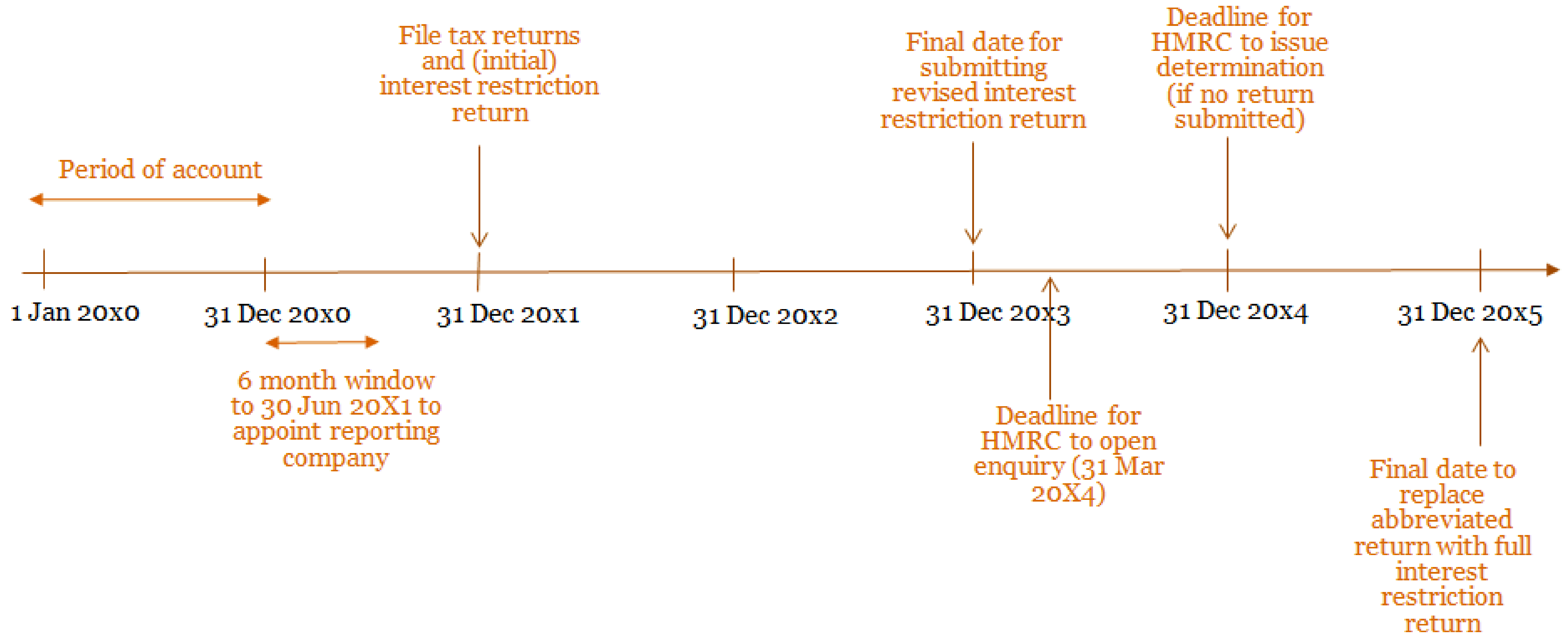
- Law effective from 1 April 2017 - legislation now enacted.
- From 1 April, interest deductions for a "group" to be restricted as follows:
  - £2m de-minimus always deductible
  - "Fixed ratio" – 30% of taxable EBITDA
  - Highly leveraged groups can go above 30% using either:
    - "Group ratio" – 30% can be increased to group interest:EBITDA (accounting based test with complex adjustments)
    - Public Infrastructure Exemption ("PIE")
  - Fixed ratio and group ratio subject to debt cap (i.e. limited to interest paid outside the group – can include interest paid to funds for fixed ratio).
- Definition of the "group" critical especially for funds
- Other key issues:
  - New financial guarantees provided by related non-group members
  - PIE – following the consultation the election will not follow an asset when it is transferred to non-related parties.
- Compliance regime – Complex regime outside of CT600.

Compliance under the corporate interest restriction rules

- A group must appoint one of its UK group companies to be the reporting company for the interest restriction rules.
- The reporting company must file an interest restriction return for the group within 12 months of the end of the group's period of account.
- HMRC can open an enquiry into an interest restriction return at any time up to 39 months after the end of the period of account (with extended deadlines if the return is filed late or if a "discovery" occurs).
- Where no reporting company has been appointed, or no correct/ compliant interest restriction return has been submitted, HMRC can issue determinations (of tax due) to individual UK group companies at any time up to 4 years after the end of the period of account.
- There are provisions for the UK group companies to appeal against HMRC's actions.
- The are numerous penalties which can be levied by HMRC where deadlines are missed and/ or the interest restriction return contains errors.

Compliance timetable

"Normal" timeline for compliance



Possible elections and deadlines

Election	Deadline	Revocable
Appointment of company	6 months following end of AP	Yes
Group ratio	Made in interest restriction return	Yes
Group ratio (blended)	Made in interest restriction return	Yes
Group-EBITDA (capital gains)	Made in interest restriction return	Yes
Interest allowance (alternative calculation)	Made in interest restriction return	No
Interest allowance (non-consolidated investment)	Made in interest restriction return	Yes
Interest allowance (consolidated partnerships)	Made in interest restriction return	Yes
Public Infrastructure Election	Prior to start of AP	Lasts for 5 years (unless conditions not met)
Abbreviated return election	Made in the abbreviate return	Yes – Needs to be made every year

Interest Restrictions

What next and impact on transactions

- Quarterly payments and accounts dated prior to enactment of the law.
- PIE election – has to be made prior to AP starts (unless AP starts prior to 1 April 2018 in which case, the election can be made by this date).
- Define "group" (more complex in fund structures).
- Appointment of reporting company and informing other group companies (within 6 months of AP end).
- Detailed calculations/ modelling. Reviewing various elections especially if relying on group ratio (can be onerous if part of larger "group").
- Separate return (either full return or abbreviated) to be filed in addition to CT600's.
- Longer HMRC enquiry window – impact on years in scope of standard UK due diligence.
- SPA tax deeds will need specific consideration as seller likely to remain responsible for filing interest restriction return (unless all "group" being sold).

Define "group" (more complex in fund structures)

Final thoughts…

Major changes to the taxation of income when corporate NRL's come within the charge to CT from 1 April 2020.

Corporate tax rates may be lower, but differences to tax base likely to increase overall tax.

Significant increase in compliance requirements which may require information from the wider group.

Many hybrid issues can be resolved/ planning opportunities, but interest cap may restrict many shareholder debt deductions anyway – need to consider the integration between the two.

Increased complexity in transactions to deal with "group" issues and longer enquiry windows.

Any questions?

Thank you!

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