Extending CGT to non-residents investing in UK real estate

Large Corporate | Personal tax

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The CIOT and ATT have responded to the consultation that followed the government's announcement at the Autumn Budget 2017 that most non-resident investors in UK land will be brought into UK tax on gains from April 2019.

The key changes proposed by the consultation are

- Most non-UK residents will be chargeable on gains accruing on the direct and indirect disposal of non-residential (commercial) property.
- The existing capital gains tax charge for non-UK residents disposing of UK residential property will be extended to indirect disposals and disposals made by widely-held companies.

CIOT sub-committee members met with the HMRC team leading the consultation before Christmas to discuss the consultation proposals. The CIOT response builds on those discussions.

The CIOT response can be found on the CIOT website and the ATT response on the ATT website.

Timing of the consultation

The scope, commencement date and core design features are largely fixed and were not part of the consultation. However, given the very significant change to the rules for taxing gains on real estate and the government's aim to create a single regime rationalising as far as possible existing provisions, the CIOT is concerned that draft legislation will be published relatively late in the consultation process. We have written separately to note our concerns that draft legislation for the anti-forestalling measure has not been published despite the fact that it is already in force. We hope

that draft legislation for this measure will be published well in advance of ‘L-Day’ in July.

Direct and indirect disposals

The new rules will extend beyond taxing direct disposals, applying also to disposals in ‘property rich’ entities where the person making the disposal holds, or has held in the last five years, at least a 25% interest in the property rich entity.

Rebasing to April 2019 will be optional for direct disposals, in that historic cost can be used if that gives a more favourable result. However, the option to calculate the gain on historic cost will not be available for indirect disposals. Instead, rebasing to April 2019 is compulsory for indirect disposals. The CIOT and ATT think this risks imposing tax on a post April 2019 gain that exceeds the overall economic gain. The ATT is also concerned that applying different calculation methods to direct and indirect disposals will introduce unnecessary complexity for non-residents, who may already find understanding and complying with the new rules challenging, as well as increasing the risk of errors and HMRC challenge.

The five-year look back period for indirect disposals is very widely drawn. The CIOT suggest that as a minimum the five-year period should be restricted to periods beginning with the Budget announcement on 22 November 2017 as the earliest point at which taxpayers were made aware of it. The five-year look back could bring ‘cornerstone investors’ in collective funds into charge despite holding a 25% interest for a very short period of time.

Consideration might be given to the option to elect to use an average holding over the five-year period, or alternatively a linked disposal rule modelled on TCGA 1992 section 19 to address the risk of fragmentation.

Given the intention is to recognise that indirect ownership equates to direct ownership in economic terms, the CIOT suggest that the same approach is adopted as for the transactions in land rules, that is, a just and reasonable apportionment to identify the gain attributable to the underlying UK property.

The distinction between direct and indirect disposals, and the interaction with double tax treaties, brings into sharper focus the issue of determining the nature of foreign entities (whether transparent or opaque). The CIOT and ATT suggest that HMRC’s entity classification list is updated in advance of the implementation date.

It is not clear whether the intention is that offshore unit trusts will be treated as opaque or as transparent under the new regime. In the context of the policy approach of achieving parity of tax treatment between UK residents and non-UK residents it is important that the approach is clarified given the scale of inbound investment in UK property through collective investment vehicles (CIV).

If the policy intention is to equalise treatment of UK and non-UK investment structures while maintaining the exempt treatment for certain classes of investor such as pension schemes, the ability to invest via a CIV without introducing either more than one layer of tax and/or an incidence of tax that is inappropriate for exempt institutional investors may need to be evaluated further. Suggestions for areas that might form part of that evaluation are included in the CIOT's response.

ATED-related CGT

The CIOT and ATT responses strongly support the abolition of ATED-related CGT from April 2019 to consolidate the taxation of immovable property gains into one regime as far as possible.

Reporting obligations for third-party advisers

The consultation proposes a new reporting requirement for certain advisers who are aware of the conclusion of a transaction.

In terms of the reporting obligations to be imposed on third-party advisers, the consultation asks about an 'undue' increase in administrative burdens or costs. Clearly there will be a potentially significant increase in the administrative burden for UK advisers in meeting this compliance obligation, the extent of that burden will depend upon the conditions imposed. The question of whether this burden is unwarranted depends in part upon whether there are alternatives that would better meet the compliance and enforcement challenges. The wholesale extension of CGT on immovable property to non-residents and alignment with other jurisdictions indicates that international experience of enforcement and compliance should be fully evaluated. The ATT note that there is a potentially large pool of third-party advisers who may be aware of the conclusion of a transaction, which means there is a risk of duplicated reports. If the obligation to report is not restricted then guidance will be needed to set out the obligations, if any, for an adviser to establish if a transaction has concluded.

Awareness and publicity

The CIOT and ATT are concerned that recent case law in relation to penalties for failure to make a non-resident capital gains tax (NRCGT) return has demonstrated a lack of awareness of the NRCGT reporting requirements by non-UK residents and particular confusion for non-UK resident individuals in relation to the thirty-day reporting requirement that applies regardless of whether or not the taxpayer is in the self-assessment. It will be important for HMRC to undertake extensive, well targeted publicity to ensure non-residents and their advisers are aware of the proposed changes and their obligations under the rules.