The new dwelling tax

Personal tax



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Aparna Nathan explains the new capital gains tax regime for non-residents

Key Points

What is the issue?

A new regime for taxing gains realised by non-UK residents with effect from April 2015

What does it mean for me?

The new regime only applies upon disposals of UK residential property interests and not to interests in other property; in particular, it does not apply to interests in personal property or commercial property

What can I take away?

There are many other interesting quirks and anomalies with the Principal Private Residence Relief (PPRR) provisions, as well as with the other provisions of the draft legislation

The tax regime for non-residents holding UK property (both real and personal) has historically been relatively benign in that they were not subject to capital gains tax (CGT) on the gains realised upon the disposals of such property. In the 2013 Autumn Statement the government announced its intention to introduce a new regime for taxing gains realised by non-UK residents with effect from April 2015.

A consultation document, *Implementing a capital gains tax charge on non-residents*, was published on 28 March 2014. The consultation period closed on 20 June 2014. There was widespread engagement with the consultation process by practitioners and professional bodies, among others.

Those participating in the consultation pressed for the abolition of annual tax on enveloped dwellings (ATED)-related CGT, given that the new regime would obviate the need for this regime.

The government published its *Summary of Responses* on 27 November 2014. Draft legislation intended for inclusion in the Finance Bill 2015 was published on 10 December 2014. The government has continued to consult on the terms of the draft legislation and, although the broad ambit of the proposed new CGT regime is fixed, the consultation should remove any significant infelicities in the drafting of the applicable draft legislation.

To the great disappointment of the professional bodies who were involved with the consultation, the new regime is in addition to, rather than in place of, ATED-related CGT.
Two main reasons were given for retaining ATED-related CGT. First, this tax and the

new regime seek to achieve different policy objectives, respectively the disincentivisation of enveloped structures and the levelling of the CGT regime applicable to owners of UK residential property interests. Second, ATED-related CGT applies a 28% rate, whereas the new regime will apply the existing CGT/CT on chargeable gains rates. In relation to individuals, they concern the 18% and 28% rates and, for companies, the 20% rate.

The professional bodies are far from convinced that these are valid reasons for retaining ATED-related CGT, given the complexity and compliance costs it is building into the new regime. This article refers to the proposed CGT charge on non-residents as the 'new regime' and considers significant (but not all) aspects of the new regime as set out in the draft legislation (published on 10 December 2014).

New regime overview

The Finance Bill 2015 introduces a new TCGA 1992 s 7AA, which provides that:

(a) a person;
(b) who does not meet the residence condition;
(c) is chargeable to capital gain tax;
(d) in respect of a chargeable relevant gain accruing to that person in a tax year; and
(e) on the disposal of UK residential property interest.

From TCGA 1992 s 7AA, it is clear that:

- The new regime only applies upon disposals of UK residential property interests and not to interests in other property: in particular it does not apply to interests in personal property or commercial property.
- The new regime applies to individuals, trustees, personal representatives and certain companies (discussed further below). The transparency of partnerships (and indeed, LLPs carrying on a trade or business) for tax purposes means that non-resident partners of such partnerships are also within the scope of the new regime.
- The new regime applies to those who do not meet the residence condition. This is set out at new TCGA 1992 s 7AA(7):

‘(a) in the case of an individual, that the individual is resident in the United Kingdom for the tax year,
(a) in the case of personal representatives of a deceased person, that the single and continuing person mentioned in section 62(3) is resident in the United Kingdom,
(b) in the case of the trustees of a settlement, that the single person mentioned in section 69(1) is resident in the United Kingdom during any part of the tax year, and
(c) in any other case, that the person is resident in the United Kingdom when the gain accrues.’

Recourse must therefore be had to the statutory residence test in order to determine whether the person in question is ‘resident in the UK’ for (or, as applicable, during any part of) the tax year in which the disposal takes place. The new regime applies to:

- ‘the chargeable relevant gain accruing … on a disposal’; and
- ‘UK residential property interests’.

Companies affected by the new regime

It is intended that not all companies will fall within the scope of the new regime.

New TCGA 1992 s 7AA(6) provides that the new regime does not apply, upon a claim being made, to a company that is:

(a) a diversely held company at the time of the disposal;
(b) a unit trust scheme that meets the widely marketed fund condition in relation to the disposal; or
(c) an open-ended investment company that meets the widely marketed fund condition in relation to the disposal.

A ‘diversely held company’ is one that is not a ‘closely held company’. A closely held company is defined in TCGA 1992 Sch C1 Pt 1. This definition is closely modelled on the close company definition provisions in CTA 2010. Broadly, a company is a closely held company if it is under the control of five or fewer participators. Interestingly, there is no mirroring reference to control by participators who are directors of the company. It is not clear whether this omission is deliberate and what, if any,

significance attaches to this omission.

‘Control’ bears a materially similar meaning to the CTA 2010 provisions: a person (P) is treated as having control of a company (C) if P:

(a) exercises;
(b) is able to exercise; or
(c) is entitled to acquire direct or indirect control over C’s affairs and, in particular, P is treated as having control of C if P possesses or is entitled to acquire:

(i) the greater part of the share capital or issued share capital of C;
(ii) the greater part of the voting power of C;
(iii) the greater part of the income available for distribution; and
(iv) the greater part of the assets available for distribution on a winding up (TCGA 1992 Sch C1 para 12)

However, a company is not a closely held company where, inter alia, one of the five or fewer participators is a diversely held company or a qualifying institutional investor. A ‘qualifying institutional investor’ is a defined term and includes a widely marketed unit trust scheme, an open-ended investment company and a trustee of a pension scheme.

TCGA 1992 Sch C1 para 6 deals with divided companies (eg protected cell companies).

TCGA 1992 Sch C1 para 7 sets out an anti-avoidance provision to counteract ‘arrangements entered into where the main purpose or one of the main purposes of any party of the arrangements is to avoid capital gains tax being charged under TCGA 1992 s 7AA(4)’, (capital gains tax charge on non-resident companies).

UK residential property interest

This is defined in TCGA 1992 s 7AA(9) Sch B1. This provides that an interest disposed of by the non-resident disponor is a ‘UK residential property interest’ if either the first or second condition is satisfied (TCGA 1992 Sch B1 para 1(1)).

The first condition is satisfied if the land has at any time in the relevant ownership period consisted of (or included) a dwelling, or the interest subsists for the benefit of land that has at any time in the relevant ownership period consisted of (or included)

a dwelling (TCGA 1992 Sch B1 para 1(2)).

The second condition is met if the interest in UK land subsists under a contract for an off-plan purchase, where that means a contract for the acquisition of land consisting of, or including, a building or part of a building that is to be constructed or adapted for use as a dwelling (TCGA 1992 Sch B1 para 1(3)).

The ‘relevant period of ownership’ is the period beginning with the later of the day on which the disponor acquired the interest or 6 April 2015; and ending with the day before the day on which the disposal occurs. Where various interests in the UK residential property disposed of have been acquired by the disponor at different times, for the purposes of determining the start date of the relevant period of ownership the interest is treated as acquired on the date of the earliest acquisition (TCGA 1992 Sch B1 para 1(4), (5)).

‘Dwelling’ is defined in TCGA 1992 Sch B1. A building counts as a dwelling when it is used (or is suitable for use) as a dwelling or is in the process of being constructed or adapted for such use. There is some concern that townhouses currently used as offices may nevertheless be regarded as ‘suitable for use as a dwelling’ (so falling within the scope of the new regime). It is arguable that the use of the present tense ‘is suitable’ means that townhouses currently configured and used as offices do not satisfy the statutory requirement: they require some (arguably not much) work to make them suitable for use as dwellings, but the fact that premises ‘may be suitable’ for use as dwellings falls outside the statutory test of ‘is suitable’ for use as a dwelling. Further, such properties are generally subject to planning restrictions that prevent residential use. It seems tolerably clear that such properties cannot be said to satisfy the ‘is suitable for use’ requirement.

It is intended that communal accommodation is excluded from the definition of ‘dwelling’. TCGA 1992 Sch B1 para 3(3) gives details of properties that do not count as dwellings, eg residential accommodation for school pupils, residential care homes, hospitals.

A catch-all provision in TCGA 1992 Sch B1 para 3(4) seeks to exclude as ‘dwellings’ a building that is an institution used (or suitable for use) as the sole or main residence of its residents. There is a slight infelicity with the drafting because a building cannot be an institution though it can be used as an institution. Consequently, provided this drafting error is rectified, it seems clear that premises

that are used (or suitable for use) as communal residential homes do not count as ‘dwellings’ for the purposes of the new regime.

Chargeable relevant gain

The new regime taxes chargeable relevant gains. New TCGA 1992 s 7AB provides that the charge is on the total amount of the relevant gains after deducting allowable relevant losses.
New Sch 4ZZB makes provision for the computation of chargeable relevant gains (or losses) and other gains or losses arising on chargeable non-resident disposals of UK residential property interests.

The default method of computation for assets held at 5 April 2015 is set out at TCGA 1992 Sch 4ZZB paras 6 and 7. In effect, only gains accruing after 5 April 2015 up to the date of disposal, during which time the disposed of property has been used as a dwelling, are chargeable relevant gains.

It is possible to elect for a different method of computation based on straight line apportionment for assets held on 5 April 2015 (TCGA 1992 Sch 4ZZB paras 2–8). The chargeable relevant gain is the proportion of the gain accruing after 5 April 2015, reflecting the period of use of the asset after that date when the asset has been used as a dwelling.

New TCGA 1992 Sch 4ZZB paras 10–19 set out the computational rules necessitated by the retention of ATED-related CGT.

Interaction with other anti-avoidance provisions

The new regime is intended to take precedence over existing anti-avoidance provisions.

Accordingly, the following amendments are made by the new regime:

1. TCGA 1992 s 8 – FB 2015 Sch [A] para 5 provides that s 8 does not apply to ATED-related CGT nor to gains falling within the scope of the new regime.
2. TCGA 1992 s 10A – FB 2015 Sch [A] para 6 makes a minor amendment to TCGA 1992 s 10A(5). However, it is understood that the intention (as stated by the explanatory notes accompanying the draft legislation) is to introduce a new

TCGA 1992 s 10A (1A), which disapplies TCGA 1992 s 10A in relation to gains that fall within the scope of the new regime.

3. TCGA 1992 s 13 – FB 2015 Sch [A] para 7 disapplies TCGA 1992 s 13 from applying to gains that fall within the scope of the new regime.
4. TCGA 1992 s 86 – FB 2015 Sch [A] para 10 introduces a new TCGA 1992 s 86(4ZA), which disapplies TCGA 1992 s 86 from attributing gains of non-resident trusts to settlors, provided that the trustees of such trusts are chargeable in respect of such gains under the new regime.
5. TCGA 1992 s 87 – FB 2015 Sch [A] para 11 introduces a new TCGA 1992 s 87(5A), which disapplies TCGA 1992 s 87 from attributing gains of non-resident trusts to beneficiaries, provided that the trustees of such trusts are chargeable under the new regime in respect of such gains.

Note: No draft clauses have yet been published on the interaction of the new regime with TCGA 1992 Schs 4B and 4C (trustee borrowing rules). It is understood that these clauses are a work in progress.

Principal private residence relief (PPRR)

The aim of these provisions is to leave the present rules broadly unchanged (for example, the ability to elect a home as a principal private residence) except for any adjustments necessary to prevent PPRR being sought by non-residents who do not occupy the UK property as their main residence.

A new concept of ‘a non-qualifying tax year’ is introduced by new TCGA 1992s 222A: a dwelling house (or part) is not treated as occupied as a residence by an individual (P) at any time in P’s period of ownership that falls within a non-qualifying tax year (or a non-qualifying partial tax year) (TCGA 1992 s 222A(1)).

A ‘non-qualifying tax year’ is a tax year that falls entirely within P’s period of ownership of the dwelling house (or part) where:

(a) P was not resident for that tax year in the territory in which the dwelling house is situated; and
(b) P failed to meet the day count test in respect of the dwelling house.

The day count test is set out in new TCGA 1992 s 222B. A ‘partial tax year’ is one where only a part of the tax year falls within P’s period of ownership of the dwelling

house (TCGA 1992 s 222A(4)).

The day count test in new TCGA 1992 s 222B is met if in a full tax year, P spends at least 90 days in the dwelling house or in one or more other qualifying units.

A day is spent in a qualifying unit if P is present there at the end of a day (new TCGA 1992 s 222B(7)). A ‘qualifying unit’ in relation to P is a dwelling house (or part thereof) in which P has an interest and it is situated in the same territory as the dwelling house (or part) in respect of which a PPRR claim is made: new TCGA 1992 s 222B(8)).

There is some concern about the requirement for P to be present in a qualifying unit at the end of day: this might be difficult, for example, for shift workers and party animals. It is clear that the day count test takes into account P’s presence in qualifying units other than the one in respect of which P wishes to make a PPRR claim: for example, if P has a London flat (the dwelling house in respect of which the PPRR claim is made) and a country house, P’s presence at the end of the day at either of those properties is taken into account in determining whether P meets the day count test in relation to the London flat.

It appears that the focus of the test is to ensure that one of the UK properties is actually used by P. If that is the case, a test focusing on presence for more than a de minimis period in any UK dwelling house or qualifying unit should suffice. Clearly, the drafting of such a test will need to balance simplicity with clarity.

An interesting feature of the day count test is that the presence of the spouse of the individual in a dwelling house in effect counts as presence by the individual in that dwelling house (new TCGA 1992 s 222B(6)). For example, assume a non-resident husband and UK resident wife who together own a UK property that is their principal private residence. The non-resident husband is present in the UK property (under the day count test) for 25 days in the tax year and his wife is resident in the UK property for most of the tax year. The husband will meet the day count test for that year because his wife’s presence in the UK property will count as his presence in the UK property.

Conclusion

There are many other interesting quirks and anomalies with the PPRR provisions, as well as with the other provisions of the draft legislation. A full discussion is outside the scope of this article. Such quirks and anomalies are being discussed with HMRC so many, if not all, of them could be addressed in the next iteration of the draft legislation.

Additionally, the draft legislation contains no provisions dealing with collection mechanisms, holdover reliefs, entrepreneur reliefs, wasting assets and options. It is anticipated that these aspects will be dealt with in the next iteration of the draft legislation.