

Finance Bill 2013: New Residential Property Taxes in the United Kingdom

February 2013

This note outlines the new residential property tax charges following the publication of draft legislation on 11 December 2012 and, latterly, 31 January 2013 by the UK Government. Following both publications we now have further details of all the new residential property tax charges and their respective reliefs:

- **The annual residential property tax charge (ARPT)**, which applies to chargeable interests in residential properties owned on, or acquired after, 1 April 2013 or converted from a non-residential property after that date.
- **Capital gains tax (CGT)** to apply at a rate of 28 per cent on the sale or disposal of residential property (**ARPT-related gains**) applicable to disposals from 6 April 2013.
- **The 15 per cent rate of Stamp Duty Land Tax (SDLT)**, which has been in force since 21 March 2012 for residential properties.

In each case, the respective charges will be triggered only where:

- The value of the residential property in question is over £2m; and
- The property is purchased or owned by a “non-natural person”.

The Government consultation on the technical aspects of these charges is open for comments until 22 February 2013 but our expectation is that the rules will be enacted substantially as currently drafted.

Non-Natural Persons

“Non-natural persons” are companies, collective investment schemes and partnerships where one or more members of the partnership is either a company or a collective investment scheme. Non-natural persons may be UK resident or non-UK resident.

Trustees are not included in the definition of non-natural person. This means that trusts (including those with corporate trustees) that own interests in UK residential property directly at trust level will not fall within the scope of the charges. If, however, a UK property interest is owned by a non-natural person held within a trust structure, the charges will apply.

Residential Property

The charges will apply to residential “dwellings” only, which may be all or part of a residential or mixed use property. In particular:

- If the residential dwelling is part of a larger property that includes non-residential parts (*e.g.*, a penthouse flat above an office block), only the residential part will be valued.
- If the property consists of a number of self-contained dwellings (*e.g.*, a block of 10 self-contained flats), each dwelling will normally be valued separately.
- If the property comprises a main dwelling with one or more parts suitable for use as staff accommodation, the main dwelling in its entirety will be valued.

Some types of property that may otherwise satisfy the definition of residential dwelling will be exempt, including boarding school accommodation, hospitals, student halls of residence, military accommodation, care homes and prisons.

ARPT

The rate of the ARPT will depend on the value of the property interest, with properties being required to undergo a valuation every five years. The value of the property that will be relevant for the first five return periods from 1 April 2013 will be:

- The value on 1 April 2012, if you owned your interest in the property at that date;
- The market value on acquisition, if the property was acquired after 1 April 2012; or

- If the dwelling is a new property or an existing building that has been altered so that it is to be a dwelling, the value at the date either of entry on the Council Tax Valuation Lists (or Northern Ireland Valuation List), or when it is occupied, whichever is the earliest.

The valuation determines the applicable rate of the ARPT until 1 April 2018 according to the table below. On that date a new valuation will be due, for the valuation date 1 April 2017. The valuation must be reported on the ARPT return. Valuations must be on an open-market “willing buyer, willing seller” basis.

Date Property Value	ARPT Rates 2012-13
£2m - £5m	£15,000
£5m - £10m	£35,000
£10m - £20m	£70,000
£20m +	£140,000

The ARPT rates will be indexed to the Consumer Price Index (CPI) and increased in April each year. The thresholds are, however, expected to remain constant. A separate return will be required for each property falling under the ARPT charge. Each return will have to contain details about the property, including its full address, Land Registry title, the interest held, the beneficial owners of the property and the valuation of the property.

The first returns and payments will be due by 1 October 2013 and, subsequently, by 30 April each year. Any charges due will have to be paid by 31 October each year. Where a property comes within the charge part way through the year, a return and payment will be required within a strict timeframe: 30 days on acquisition of an interest or 90 days for another reason (*e.g.*, the completion of conversion works).

CGT on ARPT-related gains

CGT will be payable by non-natural persons (both resident and non-resident in the UK) in respect of gains realised on or after 6 April 2013 on disposals of the whole or part of a chargeable interest in a UK residential property worth over £2m. The draft legislation takes UK resident companies out of corporation tax for the portion of any gain that is ARPT-related and brings ARPT-related gains within the CGT charge instead at the 28 per cent rate. The portion of any gain which is not ARPT-related will remain in the charge to corporation tax.

The ARPT-related gains are calculated on the gain over the market value of the property on 6 April 2013. In some cases, *e.g.* where the value of the property on 6 April 2013 is less than the original base cost (usually the purchase price), it will be possible to elect for the ARPT-related gains to be calculated with reference to the original base cost instead. The charge is calculated by reference to the number of days (starting from 6 April 2013) for which the property was in the charge to the ARPT. Days where a relief is available will not be counted.

A form of tapering relief is available where the consideration for the purchase is close to the £2m threshold and the ARPT-related gains are relatively large. The relief operates by taxing the lower of the actual gain or the tapered gain.

It is important to note that relief for ARPT-related losses will be restricted. ARPT-related losses can only be set against ARPT-related gains realised in the same year and subsequent years. Loss relief will only be allowed for losses in excess of the £2m threshold (*e.g.* if a ARPT-related loss of £2.6m is realized, only £600k of the loss would be allowable to set against ARPT-related gains).

15 Per Cent Rate of SDLT

Since March 2012, differential rates of SDLT have applied to the purchase of high value residential property in the UK. Where the purchaser is a non-natural person, the applicable rate is 15 per cent. If the purchaser is not a non-natural person, the 7 per cent rate applies.

Reliefs

The main situations in which a relief is available are summarised below:

- Where the property:
 - is held as part of a properly commercial property rental business;
 - is held as part of the stock of a properly commercial property trading business for the sole purpose of resale; or
 - is acquired in the course of a properly commercial property development trade

but in each case relief is not applicable at any time when a non-qualifying individual is permitted to occupy the property. 'Non-qualifying individual' is a very wide concept but broadly speaking includes any individual who is beneficially entitled to the property interest in question and anyone connected with that individual. "Connected persons" include a spouse or civil partner, "relatives" (siblings, ancestors or lineal descendants) and their spouses/civil partners, the trustees of any settlement of which the individual is a settlor and may include certain corporate entities owned by such settlements.

- Where the property is a dwelling owned by a business (or a member of the same group) that carries on a properly commercial business (not including a property rental business, a property development trade or a property trading business) and which is occupied as living accommodation by certain employees (or partners if the trade is carried on by a partnership) for purposes that are solely or mainly purposes of the trade. Relief is not available where the employee (or partner) occupying the property is entitled to a 5 per cent or greater share of the profits of the trade, or of the entity owning the dwelling or is an employee providing certain domestic services.
- Where the property is held by charities for charitable purposes.
- Where the property is held as part of a business (such as historic houses) that make dwellings available to the public for at least 28 days each year on a commercial basis.
- Where the property is a farmhouse owned as part of a properly commercial farming trade and which is occupied by a farm worker with a substantial involvement in the day to day work of that trade.

If a relief is applicable, it must be claimed by the chargeable person in the appropriate return on an annual basis. Where a relief is applicable, SDLT will generally be payable at the reduced rate of 7 per cent and the property should be exempt from ARPT and the charge on ARPT-related gains.

Change in Property Status and Qualifying For Reliefs

It is worth noting that any applicable reliefs will be withdrawn if the purpose for which the property is held changes during the course of the relevant tax year and the conditions for the relief cease to be satisfied. For instance, if for six months the property is held for the purpose of a genuine property development business, and for the remainder of the year it is not, half of the relevant charges will be due for that year.

With respect to the 15 per cent rate of SDLT, the relief will cease to apply if, within three years of the effective date of the transaction, the property no longer satisfies the conditions of the relevant relief. Under these circumstances there will be additional SDLT to pay.

What Should You Do Now?

In order to decide what action to take, persons owning residential property in the UK must determine whether or not they are caught by the new rules.

Individuals who own UK property directly in their own names and for their own benefit are *not caught* by the new charges and need take no further action.

Companies (or other non-natural persons) acquiring or holding UK residential property worth more than £2m on the relevant valuation date *are caught* within the scope of the new charges.

Broadly speaking, there are three possible outcomes:

1. One of the reliefs is applicable. The relief must be claimed in the relevant return. The first ARPT return, including the valuation, will be due by 1 October 2013 and the tax must be paid by 31 October 2013.
2. No reliefs are applicable. The returns must be made and charges paid as they fall due. The first return is due by 1 October 2013.
3. Restructure before 1 April 2013 in order to avoid the charges becoming applicable. This might involve either restructuring to avoid ownership by a non-natural person, or taking steps to qualify for a relief that would not currently be applicable.

Common examples of situations that are likely to be caught include the following:

- *A non-UK resident trustee who owns a UK residential property via an underlying company, where the UK property is occupied by a beneficiary of the trust.* In this situation, even if a market rent is paid, it is highly unlikely that the property rental relief would be applicable as, in most cases, the beneficiary would be a non-qualifying person. The ARPT would be payable annually and CGT would be payable on disposal.
- *A non-UK resident individual who owns UK residential property via a non-UK resident company.* If the individual or a member of his or her family uses the property as a home in the UK, this would be within the scope of the charges. If it was rented to third party tenants as part of a property rental business, however, the relief should be applicable and must be claimed annually.
- *A non-UK company that owns a property in the UK for use by one or more of its senior employees when they are in the country on business.* In this situation it will depend on the entitlement of the employee to profits of the trade as if, for example, the employee is also a shareholder of more than 5 per cent of the business, no relief would be applicable and the ARPT would be payable.

If you already own or are considering the purchase of UK residential property, and would like advice on whether the charges apply to you, including whether a relief might be applicable or if you have any restructuring options, please get in touch with your McDermott contact without delay.

For more information, please contact your regular McDermott lawyer, or:

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