Canada Life™

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Global Family Office Community – White Paper

Owning residential property in the UK

In the past it was common for a non-domicile individual who wished to purchase a residential property in the UK to be advised to do so through an offshore company. The individual would set up a limited company in a foreign jurisdiction and he or she would be the main shareholder of the company. The company would then purchase the property and the individual would live in it.

This type of ownership had some distinct tax advantages.

§ There was no Stamp Duty Land Tax (SDLT) on the purchase as it would be through a corporate structure and this was exempt from Stamp Duty.

§ There was no liability to capital gains tax on the later disposal of the property as a non-UK resident company would not pay UK tax on the capital gains.

§ And finally, there would be a potential saving for UK inheritance tax, as the property would not be owned personally.

These tax savings meant that the use of corporate structure could be an efficient way of holding a UK property. Similar tax benefits could apply to some offshore trusts and certain partnership structures.

However, gradually over a number of years the UK Government has closed these tax loopholes, thereby making the decision to hold a property through such a structure less attractive.

Closing the loopholes

As a deterrent to this tax avoidance, Her Majesty's Revenue and Customs (HMRC) started to make changes from 21 March 2012 which makes this type of corporate ownership more difficult.

§ First, they introduced SDLT of 15% on property where the purchase price was above £2m and it was bought by what is termed 'non-natural persons'; such as a company or some partnership structures for example.

From 20 March 2014 this threshold was lowered and the 15% rate now applies to properties valued at £500,000 and over.

§ Second, on 1 April 2013 they introduced the Annual Tax on Enveloped Dwellings (ATED).

This annual tax applies to residential properties owned by non-natural persons and is applied on a banded basis according to the value of the property. Initially this applied to property worth £2m and above. From 6 April 2015 it applies to property valued from £1m and above and from 6 April 2016 on property valued at £500,000 and above.

The rates of tax were increased dramatically from 6 April 2015. Over the period of ownership the tax payable could be quite significant and these amounts payable should increase annually in line with the consumer prices index. The rates for the 2016/17 tax year are:

Property value	Annual charge
More than £500,000 but not more than £1 million	£3,500
More than £1 million but not more than £2 million	£7,000
More than £2 million but not more than £5 million	£23,350
More than £5 million but not more than £10 million	£54,450
More than £10 million but not more than £20 million	£109,050
More than £20 million	£218,200

A dwelling in the context of the tax is a private residence; therefore, in some instances relief is available for residential properties when they are owned for commercial purposes, such as by a rental businesses or developer.

§ Third, from 6th April 2013, for any property within the ATED regime, capital gains tax (CGT) of 28% is payable where an offshore company sells a residential property.

In addition to these measures already put in place, the Chancellor announced last year that he is looking at ways of imposing UK inheritance tax on residential properties owned by corporate structures. It is unclear at this stage as to how this will be achieved.

It is clear that the UK government is cracking down on this type of corporate ownership of residential property and the costs of this type of ownership have increased dramatically over recent years.

Personal ownership

If the property is owned personally there are taxes for the owner to pay.

§ SDLT is based on tiers with a zero band applying to the first £125,000, with a 5% and 10% band and a top band of 12% applying to the value over £1.5m. This makes it slightly lower than the new corporate rate for higher-end properties.

§ Then there is the potential for CGT if the property is sold, although for some Principle Private Residence Relief can remove any capital gains tax altogether, but not all will qualify.

In April last year the UK Government extended the capital gains tax rules to include disposals of UK property by non-UK residents, irrespective of domicile. The rates of tax for this are 18% and 28% so can be significant.

There is an annual exemption of £11,100 available to each individual and, as the name suggests, this is exempt from CGT. The balance is taxed at either 18% or 28% depending on the individual's other income. Whilst this could still amount to a large sum of money, it could be marginally lower than the flat rate of 28% that applies to residential properties sold by a non-natural person.

Although the annual exemption is only small compared to the potential property price it is worth noting that for those who opt for the remittance basis, it is lost – as is the income tax personal allowance.

§ Then there is inheritance tax.

Someone who is UK domiciled pays UK inheritance tax on their worldwide assets and a non-domicile only pays it on their UK assets. However, with a few exceptions a non-domiciled individual who has been resident for tax purposes in the UK for at least 17 out of the last 20 tax years is deemed to be domiciled in the UK for inheritance tax purposes. This means that they will also pay UK inheritance tax on their worldwide assets.

Currently the first £325,000 of the property could be taxed at zero percent for a single person, depending on what other assets the individual has in the UK. Once this nil rate band has been used, UK inheritance tax of 40% could be payable on the remainder.

On a property worth £2m, once the nil rate band has been deducted, the balance of £1,675,000 could be subject to 40% tax, giving a liability of £670,000.

Looking to the future

The Government has announced that the 17/20 year rule that makes individuals deemed domicile is changing from 6 April 2017. From that date an individual will not only be deemed domicile for inheritance tax once they have been resident for at least 15 out of 20 tax years, but the deemed domicile rule is being extended to include income tax and capital gains tax.

In addition to this change it will no longer be possible for somebody who is born in the UK to parents who are UK domicile to claim non-domicile status if they leave and then return, to take up residency in the UK. Once they return they will be treated as being a UK domicile immediately.

In conclusion

These proposals, alongside the changes to inheritance tax, make the decision of how to buy a residential property a more difficult decision. Whilst some of the costs involved are broadly similar, the change to inheritance tax is potentially significant.

It was Lord Jenkins, the one-time Chancellor of the Exchequer, who said that "Inheritance Tax is, broadly speaking, a voluntary levy paid by those who distrust their heirs more than they dislike the Inland Revenue". This highlights the fact that whilst mitigating CGT, SDLT and the ATED may be difficult, with planning, the effects of inheritance tax on an estate can be reduced.

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