

**TAX MEMORANDUM**  
**NON-DOMS AND UK HOUSES**  
**PATRICK C SOARES**

**High value residential property and the three headed Cerberus: the new annual residential property tax, the new 28% charge to capital gains tax and SDLT at 15%**

**INTRODUCTION**

In a huge bundle of documents comprising the draft clauses and explanatory notes for the Finance Bill 2013 dated 13<sup>th</sup> December 2012 and a paper ( “the paper”) entitled “Ensuring the Fair Taxation of Residential Property Transactions: Summary of Responses HM Treasury” of December 2012, taxpayers are now getting a clearer idea of what the Annual Residential Property Tax (ARPT) ( some call it the “Mansion Tax”) will look like and also the new 28% charge to capital gains tax as well as the (to be) amended 15% charge to SDLT.

The new provisions are only concerned with interests worth more than £2m in single dwelling houses (cl.1(2) of the draft ARPT legislation, 11/11/12 (“ the draft”). These provisions have no relevance to commercial properties or dwellings not worth more than £2m

**THE ANNUAL RESIDENTIAL PROPERTY TAX ( THE ARPT)**

**Scope**

This new charge, which will come into force on Monday, 1<sup>st</sup> April 2013, will only apply to non-natural persons (“NNPs”).

NNPs comprise:

- companies,
- collective investment schemes and
- partnerships which have a company as a partner.

Thus settlements, whether onshore or offshore and whether or not they have corporate or personal trustees, will not be liable for the ARPT and nor will companies acting as nominees for the same and nor will a partnership of individuals or an individual and the settlement.

“Partnership” means UK partnerships created under PA 1890, LPA 1907 or the LLPA 2007 and “firms and entities of a similar character to any of” those 3 types of partnerships “formed under the law of a country or territory outside the United Kingdom.” See cl.56 (1) of the draft. If the partnership law creates a separate body-as in the case of a UK LLP- there is still a complete see-through (see cl. 56(2)).

## Example

A Mauritius partnership ( a similar result should come about if the new style Jersey LLP, which may be passed into law in January 2013, is used instead) results in the creation of a separate body corporate but the partners are a settlement and an individual. The Partnership owns an interest in a single dwelling interest in the UK worth over £2m. The structure does not fall within the ambit of the ARPT. These structures may have IHT advantages where businesses-property lettings-are being carried on. Note HMRC warn in para. 4.8 of the paper that they will monitor this area “in case of any manipulation.”

## Reliefs

If one is within the ambit of the ARPT there are to be reliefs available for:-

1. *a property development business*: dwellings held for the purpose of the property development trade of the company ( including developing commercial property from dwellings) and not occupied at any time by a connected person ( there is not to be a requirement that the trade must have a 2 year track record) (cls. 38-41 of the draft);
2. *a property rental business*: dwellings held for the purpose of letting to third parties for rent on a commercial basis and not occupied at any time by a connected person (cls 34 and 35 of the draft); a connected person would include a settlor of a settlement (or a spouse or relative of the settlor) which owns the company which lets out the property on commercial terms to the settlor etc.(cl. 34(5) of the draft); note it is not felt on a proper construction of cl. 35(2) of the draft that the relief is restricted to rents which fall only within the charge to corporation tax;
3. *a property trading business*: dwellings held for the purpose of a trade of buying and selling property and not occupied at any time by connected persons (cls. 42 and 43 of the draft);
4. *properties which are run as a business*: properties open to the public with access to the interior for at least 28 days per year on a commercial basis, as a venue, location or to provide accommodation or other services (cls. 36 and 37 of the draft);
5. *dwellings held to provide employee accommodation*: property held for the use of employees-with less than 5% interest in the company-of the non-natural person, for the company's commercial purposes (cls.44-46 of the draft);
6. *charities*: dwellings owned by a charity and held for charitable purposes, unless occupied by a substantial donor to the charity;
7. *farmhouses*: in situations where a working farmer occupies a farmhouse connected with the farmland for the purpose of farming the land (cl, 47 of the draft);
8. *diplomatic houses etc*: certain diplomatic, publicly owned properties, or property conditionally exempt from inheritance tax.

## Rates

The rates of the ARPT is as follows:-

<u>Taxable Value of Property</u>	<u>Annual Chargeable Amount</u>
£2m - £5m	£15,000
£5m - £10m	£35,000
£10m - £20m	£70,000
Greater than £20m	£140,000

Some consider these rates to be modest and taxpayers who own properties in other jurisdictions may be able to use to such charges.

The chargeable period for the imposition of the ARPT is from 1<sup>st</sup> April to 30<sup>th</sup> March of each year (rather than following the tax year). Where the ARPT is applicable to part only of the chargeable period, the chargeable amount will be apportioned accordingly.

The ARPT will be index linked (annually to the CPI) but the thresholds will remain constant in nominal terms. Residential properties will need to be valued every five years with the first valuation point being 1<sup>st</sup> April 2012 to see which level of charge applies.

## Example

A settlement based in Jersey owns Jersey Ltd which owns beneficially a property worth between £2m-£5m. The company will be liable for the ARPT of £15,000 per annum. If the property were owned by the settlement direct the ARPT will not apply; this however will have IHT disadvantages if the settlement would otherwise be an excluded property settlement within IHTA 1984 s48 (non-UK domiciled settlor with settlement holding non-UK located assets).

## **THE NEW CAPITAL GAINS TAX CHARGE**

### Scope and Reliefs

A new capital gains tax charge will apply with respect to disposals of residential property for more than £2m on or after 6<sup>th</sup> April 2013. It will not apply to indirect disposals such as sales of shares in companies which own high value residential property (para.4.22 of the paper). This charge will take precedence over any other CGT charges (such as under TCGA 1992 s10) which may otherwise apply. It dominates all.

Only non-resident NNPs holding high value residential property will come within the scope of the new capital gains tax charge provide they also fall within the ARPT and none of the ARPT reliefs mentioned above apply.

Thus if the non-resident NNP qualifies for any of the above mentioned reliefs-property development business etc- it will not be subject to the new capital gains tax charge.

### Consistency

The above ensures consistency between the two charges and also it is proposed to alter the stamp duty land tax provisions charging 15% to provide consistency between the three levies. In particular corporate trustees of a settlement will not be concerned with the 15% SDLT charge or the ARPT or the new charge to capital gains tax. Also an NNP which rents out property to third parties who are not connected persons will remain outside of these three regimes.

### Rate

The rate of the CGT charge will be 28% with tapering relief for gains where the property is worth just over £2m. The tapering relief will mean that CGT is imposed on either the actual gain or the amount of the disposal value that exceeds £2m multiplied by 5/3, whichever is the lower. Where the original acquisition value exceeds £2m, it is the actual gain that is lower and therefore the actual gain that is taxed. See the examples on page 30 Box 4.A of the paper.

### Rebasing

It is to be noted that as non-resident NNPs are not currently subject to capital gains tax the shock of the new charge is to be ameliorated so that only that part of the gain which has accrued on or after 6 April 2013 will be taxable. Re-basing is therefore available.

### More consistency

For consistency the government is considering extending the CGT charge to also apply to disposals of high value residential property by UK NNPs (which are currently subject to corporation tax (including on gains they realise on residential property) at a lower rate). This would mean that all NNPs-both UK and non-resident-within the scope of ARPT would be subject to CGT at 28%. See para. 4.10 of the paper.

### **Stamp Duty Land Tax**

It should be noted that the 15% SDLT charge will be amended to include a series of reliefs to mirror those in the ARPT legislation. This will come into effect from Royal Assent of the Finance Bill 2013. Thus when these rules come into effect if a company purchases residential property and any of the above relief are applicable (property development business etc.), as well as the ARPT not being applicable the 15% SDLT charge will also not be applicable. Only the 7% rate will apply.

The payment of 7% will be conditional on the appropriate relief applying for 3 years following the purchase of the property and the property not being occupied by a non-qualifying person in that time. However, as mentioned the amendments will be effective from the date of Royal Assent of

the Finance Bill 2013 which is expected to be in June/July 2013 so there will remain a period of time during which the existing SDLT rules will continue to apply.

## **CONCLUSIONS**

### *Overseas Settlements are Safe*

With the alignment of the three levies, this will mean none of the 3 charges (the ARPT, the new CGT charge and the 15% SDLT charge) will apply to an overseas settlement which buys, owns or sells high value residential property. This is welcome news. However, the inheritance tax position will have to be considered by taxpayers. They will have to see whether it is possible to create charges against the property (which do not offend FA 1986 s103) in order to avoid 10 year anniversary charges (IHTA 1984 s64) or charges under the reservation of benefit provisions which can apply when say the settlor dies ( FA 1986 s102).

### *Using overseas Corporate Partnerships*

In appropriate cases overseas partnerships may be used to overcome the IHT problems.

### *Dismantling present Structures to avoid the ARPT*

If taxpayers need to liquidate offshore companies owned by settlements to avoid the ARPT for the future, they may need to wash gains under the matching rules in TCGA 1992 s87A by making offshore distributions from the settlements now so the gains cannot be carried back to earlier years where UK resident beneficiaries have lived in the accommodation and so received “capital payments” (TCGA 1992 s87(2)).

### *Direct ownership: the simple route*

If one avoids ownership of the dwelling by an NNP these provisions are not relevant. Thus an individual can own the dwelling and these provisions will have no relevance. An appropriate borrowing may need to be taken for IHT purposes.

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