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The taxation of residential property in the UK

residential property

The taxation of residential property in the UK has changed almost beyond recognition over the past few years. What were once tried and tested structures are in most cases no longer suitable.

The tax consequences in any given situation now depend not only on the type of structure used but also the manner in which the property will be used.

A comparison of some of the main tax considerations for two popular structures for investment into UK residential property by non-UK resident individuals (personal ownership and ownership by an offshore company) is set out below.

In general terms a company still has many attractions if the property will be let out commercially (reduced Income Tax and Capital Gains Tax on a sale and no Annual Tax on Enveloped Dwellings (**ATED**)).

By contrast personal ownership is generally preferable if the beneficial owner (or their family) intend to occupy (as in that case owning via a company would incur an annual ATED liability together with a greater exposure to Income Tax and Capital Gains Tax). If the owners are concerned about the confidentiality implications of holding properties in their personal name (as details of property ownership is publically accessible) then it is possible to use a nominee entity to conceal ownership but still benefit from the tax profile of personal ownership.

In the Autumn Statement in December 2015, the Chancellor announced an increase of 3% in the rates of SDLT payable on the purchase of additional residential properties, including second homes and buy to let properties. The increase is to take effect on 1 April 2016. The Government published its consultation paper on the changes on 28 December 2015 but final details of the new rules are not expected before mid-March 2016.

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Tax consequences for a non-UK resident of using an offshore company to purchase a residential property costing more than £500,000

1 Stamp Duty Land Tax (**SDLT**) of 15% of the purchase price is payable when the purchase price exceeds £500,000. It has not yet been confirmed whether the 3% increase announced in the Autumn Statement will apply and increase the rate to 18%. However it is thought unlikely.

2 Payment each year of ATED (see Table 2 below). Currently, only properties valued at more than £1 million on 1 April 2012 (or at acquisition if later) are within the scope of ATED. However from 6 April 2016 properties valued at more than £500,000 at those dates will also be subject to the annual ATED charge.

3 Liability for ATED-related Capital Gains Tax (**ATED-related CGT**) of 28% on any gain when the property is sold. If a property is subject to the ATED it is also within the scope of ATED-related CGT (it therefore currently affects only properties valued at over £1 million on 1 April 2012, or at acquisition if later, but from 1 April 2016 the charge will be extended to apply to properties valued at more than £500,000 on those dates and will then apply to any growth in value of that property from 1 April 2016 onwards).

4 However, if you intend to let the property on commercial terms to someone not connected to you then:

4.1 the company will pay SDLT at the rate applicable for individuals (see Table 1) and these rates will be subject from 1 April 2016 to the 3% increase in SDLT announced in the Autumn Statement (even if this is the purchase of a first UK residential property by the company);

4.2 the company will not pay ATED;

4.3 the company will not pay ATED-related CGT;

4.4 but the company will pay Non-Resident Capital Gains Tax (**NRCGT**) at 20% of any gain on disposal;

4.5 the company will not be subject to the new restriction disallowing individuals from setting off interest payments against rental income (see below);

4.6 the company will pay Income Tax on any rental income (after deductible expenses e.g. interest) at the rate of 20%.

5 However, the reduced rate of SDLT on purchase (see 4.1) would be clawed back if you ceased to rent out the property within a period of three years from the date of purchase. Also, if you ceased to rent the property the company would be liable to ATED for a corresponding period of ownership and part of the profit on sale would be taxed at the higher ATED-CGT rate (28% instead of 20%).

6 The Government announced in the recent Budget that from 6 April 2017 UK residential property held in companies will be subject to Inheritance Tax (**IHT**). How this will be implemented and at what rate remains to be seen as we are in the consultation phase.

Tax consequences for a non-UK resident individual purchasing a UK residential property in their personal name

1 SDLT is payable on the purchase price at the rates shown in Table 1 and these rates will be subject from 1 April 2016 to the 3% increase in SDLT announced in the Autumn Statement if the property being purchased is an additional residential property, such as a second home or a buy to let property. A property is an additional residential property if the buyer or one of joint buyers owns another residential property anywhere in the world, unless the property being purchased is being bought as a replacement for his or her main residence. Married couples, civil partners and joint purchasers are treated as a single unit. If one of them owns another residential property but not the other, the purchase is treated as the purchase of an additional residential property by both. If a person owns a buy to let property then buys a main residence, the higher rates will apply as the purchase is not a "replacement" of a main residence. The increased rates will apply to purchases completed on or after 1 April 2016 unless exchange took place before 26 November 2015.

2 No ATED or ATED-related CGT is payable.

3 Non-Resident Capital Gains Tax (**NRCGT**)

3.1 NRCGT is payable at rates of between 18% and 28% (depending on total UK income and gains) on gains realised on a disposal of the property.

3.2 Relief from NRCGT can be obtained if the property is your principal private residence and you or your spouse have stayed overnight at the property on at least 90 occasions in each tax year since purchasing the property or have been UK resident in those tax years. If you have not spent sufficient days at the property in a particular year or years or been resident, the relief would be apportioned.

4 Income Tax

4.1 If you let the property you will pay Income Tax on the rental income. Currently an owner can set interest paid under a loan charged on the property against the rental income in calculating the Income Tax due. From 6 April 2017, phased in over a three year period landlords will be obliged to calculate profit without deducting interest payments. This disallowance of interest only applies to individuals owning rented property, not to companies.

4.2 It will be phased in over the next few years so that only 75% of interest will be deductible in tax year 2017/18, 50% in tax year 2018/19, 25% in tax year 2019/20 and 0% in 2020/21.

4.3 Instead tax will be worked out on the rental profit disregarding the interest cost but an amount equal to 20% (the same as the rate of basic rate tax) of the interest paid would then be deductible from the tax due (this new system will be gradually phased in as the old system is phased out). The effect will broadly be that those who pay Income Tax at the 40% or 45% rate will pay more tax. See Example 5 below.

4.4 The Income Tax rates applying to rental income are set out in Table 3.

4.5 The nationals of countries in the European Economic Area and the nationals/residents of certain other jurisdictions are entitled to receive a certain amount of taxable income before they are obliged to start paying UK tax. This is known as a personal allowance and is set at £10,600 for the tax year 2015/16 (and should increase slightly in future years). However, the residents/nationals of many other countries are not able to benefit from a personal allowance.

4.6 Currently, landlords of furnished residential properties can deduct 10% of their rent from their profit to account for "wear and tear" to the furniture, irrespective of whether any expenditure is actually incurred. In the July 2015 Budget, the Government announced that it will replace the 10% allowance with a new relief that allows all residential landlords to deduct only the actual costs of replacing furnishings and it is expected this will apply from April 2016.

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Tax consequences for a non-UK resident individual purchasing a UK residential property in their personal name (cont)

5 Inheritance Tax (**IHT**) will be payable on an individual's property in the UK at death at the rate of 40% of the total net value of the property over the nil rate band of £325,000. A loan secured on a UK property is deductible from the value of the property in calculating IHT provided (1) the loan is not used by a non-resident individual to buy property abroad or certain other assets not within IHT and (2) the loan is repaid on death unless there is a good commercial reason for not doing so. There may be other ways to mitigate IHT e.g. assets that pass to a spouse on death are generally exempt from IHT and it is often possible to take out life insurance to cover the cost of the IHT.

Case studies

Example 1 Purchase of a flat costing £1,050,000 by a company for private use:

- Alexander is a Russian national and not resident in the UK. He decides to purchase a flat at 6 Castle Lane, London SW1 for £1,050,000 in the name of a Jersey company, Alexander Holdings Ltd. Alexander intends to use the flat to stay in on his visits to London.
- Alexander Holdings Ltd will pay:
  - SDLT of £157,500 on the purchase of the flat;
  - ATED of £7,000 per year. The company will be liable for a proportion calculated on a daily basis if it completes its purchase part way through the ATED year;
  - ATED-related CGT will be due on any gain, so if Alexander Holdings Ltd sells the flat for £1,200,000, it will pay ATED-related CGT at 28% of the gain: e.g. £150,000 x 28% = £42,000.

Example 2 Purchase of a flat costing £1,050,000 by a company for renting out:

- Alexander decides to purchase the flat in the name of Alexander Holdings Ltd but intends to rent it out for £31,500 p.a. He buys the flat with a loan from a bank.
- Alexander Holdings Ltd will pay:
  - SDLT of £48,750 which, depending upon the outcome of the consultation, may increase to £76,500 after 1 April 2016;
  - no ATED;
  - no ATED-related CGT;
  - but will pay NRCGT on any disposal at 20% of the gain, so if it sells for £1,200,000 it will pay £30,000 NRCGT, e.g. £150,000 x 20% (the gain would be slightly less as companies can make a deduction for inflation or so-called "indexation" for the purposes of NRCGT);
  - Income Tax on rental income at the rate 20% but it will be allowed to set all interest incurred on the bank loan against rental income and will not be subject to the phased in reduction as individuals will be;
  - potentially, IHT liability – details not yet known.

Example 3 Purchase of a flat costing £1,050,000 by an individual for his or her own private use:

- Alexander decides to buy the flat in his own name and not to rent it out. He buys it with an interest only bank loan of £50,000.

Case studies (cont)

He will pay:

- SDLT of £48,750 which, depending upon the outcome of the consultation, may increase to £76,500 after 1 April 2016 if Alexander owns residential property anywhere in the world, unless the flat is replacing his existing main residence ;
- no ATED;
- no ATED-related CGT;
- but he will pay NRCGT on any disposal at rates of up to 28% of the gain (after deduction of his "annual allowance"; this is a tax free sum which is £11,100 for the tax year 2015/16). If Alexander can claim the flat as his principal private residence (**PPR**), he can claim PPR relief and avoid paying NRCGT;
- if he dies whilst owning the flat, IHT at 40% of the net value of the flat at the date of death. The outstanding bank loan will potentially be deducted from the value of the flat at the date of death. If the flat is worth £2,000,000 at the date of death, the IHT due would be:

  (Value of property – outstanding bank loan)
  less nil rate allowance of £325,000 x 40%

  = (£2,000,000 – £50,000) – £325,000 x 40% = £650,000

N.B. There are reliefs from IHT in certain circumstances. There is usually a complete exemption if an asset is inherited by a spouse and the nil rate allowance is increased in certain circumstances (e.g. it is proposed that there will be an increased allowance for main residences).

Example 4: Purchase of a flat by an individual in the name of a company acting as nominee

- Alexander decides to buy the flat in the name of Alexander Holdings Ltd which holds the flat as bare trustee or nominee for Alexander pursuant to a declaration of trust. The tax position is identical to a purchase in his individual name (and the tax treatment will, depending how the property is used, be the same as either Example 3 above or Example 5 below). HMRC ignores the company and taxes the individual.

Example 5: Purchase of a flat costing £1,050,000 by an individual for renting out

- Alexander decides to buy the flat in his personal name with the aid of a £500,000 bank loan and to rent it out. He will pay:
  - SDLT of £48,750 which, depending upon the outcome of the consultation, may increase to £76,500 after 1 April 2016;
  - no ATED;
  - no ATED-related CGT;
  - but he will pay NRCGT on any disposal at rates of up to 28% of the gain (after deduction of his "annual allowance"; this is a tax free sum which is £11,100 for the tax year 2015/16);
  - Income Tax on rental income at rates of up to 45% depending on the level of profit. He is currently entitled to set off interest payable on the bank loan in calculating the profit but from 2017 this will be phased out over a number of years and by the tax year 2020/21 the

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Case studies (cont)

profit will be calculated as if there had been no interest paid and tax would be calculated on that sum (but he will then be able to claim a deduction from the tax due on an amount equivalent to 20% of the interest);

- IHT. If Alexander dies whilst still owning the flat, his estate will potentially be entitled to deduct the bank loan and the nil rate allowance (currently £325,000) against the value of the flat at his death. IHT of 40% will be payable on the balance.

N.B. There are reliefs from IHT in certain circumstances. There is usually a complete exemption if an asset is inherited by a spouse and the nil rate allowance is increased in certain circumstances.

Table 1 - SDLT payable by individuals

Purchase price	***Rate % charged as part of purchase price within each band pre 1 April 2016***	***Rate % charged as part of purchase price within each band 1 April 2016 onwards***
£0 - £125,000	0	3 (except for properties costing less than £40,000 on which the rate is 0%)
£125,001 - £250,000	2	5
£250,001 - £925,000	5	8
£925,001 - £1,500,000	10	13
> £1,500,000	12	15

Table 2 - ATED bands

Property value	***ATED charge 1 April 2015 – 31 March 2016***
£500,000 - £1,000,000	£0 (£3,500 from 1 April 2016)
£1,000,000 - £2,000,000	£7,000
£2,000,000 - £5,000,000	£23,350
£5,000,000 - £10,000,00	£54,450
£10,000,000 - £20,000,000	£109,050
> £20,000,000	£218,200

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Table 3 - Rates of Income Tax

Income Tax rates in the tax year 2015/16	
Tax rate	***Taxable income above your Personal Allowance***
Basic rate 20%	Payable on the slice of UK taxable income between £0 and £31,785. People with the standard Personal Allowance start paying tax on income over £10,600.
Higher rate 40%	Payable on the slice of UK income between £31,786 and £150,000. People with the standard Personal Allowance start paying this rate on income over £42,385.
Additional rate 45%	Payable on any slice of UK income in excess of £150,000.
For example if you had £38,000 of taxable income and you were eligible for the standard Personal Allowance of £10,600 (perhaps because you were an EEA national) then you would pay basic rate tax at 20% on £27,400 (£38,000 minus £10,600). If you did not have a Personal Allowance for UK tax purposes (residents/nationals of some countries such as the USA are not entitled to one) you would pay tax on 20% of £31,785 and then 40% of £6,215.	

Table 4 - Summary of UK tax charges

UK residential property tax regime as at January 2016		
	Direct ownership of property by non-resident individual	***Non-UK resident company (where shares in company owned by non-resident individual)***
SDLT	Up to 12%. To be to be increased by 3% from 1 April 2016 on purchases of additional residential properties.	15% on properties over £500,000.
ATED	No.	Potentially up to £218,200.
IHT	40% subject to exemptions and reliefs.	None until 6 April 2017.
NRCGT	Up to 28%. (PPR relief potentially available if main residence.)	20%. (ATED-related CGT applies instead if the property does not qualify for an ATED exemption, such as if it is let out commercially to a third party)
ATED-related CGT	No.	28%.
Income Tax on rental income	Up to 45%.	20%