

# Ensuring the Fair Taxation of UK Residential Property

30 December 2012

## INTRODUCTION

In the 2012 Budget, the government announced the intention to address concerns that some taxpayers are not “paying their fair share” in relation to UK residential property. The main purpose of the proposed measures is to discourage holding UK residential property in a variety of UK and non-UK structures. The government describes holding properties in such structures as “enveloping”. There are three main proposals, as follows:

- the introduction of a 15% rate of Stamp Duty Land Tax (SDLT) on acquisitions of residential dwellings costing more than £2million by certain non-natural persons from 21 March 2012;
- the introduction of an annual charge on residential property valued at more than £2million owned by non-natural persons from 1 April 2013;
- the extension of capital gains tax (CGT) to gains on the disposal of residential property for more than £2million by non-resident companies and similar structures (but not individuals) from 6 April 2013.

Whilst the first measure came into immediate affect on Budget day, details of the other two changes were released in a consultation document on 31 May 2012.

## 15% ENVELOPING CHARGE

The new 15% SDLT “enveloping” charge applies where an interest in a single residential dwelling costing more than £2million is acquired by certain non-natural persons on or after 21 March 2012. The definition of non-natural persons for these purposes includes companies, partnerships with at least one corporate partner, and collective investment vehicles. The definition does not include corporate trustees of a settlement or where a company acts only as a nominee owner.

The government has included a limited exclusion for property developers where the acquisition of high value property is made by a non-natural person in the course of a property development business, for the sole purpose of developing and reselling the land. However, to qualify, the property development business must have been carried on for at least two years before the acquisition, which could result in a significant barrier to new entrants to the property development market.

There is an extension of the property development relief for companies which are part of a “property development group” which suggests that newly incorporated Special Purpose Vehicles may still be an option for existing property developers. However, specialist advice should be taken to ensure that the new 15% charge does not apply whenever a non-natural person is making a new acquisition.

## THE ANNUAL CHARGE

The second measure, which is the subject of consultation, is the introduction of an annual charge on high value residential property held by a non-natural person (which is defined in the same way as for the 15% enveloping charge).

There is an exemption from the annual charge for property development businesses which hold residential property worth more than £2million. The exemption has similar requirements to the exclusion from the 15% enveloping charge.

An initial valuation of the property will be required based on the value of the property interest on 1 April 2012 or (if later) when property is first acquired. This valuation will apply for five tax years; for properties owned on 1 April 2012 the valuation will apply for 2013/14 through to 2017/18. A revaluation will be required at 1 April 2017 which will apply for five tax years from 2018/19 onwards.

The proposed rates of annual charge are as follows:

Property value	Annual charge on 2012/13
£2m - £5m	£15,000
£5m - £10m	£35,000
£10m - £20m	£70,000
£20m +	£140,000

The annual charge will be increased each April based on the previous September’s Consumer Price Index. However, the thresholds at which each rate is paid will not be increased, creating a fiscal drag which will draw more properties into the scope of the annual charge (based on an assumption that property prices will increase).

The non-natural property owner will be required to file an annual charge return by 15 April each year. This is likely to be extended until 1 October 2013 for the first year as a result of the legislation not being introduced until Finance Bill 2013.

## **EXTENSION OF CGT TO NON-RESIDENTS**

It is proposed that tax on capital gains will be levied on the disposal of UK residential property sold by certain non-natural persons which are not resident in the UK where the sale proceeds are greater than £2million.

The definition of non-natural person is broader than for the purposes of the enveloping charge and the annual charge. The definition for CGT purposes includes companies and other similar structures, trustees, personal representatives, collective investment vehicles, clubs and associations, and entities which exist in other jurisdictions that allow property to be held indirectly (e.g. foundations).

The extension of the CGT regime will also apply to gains which accrue on the disposal of assets which directly or indirectly represent relevant UK residential property, including shares in companies where more than 50% of the value of the underlying asset is derived from UK residential property.

Principal private residence (PPR) relief will not generally be available unless it is available under the existing regime e.g. for property held by trustees which is occupied by a beneficiary as their PPR.

The rate of tax which will apply to gains caught by the new rules will be announced in Budget 2013.

One of the most important points to note is that it is the entire gain realised on transactions caught by the new rules, calculated with reference to the historic cost of the residential property. There are no provisions to rebase residential property assets to their value on 5 April 2013. In some cases the base cost could be significantly lower than the price paid on acquisition of the envelope.

Any losses incurred on the disposal of high value residential UK property by non-resident non-natural persons will be available for offset against gains on the disposal of UK residential property in the same or future years.

## **CONCLUSIONS**

It is clear that the 15% SDLT charge is likely to sufficiently discourage future enveloping of UK residential property. However, the question of whether to de-envelope property already held through a structure requires careful consideration.

The closing date for the consultation is 23 August 2012 and draft legislation (for inclusion in Finance Bill 2013) with respect to the annual charge and extension of CGT will be published in the autumn.

There is likely to be a relatively short window of opportunity in which to make changes to existing structures to mitigate the effects of the new rules.

The following decisions will need to be made by those affected:

1. Will the annual charge be payable and, if so, can de-enveloping be achieved without triggering significant tax charges (e.g. inheritance tax, capital gains tax and SDLT) before 1 April 2013?
2. Can the base cost of UK residential property held through a non-resident structure be uplifted to current market value in order to protect the historic gain on the property from a future capital gains tax charge?
3. How will future exposure to IHT be impacted by any restructuring?

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