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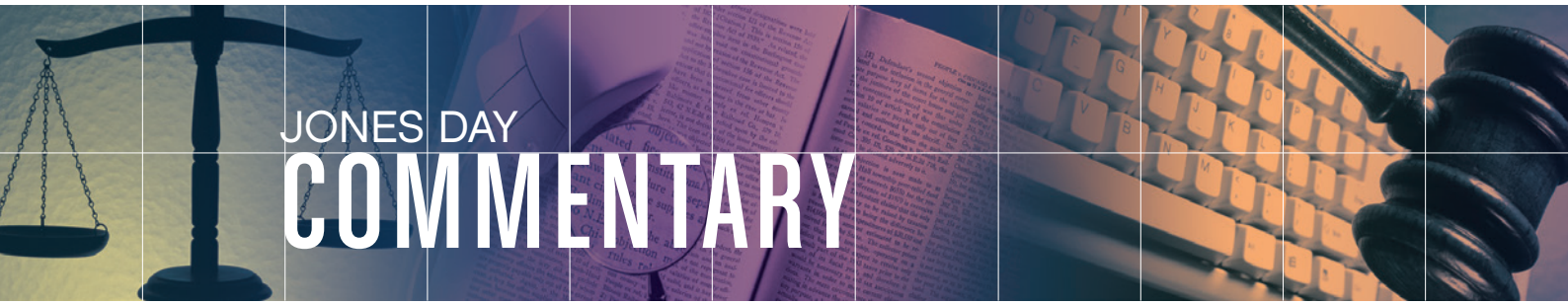

CHANGES TO THE UK TAXATION OF HIGH VALUE RESIDENTIAL PROPERTIES

In March 2012, the UK government announced that it would be introducing a series of measures designed to counter perceived widespread avoidance of UK stamp duty land tax ("SDLT") using offshore corporate vehicles. The measures would include:

a) A new SDLT rate of 15 percent for purchases of high-value residential UK real estate by "non-natural persons" (the "acquisition charge");

b) An annual charge on high-value residential UK real estate held by non-natural persons (the "annual charge");

c) A charge to capital gains tax on the disposal of an interest in a non-natural person holding high-value residential UK real estate (the "CGT charge").

The legislation implementing the acquisition charge was included in Finance Act 2012 and has had effect since 21 March 2012. Draft legislation to implement the annual charge was published shortly after the Chancellor's autumn statement in December 2012. The legislation will have effect from 1 April 2013. The draft legislation implementing the CGT charge was published on 31 January 2013 and will have effect from 6 April 2013.

The purpose of this *Commentary* is to provide a brief overview of the legislation relating to the acquisition charge and the annual charge and to give an overview of measures that might be taken to lessen the impact of these measures on non-UK owners of UK real estate.

SUMMARY OF THE LEGISLATION

Property To Which the New Rules Apply. The new rules apply only to residential property in the UK. Commercial property is wholly outside these measures and can continue to be owned through offshore special purpose vehicles.

For these purposes, "residential property" is defined as a dwelling, that is to say a building, or part of a building, if it used as a dwelling, or a building or part of a building that is being adapted or converted for such use.

Persons Who Are Liable for the Tax. Both the acquisition charge and the annual charge will apply only where the property is held by a company, by a partnership that has one or more corporate partners, or by a collective investment scheme. The "collective investment scheme" definition will catch entities such as unit trusts, but it is complicated, and specific advice should be sought on whether any particular entity falls within the definition.

The CGT charge will apply to any person (other than an individual) who is, or has at any time in his period of ownership been, within the annual charge. By defining persons in this way, the legislation intentionally catches properties held within UK corporate structures. This is most likely to avoid a challenge under EU law. However, this may have some unintended adverse consequences for properties held through UK special purpose vehicles, in particular because reliefs from the annual charge are assessed on a daily basis, but a single day of unrelieved ownership will result in the whole of a capital gain being subject to the CGT charge.

The Value Condition. The legislation will apply to single dwellings having a value in excess of £2 million. In the case of the acquisition charge, whether the dwelling has a value of £2 million is tested by reference to the consideration paid for the interest (including any consideration in nonmonetary form that would count as consideration in determining the amount of SDLT payable on the acquisition).

In the case of the annual charge, the provisions are more complicated. To determine whether an interest is within the charge (i.e., exceeds £2 million) and, if so, the amount of tax charged (as to which, see below), the legislation provides for a series of valuation dates. Where the property was held within the relevant entity at 1 April 2012, the first valuation date will be 1 April 2012. Thereafter, each fifth anniversary of the preceding valuation will also be a valuation date. If the interest is acquired after 1 April 2012, the first valuation date will be the date of acquisition. The second valuation date will be 1 April 2017, and subsequent valuation dates will fall at five-year intervals thereafter.

The value of a property for the annual charge will be its open market value. Like most UK taxes, the annual charge is a self-assessed tax, and therefore it will be for the relevant taxpayer to assess the market value of a property. However, HM Revenue & Customs can (and no doubt will) enquire into returns and can object to the value placed on the property by the taxpayer if it thinks it too low.

The Amount of Tax Charged. The amount of tax charged in respect of the annual charge depends on the value of property on the preceding valuation date.

Value of Property	Amount of Tax Payable
More than £2 million but not more than £5 million	£15,000
More than £5 million but not more than £10 million	£35,000
More than £10 million but not more than £20 million	£70,000
More than £20 million	£140,000

The amount of tax chargeable will be increased in line with inflation.

The CGT charge will be levied at 28 percent of the gain on disposals where the consideration exceeds the £2 million threshold. However, in order to avoid disposals just above the threshold being subject to tax at a very high marginal rate, the legislation provides for a form of tapering relief for properties disposed of for an amount close to the £2 million threshold.

Common Reliefs. Perhaps the most important relief from the legislation is that real estate used for a property-letting business is not within the annual charge. However, the definition of what constitutes a property rental business is quite complicated; for example, if the son of the majority owner of a special purpose vehicle occupied the property (even if he paid a commercial rent), the property would not be considered to be used for the purposes of a property-letting business. The other significant relief relates to real estate held by property developers. Again, there are significant limitations on that relief that will have to be reviewed on a case-by-case basis.

COMMENTARY

Until the enactment of Finance Act 2012, non-resident individuals and trustees would have been invariably advised to hold UK real estate through SPVs. Although the possibility of SDLT savings on a sale of the SPV would no doubt have been considered, this structure also avoided the possibility of UK inheritance being charged on the death of an individual. Following Finance Act 2012, this kind of structure, while still potentially open to nonresident individuals and trustees, would become very expensive.

Where a property is already held within a structure that would attract the annual charge (and would therefore attract the CGT charge as well), owners would be well advised to review the structure and see whether it can be unwound at an acceptable cost. The level of the annual charge, together with the fact that UK capital gains tax will be charged at 28 percent on any gain accruing after 2013, means that reorganisation of the structure would be the preferred way forward, barring unforeseen costs. It will be necessary to consider the UK inheritance tax consequences of the proposed reorganisation and certain other commercial matters: for example, the effect of the reorganisation on any financing taken out for the acquisition of the structure.

LAWYER CONTACTS

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