JONES DAY

COMMENTARY

DECEMBER 2017

Proposed UK Real Estate Tax Regime Targets Offshore Investors' Capital Gains

IN SHORT

The Situation: Historically, the United Kingdom has not taxed capital gains on real estate disposals when the seller was not a UK resident.

The Development: Coming into line with most of the world's jurisdictions, the UK government has announced broad plans, which are still in final development, to levy taxes on real estate sales by non-UK residents.

Looking Ahead: While the plans are subject to consultation through mid-February 2018, it is highly likely that a version of the current proposal will be implemented in 2019.

In its most recent budget, delivered on 22 November 2017, the UK government has announced wide-ranging plans to subject gains on the disposal of UK real estate (or shares in land-rich companies) to UK tax. This measure would take effect in 2019, and the following *Commentary* sets out in broad outline the government proposals. While the measures are subject to consultation (with the deadline for responses being 16 February 2018), the government has indicated that it is not consulting on whether the measure should be implemented. It is therefore very likely that some version of the proposals outlined below will be implemented.

The Position Until Now

Historically, the United Kingdom did not seek to tax capital gains realised on the disposal of UK real estate held as an investment where the taxpayer concerned was not resident in the United Kingdom. (In contrast, the United Kingdom did tax profits on the disposal of real estate held as a trading asset.) Over time, various measures gradually restricted this general exemption. In particular, due to concerns about the overheating UK (and London specifically) residential market, measures were introduced to tax gains on the sale of residential (but not commercial) real estate. These measures focused first on high-value residential real estate and then on the residential market generally.

It is likely that if the new measures pass, most taxpayers will restructure their real estate holding structures to fall within the corporation tax regime.

The 22/11/2017 Announcements

The UK government has announced that it now plans to introduce measures that will subject gains on the disposal of UK real estate to UK tax regardless of where the seller is resident. This brings the United Kingdom into line with the majority of jurisdictions. A consultation is being undertaken to determine the final detail of the measures but the following broad outline is available:

- Direct disposals of UK real estate will be subject to tax at UK corporation tax rates (currently 19 percent but due to reduce going forward). While some disposals may be subject to UK income tax rates, which are higher, it is likely that if the new measures pass, most taxpayers will restructure their real estate holding structure to fall within the corporation tax regime.

- The United Kingdom will also tax non-residents when they dispose of interests in land-rich companies.

- The stated aim of the policy behind the new rules is to subject all investors to UK tax, and it looks likely that exemptions will be limited.

- Non-UK investors in funds and certain UK structures are likely to be caught as well.

Further details of the measures are set out below.

Direct Disposals of UK Real Estate

With effect from April 2019, a gain realised on the sale of UK real estate will be subject to UK tax at the corporation rates (currently 19 percent but reducing to 17 percent in 2020) for corporate holders and 20 percent for individuals and certain collective holding structures. In general, no treaty protection is available for direct disposals of UK real estate. It is proposed that losses suffered on UK real estate disposals will be allowable against gains, and that the UK group regime, which allows companies to elect for gains and losses to be treated as arising to different members of the group, will be extended to apply to non-resident groups.

Indirect Disposals of UK Real Estate

A gain realised on the disposal of shares in a UK land-rich company may also be taxed under the new rules. Two conditions need to be met for a gain to be taxable:

- The company must be land rich. The UK proposes that a company whose value derives 75 percent or more from UK real estate will be treated as land rich for these purposes. The calculation will be based on gross asset values at the time of the disposal. Where the company disposed of is the holding company of a group, the UK land interests of all group members will be aggregated to determine whether the land-rich test is met.

- The seller must hold (or have held in the last five years) a 25 percent or more interest in the relevant company. Interests held by connected parties will be aggregated. In addition, where a number of investors act together (without being connected) in relation to an entity, they will be treated as connected.

Certain of the United Kingdom's tax treaties would prevent an indirect charge. However, benefits under those treaties will generally not be available where the principal purpose of the corporate structure concerned is to take advantage of the treaty.

Rebasing

Only gains attributable to increases in value of real estate after 1 April 2019 will be caught. Asset values will, for tax purposes, be rebased to the fair market value of the asset on 1 April 2019 for corporates and 6 April for others. Shares in land-rich companies and other indirect interests will also be rebased to those dates.

Collective Investment Vehicles

In general, CIVs will be treated as any other taxpayer for the purposes of the new rules. For example, shares in a UK REIT held by non-residents could be subject to a charge under the indirect disposal rules, although in practice this is unlikely to be an issue for widely traded REITs.

THREE KEY TAKEAWAYS

1. Starting in April 2019, gains on the sale of UK real estate will be subject to UK tax at the prevailing corporation rates for corporate holders, and 20 percent for individuals and certain collective holding structures.
2. The United Kingdom also plans to tax non-residents when they dispose of interests in land-rich companies.
3. Although the tax measures are subject to consultation, the government has indicated that it is not consulting on whether the measures should be implemented.

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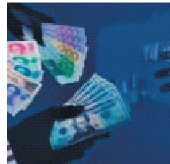

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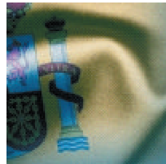

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