TaylorWessing

Investing in UK commercial property?

The UK tax regime and its application to offshore investors

The UK real estate market remains very attractive to non-UK resident investors, not only due to its consistent financial performance, but also because of moderate levels of taxation compared to many jurisdictions, together with a steady demand for the introduction of foreign capital.

However, the taxation regime is ever evolving and investors should be aware of recent changes which impact the taxation of offshore investors.

In this note we explain some of the key issues and opportunities of which you should be aware.

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World Tax

Being alive to the opportunities

Capital gains

Since April 2019 capital gains tax has applied to non-residents investing directly or indirectly in non-residential property, but with a 're-basing' to April 2019 market values to protect gains accruing before that date from tax. Capital gains tax rates for non-resident persons other than companies are 18% (for basic rate taxpayers) and 24% (for higher or additional rate taxpayers). Non-resident companies are subject to corporation tax on relevant gains at 25%. UK resident investors are also subject to tax on capital gains arising on disposal.

It is important to establish and document a clear intention from the time of acquisition of the property that the property is to be held for the medium to long term so as to support the investment nature of the venture.

We will help to ensure that the UK tax treatment of the acquisition, holding and any eventual disposal of the property is considered and properly addressed from the outset.

Tax on rent

A non-UK resident investor which is a company and which holds UK property as an investment is liable to pay corporation tax on rental profits during its period of ownership. As noted above, the current rate of corporation tax is 25%.

UK rental payments to a non-UK landlord are required to be paid under deduction of tax (at the rate of 20%) unless permission to pay gross has been granted under the Non-Resident Landlord Scheme.

Subject to certain restrictions, deductions are generally available in computing rental profits for expenditure incurred for the purposes of the property investment, in particular finance costs. 'Transfer pricing' rules limit such deductions to costs that are consistent with arm's length borrowing arrangements.

There remains scope, however, to reduce rental profits considerably via careful acquisition structuring, including the use of appropriate levels of shareholder financing.

Note that the corporate interest restriction now applies to non-UK resident companies within the charge to corporation tax. These rules limit tax relief for interest to 30% of the company's (or the company's group's) UK EBITDA, subject to a group ratio rule if this is more favourable for the group. The restriction on tax relief for interest will not apply where net UK interest expense is £2 million or less.

We will work with you to ensure that your structure is established in the most tax efficient way possible

Repatriating profits

It may be possible to structure the investment into UK property in such a way as to enable profits to be returned to investors on an exit without significant UK tax leakage. Typical routes include payment of dividends (or other distributions on a winding up of an investment vehicle) or repayment of shareholder debt (with accrued interest). Profits may be eligible to be repatriated without any withholding tax or other UK tax leakage (depending on the jurisdictions involved).

Stamp duty land tax (SDLT)

The UK charges a transfer tax on the purchase of all types of UK property (SDLT). For commercial or mixed use property purchases, SDLT is applied on a sliding scale depending on the price paid, with different rates applicable to portions of the overall price. No SDLT is paid on the first £150,000 of the price, with 2% applicable on the price between £150,000 and £250,000 and the rate of 5% applicable in respect of the price over £250,000.

However, no SDLT generally arises when a buyer acquires shares in a company that itself holds UK property. Further, if the company is incorporated outside the UK a purchase of such shares does not generally give rise to any charge to UK stamp duty or stamp duty reserve tax. As a result, there is a transfer tax benefit in acquiring and disposing of UK property via a company and, particularly, where that company is incorporated in a jurisdiction that does not impose any transfer tax on dealings in shares.

We can liaise with your local tax advisers and recommend the best structure for you and negotiate with the seller to achieve the best outcome. Types of vehicle that can offer efficiency include companies and non-UK resident (typically Jersey) unit trusts. Types of structure that can also offer transfer tax savings include 'forward sale/ purchase' arrangements where the land purchase is independent of any cost of construction of a property (particularly of interest to developers).

Value added tax (VAT)

The UK charges sales tax (VAT) on certain dealings in property. With certain exceptions sales of commercial property will generally be exempt from VAT. However, commercial property owners have the ability to 'opt to tax' their property, which causes the sale and letting of that property to be subject to VAT (current rate 20%). Broadly, if a buyer is required to pay VAT to a seller on the purchase of property, the buyer will be able to claim credit for such VAT from the UK tax authorities (the buyer will generally also opt to tax the property) on making taxable supplies of the property, such as letting. The buyer does, however, have to pay SDLT (see above) on the full amount of the purchase price for the property including the VAT.

It is, therefore, important to structure a property purchase carefully to ensure that, wherever possible, no VAT is charged in addition to the purchase price by a seller. This is generally possible where a let commercial property is acquired, under the so-called 'transfer of a going concern' (TOGC) rules. Due diligence will be required to determine the likely VAT treatment of a property purchase, and specific drafting for the sale contract is necessary to ensure that no VAT arises.

How Taylor Wessing can help

The Taylor Wessing tax group works closely with its real estate, planning and construction teams to advise on the tax implications of transactions and structures to maximise efficiency.

It is important that careful due diligence and legal advice is sought at the outset to ensure that maximum tax benefit can be obtained. No matter what type of asset is being acquired, be it offices, retail, industrial, logistics, hotels or leisure, our specialists can advise on both the direct and indirect tax treatment of transactions. We can also advise on tax issues on capital expenditure, including maximising the availability of capital allowances.

Our extensive experience in acting for overseas clients adds value and ensures consistent and efficient service delivery. We have the know-how needed to respond effectively to the challenges of the market.

Our commitment to commercial advice and our provision of imaginative, creative and innovative solutions for our clients marks us out from our competitors. We are trusted business advisers and work hard to achieve favourable outcomes for our clients' businesses.

If you have any questions on the points raised in this note, or require any further information or advice in relation to UK tax treatment, please do not hesitate to contact a member of the tax team.

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Liz Wilson ... is super sharp, technically superb, with clarity of delivery on difficult matters

Legal 500

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Graham Samuel-Gibbon ... provided excellent technical insight, clear and concise advice and responsiveness.

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