

Taxation of UK Commercial Real Estate and Foreign Ownership

By **Paul Webb**, 28th November 2019

Property in the UK can be owned by a company or by an individual and the method of ownership and the status of the company or individual involved will affect the tax treatment.

Tax on Rental Profit

1. Where an investment is made in UK commercial property in the name of a non-UK resident company and the company does not carry on a trade in the UK, basic rate income tax (currently 20%), is payable on rental profits.

To achieve the favourable tax treatment outlined above, it is important to use a non-UK resident company to acquire the UK property and that the company is managed and controlled in a manner that ensures it remains resident outside of the UK for tax purposes.

Where an investment is made in UK commercial property, in the name of a non-UK resident individual, applicable tax rates are equivalent to UK income tax rates (up to 45%).

2. The UK Government has announced that it will bring non-UK resident companies with UK property income within the scope of corporation tax from April 2020. This will mean that UK rental profit will be subject to UK corporation tax at a rate of 19%.

Implications of Falling Within the UK Corporate Tax Regime

While the lowering of the tax rate is positive, falling under the UK corporation tax regime will mean that, from 2020, the UK's corporate interest and loss restriction rules will be relevant:

- The corporate interest restriction rules restrict a group's deductions for interest expense and other financing costs to an amount commensurate with its taxable activities in the UK. The rules will apply to groups with a net interest expense of more than £2million per annum and could significantly restrict the deductibility of financing costs, leading to a significant increase in tax liabilities.

- The corporate loss restriction rules restrict a group's deductions for carried-forward losses to £5million. Above the £5million allowance, only 50% of profit can be covered by carried-forward losses. While this rule may not have such a significant impact, as the interest restriction rule, the impact should be considered.

Capital Gains

From April 2019, non-UK residents holding UK commercial real estate have been subject to UK tax on their gains. This measure brought the UK into line with most other tax jurisdictions and the concept that land should be taxed where it is situated.

The good news is that a rebasing of property costs took place as of April 2019, meaning that only gains from that point onward will be charged to tax.

The new rules will also apply to sales of interests in "property rich" vehicles - that is, entities that derive at least 75% of their gross asset value from UK land. Gains on the disposal of any interest in such a vehicle, amounting to 25%, or more will become liable to UK tax.

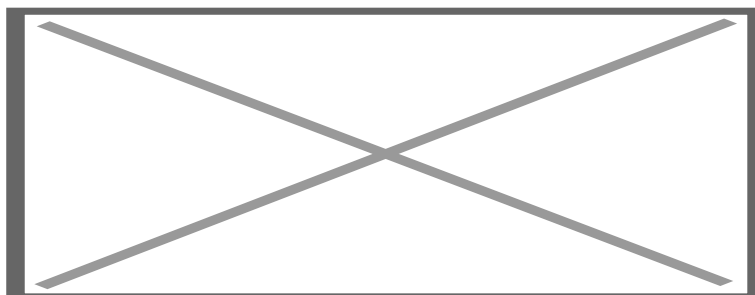
Property Developers and Traders

In 2016, anti-avoidance rules were introduced to counteract any claim that a development or dealing trade relating to UK property was actually being carried on outside the UK, and therefore not subject to UK tax.

Profits from a development project are therefore within the scope of income tax or corporation tax, depending upon who is carrying it out. These rules also apply where there are arrangements to sell the development company, rather than the land itself. They apply where shares, for example, are sold and they derive at least 50% of their value from UK land.

Stamp Duty Land Tax (SDLT)

Acquiring a UK commercial property directly incurs a charge to SDLT (a purchase tax) as follows:



No such tax generally arises when acquiring a company that itself holds UK property. As a result, there is a benefit in acquiring and disposing of UK commercial property via a company vehicle, particularly where that company is based in a jurisdiction that does not charge transfer tax on share dealings.

Value Added Tax (VAT)

The sale of a freehold or long leasehold title to a commercial property will, by default, be exempt from VAT. However, property owners have the option to 'opt to tax' their property, which may make the sale of that property subject to VAT (but, as a consequence, also entitles the property owner to claim credit for VAT charged to them on their overheads).

This is a complex area and, when acquiring UK commercial property, due diligence will be required to establish whether the property is subject to VAT or not, and what impact this may have for the purchaser.

On Death – Inheritance Tax (IHT)

From 6 April 2017, all UK residential property, whether held directly or indirectly, became liable to UK IHT (with the exception of property owned by diversely held vehicles).

- UK commercial property held directly by an individual is similarly liable to a UK IHT charge; however, commercial property held via a non-UK resident company is not.

There is, at this time, no indication that commercial property held indirectly through a company or similar vehicle will give rise to an exposure to UK IHT; however, in light of recent changes this might be a logical next step.

How Dixcart Can Help?

Dixcart can assist with reviewing existing UK commercial property ownership structures and whether action is advisable to restructure such investments.

Our UK tax specialists and commercial property lawyers can, if required, implement any resulting planning and restructuring recommendations. Please contact Paul Webb in the UK office: advice.uk@dixcart.com.