

tax lawflash

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New UK Capital Gains Tax Charge on High-Value UK Residential Property

UK government publishes draft legislation on capital gains tax charge that will apply to disposals of high-value UK residential property by certain “non-natural” persons.

In our 31 January LawFlash,¹ we set out the details of tax measures, expected to be introduced by the UK government in the Finance Act 2013, applicable to UK residential property valued at more than £2 million (high-value UK residential property) that is acquired and owned by certain “non-natural persons” (e.g., companies, partnerships that have companies as their members, and collective investment schemes). We noted that draft legislation in relation to the proposed extension of the capital gains tax (CGT) charge was expected to be published in early 2013.

The UK government has now published draft legislation² that provides further details on the application and operation of the new CGT charge that is aimed at extending the UK CGT regime to disposals of high-value UK residential property.

Current owners of high-value UK residential property held indirectly through non-natural persons and prospective sellers and purchasers of such property are advised to consult their legal advisers with respect to the application of the draft legislation to their particular circumstances.

Overview of the New CGT Charge

As was anticipated, the imposition of CGT on non-natural persons for any gain resulting from disposals of high-value UK residential property will be limited to cases where that property is also chargeable to annual residential property tax (ARPT) under the newly proposed tax regime for high-value UK residential property. This means that any reliefs that will apply to non-natural persons carrying out genuine commercial activity (e.g., property development, rental, and trading activities) under the ARPT regime would also be available for the purposes of the new CGT charge. Where applicable, the rate of CGT will be a flat rate of 28%, subject to certain limited relief to the extent that the property’s value was under £2 million for part of the ownership period after 6 April 2013.

Application to UK Residents

Following a further consultation on certain aspects of the proposed CGT measure, the draft legislation confirms that the new CGT charge will equally apply to both UK and non-UK non-natural persons. Any gain that is subject to the new CGT charge in the hands of a UK company will be exempt from the corporation tax that may otherwise have been payable on such gain. If, however, the gain is exempt under the ARPT regime and consequently not subject to the new CGT charge, the gain will be chargeable under normal principles of the UK corporation tax regime.

The draft legislation addresses the risk of potential double taxation that could otherwise have arisen if any ARPT-

1. View our 31 January 2013 LawFlash, “Proposed UK Tax Measures on High-Value UK Residential Property,” available at http://www.morganlewis.com/pubs/TaxLF_TaxMeasuresOnHigh-ValueUKResidentialProperty_31jan13.

2. View the government’s announcement at http://www.hm-treasury.gov.uk/d/written_ministerial_statement_31_january.pdf.

related gain were to be apportioned to any UK resident participators of certain closely held non-UK resident companies under the current section 13 of the Taxation of Chargeable Gains Act 1992.

Property Owned on 5 April 2013: Automatic Rebasing

It is intended that the new CGT charge will automatically be restricted to any gain accruing after 5 April 2013, unless an election is made (as explained below). A high-value UK residential property that is potentially within the scope of the new CGT charge will be treated as having been acquired on 5 April 2013 for a consideration equal to its market value on that date, and the charge will be restricted to an increase in value of the property since that date. As a result, gains on disposals that fall outside the new regime, including any gains attributable to the period before 6 April 2013, remain subject to the normal rules. UK non-natural persons will be subject to UK corporation tax on such gains, and any such gains accruing to a non-UK resident natural person may, in certain circumstances, be attributed to UK resident companies.

For disposals subject to the CGT charge, the draft legislation provides that an election may be made in order to avoid the application of the automatic rebasing described above. If no rebasing takes place by virtue of the election, the whole gain (if any) resulting from the disposal of a high-value UK residential property will be treated as an ARPT-related gain, subject to the new CGT charge, and not be taxed under the existing CGT rules, unless an exemption under the ARPT regime is available on any portion of the gain. Such an election may be considered beneficial if, for example, there was a long period of ownership prior to 6 April 2013 when the property's value was less than £2 million, such that the proportion of the gain to which the ARPT charge and new CGT charge apply is reduced.

The election is irrevocable and must be made by inclusion in the tax return for the tax year of the relevant disposal.

Other Significant Issues

As previously anticipated, the draft legislation includes provisions providing for tapering relief for gains that are slightly greater than the £2 million threshold that will be excluded from the CGT charge.

Gains and losses that fall within this new regime are to be "ring-fenced". This means that capital losses arising in respect of disposals that are not caught by this regime may not be used to reduce gains that do fall within the regime and vice versa.

In addition, the legislation imposes a CGT charge only on disposals by non-natural persons and does not apply to disposals of interests in non-natural persons that hold high-value UK residential property. This indicates that, as expected, indirect transfers of such property (e.g., as a result of a sale of shares in a non-UK company) will not be affected by this charge. Disposals to a connected party that are not at arm's length are generally treated as taking place at market value under the CGT rules, and the normal rules permitting disposals within a UK group to be deemed to take place on a "no gain, no loss" basis are disappplied to disposals falling within the new regime. There are also special rules relating to a deferral of tax otherwise triggered on a company migration.

The published draft of the legislation is open for consultation until 22 February 2013 and is therefore subject to changes. The final version of the legislation is expected to be enacted in the Finance Act around July 2013.

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