



Investing in UK Real Estate?

Tax issues for non-residents investing in UK real estate

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Introduction

This note is a general guide to some of the main UK tax considerations for a non-UK resident looking to acquire UK real estate as an investment, based on the law as at April 2010. Tailored advice on the facts should be sought to confirm the precise UK tax implications and ensure the right acquisition structure.

Typical non-resident structure

A non-UK company is historically a popular vehicle for non-UK residents to hold UK real estate, as it offers the following advantages:

Rent taxed at 20%

UK companies are generally taxed at 28% on their net rental income. However, non-UK tax resident companies holding UK property as an investment only pay tax at 20% on the net rental income. This rate does not depend upon a tax treaty, so it applies irrespective of where the non-UK company is resident.

The UK operates a system for withholding this 20% tax from the rent before it is paid to non-residents. However, it is possible to obtain a prior clearance from the UK tax authorities for rent to be paid gross of tax, pending eventual settlement of the appropriate tax due at the tax payment point (31 January in the year after 5 April).

Generous deductions for interest expenses

The UK has generous rules that allow the amount of rent that is taxed to be reduced by the interest paid on third party finance taken out to acquire the UK real estate. Interest on shareholder debt may also be deductible, subject to the UK transfer pricing rules. The UK generally withholds 20% tax from interest paid to non-residents, though this will depend on the precise structure of the debt and/or any available tax treaty relief.

No UK tax on gains when investment property sold

Non-UK residents holding property as an investment are not generally subject to UK capital gains tax. Therefore, any gain realised when a non-UK

company sells UK real estate should not be taxed in the UK. The non-UK company can also generally be sold without triggering UK tax on the gain, or any UK transfer taxes.

Capital allowances available

Non-UK residents can claim capital allowances, which will reduce the amount of rent that is subject to UK tax. Capital allowances are a form of depreciation allowances on plant and machinery, and can be very valuable. Broadly, if available, they can be claimed on a reducing basis at either 10% or 20% per year, depending upon the type of plant and machinery. Agreements should be drafted to optimise these, where possible.

Minimises transfer taxes

Stamp duty land tax ("SDLT") is payable by the purchaser of UK real estate generally at a rate of 4% of the purchase price. The sale of shares in a non-UK company that owns UK real estate is not generally subject to SDLT or any other UK transfer taxes.

Some things to bear in mind

The acquisition of UK real estate can be complex and there are a number of issues that need to be carefully considered and planned around to reduce exposure to UK tax and ensure that the structure is practical to run on a day-to-day basis. Below are just some of the other more significant issues that need to be considered (in addition to the points above) when acquiring UK real estate. As always, it is vital to get appropriate professional advice.

Residence

The offshore entity must be managed and controlled outside the UK to maintain non-UK tax resident status. In the case of a company, this generally requires that a majority of the directors (or equivalents) are non-UK tax resident and that all board meetings are held outside the UK.

Investment vs trading

The tax treatment outlined above assumes that the non-UK resident company will own the UK real

estate as an investment. If it is developing or trading in UK real estate, then the profits may be taxed differently. The distinction between trading and investment is important - if a non-UK resident company is treated as trading in UK property, it may become subject to UK corporation tax at 28% on all of its profits from that trade carried on in the UK, including any gain on the disposal. This can be a particular issue if the real estate is sold soon after acquisition or development. Alternative structuring may be possible if trading is intended. Non-UK developers also need to watch out for anti-avoidance legislation, which can bring gains into the charge to UK tax.

Value Added Tax (VAT)

VAT will usually be chargeable on the acquisition of UK commercial real estate. The current rate of VAT is 17.5%. If the property is let, then a sale may be treated as a transfer of a going concern, provided certain conditions are met. In that situation no VAT will be payable, reducing funding costs and SDLT.

Similarly, VAT is usually charged on the rents paid by tenants. Owners of UK commercial real estate do not automatically have to charge VAT on the rents or sale price; it depends upon whether they have opted to charge VAT. However, if a landlord does not "opt to tax" in this way, it will not generally be able to recover any of the VAT it pays when acquiring, maintaining or refurbishing the property, and that VAT will become an absolute cost. It is generally only worth a landlord not "opting to tax" if it can charge more rent as a result and the extra rent makes up for any lost VAT.

Different VAT rules apply to property for residential or charitable use. Specific advice should be obtained on the facts where appropriate.

Offshore unit trusts

Many investors in UK real estate structure their holdings via an offshore property unit trust. The main difference between an offshore unit trust and a non-UK company is that the unit trust is generally treated as transparent for UK income tax purposes. The investors in the unit trust will, therefore, be taxed as if they received their share of the rents directly. These vehicles are particularly attractive to UK tax exempt investors because they can receive the rent tax free. Such investors prefer not to hold

UK real estate via a non-UK company because they cannot reclaim the 20% tax it pays on the rent.

Due diligence

Where an interest in UK real estate is acquired indirectly (via shares or units in a separate vehicle) there is always a risk that the vehicle has pre-existing tax or other liabilities. Appropriate due diligence should be carried out so that any risks can be identified and quantified and accounted for in the transaction.

Contact:

For further information, please see our Tax page on the BLP website:

<http://www.blplaw.com/index.cfm/Tax/1016>