UK Real Estate Taxes

We are assuming for the purposes of each scenario a non UK resident, non UK domiciled individual purchasing either under scenario A, a residential property in the UK for his private use or scenario B, the purchase of a commercial property (a factory/office/warehouse or the like) also owned on an individual basis.

Residence and Domicile

Many countries have a statutory test of residence. The UK is planning to bring in for the first time, from 6 April 2012, the statutory residence test which would determine whether an individual was resident in the UK for tax purposes or not. One should always bear in mind an individual can be resident in two different jurisdictions or more at the same time for tax purposes. For now residence rules in the UK are a mixture of decisions taken in the UK courts, HM Revenue & Customs guidance and practice.

Simply put, an individual is resident in the UK if they spend the majority of their time here year on year, particularly if they live and work here. An individual is not resident in the UK for tax purposes if their life and work is not here and they do not spend time in the UK of more than 183 days in any 12 month period, and do not anticipate spending an average of 91 nights a year in the UK on a rolling three year test. You may also be regarded as resident in the UK if you are a perpetual visitor to the UK and come here for settled purpose.

Domicile

Unusually in UK tax, domicile is a concept which has an impact on an individual's income tax, capital gains tax and possibly inheritance tax position and it is not based on where they live. An individual acquires a domicile of origin at their birth and they acquire that from their father, assuming he is alive at their birth. He, in turn, acquires it from his father and so on. If say an individual is born in Sweden and is say, fifth generation Swedish and then comes to the UK for residence for some years, he would normally be regarded as UK tax resident but not UK domiciled.

People who are UK resident but not UK domiciled pay tax on income and gains that arise outside the UK either on a worldwide basis with credit for any overseas tax paid or the alternative remittance basis whereby they can elect, subject to certain loss of reliefs or charges, to be only taxed on income and gains they have outside the UK if they remit or enjoy them in the UK. If an individual is not resident then largely being non domiciled has little or no impact for UK tax.

UK Real Estate Taxes

Acquisition of UK Residential Property

Taxes on Acquisition

On the purchase of a property in the UK, stamp duty land tax arises. This is on a sliding scale from as low as nil (up to £125,000 purchase cost) to 5% of properties costing £1 million or more.

There are no other taxes to consider on the purchase of the property. Note: The acquisition of residential property is exempt from VAT with no possibility of opting for taxation.

Sale of Property

If an individual is not resident and not ordinarily resident in the UK and the property is held as a passive investment property (not being held for property development etc) then upon the sale there is no UK capital gains tax as non resident individuals owning passive investments are not subject to UK capital gains tax.

Individuals who own assets directly in the UK might be subject to UK inheritance tax even if they are not resident nor ordinarily resident or domiciled here.

Inheritance tax, after certain exemptions is payable at a flat rate of 40% on gifts on death and on certain lifetime gifts can be paid at 20%. For inheritance tax purposes it is normally advisable to reduce the value of the UK estate by either borrowing funds for its purchase, as this will act as a debt against the value to be assessed. Alternatively the risk of inheritance tax can normally be insured against.

As noted above a VAT charge is not possible as the disposal of residential property is exempt from VAT with no possibility of opting for taxation.

Commercial Premises – Taxes on Acquisition

As in the above case, stamp duty land tax is payable on purchase although the maximum tax rate is capped at 4% but again there is a sliding scale.

Value added tax

The acquisition of commercial property is exempt from VAT but there is an option for taxation which is at the discretion of the seller. If the seller has opted for taxation the value for the purposes of calculating stamp duty land tax will be the VAT inclusive amount.

There are no other taxes on purchase.

Commercial Premises – Sale

(a) VAT
As noted above, sales of commercial property are exempt from VAT but with the possibility of opting for taxation. Each owner must make their own option for taxation and cannot rely on an option made by a previous owner. Once an option for taxation is in place it remains for at least 20 years.

If an option for taxation has been made and the property has been let it may be possible to treat the sale as a VAT free sale of a property letting business transferred as a going concern (provided that the relevant conditions have been met).

UK Real Estate Taxes

(b) Inheritance tax, after certain exemptions is payable at a flat rate of 40% on gifts on death and on certain lifetime gifts can be paid at 20%. For inheritance tax purposes it is normally advisable to reduce the value of the UK estate by either borrowing funds for its purchase, as this will act as a debt against the value to be assessed. Alternatively the risk of inheritance tax can normally be insured against.

(c) If an individual is not resident or nor ordinarily resident in the UK and the property is held as a passive investment property (not being held for property development etc) then upon the sale there is no UK capital gains tax as non resident individuals owning passive investments are not subject to UK capital gains tax.

Other

If we assume the property is to be rented out in the UK then this is what is called a Schedule A business. The rental income is taxable in the UK irrespective of where the owner of the property lives and the tax rates can be as low as 20% and as high as 50% if rental profits are above £150,000 a year. Certain expenses for the property rents are deductible such as property taxes, insurance, repairs etc. If the property is bought with the aid of a loan then the interest on that loan serves to reduce the rents for UK income tax purposes. If the loan is secured from an overseas lender normally again the same comments will apply on the interest deduction but in certain cases withholding tax from the UK on that interest payable to a non resident can apply.

VAT on Rent

The VAT position of rental income depends on a number of factors:

1. Residential letting is normally exempt from VAT with no possibility of opting for taxation.

2. Letting of residential property as a ***holiday home*** is automatically excepted from exemption with no requirement to opt for taxation. So, if the income from the holiday letting exceeds the UK VAT registration threshold (currently GBP 73,000) the owner will be obliged to register and account for UK VAT at the standard rate (currently 20%) on the letting income.

3. Letting of commercial property is exempt but the owner can register for VAT and opt for taxation and apply VAT to the rent at the standard rate of 20%.

The UK has no wealth tax as such.

Strategies - Alternatives

One of the ways a non resident will often own UK property is to own it through a non UK resident company. The benefit of this is as follows:

(a) For inheritance tax purposes in the UK the shares in an offshore company are the situs of the assets not the property in the UK. The result being that if an individual were to die owning the shares of a non resident company there would be no UK estate for inheritance tax.

(b) A non resident company is charged to income tax in the UK on its rental profits and a flat tax rate of 20% irrespective of the rental profit

(c) Possible residence in the UK – if an individual thought they might become resident in the UK at some point in the future, then strategies might be devised before they came to the UK using non UK trust structures to protect the capital gains position on the UK property.

UK Real Estate Taxes

If an individual becomes resident to the UK and continues to claim the benefit of his non domicile status (see above) then for the first seven years, under current rules, the claim for the remittance basis costs the individual his UK tax free personal allowance and his UK capital gains exemption. Once they have been here seven years or more, to access the remittance basis will cost a flat charge of £30,000 to the UK HM Revenue & Customs the proposal is this will increase to £50,000 a year once an individual has been here 12 years. That to be effective from 6 April 2012.

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