Overseas Investors looking to buy property in the UK need expert and robust tax advice to guide them through...

Tax on property profits
Overseas companies investing in UK property pay UK tax at 20% on their rental profits. Overseas individuals investing directly can pay tax at rates of up to 50% (reducing to 45% from 6 April 2013) and so how they invest in UK property should be a key planning priority. The profits assessable are normally reduced by relief for interest on property financing and capital allowances; the latter gives partial relief for the cost of their investment. However, not all of the expenses incurred will qualify for tax relief. For example, in some cases, legal and letting agent's fees may not qualify for relief.

Capital gains and inheritance tax
The general rule is that overseas investors not resident in the UK for UK tax purposes are not generally liable to UK tax on investment gains on the sale of UK property. However where property is acquired for development or resale, overseas investors can be taxed on gains as income, and so they need to structure their affairs carefully to avoid this. They also need to make sure they do not inadvertently risk becoming UK resident or fall foul of other UK anti-avoidance legislation.

From April 2013, overseas investors owning property through corporate type entities will be subject to UK capital gains tax at 28% on high value residential property where an individual dwelling is worth more than £2 million. There are reliefs from the tax for investors who acquire the property for development or for rental income, and so generally the tax will apply where the overseas investor acquires the dwelling for their own or their family's use. This measure was introduced as part of a general package of tax increases on high value residential property, the others being an Annual Residential Property tax and increases in Stamp Duty Land Tax rates.

A UK property can be within the scope of UK Inheritance Tax. It is normally possible to structure the property ownership for an overseas investor so that its value falls outside the investor's UK Estate. For higher value residential property, the structure will also need to take into account capital gains and the other taxes applying to such properties to ensure that all are minimised.

Minimising UK tax, including withholding tax on rents
Tenants paying rents direct to overseas investors, or the letting agents who collect rents on their behalf, are required to withhold and pay over to the UK tax authorities, 20% of the gross rents, net of any expenses paid on behalf of the landlord. This will give a real cash flow cost for most investors as the tax deducted will usually be far in excess of an investor's actual UK tax liability and the excess amount will only be repaid at a later date.

To better manage their UK tax affairs, there are procedures which an overseas investor can put in place which should enable tenants or letting agents to pay rents without deduction of tax. Investors should normally take advantage of these to improve their tax cashflow position.

Financing the investment to minimise UK tax
Overseas investors often seek to heavily gear their borrowings, so that the interest expense reduces the UK tax they have to pay on rental profits. The UK authorities can deny a tax deduction for financing costs where the borrowings or interest rates charged are more than would have been charged between parties acting at arm's length.

Capital allowances
Under the UK system of capital allowances, overseas investors are normally able to claim partial relief for the cost of their investment in property. Capital allowances are akin to tax depreciation and can represent an extremely valuable tax relief as in practice quite considerable expenditure is involved. The allowances are available for plant and machinery included in a building that is not a dwelling house, for example the air conditioning system, although not the building itself. Higher rates of allowances are available for buildings in designated Enterprise Zones and also for certain environmentally friendly and energy saving equipment.
It is possible to pass allowances from owner to owner. This is normally achieved by the making of an election between a vendor and purchaser. It is therefore important that this is considered at the time contracts are being negotiated. Investors can also claim allowances on items they themselves install in buildings which they are constructing or refurbishing.

**Withholding tax on interest**

Tax may need to be deducted at source from interest payments to overseas lenders (in the same way that this can apply to rental payments). The terms of finance often provide that any tax withheld is borne by the investor and so will increase the effective cost of finance. With careful structuring of funding, it is normally possible to eliminate the withholding tax obligation. This is particularly beneficial where the lender has no actual UK tax liability.

**Stamp Duty Land Tax (SDLT) on property acquisitions**

A transfer tax, known as Stamp Duty Land Tax is payable on the acquisition of most UK property interests. For most property the rates of SDLT are up to 4%. For individual residential dwellings worth more than £2 million, the normal rates are up to 7% and a special rate of 15% applies where the purchaser is a corporate type entity. As with the capital gains tax on high value residential properties, there are exemptions from the 15% rate where property is being developed or held for rental income, and so the 15% rate will normally apply where the investor is using the property for personal or family use.

SDLT is also payable by reference to rents where a property owner grants a lease. Complex rules apply to calculate the SDLT on leases.

SDLT represents a significant cost of investment and has a significant impact on investor returns. The rules are complex, but with careful structuring the SDLT cost can be minimised.

**Annual Residential Property Tax (ARPT)**

As part of the tax measures applying to high value residential property, a new tax, ARPT, has been introduced. It is an annual charge applying to residential dwellings worth more than £2 million owned by investors which are corporate type entities. The charge starts at £15,000 per year increasing to £140,000 for properties worth more than £20 million. Exemptions apply for development and rental businesses and so ARPT is most likely to apply to investors who acquire such property for personal or family use.

**Value Added Tax (VAT)**

In relation to commercial property, an investor can register for UK VAT and elect to charge VAT at the standard rate. Where such an election is made VAT becomes chargeable on both the rents and on any sale proceeds. However the investor will, in such circumstances be entitled to recover VAT charged, for example on the acquisition of a property. Where an investor elects to charge VAT, the tax is usually a cashflow cost for the tenants. However where an investor lets or sells a property to a tenant which cannot recover VAT, for example a bank or an insurance company, the VAT charged on the rent or purchase price will be an absolute cost to the tenant or purchaser. Investors acquiring property likely to be used by tenants in the financial services sector (or to other persons in similar situations who cannot recover VAT incurred on costs) need to consider the VAT position carefully.

For commercial property, the owner normally has a choice of whether or not to elect to charge VAT. However, for residential property, the rules are more prescriptive. A property owner investing solely in residential property cannot register for VAT and this means that the owner cannot recover VAT suffered on the costs associated with the acquisitions of the property or on other goods or services acquired by the investor.

Whether commercial or residential properties are being contemplated, VAT law in the UK is complex. Investors therefore need to take appropriate advice.

SDLT is chargeable on consideration given for a property inclusive of VAT. Therefore charging VAT may increase the amount of SDLT payable.

**Tax reporting obligations**

Overseas investors need to comply with various UK reporting obligations to the local tax authorities. It is important to use advisers who are aware of the obligations and can establish the extent to which any further parties may require information on their UK tax affairs. For example, in some instances the providers of finance require a certain degree of comfort in relation to an investor’s UK tax position before completion of finance agreements.

Consideration also needs to be given to any non-UK tax reporting requirements. Investors occasionally require assurance in the form of, for example, quarterly management accounts where significant assets are held overseas.

**How we can help**

As with all advice, it is vital to see the complete picture. It is about making the jigsaw fit together to maximise post tax returns. As UK tax legislation is continually changing, you need advisers who are familiar with current rules and practice, and who can provide you with up-to-date technical advice, in a commercial and practical way.

**Have you considered:**

- all tax reliefs available to you for investment in property, including capital allowances?
- how you should structure your investment in UK property?
- how you should finance your investment to secure the most beneficial UK tax position?
- how you can manage your UK tax liabilities to minimise withholding tax and maximise recovery of UK VAT?
- how you are going to deal with your UK tax reporting obligations?

We can guide you through the minefield of UK tax law and practice to help you manage and mitigate your UK tax affairs, whilst minimising the risk of challenge by the UK tax authorities.

**For further information please contact:**

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