Investment in UK residential property is often considered as part of a balanced portfolio of investments for the sophisticated investor. However, care should be taken as to the method of acquisition as there are various tax traps for the unwary.

Direct Ownership
Direct ownership by individuals is clearly the simplest way to purchase a property, however, consideration should be given to tax issues such as the potential exposure to UK inheritance tax (IHT) at 40% and income tax at up to 45%.

A non UK domiciled individual (broadly someone not born in the UK) is subject to IHT on the net value of their UK assets, such as UK property. Individuals are able to reduce the value of the property exposed to IHT by utilising finance to acquire the property and in addition are entitled to an IHT free amount of £325,000, called the nil-rate band, which means the first £325,000 of an individual’s UK estate subject to IHT is taxable at nil % with the balance subject to IHT at 40%.

Income tax will be charged at rates of up to 45% on any net rental income after allowable costs (for example repairs, interest on qualifying loans, agent’s fees etc). To avoid the need for tax to be withheld at source on rental income the purchaser should register under the HMRC Non-Resident Landlords Scheme and file annual tax returns, paying tax in July and January each year.

Capital gains tax (CGT) is levied on the capital gains arising from a sale of UK residential property by a non-UK resident individual post April 2015. Each individual is entitled to an annual allowance (£11,100 in 2016/17) and CGT is thereafter levied at 18% for basic rate taxpayers and 28% for higher rate taxpayers. CGT returns must be submitted within 30 days of sale.

Stamp Duty Land Tax (SDLT) is paid by the purchaser depending on the purchase price. SDLT is charged on residential properties at a blended rate of between 2% and 10% for properties valued between £125,000 and £1,500,000 and 2% and 12% for properties over £1,500,000.

With effect from 1 April 2016, if the property purchased is an individual’s second property, and does not replace their main dwelling, an additional 3% SDLT may be payable.

The Annual Tax on Enveloped Dwellings (ATED) is not relevant for properties owned direct by individuals.

Corporate Ownership
Currently ownership via a non-UK company offers an immediate advantage in respect of IHT for non-UK domiciled individuals. The reason for this is that the individual does not directly own UK land rather they own shares in a non-UK company, which are not subject to IHT.

From April 2017 all UK residential property, however held by a non-UK domiciled individual, irrespective of whether it is owned by an offshore company, will be subject to IHT.

Income tax is charged on the company at the basic rate of income tax of 20% on net rental income. Where net taxable rental income exceeds the threshold for basic rate income tax (£32,000 in 2016/17), an annual income tax saving of 20% to 25% can be achieved via corporate ownership as compared to if the property was directly owned.
Companies, not within the ATED charge, are subject to CGT at 20% on any capital gain arising after April 2015 when the property is ultimately sold. Under current provisions should a sale be facilitated by way of share transfer, CGT will not be due although the purchaser is likely to negotiate the sale price due to uncrystallised latent gains held at company level.

Should the company fall within the charge to ATED, CGT is levied at 28%. Again, CGT returns must be submitted within 30 days of sale.

SDLT is payable at the same rates as individual ownership as long as ATED is not payable. If ATED is ultimately payable SDLT is charged at a flat rate of 15% on purchases, by companies, of residential properties costing more than £500,000.

ATED is charged on properties owned by non-natural persons such as companies. The charge is levied annually and ranges between £3,500 for properties valued between £500,000 - £1 million and £218,200 for properties valued at more than £20 million.

ATED charges can be avoided if the property is let commercially and connected persons do not occupy the property. Even where there is no ATED payable an annual ATED return must be completed and submitted to HMRC. For more detail on ATED please see our High Value Residential Property factsheet. The company should also register under the HMRC Non-Resident Landlords Scheme and file annual tax returns, paying tax in July and January each year.

**Trust Ownership**

It is also possible that a trust could be settled to acquire the property. ATED will not apply to a trust even if the property is not let, although IHT is still in point. Should the trustees borrow to fund the property acquisition the debt can be used to offset the value for IHT purposes. In addition, the net property value is subject to an IHT charge every ten years from the establishment of the Trust at a rate of 6%. If the property is let by the Trustees any net rental income is taxable at 45%.

It is possible for a trust to form a subsidiary company to acquire the property. The rules previously described in the corporate ownership section apply in this case and IHT and income taxes can be mitigated. In addition, in the right circumstances a trust can provide non-tax related benefits and opportunities for devolution of assets and asset protection for future generations.

The rules as described herein are limited to UK tax consequences in force at May 2016 and are provided as a general discussion document only. As such, the information provided should not be taken as advice and should not be relied upon as such. Individuals should take their own specific advice as regards their personal circumstances and requirements and in particular individuals should be aware of the tax consequences of UK property investment in the jurisdiction where they are tax resident.

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