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United Kingdom – Consultation Published on Taxing Nonresidents' Gains on Property

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The U.K. government has published its plans to make gains made by nonresidents on U.K. residential property subject to capital gains taxation from April 2015 in a comparable way to U.K. residents. Following up on a commitment made in the Autumn Statement, the U.K. government published on 28 March 2014 its consultation[1] on introducing a capital gains tax charge on future gains made by non-U.K. residents disposing of U.K. residential property[2]. This *Flash International Executive Alert* concentrates on the issues that will affect internationally mobile employees and their employers.

Why This Matters?

This is important for internationally mobile employees and their employers because many assignees from the U.K. keep U.K. residential property and may sell the property while on assignment. Typically these assignees would expect such a sale to be free of U.K. capital gains tax. Until legislation is published and at this early stage in the consultation, the position is not entirely clear. Even if there is no tax due there may be, in future, a withholding requirement, which would not apply to a U.K. resident individual, and assignees might expect their employer to help fund this.

The government has also indicated that the new rules will apply to non-U.K. resident individuals who are partners in a partnership owning residential property and to non-U.K. resident trusts. The new rules will also apply to residential properties owned by a company, in certain circumstances.

The definition of "residential property" also looks likely to include investment property (residential property held as an investment and residential property that is let out by a non-U.K. resident landlord); the government is consulting on a precise definition.

Background

Currently the U.K. charges capital gains tax on disposals made by residents. The U.K. does not charge capital gains tax on an individual's own or main residence. Where an individual has more than one residence, he or she can elect which residence should be regarded as the main residence for capital gains tax purposes. Where an individual's residence is regarded as his/her main residence, certain periods of absence including working abroad can be considered as periods of occupation – where certain conditions are met – so that the exemption from capital gains tax is not lost.

Non-U.K. residents are not liable to capital gains tax unless:

1. The disposal is of an asset used for the purposes of a U.K. trade through a branch or agency; or

2. The individual is a temporarily non-U.K. resident and the disposal relates to an acquisition made while U.K. resident but disposed of in the non-U.K. resident period. In this case, any gain is charged on the individual in the year he or she becomes resident again.

To be regarded as a temporarily non-U.K. resident, the individual has to be U.K. resident for four out of the seven years prior to the year in which residence ceased and return to the U.K. within five years. Additionally, gains made on the disposal of assets acquired during the nonresident period are not charged to CGT.

New Proposals

Overview

Under the proposal, from April 2015, "non residents making gains on U.K. residential property will be subject to U.K. CGT in a comparable way to U.K residents."[3] The charge will arise on "property used or suitable for use as a dwelling, i.e., a place that currently is, or has the potential to be, used as a residence."[4]

The proposals state that "… private residence relief (PRR) is intended to ensure that individuals do not have to pay CGT on gains that accrue during the time a property is used as their main residence. In general, a U.K. residence will not be the main residence of a non-resident and therefore the CGT exemption available under PRR will not be appropriate. However, the government recognises there may be exceptions to this general position and will make PRR available to non-residents in certain circumstances. For example, where a person emigrates from the U.K. and then sells what was their main residence, it is appropriate that PRR should be available for the time the property was used as their main residence…"[5]

KPMG Note

It is not clear how the new proposals will interact with the current rules regarding periods of absence which are treated as periods of occupation and hence allow the private residence relief to be available. KPMG LLP (U.K.) will be discussing this point with Her Majesty's Revenue & Customs (HMRC).

The PRR Election

The government is considering changing the rules regarding the election for PRR where an individual owns more than one residence. The government has suggested two options:

1. Remove the ability for a person to elect which residence is his or her main residence for PRR. This would mean that PRR would be limited to that property which is demonstrably the person's main residence. The government envisages that this would build on the existing process that applies where an individual with two or more residences has not made an election. In these cases, the person's main residence is determined by the balance of all the evidence including factors such as the address where the taxpayer's spouse or family lives, mail is sent, and that is on the electoral roll; or

2. Replace the ability to elect with a fixed rule that identifies a person's main residence, e.g., that in which the person has been present the most for any given tax year. Depending on the test that is devised, this may mean that taxpayers have to keep different or additional records.

The government notes that the first option would allow more flexibility for different circumstances, but this could result in some uncertainty. The second option could be a definitive test which would provide more certainty but might offer less opportunity to deal with particular circumstances.

KPMG Note

Where individuals are clearly non-U.K. resident (under the U.K.'s new statutory residence test) then they will know that they could potentially be affected by the new rules. However, a difficulty that may arise is where it is not clear whether this is the case. For example, where the automatic overseas tests for non-U.K. residents are not satisfied, but where a combination of days spent in the U.K. and "ties" to the U.K. mean that the individual is indeed non-U.K. resident.

Such individuals who are non-U.K. resident (based on the number of U.K. ties and the number of days they spend in the U.K.) may already have to keep extensive records regarding U.K. homes and available accommodation. It is to be hoped that the changes to the election do not increase this administrative burden. KPMG LLP (U.K.) will also be discussing this point with HMRC.

Treaty Relief

If these new rules are introduced, it is likely that treaty exemption will not be available under a standard U.K. double taxation treaty because the residential property will be situated in the U.K. and the U.K. would have the primary taxing right on the disposal of U.K. assets. On this basis, the other country would then be expected to give credit for the U.K. capital gains tax paid.

Tax Withholding

The government proposes to introduce a withholding tax rather than just rely on an option to self report on a tax return. It is proposed that the individual may have the option to pay the withholding tax or pay the tax due.

KPMG Note

Given the number of reliefs due, a straight-forward withholding tax on proceeds would mean that a number of individuals would overpay the amount of tax. KPMG LLP (U.K.) would like to see some mechanism for reducing the withholding without having to wait until a tax return is filed after the end of the tax year.

KPMG LLP (U.K.) will discuss the operation of this withholding tax with HMRC. For example, perhaps no withholding would be required when the purchase price exceeds the sale proceeds. Additionally, perhaps no withholding would apply if the individual has a record of filing U.K. tax returns as a non-U.K. resident, possibly in a manner similar to the non-U.K. resident landlord scheme.

Other Points

Resident individuals have an annual exempt amount of £10,900. The intention is that non-U.K. residents that will be subject to capital gains tax will also be able to use the exempt amount.

The current rate of capital gains tax is 18 percent or 28 percent dependent on the total U.K. income and gains. Non-U.K. residents are also expected to be charged at 18 percent or 28 percent based on their U.K. income or gains.

Footnotes:

1 See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298759/CGT_non-residents_condoc.pdf .

2 See: https://www.gov.uk/government/news/autumn-statement-5-december-2013 .

3 From: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298759/CGT_non-residents_condoc.pdf .

4 Ibid.

5 Ibid.

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If you have any questions, please contact your usual KPMG professional or send an e-mail to: go-fmforum@kpmg.com.

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