NEW RULES FOR TRANSACTIONS IN UK LAND

4 AUGUST 2016

SUMMARY

New rules will impose tax on profit from **dealing in** or **developing** UK property. They can apply to both UK tax residents and non-residents. The rules are broadly drafted, and should be considered on **any sale of UK land**, or **the sale of any asset** (such as shares) deriving half or more of its value from UK land.

For a summary of the changes that these new rules bring, see overleaf.

THE NEW RULES

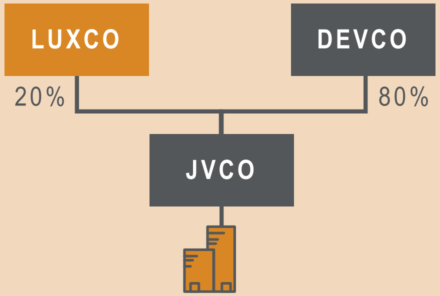
There are three circumstances in which the rules can apply:

- Where you sell **UK land**, and one of your **main purposes** was to make a profit from selling the land. This "main purpose" can be present when the land was acquired, when shares in a company (or other entity) holding the land were acquired, or when any development of the land took place.
- Where you sell **UK land** held as the trading stock for a trade you carry out. Unlike the previous position, HMRC does not consider it needs to establish that this trade is connected with a "permanent establishment" you have in the UK.
- If you sell any assets (such as shares) which derive **at least half their value from UK land** (through any number of companies, trusts, or partnerships), then the rules apply where you are party to an arrangement to deal in or develop the land and make a profit from selling any property deriving any part of its value from the land.

These rules apply on a company-by-company basis, so can impose tax on disposals within a group. They can also consolidate activities carried out by others on behalf of the entity selling the land or asset, and can apply to an entity other than the one selling the land if commercially that entity realises the profit (e.g. through a profit participation arrangement or a management or development agreement).

Broad anti-avoidance and "anti-forestalling" rules apply where measures are (or have been) put into place to avoid the rules, which apply retrospectively since Budget Day on the 16 March 2016.

EXAMPLE



Facts

LuxCo, a non-resident company, enters into a joint venture agreement with DevCo, under which LuxCo contributes equity funding for the development and DevCo contributes UK property to be developed. Shares in a new JVCo are allocated between the two entities in proportion to these contributions. The JV agreement provides that JVCo is to develop the land, with DevCo having the obligation to find and engage contractors. Two years after the development is completed, LuxCo sells its shares in JVCo to DevCo, at a gain over its original equity contribution.

Result

LuxCo has sold shares in JVCo, which derives all its value from UK land. LuxCo was party to an "arrangement" (the JV agreement) to deal in or develop the UK property. If HMRC can successfully argue that one of the main purposes of the JV agreement was to allow LuxCo an exit by disposing of shares in the JV agreement, **UK tax will be payable** at 20% of the gain.

TIMEFRAME

The rules are not yet in force, but they will have retrospective effect from **5 July 2016**. The anti-avoidance provisions will have effect from Budget Day (which was the 16th of March). There is no grandfathering — any disposal on or after 5 July could be caught.

We do not expect any material changes to the rules to be made before the Bill receives Royal assent. The provisions as currently drafted should be treated as if they were law.

IMPACT ON YOU

These rules should be considered whenever sellers, purchasers, or borrowers intend or expect to be outside the UK tax net in relation to any development or sale of UK land. The new rules can increase UK tax exposure from 0% to 20% of profits.

The rules will impact much ongoing real estate finance and indirect real estate structuring work. It will also have a significant impact on historic offshore holding structures, and should be borne in mind where historic structures, such as offshore property funds or companies (and the associated tax liabilities) may be inherited.

Care should be taken when drafting construction contracts, development agreements, fund documentation, and joint venture or shareholders' agreements to ensure that the impact of the rules is minimised.

WHAT WE CAN DO

Addleshaw Goddard has the technical expertise, commercial focus, and real estate sector know-how and experience to assist you with these rules. We would be happy to help you assess the impact that these rules could have on your business. We can work with you to revisit old structures which may no longer be delivering the tax savings you expect and help restructure these in a tax-efficient manner. We can ensure that robust protections are in place in transactional documentation and, where relevant, help preserve evidence of your intentions to ensure future purchasers and HMRC are comfortable with the tax position you have taken.

We have a five-partner tax practice throughout London and the North Please do contact us at the details below:

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WHAT'S CHANGED? A COMPARISON OF THE OLD AND NEW RULES

Non-residents disposing of UK land were treated significantly differently to UK tax residents. A number of options were available to the former to argue that their profits were not within the scope of UK tax, including arguing that they did not have "permanent establishment" in the UK or that the profits were properly foreign-sourced income of a foreign company. The table below outlines the changes that these rules bring, which depend on **the asset class** sold, whether the asset sold is part of a **trade** of the vendor or is an **investment**, and whether the vendor is **UK tax resident**. Anti-avoidance rules, in particular the "Diverted Profits Tax" (currently at 25%), can apply to override the treatment set out in this table.

PROFIT OR GAIN MADE ON THE...			OLD RULES TO BE REPEALED WITH EFFECT FROM 5 JULY	NEW RULES WITH RETROSPECTIVE EFFECT FROM 5 JULY
SALE OF...	HELD FOR...	BY A...		
UK REAL ESTATE	TRADING PURPOSES	UK RESIDENT	Corporation Tax (**CT**, at 20%) or Income Tax (**IT**, at 20–40–45%) chargeable on profits.	CT (20%) or IT (20–40–45%) chargeable on profits.
		NON-RESIDENT	No UK tax except IT (20%) on profits from trade attributable to UK permanent establishment (**PE**).	**CT (20%) or IT (20–40–45%) chargeable on profits.**
	INVESTMENT PURPOSES	UK RESIDENT	CT (20%) or Capital Gains Tax (**CGT**, at 10–20% or 18–28%) on gains. If rate differential then transactions in land rules can apply, see below.	CT (20%) or CGT (10–20% or 18–28%) on gains. If rate differential then new rules can apply, see below.
		NON-RESIDENT	Non-resident CGT (**NRCGT**, at 20% or 18–28%) chargeable on sale of **dwelling** by individual or close company. (CGT may also be payable where property is subject to the Annual Tax on Enveloped Dwellings (**ATED**).) **Transactions in land rules can apply** where there was the "sole or main object" of realising a gain from disposing of the underlying land, tested on: ▶ acquisition of land; ▶ acquisition of property deriving value from land; and ▶ at the time of any development. Explicit anti-avoidance purpose. HMRC guidance that rules don't apply where transactions "do not amount to a trade". HMRC focus on "diversion" and "slice of the action" schemes. Statutory clearance procedure.	NRCGT (20% or 18–28%) chargeable on sale of **dwelling** by individual or close company. (CGT may also be payable where property is subject to ATED.) **New transactions in land rules can apply** to impose IT or CT where there was "the main purpose or one of the main purposes" of the vendor or an associate of realising a profit or gain from disposing of land, tested on: ▶ acquisition of land; ▶ acquisition of property deriving value from land; and ▶ at the time of any development. "Anti-fragmentation" rules may apply to aggregate activities of associates (i.e. 25% common control or common participation in management). No limitation to anti-avoidance purpose. No clearance procedure.
PROPERTY DERIVING VALUE FROM UK REAL ESTATE	TRADING PURPOSES	UK RESIDENT	CT (20%) or IT (20–40–45%) on profits.	CT (20%) or IT (20–40–45%) on profits.
		NON-RESIDENT	No UK tax except: ▶ CT (20%) if profit from trade attributable to UK PE; or ▶ IT if **transactions in land** conditions are met (see below).	No UK tax except CT (20%) if: ▶ profit from trade attributable to UK PE; or ▶ **new transactions in land rules** conditions are met (see below).
	INVESTMENT PURPOSES	UK RESIDENT	CT (20%) or CGT (10–20% or 18–28%) on gains. If rate differential then **transactions in land rules** can apply, see below.	CT (20%) or CGT (10–20% or 18–28%) on gains. If rate differential then **new transactions in land rules** can apply, see below.
		NON-RESIDENT	No UK tax except IT (20%) where **transactions in land rules** apply, i.e.: ▶ there was the "sole or main object" of realising a gain from disposing of the underlying land, tested on: • acquisition of land; • acquisition of property deriving value from land; and • at the time any development commences; or ▶ the land is held as trading stock. Exception for disposal of shares in property trading company.	No UK tax except CT (20%) under the **new transactions in land rules** if: ▶ property derives 50% or more value from UK land; or ▶ vendor (or associate) party to an arrangement the main purpose of which is to deal in or develop underlying land and dispose of any property deriving value from the land. "Anti-fragmentation" rules, anti-avoidance purpose, and clearance procedure as above. No exceptions except for private residences.