

Real Estate & Construction

Offshore investment in UK real estate

Offshore investors in UK real estate are still able to benefit from tax efficient structures. UK tax on gains can be avoided and income tax charges can be mitigated. This flyer provides an introduction into some of the key tax aspects for investors when using appropriate offshore structures.

UK tax on gains

Gains realised by non-residents on the disposal of UK real estate can be tax free.

UK tax on income

Net rental income is chargeable to UK income tax and calculated on an accruals basis. Deductions can be made for interest and, in certain restricted circumstances, tax depreciation. In general, capital expenditure and related expenditure such as acquisition costs, are not deductible.

The rate of tax depends on the type of investor. Offshore companies are subject to a 20% rate.

Non resident individuals and trusts are subject to progressive income tax rates of up to 50% (40% prior to 6 April 2010).

Financing

Interest on loans wholly and exclusively used in the UK rental business is generally deductible in calculating taxable income. Restrictions apply where the rate charged is more than on commercial terms or where the loan is from a related party and is not on arm's length terms.

Certain interest payments may be subject to withholding at a rate of up to 20% and advice should be taken to minimise this exposure.

Tax depreciation

In principle, the UK does not give a deduction for depreciation against taxable income. The exception is a tax depreciation for specific fixtures, plant and machinery in commercial properties.

On the disposal of the property, where previously claimed, the benefit of tax depreciation can be clawed back and therefore specific disposal planning is advised.

Wear and tear allowance

A wear and tear allowance of 10% of the rent less council tax and water rates may be claimed against the rental income on the letting of a furnished property.

Repairs

In general, the costs of repairing a property are allowable in calculating net rental income. The key exemption is extensive repairs to integral features. However, unless the wear and tear basis is claimed, the replacement of furniture should be allowable against taxable income.

Tax administration

An annual tax return is required to be prepared assessing net rental profits for the period to 5 April each year ("Tax Year"). This return is required to be submitted by 31 January following the year of assessment. Online filing is not currently available. Penalties arise on the late submission of a tax return.

For example, the tax return for the Tax Year to 5 April 2010 must be submitted by 31 January 2011.

Tax payments - Non-Resident Landlord Scheme

We are normally able to obtain agreement from the UK Tax Authorities for tax liabilities to be settled in three instalments. These are payable on 31 January during the relevant Tax Year and on 31 July and 31 January following the Tax Year. The first two instalments are each based on half the tax liability for the previous Tax Year. The third instalment is the balancing amount.

If an advance agreement is not obtained, the UK agent, or in his absence, the tenant, is obliged to withhold 20% of the rent payment and pay this to the Tax Authorities. Following submission of the annual tax return, any overpayment of UK tax can be reclaimed.

Interest and in some cases penalties arise on the late payment of tax.

Losses

In general, unless properties are held by more than one entity, rental profits and losses across properties can be offset. Where there are excess losses in any year, these are carried forward and set against future rental profits.

Value added tax ("VAT")

The VAT rate is currently 17.5%. The rate will increase to 20% from 4 January 2011.

Residential property is generally exempt from VAT.

Commercial property is generally exempt, but where an election is made, VAT is charged. When making an election, consideration needs to be given both as to whether the seller has previously made an election and also to the tenant's VAT position.

New builds are subject to specific rules.

Where a property is exempt no VAT is chargeable on the rent or disposal consideration, although VAT suffered cannot be reclaimed.

Where an election is made, VAT is generally chargeable on the rent and sales consideration. VAT can also be claimed on expenses and purchase consideration. In certain situations, recoverability of VAT may be restricted.

Stamp Duty Land Tax ("SDLT")

SDLT is chargeable on the acquisition of property and is charged at a rate of 4% on consideration in excess of £500,000. Reduced rates apply to lower levels of consideration. From 6 April 2011 SDLT on residential property will increase to 5% where consideration is in excess of £1 million

Trading in land

Although a gain on the disposal of an investment property can be exempt from UK tax, if it forms part of a trading activity it can be subject to UK tax. The UK tax authorities frequently challenge the status of offshore real estate investors where they consider trading activity to be undertaken.

For offshore companies dealing in real estate, UK corporation tax at 28% (reducing to 27% from 1 April 2011) can apply to their profits. This might be reduced to 20% income tax where there is negligible UK activity and UK presence. For offshore property development companies, there is a significant risk that their profits will be subject to corporation tax at a rate of 28%. Planning to reduce this exposure may be possible.

Non-resident individuals and trusts are subject to income tax on both trading and development activities at progressive income tax rates of up to 50%.

Depending on where the trader is resident, the tax charge may be reduced or even avoided through claims under appropriate double tax agreements.

Inheritance tax ("IHT")

On death, non UK domiciled individuals are liable to IHT at a rate of 40% on the value of their UK sited asset in excess of £325,000.

Companies are not subject to IHT. Therefore many non-UK investors use an offshore holding company to avoid IHT.

How we can help

The information on this flyer is intended to provide an overview of the UK tax position and should not be relied on to implement any structure.

Cross border planning is extremely complex. When correctly structured and implemented, there can be significant tax savings and cashflow advantages. Problems can arise where proper advice has not been taken or structures have been incorrectly implemented and operated. In these instances tax leakage may increase and there is a greater risk of successful attack by international tax authorities.

We can also advise on how potential tax exempt investment gains can be distinguished from taxable trading profits.

In recent years, supported by bilateral agreements, the powers of tax authorities have increased resulting in greater exposure to penalties and interest on unexpected tax liabilities.

We would advise that before entering into a transaction, you contact us to provide advice on how to reduce tax leakage. Additionally, due to continual changes in tax law and practice we would advise that structures are regularly reviewed to ensure that they are appropriate and correctly implemented.

We can also assist with other services, such as:

- Business assurance
- Pre and post transaction accounting
- Input into sale and purchase agreements
- Financial and tax due diligence
- Assistance in raising finance
- Other transaction services

Contact us

If you would like to discuss how BDO could help you structure and implement your cross border real estate business, please contact your usual BDO advisor or:

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