TRAVERS SMITH

# A mansion tax by the back door?

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Earlier this year, following a sustained period of media comment, George Osborne MP announced that the Government was concerned about wealthy people, especially foreigners, putting their homes into companies to avoid paying SDLT, and warned that such people would in future face "very punitive charges".

This led to the introduction in Budget 2012 of a new 15% SDLT rate on the purchase of residential property worth over £2m by a "non-natural person". This dubious nomenclature includes companies and other corporate entities, trustees (other than bare trustees) and collective investment schemes, personal representatives, clubs and associations and other bodies governed by overseas laws.

The Government also promised a consultation on two possible additional measures: an annual SDLT levy on the owners of such a property and the extension of CGT to the sale of residential property by a non-resident non-natural person. The consultation paper has now been issued and in this brief note we consider its contents and possible implications.

*If the Government is seeking to stop tax avoidance via the sale of shares rather than property, it is illogical to do so by introducing new taxes on the acquisition, holding and sale of property.*

### What are the two measures?

- The annual levy: the Government proposes that from 1 April 2013 it will charge an annual SDLT levy of £15,000 on non-natural persons (wherever resident) owning residential properties worth between £2m and £4m, rising in bands to a maximum of £140,000 per annum on properties worth over £20m. In terms of ascertaining the value, in the absence of any intervening sale, for the first five years the purchase price will be used. Again, without a sale, a revaluation will be required every five years. This is intended to persuade owners to take properties out of their corporate wrappers so that SDLT is payable on future sales.
- The CGT charge: the Government proposes extending CGT to the gains made by non-resident non-natural persons on the sale of residential property in the UK, and to implement this measure on 6 April 2013 in respect of properties worth over £2m. The rate of CGT payable has not yet been decided.

### What are the problems?

<u>Targeting the measures</u>

At the time of announcement, the Government was clear that the perceived abuse targeted by these measures was SDLT avoidance via the sale of shares in companies which hold residential property, rather than the sale of the property itself. The consultation document reiterates this, emphasising that the Government accepts that there are many legitimate reasons to hold a residential property in a company, and that there is a will to target the measures so they only hit abusive tax planning.

Unfortunately, the Government's recognition of this difficulty highlights the core problem perfectly. Very few owners of high value residential property choose to own it through a corporate vehicle for SDLT reasons. Although if this structure is in place a future sale would not trigger an SDLT charge and this benefit might secure a higher purchase price from the buyer, this possibility is usually incidental to the owner's wider tax planning. The key reasons for using a corporate vehicle to hold the property are, for non-UK individuals, to prevent UK property forming part of their estate for inheritance tax purposes, and, for some individuals, to achieve anonymity of ownership.

It is almost impossible to see how legislation of the type proposed could be framed in a way which would effectively distinguish between those situations which the Government regards as the legitimate use of a corporate owner and those situations involving SDLT avoidance.  It is, in fact, rare for a single-purpose property-owning company to be sold rather than the property itself, because most buyers would rather pay SDLT than inherit a second-hand company from an overseas seller whom it may not be able effectively to pursue if there are problems with the company later on.

The existing proposals would catch residential property funds investing in high value property and a large number of property developers.  In response to protests from these sectors, the Government has expressed a desire to protect bona fide businesses from the charge, but at present the proposed exception for property developers is only available to those with a two year track record of development who are developing for sale rather than for letting.

Our view is that if the Government is seeking a targeted measure to stop tax avoidance via the sale of shares instead of property, it is illogical to introduce new taxes on the acquisition, holding and sale of property.  The more appropriate approach would be to tax the sale of the shares.  Although this would not be without its own complications, it would at least address the perceived abuse without the risk of collateral damage.  Alternatively, if the existing approach to the legislation is retained, property exploited on a commercial basis could be excluded.

<u>Will the CGT charge be workable in practice?</u>

Imposing CGT on the sale of UK properties owned by non-residents, even in limited circumstances, is a significant change in the UK tax system in that it includes a new type of transaction in the tax base.  There is a concern that this is the thin end of a rather unpleasant wedge, and that the CGT charge might in due course be extended to more categories of seller and property than currently suggested.

It is unclear how this tax will be collectable.  Under the proposals, sellers should account for it under the self-assessment procedure by filing a tax return.  Precedent suggests that collecting tax from non-residents via conventional assessment does not work because of the difficulties of effective enforcement.  Many other jurisdictions that impose CGT on sales of land by overseas sellers do so by requiring the buyer to account for withholding tax out of the sale price.  This allows for effective enforcement because the tax authority can take a charge over the property if the tax is unpaid.  This cannot be done if the tax liability rests with the seller rather than attaching to the land.

It is hard to see the proposed CGT levy as part of a coherent package to dissuade the sale of shares in property holding companies rather than the properties themselves, because by applying to sales of land rather than sales of shares it incentivises owners to retain their corporate wrappers.

## Conclusion

The proposed measures are, in our view, conceptually flawed and disproportionate to the mischief which they are intended to cure.  As they evolve, they are likely to become extremely complex, and potentially damaging for the property and, especially, the funds markets.  Regrettably, fundamental change to the proposals is probably unlikely.  Given the increasing number of Budget measures which have been reversed, political pressures almost certainly mean that there is little chance of achieving major change to an anti-avoidance measure that is inherently popular because it is portrayed as targeting the rich.

If you would like any advice in this area please get in touch with your usual contact or, alternatively, Julian Bass or Simon Yates.


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