

Extension of corporation tax to non-resident corporates landlords (NRCLs)



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RECAP

NRCLs are currently liable to income tax - not corporation tax - on net rental profits. From 6 April 2020, rental profits of NRCLs will instead become liable to corporation tax (CT), with different rates, computational rules, payment and filing requirements. Some headline consequences:

corporation tax will be levied at 19% (assuming that, as announced in the election campaign, the rate will not be reduced to 17%) – currently, NRCLs pay basic rate income tax at 20%;

expenses of management should be deductible for NRCLs (unlike under income tax);

surrenders of losses between group members will become possible under the CT group relief rules;

financing will come within the loan relationship rules, where net debits and credits are calculated separately before being set off against rental profits. This may be more flexible, but the potential downsides include:

- potential restriction on deductions for interest and other finance costs (corporate interest restriction (CIR)) in excess of £2m per group to (broadly) 30% of EBITDA, subject to making an election which may allow full deductions for third party debt;
- restrictions on deductions of interest and other relevant costs under the UK's anti-hybrid rules; and
- restrictions on use of brought forward income losses and capital losses over £5m per group to 50% of profits in any one year – though pre-6 April 2020 property

rental losses will still be able to be carried forward for use against future profits without restriction.

Existing income tax withholding provisions under the non-resident landlord scheme will continue to apply to NRCLs (notwithstanding that they will be in the CT regime), unless the NRCL has permission to be paid gross.

COMMENT

The traditional offshore corporate holding structure, where, effectively, tax on income is reduced by tax deductible, transfer-priced finance costs (such as interest on shareholder loans), will no longer operate tax efficiently to the same extent for higher-value property-holding groups or entities.

This will potentially increase tax costs and consequentially reduce returns, so in this more challenging environment, consideration should be given (in particular in income-driven models) to optimising use of available allowances, such as capital allowances for expenditure on plant and machinery (at 6% or 18%, depending on the items concerned) and the relatively new structures and buildings allowance (currently at 2% p.a. of qualifying expenditure).

Those NRCLs with external debt might consider making an election to use the "group ratio" method, which can prevent or reduce CIR restrictions on third-party debt. However, care is needed to ensure that the debt is not inadvertently recharacterized as "related party debt" through linked shareholdings, guarantees or other arrangements.

Where there are hybrid entities, instruments or other arrangements, potentially all relevant financing costs

could be disallowed. Arrangements where this could be an issue (e.g., where there are "check the box" entities for US tax purposes in a structure) may need to be restructured.

We are likely to see more use of parallel, rather than group, structures to maximise use of the £2m and £5m de minimis amounts in the CIR and carried forward loss restriction rules respectively, although care should be taken with anti-avoidance provisions. While private equity real estate generally uses parallel structures anyhow, such that CIR may have less impact, the hybrid rules could still be relevant depending on the profit extraction methods and identities of the investors.

As regards compliance matters, NRCLs already carrying on a property rental business at 6 April 2020 will be automatically registered for CT and allocated a CT unique taxpayer reference number (UTR). Payment deadlines, tax return formats and filing requirements will all change, in many cases materially. Detailed HMRC guidance on these practical issues will be published in due course. NRCLs should contact their UK tax compliance providers for advice on steps they should be taking if they have not already done so.

In addition, HMRC are already tightening up on compliance measures by issuing notices to tenants reminding them of their obligation to deduct 20% tax at source. Landlords should therefore check that they have valid NRLS gross payment certificates if they wish to avoid adverse cash flow implications.