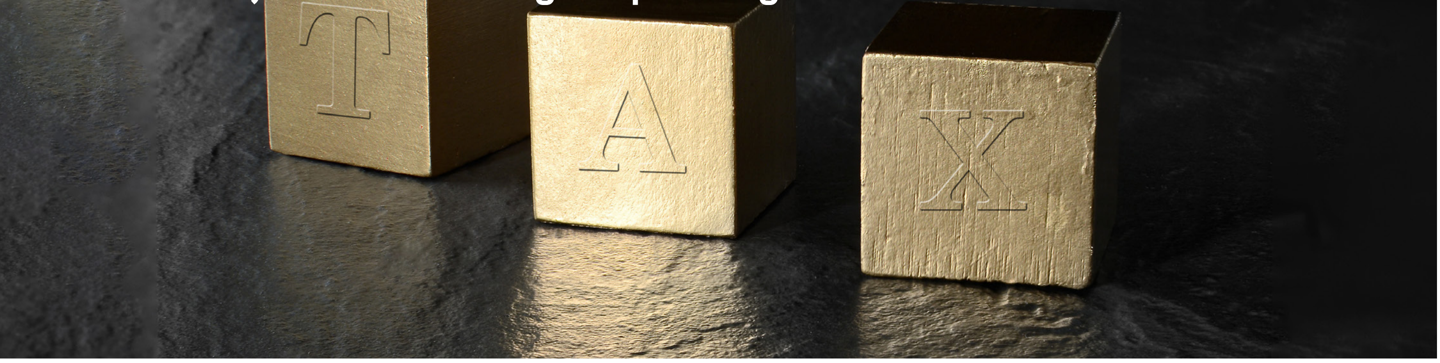
Sovereign's Laurence Lancaster on the Merits of Detailed Tax Planning for Foreign Investors in UK Property

Laurence Lancaster, Group Head of Tax, at The Sovereign Group, believes that no time is like the present for planning ahead. Across the globe, national governments and local governments are identifying new ways to raise taxes without impacting their political potential, and for the UK since the global financial crisis, there has been an increasing focus on foreign investors, including expatriates, to ensure they pay at least their fair share of duties and taxes in the UK, should they wish to own assets there, or reside there, even as non-domiciled residents. Lancaster spoke with Hubbis at length recently to highlight how the current pandemic offers wealthy expatriates, foreign individuals and investors with a good window to consider some smart, forward-thinking tax planning.



Lancaster is a non-practising UK barrister, specialising in UK private client and pensions taxation. Based in Hong Kong, his typical clients are high net worth individuals who require tax mitigation strategies and tax advice. He is a specialist on UK tax matters, and as Head of Tax for The Sovereign Group, he helps devise internal tax policies and strategy with a particular focus on UK tax compliance.

Lancaster begins our discussion back in 2012, at the Budget of the then-chancellor George Osborne, who to offset some of the domestic austerity measures was looking to impose a greater tax burden on high-net-worth individuals (HNWIs), focusing first on UK residential property. "They had their sights set on the acquisition of UK property through offshore companies, typically by non-domiciled, non-resident investors, perhaps based on land registry data showing how much high-end UK real estate was indeed owned by offshore companies. The reason was that anyone could acquire a property in the UK through an offshore company by paying the lowest stamp duty land tax (SDLT), the top rate of which then was just 4%."

And non-domiciled individuals (non-doms) could buy shares in the offshore company owning the assets, and not pay any tax on that share purchase, even though it was in substance the transfer of ownership of the property essentially, which would normally trigger SDLT and other levies potentially.

"Moreover, back then, if you held shares in the offshore company and not the property directly, and you were non-dom, you would not pay any inheritance tax," Lancaster reports, "so effectively there was this complete tax avoidance game going on with overseas investors whereby the first one would pay stamp duty through the company but then after that, there would be no tax that would be payable. And if the property was let out, it was quite easy to take out a mortgage and offset all the interest against rental income, so little if any income tax was being paid on rental income."

"These are the times we have been living in," he explains. "And the pressure for revenues for governments will only rise in the future, especially after this pandemic, so it is advisable to plan ahead, and structure properly. Although I suppose there is some small possibility that the government might loosen some taxes in order to boost inward investment after the virus abates."

Lancaster says few would argue, knowing the facts, that new measures were needed. "However," he comments, "in 2020 we are now at the other extreme. Back in 2012, they imposed a penal 15% SDLT rate if the residential property was bought through a company. It was originally targeted at high-value dwellings of over GBP2 million, but now it applies to any property of over half a million pounds."

MORE...AND MORE

However, Lancaster highlights one important exclusion of 2012, namely a letting exemption so that if a company buys a property and lets it out to a third party not linked to the shareholder, then normal SDLT rates apply.

He then runs through a variety of measures introduced in Budgets from 2013 onwards, including the annual tax on enveloped dwellings (ATED) targeting companies, but with the letting exemption. Then new capital gains taxes (CGT) applied to overseas companies where the letting exemption did not apply, and then from 2015 a similar (but lower rate) CGT for all other non-UK residents on any such asset, with no exemptions. However, he also notes a rebasing date, whereby if it was owned before April 2015, the owner is deemed to have acquired it on that date, meaning that if it was bought in 2010, the owner would report it for CGT purposes based on its April 2015 value.

More changes ensued in 2017, with inheritance tax (IHT) introduced for all non-UK domiciled investors who hold their residential UK property through offshore structures. Then in 2019, there was the extension of CGT to include commercial property and property rich companies. "Now, anybody who is non-resident and has commercial property, CGT will apply, whether owned by an individual or trustee and possibly also if owned indirectly in a company, so that without careful planning double CGT can potentially arise."

And 2020 saw the alignment of overseas companies with UK companies in terms of the main subject of corporation tax rather

LAURENCE LANCASTER
The Sovereign Group

than income tax, he reports: "and so if you are an overseas company, you are now going to be subject to corporation tax when you sell property, both residential or commercial." And from April 2021, as announced in the 2020 budget, there will be a new 2% SDLT charge for non-resident investors. "So, with the 3% SDLT surcharge that we already have on the purchase of a second home, anyone buying a property worth more than GBP1.5 million will now be subject to a top rate of 17% SDLT from that date. And if you happen to be a company buying the property and the property is not `let out to a third party, you will be subject to a flat charge of 17% SDLT."

COMPLEXITY REQUIRES SOPHISTICATED ADVICE

Lancaster comments that the UK rules now present a highly complex regime, meaning that it is highly advisable to take tax advice, especially as there are opportunities for tax mitigation. "The starting point of such planning," he reports, "is to separate out investment property from personal use and to look at the position of the company in relation to both types of property use."

He explains that for personal use, a company should be avoided, as they would be hit with the 17% SDLT flat rate, ATED, and then IHT on top potentially.

However, he explains that companies remain advantageous for investment properties, first because the 19% flat rate of corporation tax rather than potentially up to 45% income tax that applies to individuals, and secondly because a company still gets full relief on mortgage interest, whereas individuals do not. Moreover, other expenses can be offset through the company. "The prevailing view is therefore for an investment property it is better today to go through a company structure, and today a UK company, not an overseas company, is better, even if the investor is not resident or domiciled in the UK."

UK EXPATS: BE AWARE

For UK expats who remain UK domiciled and who want a property for personal use, they should buy in their own name and apply for the main residence relief, which applies to the main UK property, allowing for exemption from CGT, at least for those who return later to the UK to live in the property as their main residence.

And for those non-doms buying a property in the UK to use personally, unless for more expensive properties they might want to create a trust for that acquisition, but structured as a non-discretionary trust, which could potentially still have IHT benefits. "And for families with members perhaps going to study in the UK, who will use the property, there are some CGT advantages of utilising those family beneficiaries – children, grandchildren and so forth – using the asset as a residence over the years."

Lancaster mines down into the IHT concerns, noting for non-doms there remains certain types of trusts, under which rights of use are clearly carved out, which can be used if the property is for personal or family use. And for those going down the investment route, there are certain types of overseas pension schemes that you can consider and also still the use of life insurance, or more accurately insurance wrapper, but this must be structured correctly, with substance as an insurance policy or a pension scheme.

"The CGT rules introduced in 2015 and extended in 2019 for commercial property offer an important exemption for certain types of pension," Lancaster reports, "so they can be considered by investors, meaning that investment properties linked to life insurance and certain pensions allow for some tax mitigation. However, these investments must produce income, not in any way linked to the beneficial owner. In short, pensions potentially provide exemptions from both CGT and IHT charges, while for life insurance it is just the IHT that can be mitigated. And note that most of the time with these arrangements, you would want the individual to be non-UK resident, so we are very much focusing on our expat market."

HOW TO SAVE 5% ON LARGE INVESTMENTS

Lancaster then clarifies that the new 2% SDLT charge only applies to a non-resident investors for purchases from April 1, 2021, and not before. And as to the 3% SDLT surcharge in place since 2016, that applies to any UK residential property buyer who owns any other worldwide residential property worth more than GBP40,000.

"The exemption, however," he explains, "is that if the UK property is acquired to become your main residence globally within three years of the date of sale of your former main residence, wherever that is in the world, you are exempt from the 3% SDLT surcharge. This means an expat selling a home in Asia to buy a home in the UK, can be exempt from the 3% surcharge and has a three-year window to move in to the new UK property to fulfil the main residence criteria. And if you do all that before April 1 next year, you are effectively saving the 2% plus the other 3%."

MORE ADVERSE CHANGES COMING?

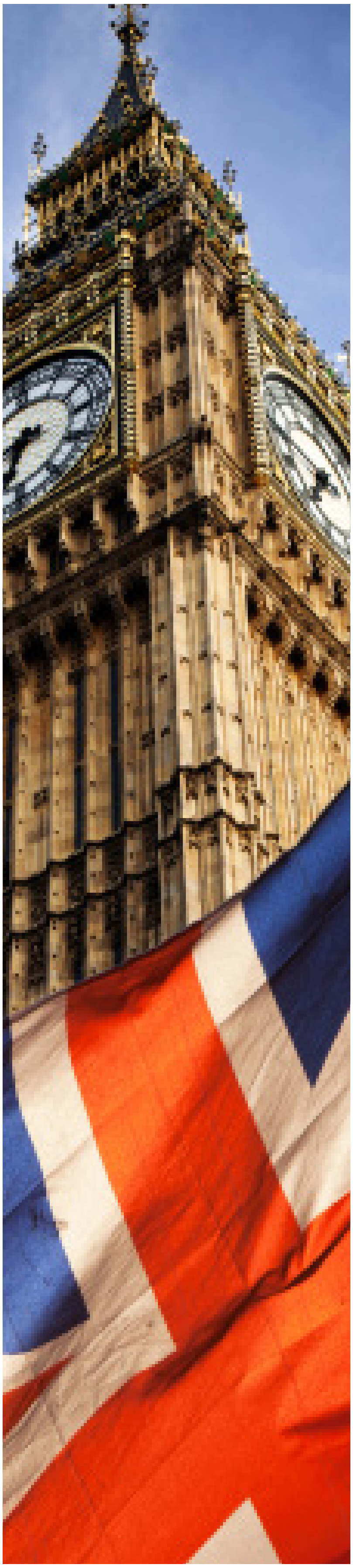
Lancaster observes that all these changes have been driven politically, to assuage pressure from various sources more perhaps even than for raising revenues, as transactions tend to reduce disproportionally more. "These are the times we have been living in," he explains. "And the pressure for revenues for governments will only rise in the future, especially after this pandemic, so it is advisable to plan ahead, and structure properly. Although I suppose there is some small possibility that the government might loosen some taxes in order to boost inward investment after the virus abates."

Lancaster comments that this lockdown provides a hiatus in normal life during which the more prescient clients can exploit. "This is complex," he warns, "and there are many holes you can fall into if you do not structure and plan properly. Anyone telling you over a glass of wine on a skype call that these matters can be ignored is somewhat foolhardy. Another issue right now is that the UK property market is quite depressed and the pound very weak, so theoretically it might be quite a good time to buy, especially if you think ahead to the April 2021 tax rises, or to de-envelope a property from a company so that it is owned directly, to minimise potential double CGT."

"And further ahead," he continues, "you want to be planning carefully for IHT implications, as there are truly draconian taxes for people acquiring through companies where the property is not let out. There are also all sorts of filing obligations as well with UK property, for example, if you sell or dispose of shares in a company that holds UK property, that has been subject to CGT since April 2019 and of course requires reporting within 30 days, even if there is no gain." This now being one half of the double CGT imposed both on the shareholder and the company.

TAKE TIME... IT IS WELL WORTH IT

His final comment is that good advice pays off for anyone considering such acquisitions, and even for those with any existing UK commercial or residential property so that they are properly structured for the future. "This is a very good time to step back and take a good, long look at these matters, for peace of mind for the individuals and families concerned." ■



Getting Personal with Laurence Lancaster

Lancaster is today Group Head of Tax for The Sovereign Group. He is a non-practising UK barrister, specialising in UK private client and pensions taxation. His typical clients are high net worth individuals who require tax mitigation strategies and tax advice.

His specialist areas include: advising on individuals' UK residence and domicile status; UK tax treatment of trusts and other structures including close companies and life insurance policies; UK's pension tax regime; taxation of UK residential property; estate planning; and double taxation treaty advice. As Head of Tax for The Sovereign Group, he helps devise internal tax policies and strategy with a particular focus on UK tax compliance.

Born in Coventry in the English Midlands, Lancaster attended state schools, then going to the University of Bristol and studied law, followed by a Master's in Law at Warwick University and then to Nottingham Law School to do his bar exams, before being called to the bar in 2006. Less than two years later, in 2008, he joined Sovereign where he has been rising the ranks ever since.

"The highlights of my career have been grappling with all of the technical changes to UK taxation really," he reports. "I started my career in tax in 2008, and since then there has just been a major sea change in legislation. Obviously, I specialise in UK private client tax and there has been an incredible amount to do to sort out our clients' affairs, including helping them in situations where they should not have been taxed, and they can successfully claim a tax refund from HMRC. But generally, we are looking at the ever-changing rules, advising clients how they apply to a certain situation, and successfully advising them on legally mitigating their taxation."

Lancaster is married to a Singaporean, and the couple has recently welcomed a daughter, shortly before Christmas. "X-mas, paternity leave and lockdown have meant we have enjoyed all the five months together," he reports, "which has been wonderful from a personal viewpoint. From a work perspective, it has been a bit of a struggle trying to do technical work with tax legislation from home, and perhaps with the normal issues surrounding a young baby, but I have been getting by well enough."

He has kept fit by running since university days, and continues to do so now, and also enjoys tennis and other sports, more form the spectator stands than on the courts or fields. "Singapore is also a great base from which to explore the region – I have been here since 2019 – and we enjoy travels to Bali and other interesting locations when we are in more normal times, although now we are restricted by the virus and of course the baby."

He considers the lockdown a major setback for economic and social life but hopes that the pandemic will have some benefits from reduced pollution, and also a greater focus on society at large and perhaps result in less individualistic behaviour. "But of course, once things return to normal," he says, "perhaps we will forget all that and go back to our old ways."