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TAX ADVISORY

UK Tax Changes for Offshore Corporate Landlords

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From 6 April 2020, non-UK tax resident corporate landlords (NRLs) are subject to corporation tax rather than income tax on their UK rental profits. Prior to this change, NRLs were subject to income tax (through withholding tax or direct assessment) on UK property rental income, unless they were operating out of a UK permanent establishment.

The most significant consequences of this change are that NRLs are now subject to the corporate interest restriction rules (CIR) and carry forward loss restrictions. CIR limits the amount of interest that can be deducted for tax purposes to, broadly, 30 percent of EBITDA, and the amount of carry forward losses that can be set against profits is capped at 50 percent of profits in any year.

NRLs are now also subject to corporation tax on any gains made on a disposal of UK real estate, whether direct or indirect, and regardless of whether the property is commercial or residential.

Key Changes

- **Registration.** NRLs will need to register for corporation tax if they have not already done so. Her Majesty's Revenue and Customs (HMRC) is in the process of automatically registering existing NRLs for corporation tax and will issue a corporation tax unique taxpayer reference (UTR) by 30 June 2020. Corporation tax returns must be submitted electronically together with iXBRL tagging and any necessary supplementary accounts.

- **Filings.** The first corporation tax accounting period relevant to NRLs starts on 6 April 2020 and ends on the earlier of the first accounting date of the NRL to occur after 6 April 2020 and 5 April 2021. All returns need to be filed online within 12 months of the accounting period end date. However, for those NRLs that have taxable profits in excess of £1.5m or in excess of £20m a quarterly instalment payment regime is operated.

- **Tax rate.** The current rate of corporate tax is 19 percent, (as opposed to 20 percent income tax previously payable by NRLs).

- **Interest relief capping.** The corporation tax regime allows tax relief on a wider range of finance costs than the income tax regime. However, CIR imposes a restriction on the deduction of net interest and funding costs for corporation tax purposes. CIR applies to a company/group of companies with an annual net UK interest expense in excess of £2 million. Tax deduction of net interest expense in excess of £2 million is, broadly, capped at 30 percent of UK EBITDA (as calculated for tax purposes, rather than accounting purposes). CIR may be problematic for some NRLs that are funded principally by shareholder debt, and these restrictions could have a significant impact on structuring UK real estate transactions involving significant levels of debt financing.

- **Interest payment relief**. Income tax rules allow interest payable on a loan used to finance a property to be treated as a tax deductible business expense for NRLs. Under the corporation tax regime, in contrast, an NRL's interest and finance charges will be treated as non-trading debits under the loan relationship rules and can be offset against non trading credits (broadly, interest receipts) with any excess (a non-trading deficit) available to offset rental profits.

- **Hybrid restrictions.** Corporation taxpayers are subject to the UK hybrid mismatch rules. For NRLs, this means that certain payments involving hybrid entities or hybrid instruments may be disallowed for tax purposes under these rules. Hybrid entities, or financial instruments that are entities or instruments, are treated differently for tax purposes in different jurisdictions (e.g., an entity that is transparent for tax purposes in one jurisdiction but opaque in anther, or an instrument where payments are taxed as treated as tax deductible interest payments in the payer jurisdiction and non-taxable distributions in the recipient jurisdiction.) All existing NRL structures should be reviewed carefully for any potential hybrid issues.

- **Loss relief.** Group relief will be available for losses between group members under the corporation tax group relief rules. There is an annual restriction — limited to 50 percent of profits with an annual allowance of £5 million — of carried-forward losses that may be deducted in an accounting period. Additionally, interest expenses may be deductible under non-trading loan relationship rules as discussed above.

Comments

The changes will impact all non-resident companies that either carry on UK property business directly or by using a tax transparent collective investment vehicle such as a Jersey property unit trust.

In particular, the typical corporate holding structure where 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.

Companies will need to calculate their profits in accordance with corporation tax principles, which may represent a significant change from the current method of calculation.

CONTACTS

For more information about UK tax on property rental businesses under the new regime, contact your Katten lawyer or either of the following:

Charlotte Sallabank
+44 (0) 20 7776 7630
charlotte.sallabank@katten.co.uk

Kit Fowler
+44 (0) 20 7770 5212
kit.fowler@katten.co.uk