STRUCTURING NEW PURCHASES OF HIGH VALUE UK RESIDENTIAL PROPERTY FOR PERSONAL USE

For several decades, the standard method of owning prime UK residential property for personal use was via a simple offshore company. There was no exposure to Inheritance Tax or Capital Gains Tax and also no Income Tax, although the "shadow director" rules always needed to be considered in respect of the benefit-in-kind anti-avoidance provisions.

The highly-targeted tax changes which came into effect in 2013 have completely turned the position on its head in respect of residential properties valued at £2m or more (but do not apply to properties acquired for letting, trading or development). In the vast majority of cases, corporate ownership is by far the worst option. Whilst it is certainly true that ownership via an offshore company ensures that Inheritance Tax (40%) is avoided altogether, Capital Gains Tax (28%) would now apply to all gains on the increased value of the corporate-owned property after 5 April 2013, and the new Annual Tax on Enveloped Dwellings ("ATED") also applies from 1 April 2013. This is an annual tax on the value of the property, charged at the following rates:

PROPERTY VALUE	ANNUAL CHARGE
£2m to £5m	£15,000
£5m to £10m	£35,000
£10m to £20m	£70,000
£20m+	£140,000

If this wasn't bad enough, since 21 March 2012 Stamp Duty Land Tax at the premium rate of 15% applies to new purchases over £2m made by corporate vehicles, limited partnerships or collective investment schemes, compared with the standard 7% rate.

These new measures have together resulted in a completely new tax and estate planning environment for owning high value UK residential properties. There is no "one size fits all" solution, and every case must be considered on its own merits. The planning opportunities have not been helped by further anti-avoidance provisions introduced in April 2013 which limit the circumstances in which debt is able to be offset against the value of the property for Inheritance Tax purposes where the property is owned personally or by a trust.

So, what options are open to the new purchaser?

There are several key questions to consider in each case. Which band of ATED would be applicable? Who is intended to beneficially own the property? Are they actually resident in the UK or is the property merely a *pied a terre?* Are any of the intended beneficial owners either domiciled or "deemed domiciled" in the UK? If not, is their status expected to change? For how long do they expect to own the property? How old are they? Are they generally in good health? Do they require mortgage finance to buy the property?

Only once the answers to these questions are known is it possible to fully consider the best option in each case.

It should be stressed that for those buyers who demand privacy of ownership, and who are not willing to have their names on public record as the property owner at the Land Registry, it is possible to own the bare legal title to the property via a corporate vehicle as a nominee without falling foul of the ATED rules, although the details of the nominee arrangement will still have to be disclosed to the Land Registry (without being on public record) in order to satisfy the Registrar that the 15% Stamp Duty Land Tax rate should not be applied.

Many professional advisors are advocating that their clients, generally, should avoid using a corporate vehicle to beneficially own the property. There are better, lower cost options available, although for elderly owners, or those in poor health, corporate ownership might just be the most practical solution.

Ownership through an offshore discretionary trust (even with a corporate trustee) can also sometimes be a good option as it avoids the ATED charge, although there would be a 6% Inheritance Tax charge on the net value of the property (i.e. offsetting a mortgage on the property) on each 10-year anniversary. If the clients are resident in the UK and are therefore receiving a benefit from using the trust-owned property, then the "gift with reservation of benefit" rules would apply, which means that the net value of the property would be deemed to be part of their estate for Inheritance Tax purposes.

In the vast majority of cases, direct ownership by the clients (albeit perhaps with a nominee company used to hold the bare legal title) seems to be the most common ownership arrangement recommended by leading professional advisors. The ATED rules are avoided entirely, as are the 10-year anniversary trust charges and the 15% Stamp Duty Land Tax rate. Capital Gains Tax is still potentially an issue, especially following the announcement in 2013 that the UK is going to levy tax on capital gains from "second homes" from April 2015. The legislation for this is not yet published, but it is generally expected that the existing "principal private residence" exemption for first homes would remain, and this would therefore protect those owners who are actually resident in the UK.

Of course, the downside of not using an offshore company to own the property is that the owners are no longer exempt from Inheritance Tax. The property would be within the taxable estate. Appropriate use of Wills can postpone the Inheritance Tax charge until the death of the survivor of a couple, but the exposure to Inheritance Tax is a major one.

Mortgages taken out to finance the purchase of a property are deductible, but loans taken out at a later date, including the amount of any increased facility, would not be allowable. This certainly restricts many debt structuring opportunities, but in the current climate a mortgage of up to around 75% of the property value ought to provide relief up to that level. The remaining 25% exposure (less any unused nil-rate band of currently £325,000 per person) can, subject to age and health status, typically be dealt with by taking out appropriate life insurance.

For relatively young and healthy buyers, the cost of life insurance can be surprisingly cheap, and can often be the most cost-effective option. It is crucial to be able to access appropriate life cover, which can often be hard to source for non-residents of the UK, and/or for high levels of cover.

In essence, buyers are typically needing to do a comparison between (a) using an offshore company, paying the 15% Stamp Duty Land Tax and the relevant ATED charge plus Capital Gains Tax, (b) using an offshore trust together with the costs of a mortgage (and possibly life insurance) and paying the 6% 10-yearly Inheritance Tax charge, and (c) buying in their own names and paying the costs of a mortgage and life insurance. There are many variables involved, which is why a standard solution does not exist.

CASE STUDY 1

Consider the case of a 50-year old couple, in good health, who are resident in the UK. They are buying a £20m London property with a £14m mortgage. Their combined nil-rate bands are worth £650k.

	OFFSHORE COMPANY	OFFSHORE TRUST	PERSONAL OWNERSHIP
SDLT	15% (£3 million)	7% (£1.4m)	7% (£1.4m)
ATED	£140,000 pa	N/A	N/A
CGT	Yes (28%)	N/A*	N/A*
10-yearly 6% IHT	N/A	£360,000 (£36k pa avge)	N/A
Life Insurance	N/A	£10,000 pa **	£10,000 pa **

* assuming Principal Private Residence Relief available
** estimate based on £2.5m of cover, joint lives, last-to-die 20-year term cover

Now, using the same circumstances, assume that no mortgage was required:

	OFFSHORE COMPANY	OFFSHORE TRUST	PERSONAL OWNERSHIP
SDLT	15% (£3 million)	7% (£1.4m)	7% (£1.4m)
ATED	£140,000 pa	N/A	N/A
CGT	Yes (28%)	N/A*	N/A*
10-yearly 6% IHT	N/A	£1.2m (£120k pa avge)	N/A
Life Insurance	N/A	£35,000 pa **	£35,000 pa **

* assuming Principal Private Residence Relief available
** estimate based on £9m of cover, joint lives, last-to-die 20-year term cover

CASE STUDY 2

Now consider another 50-year old couple, again in good health, but this time not residing in the UK. They are buying a £7m London property with a £5m mortgage as a *pied a terre.*

Again, their combined nil-rate band is £650k.

	OFFSHORE COMPANY	OFFSHORE TRUST	PERSONAL OWNERSHIP
SDLT	15% (£1.05 million)	7% (£490,000)	7% (£490,000)
ATED	£35,000 pa	N/A	N/A
CGT	Yes (28%)	N/A*	N/A*
10-yearly 6% IHT	N/A	£120,000 (£12k pa avge)	N/A
Life Insurance	N/A	£45,000 pa **	£45,000 pa **

* assuming Principal Private Residence Relief available
** estimate based on £1m of cover, joint lives, last-to-die 20-year term cover

Now, using the same circumstances, assume that no mortgage was required:

	OFFSHORE COMPANY	OFFSHORE TRUST	PERSONAL OWNERSHIP
SDLT	15% (£1.05 million)	7% (£490,000)	7% (£490,000)
ATED	£35,000 pa	N/A	N/A
CGT	Yes (28%)	N/A*	N/A*
10-yearly 6% IHT	N/A	£420,000 (£42k pa avge)	N/A
Life Insurance	N/A	£13,000 pa **	£13,000 pa **

* assuming Principal Private Residence Relief Available
** estimate based on £3m of cover, joint lives, last-to-die 20-year term cover

SUMMARY

As can be seen, the considerable number of variables involved can produce some vastly different results, and this really emphasises the need to look at each set of circumstances on a case-by-case basis. The solutions above are potentially further complicated by the situs rules for life insurance policies (non-UK carriers are therefore strongly preferred), and also by the remittance rules where the client is UK-resident, but not domiciled in the UK as it will be necessary to avoid making remittances to the UK of foreign income and gains to fund life insurance premiums or to service an onshore mortgage.

PraxisIFM is able to fully co-ordinate the structuring process, working closely with third party tax advisors and life insurance specialists. We can also arrange mortgage facilities from a variety of offshore and onshore lenders.

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