TaylorWessing

Property Passport
United Kingdom

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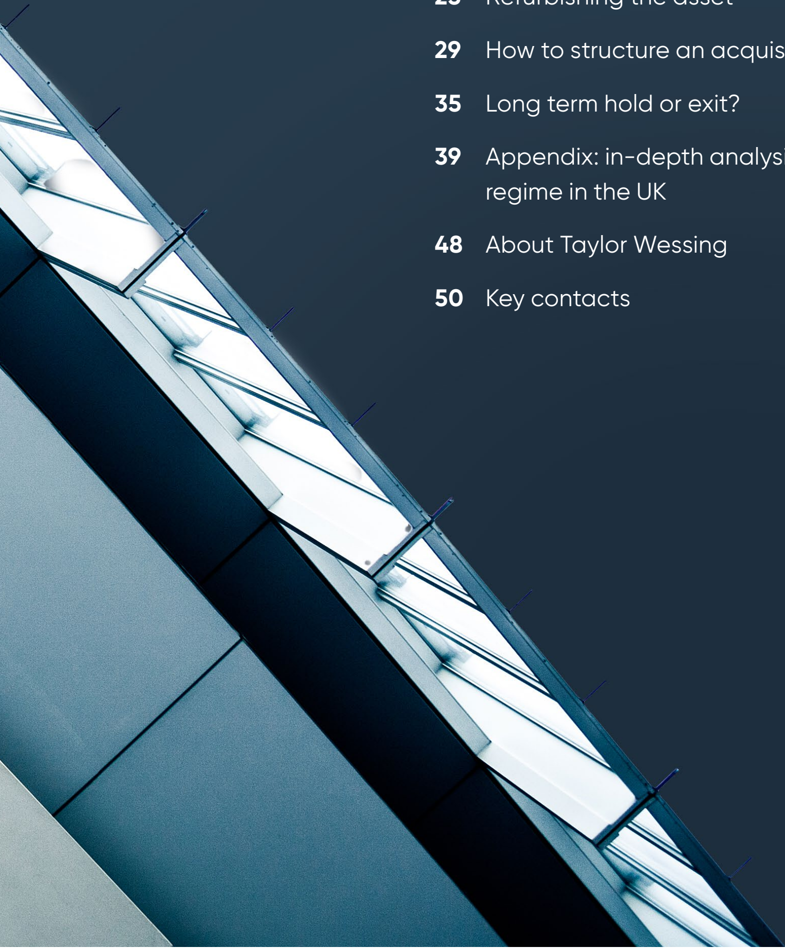

Introduction

Like the rest of the world the UK market has been affected by extreme events including a pandemic, war and economic instability. The UK itself has also faced continuing political uncertainty since Brexit; the year 2022 bringing three prime ministers, four chancellors and six fiscal events, adding more pressure to the inflationary landscape.

Despite the tumultuous background the UK property market remains a strong and stable economic force. While 2022 was characterised during the autumn by a stalling of the property market, since then confidence has rapidly improved with the outlook for 2023 being strong.

The UK Government continues to emphasise that the UK is open for business on a global basis and that trade deals are there to be struck with both Europe and beyond. From a pure property perspective, London will continue to be a key centre for overseas investment. However, since the Conservative Government came to power there have been continued efforts to rebalance the economy by increasing investment across the UK.

This investment in towns, cities, rural and coastal areas has continued to increase the potential for capital appreciation and strong yields outside London. This means investors are looking beyond the capital for investment returns.

With the return to the office since the pandemic, the City of London office market has seen consistent levels of recovery, with high-quality space remaining key as the need for environments which enhance employee's wellbeing increases. In addition, as the sector starts to settle and with the pound at an historic low, many international investors are identifying clear future growth prospects. International investors are therefore seizing the chance to invest in office, hotel and residential investment and development opportunities.

At Taylor Wessing we are highly experienced in all aspects of Real Estate – it is at the heart of what we do and clients value us for it. From initial expression of interest in the UK market to acquisition, management, refinancing, development and possible disposal, we understand the needs of our clients. International clients regularly turn to us for advice on how to structure, build and renew their UK property portfolios. We are there for you too.

The passport is intended to be a concise and practical guide for overseas investors and others who require advice on:

- **Investing in UK property** – why is the UK an attractive investment; reasons to invest; tips for a profitable investment; selecting the right asset; structuring the right deal.
- **Managing UK property efficiently** – understanding the rules which apply in relation to UK landlord and tenant law in order to gain value from your property investment, and
- **Structuring UK property investments for efficiency** – considering the various corporate and tax structures that will enable you to achieve your investment in an economic and effective way.

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Why the UK?

When it comes to investment strategy, global investors differ in their thinking. Some look for short term returns and yield compression (investing at the bottom of the cycle), while others take a very long term view – buying at lower yields but taking the view that they are securing wealth for future generations. For others the key is asset or jurisdictional diversification.

The key to investment strategies is London's position as a leading global city – financially, culturally and socially. Whether in the West End, Mayfair, Knightsbridge, the City, Docklands or other locations, London is attractive to major corporate occupiers crossing all sectors (from retail to technology to insurance, financial services and beyond). The covenant strength of those occupiers and the terms of the leases under which they occupy help to create the investment value. Further, London is expected to grow significantly as a city over the next 20 years and overseas investors are already helping to deliver the 40,000+ residential units per annum which are needed to sustain this growth.

While Brexit (and our impending divorce from the EU) creates a very challenging environment, the UK's political landscape is relatively stable, with both Central and London government across the political spectrum welcoming international investors to London and beyond. In addition, the legal and tax systems are transparent. Unlike some of our European neighbours, there is no tradition of introducing retrospective legislation to increase the overall tax burden. Although the UK tax regime applicable to real estate has been in a process of change in recent years, broadly the result is to bring the UK in line with the position in other jurisdictions.

Whether you are looking to purchase, fund or develop in the UK, you will be joining a growing group of international investors who, in the challenging times in which we live, see London (and the UK) as a highly attractive place to invest.

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Clients note that the firm can provide a comprehensive service owing to its 'big network of specialist lawyers' and ability to 'pull in experts when needed'.

Chambers and Partners

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Taylor Wessing handles an impressive array of investments, developments and projects for investment funds and trusts, corporate entities and charities, amongst others. Clients have confidence in the service and advice – they provide good commercial advice, being reactive and proactive, and getting deals across the line.

Chambers and Partners

Selecting the right asset

UK real estate has, at least since the Second World War, been cyclical. In light of this, investors need advice on asset classes in which to invest, asset location, covenant strength of tenants and overall timing. At the bottom of the market, yield compression can look attractive, but at the top of the market, purchases can look expensive unless one is looking to 'reinvest the family silver' ie to hold a well located property throughout the current cycle and well beyond.

In Central London, international investors have looked traditionally to core strategic locations for example, Mayfair. Today, international investors have now very much spread beyond that to Mayfair and West End, City and Dockland markets, and are also now looking beyond London and into the regions so as to secure value. Care must be taken, however, as attractive yields in a non-prime location may simply be due to the covenant strength of the tenant (particularly where the tenant is a government body). Of course, the tenant may change and so specialist advice should be sought.

At Taylor Wessing we work closely with local and international firms of surveyors, quasi private family offices and other bespoke houses looking to work with international investors. We are always focussed on delivering the deal with strong commercial advice, efficiently and with the minimum of fuss.

Our real estate team has decades of experience of acting on property acquisitions and sales both large and small for both commercial and residential properties. From trophy assets to investment purchases of multi-tenanted Grade A well let investment stock, to the acquisition of shopping centres, from the forward purchase of complex development sites to the purchase of high end flats, we have a wealth of experience in all areas. From our long years of experience we appreciate the issues that particularly concern overseas investors.

We guide investor clients through the whole purchase, discussing with you/your other advisors and reporting on many different areas including:

- Title to the property (are there restrictive covenants or other third party rights which restrict the use of the property?).
- The search package provided or a package that we agree to effect with you (ie searches of public registers for information relevant to any purchase).
- Replies to pre contract enquiries.
- Reviewing and reporting on environmental and zoning/planning matters, and the permissions, licences and consents that are required for development.
- Verifying tenancy schedules.
- Reviewing and reporting on the occupational leases (including service charge recoverability).
- Outstanding rent reviews.
- Outstanding tenant disputes or disputes with other parties such as neighbours.
- The build package (for example, if the property has been constructed/refurbished within say the past eight years, it would be beneficial to take an assignment of such development package as may be available).
- SDLT (Stamp Duty Land Tax), VAT, capital allowances and other tax and structuring issues.
- Liaising with your surveyors on management contracts.
- Negotiating and agreeing the form of purchase contract and ancillary documents.
- Advising on vacant possession strategies if the property is a target for development, and
- Dilapidations claims if the lease/s are nearing the end of the term.

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Taylor Wessing is trusted by clients around the world to deliver success through an outstanding partner-driven service.

Legal 500

Managing the asset

Real estate assets have a natural life cycle and the assets need to be nurtured throughout that cycle to maximise return for investors. There are a number of aspects which are important to managing any building.

Attracting the right tenants

Whether you own or are looking to own a prime West End office building, an out of town shopping centre or a portfolio of industrial warehouses, the key question will be – how do I secure my rental income and can I trust the tenants to look after my building properly?

Different sectors of the market will look at this in different ways. For most landlords, the key will be the covenant strength of the proposed tenants (and, if not sufficient, how that covenant strength can be boosted by rent deposits/parent company or bank guarantees). For others, covenant strength will be less important. For example, landlords of short term rented storage space will be more interested in occupancy rates and the ability to take back possession if a tenant fails to pay the rent.

The market will dictate what package you need to give to tenants (by way of rent free period or other incentives), but choose your tenants wisely. You could be starting a long relationship with them!

Allocating liability

Allocation of liability is largely a factor of the age and nature of the building. If a tenant is taking space in a building in, say, the final five years of its life prior to demolition, the tenant will want to have its repairing liability capped. Similarly if a tenant is taking space in a brand new building, it will be concerned about liability for remedying defects in the building from the construction phase.

Flexibility

Increasingly in today's market both landlords and tenants are looking for flexibility. This means that, more often than not, tenants are not being offered leases with security of tenure, but rather leases which have break clauses in them say at three or five year intervals. (Security of tenure means the automatic right to renew the lease when it expires, unless the landlord can dispute this on a limited number of grounds).

Collecting your rents

As an overseas landlord, it is important to have trusted local surveyors to manage collection of rents and to run any service charge efficiently for you.

Managing rent reviews

Your surveyors will also likely act on (or outsource to specialist surveyors) rent reviews for you, to advise you on what steps need to be taken to implement reviews and to secure the best possible increase in rent, given the local market dynamics and the terms of the lease. Our real estate disputes team works regularly with surveyors in interpreting rent review clauses.

Managing the asset

We work closely with surveyors in managing property assets throughout the cycle of the letting, from:

- grant of lease to licences for fit out/licences to assign/licences to underlet
- dealing with any breaches by the tenants during the life of the lease to renewing the lease at the end of the term, and
- interim or final schedules of dilapidations to service charge disputes and debt recovery.

We work together to ensure that the value of the asset is protected and enhanced.

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Their client interaction skills are strong, they are attentive to our needs and good value for money. Their client service and desire to support is exceptional.

Chambers and Partners

Financing the asset

An investor may wish to finance the acquisition and/or development of a property by raising debt, either at the time of acquisition or by way of refinancing, following the acquisition of a property. The investor may wish to consider that some sellers may perceive procuring debt as slowing down transactions.

Our team acts for a wide range of banks and other lenders internationally on complex arrangements, including sharia'h-compliant financing.

We are highly experienced in negotiating and structuring property acquisitions and development projects to ensure that they are suitable for financing. Typically, such financings are structured conventionally as interest bearing term loans, in some cases also supported by mezzanine or alternative finance.

If an investor is contemplating debt finance, it is important that the expectations of a lender are considered at an early stage, to ensure that the corporate structure, tax structure, and title structure will be compatible with a lender's expectations. This would ensure that if financing is required, the lender's loan criteria can be met quickly and smoothly.

Typical lender requirements

When looking at financing the acquisition of real estate in the UK, a lender will typically expect the following criteria to be met:

- The property to be owned by a ring-fenced special purpose vehicle (SPV) which is able to grant full security, including a mortgage over the property, in favour of the lender.

- The lender's expectation is that the SPV would not have any other creditors, other than the investors, and that the investors' debt would be subordinated/postponed to the lender's debt.
- In most cases, the lender would expect to take security over the entire issued share capital of the SPV, whether the SPV is incorporated in the UK or offshore.
- A loan agreement would be entered into between the SPV and the lender, which would contain, amongst other things, a number of undertakings which the SPV must comply with in relation to how to manage the property, the rental income received from the property, and the operation of the SPV itself.
- A lender would expect to have some control over the rental income received from the property to ensure that this rental income is first applied in payment of interest under the loan. This can be done by granting security and signing rights to the lender in respect of the bank account into which rental income is paid, or, if a managing agent collects the rent, by obtaining an appropriate duty of care undertaking from the managing agent.
- Lenders will typically require a number of other conditions to be satisfied prior to making the loan available, including the receipt by the lender of a satisfactory valuation, building survey, insurance, and report on title/certificate of title, as well as board resolutions, directors' certificates and legal opinions.

Mezzanine finance and joint ventures

In current market conditions, it is not uncommon for the financing of the acquisition of a property to be funded by equity, senior debt, and mezzanine debt. Mezzanine lenders may seek to require their debt to be serviced at the same time as senior debt or, for example, agree that mezzanine payments are postponed and made upon the sale or refinancing of the asset. The latter approach is akin to a joint venture model.

A mezzanine lender will typically expect to take second ranking security over the property, and will require that an intercreditor deed or priority deed is agreed with the senior lender in order to document any enforcement rights the mezzanine lender may have.

Alternatively, additional equity or finance could be sought with a joint venture partner, and this could be brought into the acquisition structure at a level which sits above the level into which debt is introduced. This would be done with the input of our corporate and tax teams to ensure that the proposed structure is tax efficient and the intention of the parties is adequately documented through a joint venture agreement or otherwise.

Development finance

Under a facility which also provides for funding to be made available to finance the development of a property, the basic requirements of a lender are the same as for an acquisition facility, but a lender would also expect the following:

- An independent project monitor appointed by the lender to verify that the development will be completed on time and on budget, and to sign off on invoices to be paid by drawdown of the loan.
- Approval by the lender of the professional team appointed to complete the development, and collateral warranties to be provided to the lender from that professional team.
- Review and approval of any planning consents and pre-let agreements put in place and sign off on any rights of light issues that may arise pursuant to the development.
- If relevant, provision by the lender of an interest roll up facility to service interest on the loan during the development phase.
- The lender would also expect the borrower to sign up to a number of other development specific covenants and undertakings.

Financial covenants

When determining whether a lender is willing to fund an asset, and how much it is willing to fund, the lender will consider the asset class, tenant strength and geography of the asset, as well as the expected compliance by the SPV of a number of financial covenants:

- **LTV:** the LTV covenant, or the loan to value covenant, is the ratio of the principal amount of the loan expressed as a percentage of the value of the property.

- **Interest cover:** the interest cover covenant that tests the ratio of rental income received from the property to the interest due under the loan over a certain period.
- **Debt service:** the debt service covenant (or DSCR, as it is also known) serves a similar function to the interest cover covenant and is intended to benchmark the ability of the SPV borrower to service its debt through the income received from the property.

Islamic finance

Real estate is predominantly a Sharia'h compliant asset class and can therefore be a very suitable form of security for structures where investors require finance to be provided on a Sharia'h compliant basis.

There are a number of mainstream and specialised lenders who will agree to provide finance on a sharia'h compliant basis, and those that do so will typically provide this finance using either a commodity murabaha structure or an Ijara lease structure. This is a specialised area of real estate finance in which Taylor Wessing frequently assists clients.

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They work to tight deadlines in an efficient and professional way.

Chambers and Partners

Refurbishing the asset

Whether you are looking to purchase a high end residential property or invest in a commercial property, the purchase of property often needs extensive development, renovation or refurbishment.

We are experts in advising international clients on property development and refurbishment and focus on preferred contractual structures, permissions and approvals. Of course, there are numerous other construction matters which may need to be considered and we have a sizeable construction team ready to advise on all eventualities.

Choosing the right contractual structure and insurance

Depending on the extent of the works required for the property, and its proposed end use, construction works for a development and renovation or refurbishment may involve:

- the property owner
- a team of design consultants (most likely led by an architect)
- a project manager
- a main building contractor, and
- several subcontractors.

In the UK, there are a number of industry standard contracts which deal with the risk allocation and duties of the parties in various ways. Deciding on the appropriate contracts for you will depend on a number of factors, including:

- How involved you (as the property owner) wish to be in the project.
- The level of design input to be provided either by the architect (and other designers) or the builder.
- Where the allocation of risk is, whether it is to be split between several parties directly appointed by you or whether it is to remain with the main builder.

- Whether you wish to appoint a project manager to assist with the management of the project.
- Tax implications for each type of contractual structure.

We have extensive experience covering all areas of construction law, from recommending a contractual structure to delivering legal protection for the works to be carried out at your property, to drafting and negotiating the suite of construction documents needed for a development project.

There are several different types of insurance that you will need to be aware of. Insurance is critical to protect against potential liabilities to the public and in respect of issues that may arise in relation to the development. It is important that you take specialist insurance advice on the appropriate type and level of insurance cover for your project.

Permissions and approvals that may be required for refurbishment works

If you are proposing to carry out development works in the UK, this will usually require planning permission from the local planning authority. A planning application will need to be submitted comprising of architectural drawings and details of the proposed works.

In the UK, planning permissions are invariably granted subject to conditions which need to be complied with and incorporated into the construction process.

Depending on the type of development that you wish to carry out, there are likely to be various UK standards and regulations that the works will need to comply with, such as building regulations (which regulate the standard of construction and materials used in building works in the UK) and health and safety regulations.

A National Planning Framework for the UK makes it clear that sustainable developments are more likely to receive planning permission. Taking account of sustainability issues will have a big impact on the value of the property at resale in the UK.

We can advise you on the necessary steps to be taken under the planning process in the UK and also what applicable regulations and standards will apply to your development, whether your property is to be used for residential or commercial purposes. Our team has extensive experience of working alongside consultants for projects to identify, manage and interpret the legal considerations.

Managing payments and disputes

The payment process should be set out in a building contract. Usually building contracts provide for the builder to apply to you as its employer for payment.

Applications for payment by the builder should be reviewed promptly and payment should be made by you in line with the timescales set out in the contract.

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Clients say that the team offers 'excellent customer service, impeccable advice and good value for money'.

Chambers and Partners

How to structure an acquisition

There are numerous structures that can be used to hold UK real estate. The right structure will depend on the tax analysis around the investor's intentions for the property.

By way of example, one should consider:

- Is the property intended for investment or trading?
- Is the investment with others as part of a joint venture?
- Is there to be any bank debt or other external funding?

The most common structures for real estate ownership (not exhaustive)

UK company – this is the most common vehicle for investment in UK real estate.

A private limited company will have a share capital and, subject to relatively narrow exceptions, the legal liability of the shareholder(s) will be limited to payment of the share capital held by them in the company. The main advantages include its simplicity, the limited liability of the owner(s) and its flexibility in terms of ownership and management.

In certain circumstances a public limited company may be used, for example where it is desired to list the vehicle's shares for public ownership. Certain tax benefits apply to suitably structured listed companies that qualify as real estate investment trusts (REITS).

Partnerships – to constitute a partnership the persons concerned must 'carry on a business in common with a view of profit'. It is a question of fact whether or not a partnership exists and property co-ownership does not of itself create a partnership.

Each partner is taxed on his/her own share of the profits. In addition, there are no restrictions on partners participating in the management and control of the business of the partnership.

A partnership structure has the significant disadvantage that all the partners are jointly liable for the partnership debts and such liability is unlimited.

Limited Partnerships (LP) – an LP is similar to a partnership, except that certain partners elect not to take an active role in the management and control of the business of the LP (in return for receiving limited liability).

The advantage of using an LP structure is that a partner can enjoy limited liability but at the same time can retain tax transparency to a significant extent.

An LP must have at least one general partner. That partner is liable for the partnership debts and obligations, but a limited company with a nominal issued share capital usually acts as general partner.

Limited Liability Partnerships (LLP) – an LLP is a body corporate with a legal personality separate from its members. Importantly, the members have limited liability. It therefore has advantages over a limited partnership as there is no need for a 'general partner' who is liable without limit.

Each member of an LLP may participate in management without losing the benefit of limited liability. Except in certain circumstances, an LLP is treated for taxation purposes as if it were a partnership; profits and losses will accrue directly to the members in their relevant proportions.

Non-UK companies – in recent years it has been popular to hold UK real estate through a company incorporated outside the UK. The advantages of doing so will largely depend on the specific tax analysis and recent changes to the UK tax regime have eroded previous benefits to offshore ownership structures in many respects. Non-UK companies holding UK real estate must pay UK corporation tax on rental profits under the 'non-resident landlord scheme' and pay UK corporation tax on capital gains from realisations of assets. Investors may also be liable to UK corporation tax on gains from realisations of their shareholdings in UK property rich vehicles. There will also be cost and administrative implications in maintaining a non-UK tax residence.

However, there remain potential advantages in owning UK real estate through a non UK resident company, being the elimination of UK stamp duty on a share sale, and for unsecured loans, avoidance of UK sourced interest to which witholding tax might apply.

Jersey Property Unit Trust (JPUT) – a JPUT is a unit trust governed by Jersey law and used to hold real estate. A unit trust is not a legal entity: under a unit trust, legal ownership of the trust assets is vested in one or more trustees, who hold on trust for the benefit of holders of units in the trust. JPUTs are generally structured so that income is treated as belonging to (and is therefore taxed in the hands of) unitholders. Similarly to non-UK companies, investors in JPUTs may, from April 2019, be liable to UK tax on gains from realisations of their holdings in a JPUT (and the JPUT itself may be liable to UK tax on realisations of UK property). It may be possible to make an 'election for transparency' so that a JPUT is treated as a partnership for the purpose of taxation of chargeable gains, but is still treated as a company for SDLT purposes such that units can be sold without a charge to SDLT or stamp duty.

Managing liability and tax efficiency will be core to your needs. We regularly advise on establishing appropriate UK and/or foreign corporate structures, such as those described above. Such arrangements are bespoke and will require detailed discussions before an appropriate structure can be selected and implemented.

Investing in UK real estate? The UK tax regime and its application to offshore investors

The UK real estate market remains very attractive to non-UK resident investors, not only due to its consistent financial performance, but also because of moderate levels of taxation compared to many jurisdictions, together with a steady demand for the introduction of foreign capital.

In the past the UK tax regime for real estate has offered numerous advantages to the non-UK resident investor with careful structuring and attention to detail. However, the UK taxation regime has evolved in recent years particularly in relation to residential property and new rules aimed at ensuring UK tax applies to all profits of property development. Furthermore, from April 2019, capital gains tax was extended to cover many non-residents investing directly and indirectly in UK commercial property, and from April 2020 rents were brought within the scope of corporation tax (and ceased to be subject to UK income tax) for a non-UK resident company and with that new rules restricting interest deductibility on financing costs.

In the next section we explain some of the key issues and opportunities of which you should be aware.

Key features

- 19% corporation tax (rising to 25% in April 2023) on rental profits from investment property held by UK and non-UK resident companies.
- 19% corporation tax (rising to 25% in April 2023) on profits from property development.
- Potential to use own-source debt finance to reduce taxable profits (subject to certain restrictions).

How does the UK tax real estate business?

Investment or trading?
The UK distinguishes between the acquiring and holding of property for medium to long term returns in the form of rental income and capital growth (typically termed 'investment') and the acquisition/development of property for onward sale (typically referred to as 'trading').

A non-resident person that trades in UK property will be subject to UK corporation tax or income tax (as appropriate) where the trade comprises trading in UK land or developing UK land with a view to disposing of it, regardless of whether or not the trade is carried on through a permanent establishment in the UK or elsewhere.

With effect from 6 April 2019, capital profits from disposals of commercial property acquired and held by non-UK resident persons as investments are also subject to UK tax (including gains realised in certain cases by disposing of vehicles that hold, directly or indirectly, UK property).

Broadly, non-resident investors will benefit from a 're-basing' of their assets to current market value at April 2019, so only gains occurring thereafter should fall into tax (if the original cost is higher than the April 2019 value it is possible to use that cost instead).

The position for residential property is explained below.

Income (eg rental) profits from investment property owned by non-UK residents may be paid gross without deduction of UK withholding tax at source on appropriate application being made to the UK tax authorities.

With effect from April 2020, the scope of corporation tax was extended to non-resident companies within the charge to UK income tax. The current corporation tax rate is 19% (rising to 25% from April 2023), but being within the scope of corporation tax will also result in certain other corporation tax rules, including restrictions on tax relief for interest expenses, applying to non-resident companies.

Ultimately, the trajectory of the UK tax regime is moving to one where all investors (UK or offshore) are taxed equally, but at a low headline rate (19%) compared to many jurisdictions (although rising to a less competitive 25% from April 2023).

Commercial or residential?

The UK's tax regime has in recent years changed to introduce considerably higher tax charges for certain owners of residential property. These charges are explained in more detail in the Appendix. From April 2015, certain non-UK resident owners of residential property became subject to UK tax on capital gains derived from a disposal of their property.

Broadly, from April 2019 the capital gains tax and income taxation regimes applicable to residential and commercial property have been aligned.

Long term hold or exit?

Are you looking to, or have you invested for the short, medium or long-term?

At Taylor Wessing we fully recognise that different clients have different investment strategies – driven by unique commercial, familial or geopolitical circumstances.

It is important for us to fully understand at the outset your unique commercial imperatives as the strategy of acquiring, managing and exiting the asset (as well as the holding structure) will largely depend, and needs to reflect, the investment intention of the acquisition. You need to consider whether the asset will be held for any length of time or whether the intention is to sell the asset (and crystallise profit) at an early stage. On any purchase we will analyse the constituent parts of the project with you, provide constructive solutions for resolving any issues that may arise, and drive the transaction through to the earliest possible conclusion by using our extensive partner led teams.

If there is an intention to retain the asset for a period of time then there will also be an enhanced prospect of working the asset to increase value (eg by potential lease regearing and refurbishment). The letting strategy will need to be taken into account and also the existing lease profile of the building – for example, there may be times when to relet to a better covenant (and so enhance value) you need to pay tenants to surrender their leases early.

The ability to add value to a property through asset management is often overlooked by those providing legal services. We recognise the importance that this aspect of the property ownership will have for you, and will work in collaboration with you to achieve your objectives.

Whether you are looking for a short, medium or long term exit, we at Taylor Wessing have a strong and experienced team who regularly act for overseas investors in all aspects of their real estate needs. We put ourselves in our clients position. We want you to know that you are well served in all of these areas by our pro-active and commercial advice.

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One client praises the team as 'commercially switched-on and very strategic in their advice'.

Chambers and Partners

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Taylor Wessing LLP's 'engaging, knowledgeable and personable practice provides a very cohesive and complete solution to real estate issues'.

Legal 500

Appendix: in-depth analysis of the tax regime in the UK

The UK rules on real estate taxation have been subject to considerable change over the last few years. Maximising net gains and net income after tax and the cost and ability to extract those proceeds is key.

Investment in commercial property – recognising the opportunities

Capital gains

Where a non-UK resident investor acquires a UK commercial property for investment purposes, any capital gain earned on a subsequent disposal of the property will be subject to UK tax. From April 2019, capital gains tax has been extended to non-residents investing directly or indirectly in non-residential property, but with a 're-basing' to April 2019 market values to protect gains accruing before that date for tax (save where historic cost exceeds April 2019 value). UK resident investors are also subject to tax on capital gains arising on disposal.

By contrast, property acquired and held on trading account or with a view to development and/or onward sale will broadly be subject to different corporation tax rules and the above regime (including the April 2019 re-basing) will not apply. It is important to establish and document a clear intention from the time of acquisition of the property that the property is to be held for the medium to long term to support the investment nature of the venture. We will help to ensure that the UK tax treatment for the acquisition, holding and any eventual disposal of the property is considered and properly addressed from the outset.

Tax on rent

A non-UK resident investor which is a company and which holds UK property as an investment is liable to pay corporation tax (at 19%, rising to 25% in April 2023) on rental profits during its period of ownership.

Deductions are available in computing rental profits for expenditure incurred for the purposes of the property investment, in particular finance costs. 'Transfer pricing' rules exist to limit such deductions to costs that are consistent with arm's length borrowing arrangements.

The corporation tax regime also includes restrictions that may apply to limit tax relief for interest to 30% of the company's (or the company's group's) UK EBITDA, subject to a group ratio rule that broadly seeks to prevent multinational groups gearing UK companies to a higher level when compared to the group's overall level of external debt. The restriction on tax relief for interest is subject to an annual de minimis of £2 million in interest expense.

We will work with you to ensure that your structure is established in the most tax efficient way possible.

Repatriating profits

It may be possible to structure the investment into UK property in such a way as to enable profits to be returned to investors without significant UK tax leakage on an exit. Typical routes include payment of dividends (or other distributions on a winding up of an investment vehicle) or repayment of shareholder debt (with accrued interest). No UK withholding tax applies to dividends, and interest may be eligible to be repatriated without any withholding tax or other UK tax leakage (depending on the jurisdictions involved).

Stamp Duty Land Tax (SDLT)

The UK charges a transfer tax, SDLT, on the purchase of property interests in England and Northern Ireland. SDLT was originally UK-wide but has now been replaced by Land and Buildings Transaction Tax in Scotland and by Land Transaction Tax in Wales. These systems are heavily based on the SDLT rules. This guide will discuss the SDLT rules only. For commercial or mixed use property purchases, SDLT is applied on a sliding scale depending on the price paid, with different rates applicable to portions of the overall price. No SDLT is paid on the first £150,000 of the price, with 2% applicable on the price between £150,000 and £250,000 and the rate of 5% applicable in respect of the price over £250,000. For residential properties, the maximum rate is currently 17% for purchases over

£500,000 by certain offshore companies and other non-natural persons (under special rules, explained below). However, no SDLT generally arises when a purchaser acquires shares in a company that itself holds UK property. Further, if the company is incorporated outside the UK a purchase of such shares does not generally give rise to any charge to UK stamp duty or stamp duty reserve tax. As a result, there is a transfer tax benefit in acquiring and disposing of UK property via a company and, particularly, where that company is incorporated in a jurisdiction that does not impose any transfer tax on dealings in shares.

We can liaise with your local tax advisers and recommend the best structure for you and negotiate with the seller to achieve the best outcome. Types of vehicle that can offer efficiency include companies and non-UK resident (typically Jersey) unit trusts. Types of structure that can also offer transfer tax savings include 'forward sale/purchase' arrangements where the land purchase is independent of any cost of construction of a property (particularly of interest to developers).

Value Added Tax (VAT)

The UK charges sales tax (VAT) on certain dealings in property.

With certain exceptions sales of commercial property will generally be exempt from VAT. However, commercial property owners have the ability to 'opt to tax' their property, which causes the sale and letting of that property to be subject to VAT (current rate 20%). Broadly, if a buyer is required to pay VAT to a seller on the purchase of property, the buyer will be able to claim credit for such VAT from the UK tax authorities (the buyer will generally also opt to tax the property) on making use of the property for the purposes of making supplies which are subject to VAT. The buyer does, however, have to pay SDLT (see above) on the full amount of the purchase price for the property including the VAT.

It is therefore important to structure a property purchase carefully to ensure that, wherever possible, no VAT is charged in addition to the purchase price by a seller. This is generally possible where a let commercial property is acquired, under the so-called 'transfer of a going concern' (TOGC) rules. Due diligence will be required to determine the likely VAT treatment of a property purchase, and specific drafting for the sale contract is necessary to ensure that no VAT arises.

Residential property investment – a changing landscape

In the past few years the UK has introduced significant changes to the taxation of ownership of UK residential property. Initially, the focus of the changes was upon 'enveloped' ownership of high-value residential properties within companies and other vehicles. However, capital gains arising on the disposal of UK residential property by certain non-UK resident persons were then included in the charge to UK tax. From April 2019, as discussed on page 39, the capital gains tax treatment of investors in residential property was broadly aligned with that of investors in commercial property.

Annual Tax on Enveloped Dwellings (ATED)

In 2013 the UK introduced an annual tax on valuable (ie worth over £500,000) UK residential properties held within companies or other vehicles (whether UK resident or non-UK resident) known as ATED. The charge is based on the market value of individual dwellings as at 1 April 2012 (or the purchase price of the dwelling if purchased after 1 April 2012). Revaluation is required broadly every five years so for chargeable periods beginning after 1 April 2022 the revaluation date is 1 April 2022. The ATED is levied each year in accordance with bands in the table below.

The ATED does not generally apply where the property is owned by an individual or via trusts. There are also exemptions for ownership of residential properties for business purposes (including where a property is acquired and exploited for rental to third parties, is acquired for development and re-sale, or is acquired and held for use by business employees). Consequently there are planning opportunities available for ownership of such UK

ATED charge from 1 April 2022 to 31 March 2023

Market value of residence	ATED charge
£500,000 to £1,000,000	**£3,800**
£1,000,001 to £2,000,000	**£7,700**
£2,000,001 to £5,000,000	**£26,050**
£5,000,001 to £10,000,000	**£60,900**
£10,000,001 to £20,000,000	**£122,250**
£20,000,001 and over	**£244,750**

residential property to mitigate ATED liabilities, including 'de-enveloping' to remove the property from existing company ownership.

Non-resident capital gains tax
Capital gains derived from the sale of UK residential property will be subject to capital gains tax, although the taxable capital gain will be limited to the difference between the sale price for the property and the value of the property as at 1 April 2015 (or, the purchase price if the property was acquired after 1 April 2015). For non-UK resident individuals, the capital gains tax rate will be the same as for UK resident individuals (generally 28% for a higher or additional rate taxpayer).

For non-UK resident companies, the capital gain is subject to corporation tax at the rate of 19% (rising to 25% in April 2023). Since April 2019, the non-resident capital gains tax rules for residential property have broadly been aligned with the new regime applicable to direct or indirect realisation of UK commercial property (as discussed above).

SDLT on residential property
Where residential property is acquired for a purchase price exceeding £500,000 by a company, a partnership including a corporate member or a collective investment scheme, a penal 15% rate of SDLT is imposed on the purchase. A 2% surcharge is also payable where the purchaser is non-UK resident.

Broadly, as with the ATED rules, acquisitions for business purposes (eg development with a view to re-sale, or letting to arm's length tenants) will not trigger this penal rate, which is designed to dissuade ownership of residential property for personal occupation through corporate or other vehicles.

Where UK or non-UK resident individuals hold one or more residential properties (whether in the UK or elsewhere) and acquire a further property for more than £40,000, there is a 3% surcharge for SDLT purposes. This 3% surcharge always applies for companies acquiring residential properties regardless of whether the acquiring company holds any existing residential property.

The 2% non-resident surcharge also applies to individual purchasers.

In relation to individuals acquiring residential properties, an exemption is available for first-time buyers, with residential property up to £425,000 exempt from SDLT, and the first £425,000 of a purchase of up to £625,000 being free of charge.

Inheritance Tax (IHT)

If UK property (residential or commercial) is owned by an individual then, regardless of where that individual is resident or domiciled for tax purposes, that property will be subject to UK IHT. The value of that property will form part of the individual's estate on death and will be subject to IHT at 40% (subject to any available exemptions or reliefs). Certain lifetime gifts of UK property held directly (such as gifts to a trust) may also give rise to a charge to IHT at 20% of the value of the gift. Previously non-UK companies and trusts were often used in structuring UK property ownership so that an individual did not hold UK property directly; holding UK property through a non-UK company could avoid the value of the property being subject to IHT. However, since 6 April 2017, using such structures has not prevented a charge to IHT on the value of any UK residential property held in the structure. To the extent that the value of shares in non-UK companies or other similar entities is derived from interests in UK residential property (including in certain circumstances loans relating to UK residential property), those shares are now subject to IHT. Additional IHT implications also arise where UK residential property is held in a non-UK resident trust whether directly by the trustees or via underlying non-UK companies. These rules only apply to residential property; UK commercial property owned via non-UK companies or other opaque entities remains outside the scope of IHT where the company is owned by a non-UK domiciled (and not deemed domiciled) individual or a trust set up by such an individual.

Value Added Tax (VAT)

Unlike commercial property, most dealings in residential property are exempt from VAT as the option to tax does not apply to such property. This can be disadvantageous to investors, who may be unable to recover VAT on their own expenses (eg management and advisor costs) because they carry on VAT-exempt business.

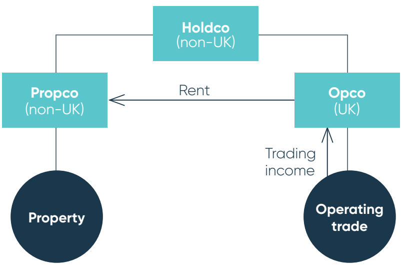
However, the construction of residential property or conversion of non-residential property to residential use may permit irrecoverable VAT to be avoided by the developer without that developer having to charge VAT to purchasers. The rules in this area are complex, and specialist advice should always be sought.

Specific situations and industry sectors

Within the general principles outlined above lies a wealth of specific law and practice applicable to particular circumstances or business areas concerning UK property. Examples of particular areas of relevance to our practice, in which we have in-depth expertise, include:

Hotels and other owner-operated property businesses (eg self-storage)

Typical approaches to maximise tax efficiency include 'Propco/Opco' structures, where the capital asset is held by a 'Propco' (which would hold the capital asset as an investment) whilst the operating business is carried on by a separate 'Opco' (which would broadly pay UK tax on the profits of its trade – but subject to deductions for rental payments made to the Propco).



Similar Propco/Opco structuring is often employed by residential developers (eg in the PRS or student accommodation sectors) so the Opco undertakes (VAT exempt) residential letting, but the Propco may be able to secure recovery of VAT on development costs through the operating lease model.

Property funds

The tax regime can offer benefits for private and public property funds and portfolio companies, where UK commercial property investments can be held in separate offshore special purpose vehicles or 'SPVs' to offer the ability to sell the SPV without SDLT for a buyer.

The UK also offers a special tax regime for REITs. Broadly, a REIT is exempt from UK tax on capital gains and rental income – despite the fact that the company is incorporated and tax resident in the UK. Instead, distributions from the REIT to shareholders are treated as if they were payments of rental income and generally subject to UK withholding tax (currently, 20%).

Taylor Wessing has considerable experience in advising on the launch of REITs and other property funds from a tax, real estate and corporate finance/capital markets perspective.

Islamic finance and UK real estate

This is a highly specialised area where careful tax structuring is required to achieve a 'level playing field' for finance arrangements undertaken in a form which is compliant with Sharia law principles as compared with more conventional funding. Examples of such structures include the Ijara lease, under which rental payments provide returns on finance, and Sukuk Al-Ijara, suitable for raising finance from a bond issue to the markets. Taylor Wessing is familiar with these structures and the specific tax reliefs which may be obtained in connection with such arrangements.

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Interviewees describe the firm as 'excellent technically' and highlight its 'commercial approach,' and one source notes that the firm is 'consistently excellent and provides a top-quality service'.

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Key contacts

We would be delighted to discuss your legal needs in confidence with you. Please contact us for further information.

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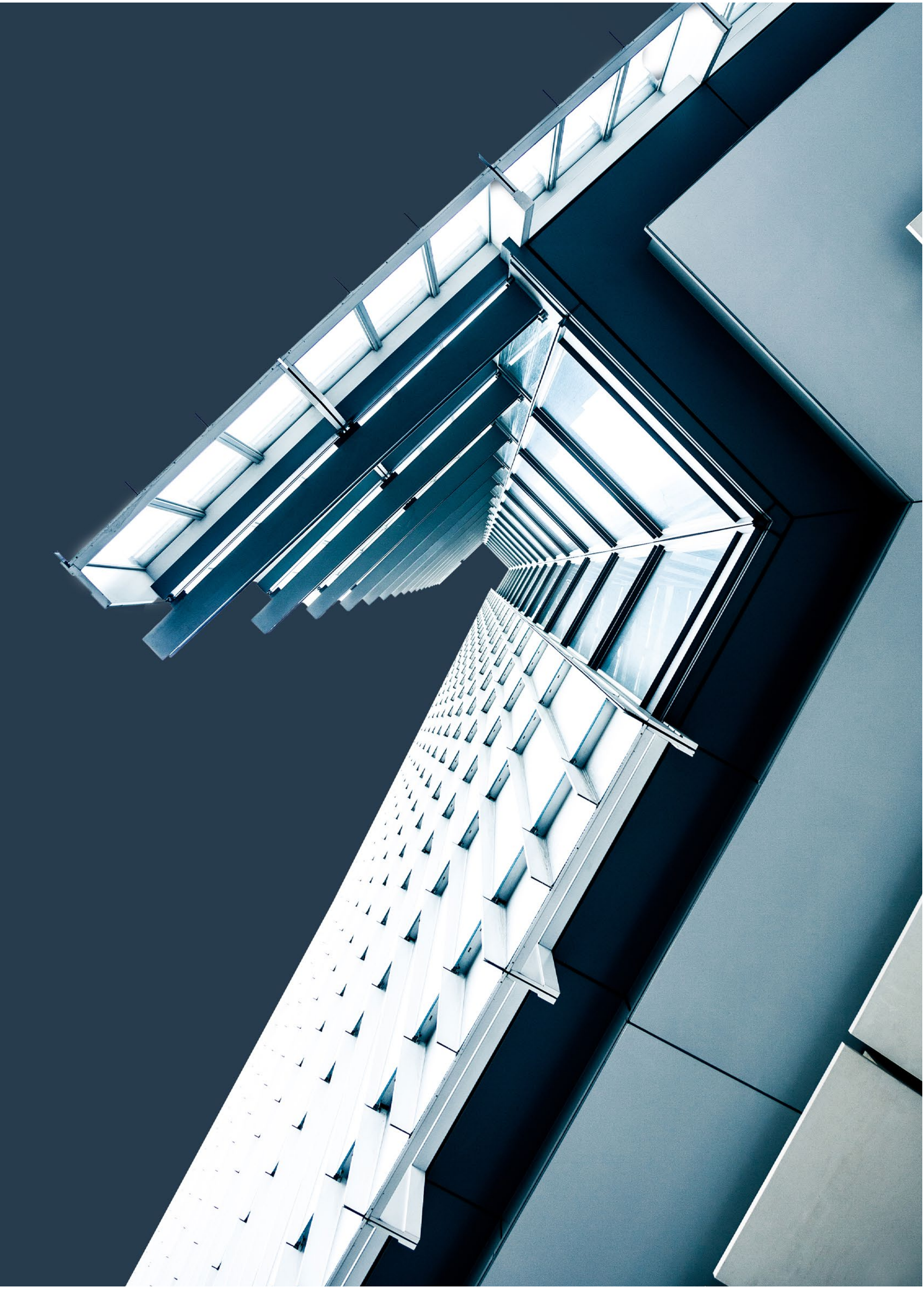

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Taylor Wessing statistics published are correct as of 1 September 2021.

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