UK Real Estate Structuring for Non-domiciled Persons and Solutions for Ownership of Yachts, Private Jets and Art

IWP Event 5 June 2013

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Purpose of holding structures

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- Tax mitigation
- Confidentiality
- Asset protection
- Succession planning
- Avoid probate formalities
- Other

Overview of real estate and chattels tax treatment- income /gains of UK residents

- UK residents:
  - Arising and remittance basis
  - Rental income taxable as property business income or chattel leasing trade income. Deduct business expenses: funding interest, repairs
  - Non-arm's length use of the real estate or chattel by UK residents who are directors or shadow directors of ownerco can result in the benefit being taxed as a benefit in kind attributable to a UK taxable employment/office
  - Profit on sale of real estate or chattel taxable as:
    - Income if seller is a manufacturer/developer or trader
    - Gain if seller is an investor, subject to reliefs such as:
      - Real estate: principal private residence relief
      - Chattels: see next slide
  - Note availability of tonnage tax for commercial shipping

Chattels – capital gains reliefs

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- Gains on the disposal of chattels are exempt if the gross consideration does not exceed £6,000
- Gains on chattels which are wasting assets are not chargeable assets unless they qualify for capital allowances· Basically, capital expenditure on "plant and machinery" used in a UK taxable business should qualify for capital allowances although there are ways of switching off entitlement to capital allowances
  - A wasting asset is one which has a predictable life of 50 years or less. Plant or machinery is deemed to have a life of less than 50 years
  - The Upper Tribunal held that a painting put on display to the public in a stately home qualified as a wasting asset (*The Executors of Lord Howard of Henderskelfe v Revenue and Customs Comrs UT 2013, FTC/02/2012).* It is understood that HMRC are appealing against this decision
  - Fine wine and spirits: RI208: whether wasting depends on how fine!
  - Guns, clocks, watches, cars, yachts, jets: usually treated as machinery qualifying as a wasting asset; pair of guns usually = set
  - Private motor cars. A mechanically propelled road vehicle constructed or adapted for the carriage of passengers is not a chargeable asset unless it is of a type not commonly used as a private vehicle and unsuitable to be so used. HMRC state that vehicles outside the private motor car exemption include taxi cabs, racing cars, single seat sports cars, vans, lorries, other commercial vehicles, motor cycles, scooters and motor cycle or sidecar combinations. These should generally be "machinery"

Overview of tax treatment- income/gains of non-UK residents

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- Non-UK residents are only taxable on:
  - UK source rental:
    - Real estate: either accept 20% withholding tax under the non-resident landlord scheme or claim business expenses and submit return
    - Chattels: no withholding tax on rent
  - Trading/development profits attributable to a trade carried on in the UK or UK permanent establishment
  - ATED property (see below)

Overview of tax treatment- SDLT/stamp duty

- Purchaser of real estate pays stamp duty land tax at a rate of 1% on consideration (above £125k), 3% (>£250k), 4% (>£500k), 5% (>£1m), 7% (above £2m). Residential lease rate 1% (NPV of rent above £125k). Rates on commercial property are different
- No SDLT on licences
- Note 15% rate on purchase of ATED property (see next slide)
- No SDLT or stamp duty on chattels

Overview of tax treatment- Annual Tax on Enveloped Properties

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- Property enveloped in companies:
  - New annual tax on enveloped dwellings tax ("ATED") rules rules apply an annual tax of between £15,000 and £140,000 on residential properties worth >£2m held by [a company] unless the property is let to unconnected persons or held for development/trading purposes.
  - Where ATED applies, the company is also exposed to capital gains tax on gains accruing from 1.4.13
  - 15% SDLT on purchase of £2m+ value property subject to ATED

Overview of tax treatment- IHT and pre-owned assets regime

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- IHT exposure for UK domiciled/deemed domiciled individuals owning assets wherever located
- IHT exposure for FDs and FD settlor trusts if assets UK situs
- Pre-owned assets regime:
  - Occupation of land or use/possession of chattel retained by person who gifted or funded the acquisition of the land/chattel in such a way as to reduce the value of his IHT estate without suffering IHT (unless the IHT is avoided as a result of certain intentional exemptions). UK resident subject to income tax on market rental (land)/notional interest (chattels)

Overview of tax treatment- VAT and customs duties

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- Supplies of residential property (sale/lease/licence) are generally VAT exempt or, if new, zero-rated; VAT may apply to certain supplies of new commercial buildings and buildings which the owner has elected into VAT
- Supplies of chattels (sale/lease/licence) are in principle VATable but there are numerous special regimes and opportunities to turn the supply into a non-EU "outside the scope" supply
- Where possible use transfer of going concern relief or buy the asset owning company to avoid VAT on purchase
- Note potential for VAT on other supplies to the owner, eg yacht/aircraft fuel, repair/renovation expenses
- Customs duties n/a to land but may be relevant for imported chattels
- Note potential for other indirect taxes, eg excise duties on fuel, air passenger duty, insurance premium tax, business rates, council tax

Overview of tax treatment- No general UK wealth tax

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- No UK wealth taxes generally, other than ATED

Structuring concepts - Alienation

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- **Alienate the property or income**
  - On alienation there are the obvious tax concerns on disposal: taxation of chargeable gain or profit on sale (noting deemed MV rules), IHT, transfer taxes such as stamp duty/SDLT, VAT
  - But anti-avoidance rules may also tax:
    - the transfer of income streams
    - accrued income
    - convert gains into income, eg offshore fund rules, “old 776 slice of the action” profits
    - the alienated income/gains as deemed income gains of the transferor/settlor
    - or ignore the transfer (IHT gift with reservation of benefit rules)
  - Holdover and rollover reliefs generally don’t apply on transfers to offshore persons
  - Emigration is worth considering, whether of companies, individuals or trusts but various anti-avoidance rules may charge accrued gains and income on emigration, noting that the UK has no capital gains emigration charge for individuals (but does for companies and trusts)

Structuring concepts – UK structures

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- **Interpose a UK company**
  - Limited liability is beneficial from an asset protection perspective; opco/propco structures
  - Holding assets through a UK company offers [23%/20%] rate Corporation Tax rather than [45%] income tax/28% capital gains tax applicable to direct ownership. But distributions then taxable (31.1% on net dividends; 28% capital gains tax on gains unless 10% entrepreneur's relief available). But note new ATED rules making companies unattractive residential real estate holding vehicles in certain circumstances – see above
  - Investments in certain trading companies, including property trading companies, and eligible holding/stakeholder companies not treated as remittances
- **UK trust**
  - Lifetime settlement of non-exempt property generally attracts 20% IHT charge
- **UK general or limited partnership or LLP**
  - Limited liability available
  - Combine with UK company to stream profits on a transparent basis one way and to a corporate block the other way? Note consultation on use of partnerships with corporates
  - Flexible SDLT provisions on transfers to/from/within partnerships involving connected persons
  - Flexible capital gains rules allowing tax-free changes of partnership profit-sharing ratios
  - Use as an alternative to trusts to allow transfers of interest to family members without loss of control (parents control the general partner/authorised member) as PETs thus avoiding IHT lifetime transfer charges
  - Avoids benefit in kind rules
- **Private onshore authorised unit trust or oeic**
  - 20% tax on income and gains exempt, but the "genuine diversity of ownership" test has made these difficult to operate
  - Authorised unit trusts and oeics are excluded assets for IHT in the hands of FDs and FD settlor trusts

Structuring concepts – other structuring possibilities not using offshore structures

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- Use capital gains reliefs: PPR; chattels exemptions; holdover reliefs for business incorporation, gifts of business assets and gifts where IHT applies but note restrictions on transfers offshore; spouse exemption
- Maximise deductions against tax on rent: borrow to the maximum permitted by transfer-pricing rules
- SDLT: 0.5% on property enveloped in UK companies and 0% on property enveloped in non-UK companies; 0% on gifts/liquidations but watch out for assumption of debt
- IHT: use nil rate band, spouse exemption (watching out for FD restriction), business (property development, some serviced offices/furnished holiday lets but *Pawson* case is negative) and agricultural property relief if available; use life insurance; use debt offset; heritage property relief
- VAT: direct supplies to VAT registered business able to recover input VAT; structure supplies as outside the scope supplies; use zero-ratings eg for certain yachts/aircraft; set up a leasing business to recover input VAT

Structuring concepts - Offshore structures

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Possible disadvantages/benefits

- Certain jurisdictions may appear on blacklists and suffer withholding tax on source income
- Minimal tax treaty protection
- Trusts may be ignored by certain jurisdictions
- Tax exemptions
- More private than onshore structures: share register, accounts – but the world is becoming less private: amnesties, disclosure of information agreements, mutual cooperation provisions in DTTs
- More flexible laws; less regulation

Structuring concepts - Offshore structures

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Benefits for UK residents

- Not many tax benefits: holding assets through offshore structures is countered by various anti-avoidance rules which attribute the offshore income and gains back to UK residents. Consider use of "EU freedoms" to challenge anti-avoidance.

Benefits for UKRNDs, NRs and FDs

- Onshore rental income accruing to an offshore structure will generally be taxable on the offshore entity under UK source rules and the above anti-avoidance rules will apply to UKRNDs; however, maximising deductions, eg interest, can substantially reduce the net tax
- Developers and traders: avoid foreign entity being taxed on UK permanent establishment and trading in UK; sell after planning permission; use jurisdictions with dtts with long pe-free building periods; reduce profit with service fees; beware Ch3 ITA07 ("old 776") and override with DTT
- offshore income and gains accruing to the offshore structure will be taxable only on UKRNDs and only if remitted
- an offshore trust can be used to defer taxation of onshore gains until they are matched with benefits received by the UKRND from the trust and to convert such gains into remittance basis gains
- enveloping property in an offshore company allows a FD or trust to convert UK situs property within the scope of IHT into non-UK situs shares in an offshore company outside the scope of IHT
- Use an onshore authorised unit trust/oeic structure or offshore investment fund structure to reduce onshore tax or avoid the anti-avoidance rules aimed at offshore structures

Possible new high value residence ownership structures

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- Impact of ATED rules
- First time non-UK residents subject to CGT in respect of UK property
- First time UK has form of wealth tax (like other EU countries including France and Spain)
- New rules do not apply to letting, trading or property development businesses – carry on as before
- Don‘t forget other tax-planning:
  - Avoid taxable remittances
  - Consider new statutory residence rules when buying a UK property

Overview

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	Direct ownership	Offshore company held by an offshore trust	Direct ownership by offshore trust (with no holding company)
SDLT on purchase	7%	15%	7%
ARPT	None	£15k-140k pa	None
Capital gains tax	None for non-UK residents or UK residents who benefit from principal private residence relief	28% tax on post-5 April gain on sale of property. No charge for sale of shares in the company	None but gains of the trust can in certain circumstances be attributed to resident settlor or beneficiary subject to principal private residence relief
Income tax	No issues as occupied by owner	UK resident occupiers will need to take care to avoid benefit in kind charge	None if no rent being paid but income of the trust can in certain circumstances be attributed to a resident settlor and beneficiaries
UK inheritance tax	Net property value potentially subject to 40% tax on death of owner	No liability for non-UK domiciled settlor	Up to 6% charge on net value of property in trust every 10 years and on distribution. Potential 40% charge on death of settlor under gwr rules if he is the beneficiary

Part 1 - New UK high value residence purchase

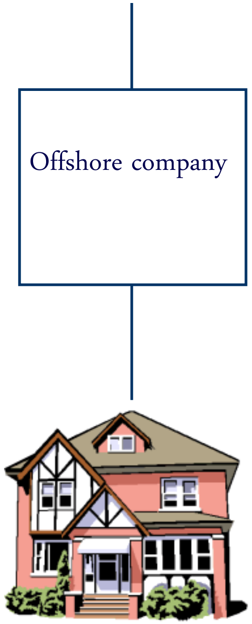
Options:

- Offshore company with/without offshore trust above it
- Direct ownership
- Direct ownership through a nominee (e.g. bare trust)
- Ownership through offshore trust or double trust structure
- Buy the company, save 7/15% SDLT then restructure if you want

New high value residence purchase - offshore company with/without trust above it

- SDLT at 15% usually too high a price for this structure but consider buying the company

	Offshore company held by an offshore trust
SDLT on purchase	15%
ARPT	£15k-140k pa
Capital gains tax	28% tax on post-5 April gain on sale of property. No charge for sale of shares in the company
Income tax	UK resident occupiers will need to take care to avoid benefit in kind charge
UK inheritance tax	No liability for non-UK domiciled settlor



New high value residence purchase - Direct ownership (possibly through a corporate nominee)

Advantages

- No Annual Charge
- No CGT if PPR available or beneficiaries non-resident
- SDLT - normal rates apply so maximum rate 7%
- Simple

Disadvantages

- No privacy (so use a corporate nominee); probate
- IHT exposure if owner dies but consider mortgage finance, life assurance, etc

New high value residence purchase – Trust or double trust structure

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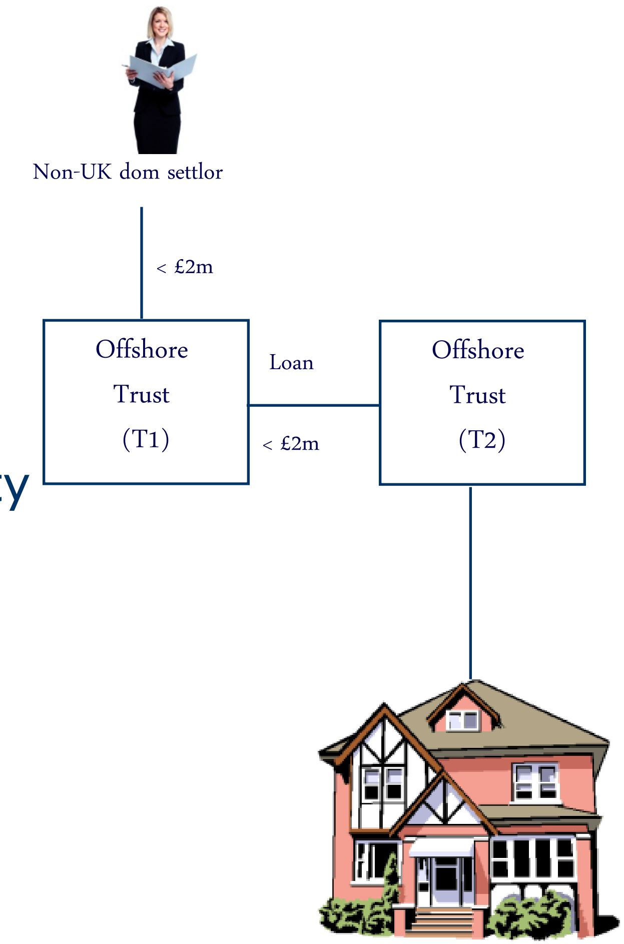
Advantages

- No Annual charge
- No CGT if PPR available or beneficiaries non-resident
- SDLT - normal rates apply so 7% SDLT
- No IHT if individual dies but exposure to IHT 10 year charge for trustees on property value less value of loan

Disadvantages

- More expensive
- Care needed in order to side-step anti-avoidance rules such as gift with reservation rules, s103 FA86, new Sch 34 FB13, GAAR, caselaw
- If any UK resident beneficiaries of trust, rent-free occupation can cause general income/gains of trust to become taxable. Paying rent creates income taxable at 45%



Part 2 - Existing high value residence

- No longer necessary to consider rebasing. CGT only applies from 5 April 2013
- Options:
  - Do nothing
  - Sell/genuine letting
  - Restructure to:
    - Direct ownership (with/without nominee)
    - Trust or double trust structure

Existing high value residence – Comparing structures

- Compare:
  - Do nothing: ATED/CGT, benefit in kind risk and other costs/risks of current structure; with
  - De-envelope: IHT exposure created, cost/risk of IHT mitigation and ongoing structural costs/risks

Existing high value residence– Comparing structures

- Current structure costs:
  - ATED (depends on property value, length of time property likely to be held)
  - CGT exposure (depends on anticipated capital gain up to disposal, which in turn depends on market value on 5.4.13 and estimated market value at estimated disposal date)
  - Benefit in kind risk
  - Company/trust maintenance cost

Existing high value residence– Comparing structures

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- New structure cost/risks
  - IHT cost/risk (depends on structure used: nothing, insurance cost, loan service cost and risk of attack under gwr rules, s103FA86, GAAR, caselaw, new FB13 Sch 34)
  - Ongoing structural costs and professional fees on de-enveloping
  - De-enveloping cost

Existing high value residence– Comparing structures

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- De-enveloping cost:
  - Liquidation of company/distribution of property:
    - Typically no charge on gain on property at company level but gain may be taxed on UK resident shareholder under s13 TCGA or, where company under a trust, settlor or beneficiary under ss86/87 TCGA.
    - S87 may attribute gain to UK resident beneficiaries of trust – watch out for rent-free occupation but note rent would be taxable at 45% rate
    - UK shareholder potentially taxable on distribution as dividend or capital gain. Check tax treatment in other countries of residence
    - SDLT risk if property financed by external debt and shareholder assumes that debt or refinances – may be ways of mitigating this
  - In all cases careful planning to fit the particular fact pattern is required

Existing high value residence - Conclusions

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Before restructuring should consider:

- Purpose of existing structure - are there any current non-tax issues?
- What is client's attitude to complication and/or risk and/or tax?
- Overall UK tax impact
- Tax (or other) implications in foreign jurisdiction
- Future use and sale of UK property

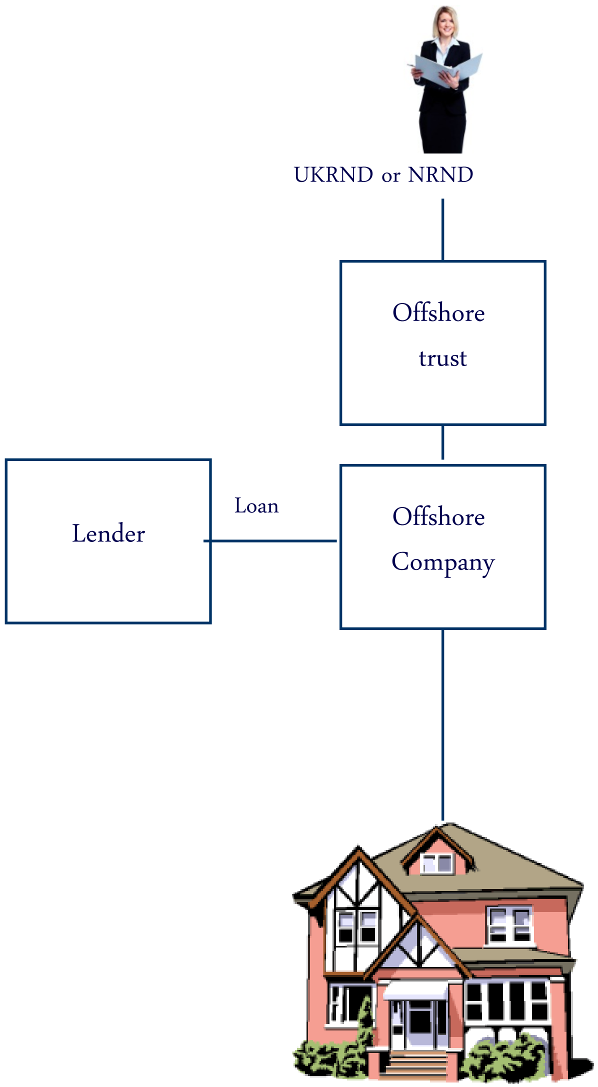
Real estate investment – offshore company and high debt gearing

Advantages

- No ATED, CGT, IHT, benefit in kind charge leaving income tax and SDLT as the main tax issues
- Use non-resident landlord scheme to avoid withholding tax and reduce assessed rental income tax substantially by deduction of interest expense

Disadvantages

- UKRNDs need to navigate s13/86/87 TCGA deemed gains and ss721 deemed income rules
- Careful structuring of loan necessary to avoid withholding tax
- Non-third party debt funding needs to be transfer-pricing compliant



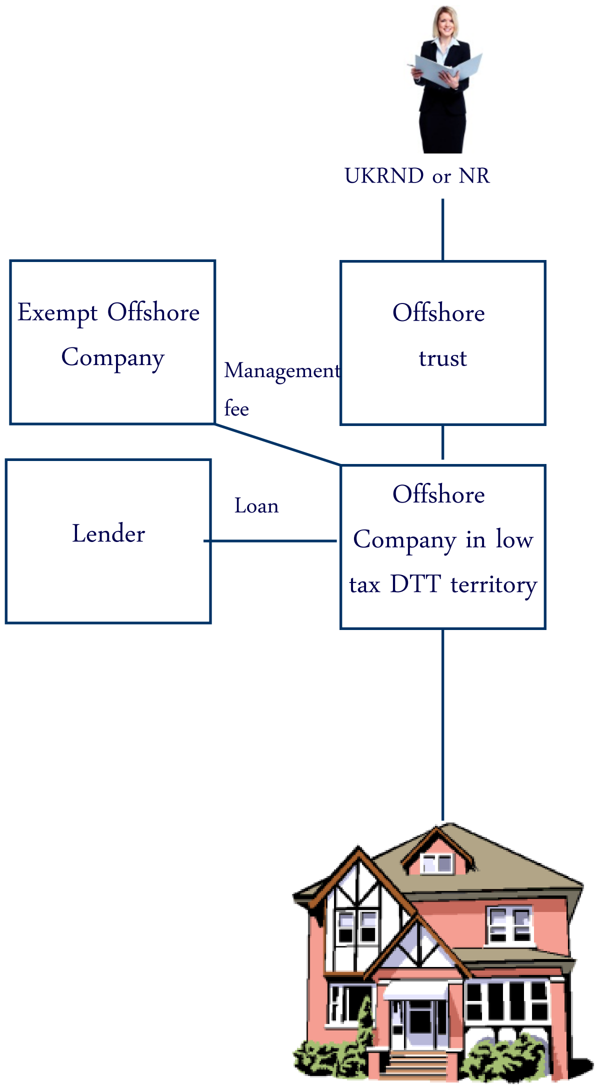
Real estate development – Using double tax treaties, flexible debt, management charges

Advantages

- No ATED, CGT, IHT, benefit in kind charges
- SDLT saving potential by splitting land and construction services
- Avoid tax on trading income using DTT with narrow pe definition/long construction period exemption
- Use unconnected UK builder
- Transfer to new offshore co on obtaining planning permission?
- DTT should override "old 776" charge
- Use debt to maximise interest deductions
- Consider management fee to exempt offshore co to reduce taxable profit

Disadvantages

- More expensive
- UKRNDs need to navigate s13/86/87 TCGA deemed gains and ss721 deemed income rules
- Careful structuring of loan necessary to avoid withholding tax
- Non-third party debt funding and management fee needs to be transfer-pricing compliant



Yachts and jets

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- VAT: on the yacht/jet and also associated supplies, eg management, fuel
- Customs duties
  - Aircraft: "end-use" relief normally available but importer may need to be registered and non-EU importers may have problems unless use temporary importation – see withdrawn notice CIP (11) 88
  - Yachts: usually a zero rate will apply
- Fuel duty
- Tax on income/gains derived from the yacht – whether these can be attributed to a UK resident principal under the offshore anti-avoidance rules
- Income benefit in kind rules
- Non-arm's length benefits could be matched against other capital gains in the trust and taxed on UK residents
- IHT
- Tax on distributions up the chain
- Aircraft passenger duty
- Luxury taxes – not in the UK

Yachts and jets

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- VAT on yachts/jets is a highly specialised area where it is almost impossible to keep on top of the constantly changing practices of each EU country
- A yacht/jet being used in the EU needs to be "VAT paid"/"in free circulation": VAT must have been paid on any non-private purchase in the EU or on importation (even if you are just the lessee/licensee bringing the yacht/jet into the EU) or a relief must apply
- VAT may also apply to leases/licences of the yacht/jet by a VAT registerable business

VAT place of supply rules

- Place of supply rules:
  - Sale: where the goods are physically located, special rules for where the goods are to be exported outside the EU or are new means of transport to be exported to another EU destination
  - Dry lease: if the lease is for more than 30 days (jet)/90 days (yacht) the place of supply is where the lessee belongs if VAT registered, otherwise where lessor belongs but:
    - In short term hire cases the place of supply is where the yacht/jet is put at the lessee's disposal; and
    - Supplies between EU lessor/non-EU lessee and vice versa: supply treated as made in or outside the EU to the extent use and enjoyment is different from where the place of supply would otherwise be, ie long lease to non-EU person treated as made outside the EU except to the extent of EU use and enjoyment – Malta leasing structure is based on fixed assumptions as to EU and non-EU use based on the size of yacht
  - Passenger transport: where transportation takes place in proportion to distance travelled, even where lessor and lessee are both EU, but note potential zero-rating exemption below

VAT zero-rating/exemption

- Reliefs
  - Zero-rating/commercial exemption
    - Sales and leases may be zero-rated if involving:
      - Ships of a gross tonnage of not less than 15 tons neither designed nor adapted for use for recreation or pleasure and integral parts/safety equipment. Most yachts will not satisfy this definition although France exempted all yachts registered on a commercial register, including yachts being chartered commercially but are being challenged by the EU
      - Jets used by an airline operating for reward chiefly on international routes and integral parts/safety equipment
    - Passenger transport in any yacht/jet designed or adapted to carry not less than 10 passengers or…from a place within to a place outside the UK or vice versa. HMRC guidance indicates that time charters/wet leases can be treated as passenger transport
  - Services provided for handling of yachts in a port or jets in a customs and excise airport or outside the UK and making arrangements for supply of space, leasing, sale, repair, maintenance, passenger transport in a yacht/jet or a service – covers some of the services of yacht/jet managers; sometimes zero-rating depends on the yacht/jet being "qualifying"
  - *Bacino* case suggested needed to look at end user's use, so if end use was for pleasure then no zero-rating or commercial exemption available. But Finnish *Oy* case suggests that the Bacino case has limited application as that case found that leasing by a company could be treated as zero-rated/exempt where the leasing was to an airline supplying passenger transport services but also being used privately by the ultimate owner. There seems to be an informal rule of thumb being operated that says that there needs to be at least 50% business use: hire to third parties or business use by the ultimate beneficial owner (the latter being difficult to justify in the case of a yacht)

VAT solutions

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- Private sales may be VAT free
- Buy the yacht/jet chartering business as a VAT-free going concern
- Buy the company owning the yacht/jet chartering business
- Import into country with lowest VAT rate – but note that the yacht/jet must actually go there to be imported there for VAT on importation to be deductible (*Facet* and withdrawal of “fallback” relief); note Croatian route
- No longer possible (?) to use the French commercial exemption to import into France and charter and buy supplies VAT free
- Use temporary importation relief
- Use a leasing structure to recover the purchase/import VAT

VAT and customs duty - Temporary importation

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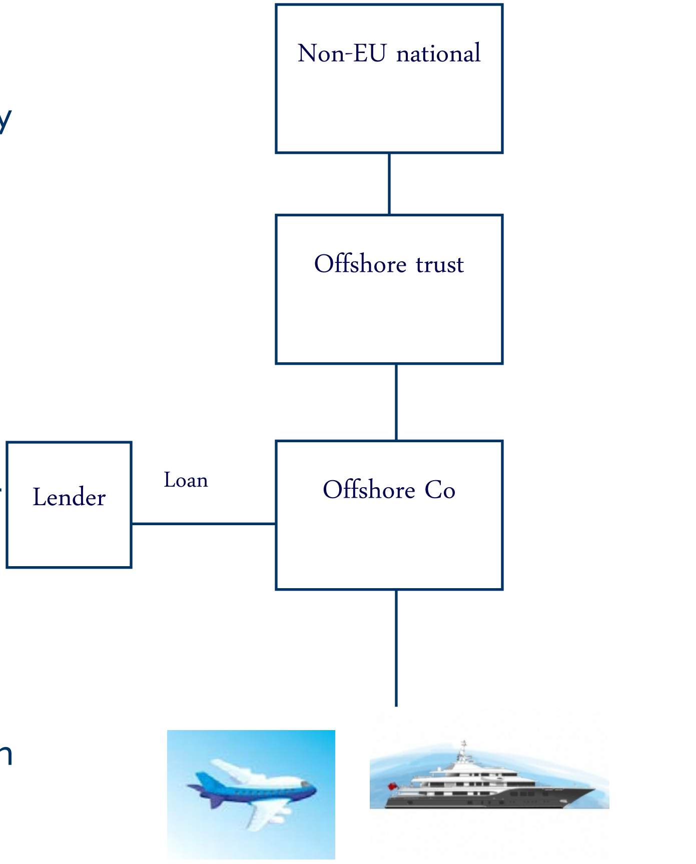
- Set up the structure and buy the yacht/jet VAT free while it is out of the EU or in a customs warehouse then import under temporary importation
- Direct tax issues: see let property; consider benefit in kind rules and LLP solution
- Owner needs to be non-EU established
- Use allowed in EU for up to 18 (yacht)/6 (jet) months at a time
- Yacht/jet must be registered outside EU
- Yacht/jet must be for private non-commercial use only: no hire or sale
- Use must be by:
  - non-EU resident; or
  - EU resident (but registered owner or, if a company/trust, non-EU employee/member must be with the yacht/jet at importation and in EU at the time of use or absent with permission); yacht/jet must be predominantly for use of non-EU owner; the EU person must hold written authorisation from registered owner and be instructed to use yacht/jet only occasionally
- Different countries apply these rules differently making it difficult to rely on this route if intending to carry non-EU residents
- VAT and duty will be due where applicable on management services/fuel/provisions/repairs

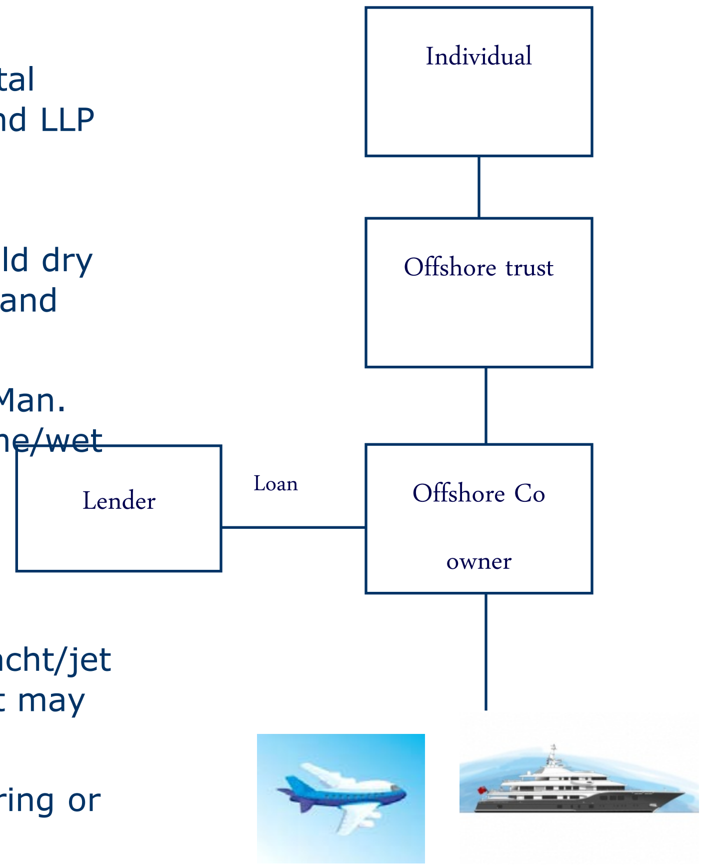


Vessel/aircraft registered outside EU

or, if not registered, belongs to non-EU resident

VAT - Leasing structure

- Direct tax issues: similar to let real estate but no tax on rental income unless s721 applies; consider benefit in kind rules and LLP solution
- Offshore co owner registers for VAT on the basis of having a genuine leasing or passenger transport business. Owner could dry lease to another company which forms the leasing business and imports
- What is a genuine leasing business? Obtain ruling in Isle of Man. Requires a realistic business plan. Stronger case if owner time/wet leases but more expensive to operate that way
- Make sure that there is > 50% commercial end use
- Arm’s length hire needs to be paid, including for private use
- Make sure leasing/passenger transport is compatible with yacht/jet registration and regulations. Commercial registration of a jet may restrict airports
- VAT potentially payable on hire: minimise by careful structuring or use the Malta fixed apportionment based on yacht size
- Potential VAT-free management, fuel etc supplies. *Facet* case technically requires spares to actually be imported to the country of VAT registration. Roll up in composite supply of management services?



Vessel/aircraft leasing/passenger transport business

Art

- For another time….