

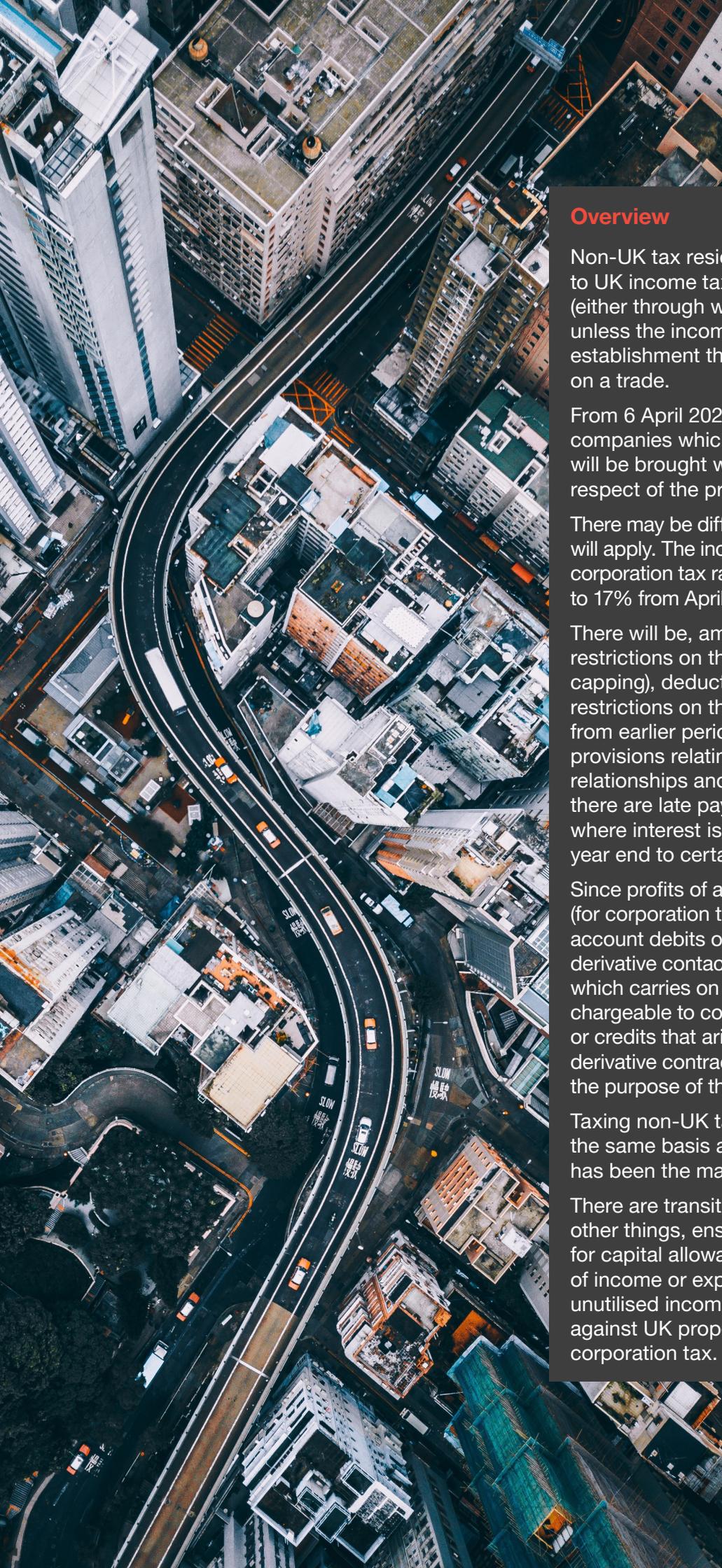


# Non-resident landlords transition to CT

Bringing non-resident companies into the charge to  
corporation tax on UK property rental income from April 2020.



**pwc**



## Overview

Non-UK tax resident companies are currently subject to UK income tax on UK property rental income (either through withholding or by direct assessment) unless the income is in relation to a UK permanent establishment through which they are also carrying on a trade.

From 6 April 2020, all non-UK tax resident companies which carry on a UK property business will be brought within the scope of corporation tax in respect of the profits of that business.

There may be differences in the tax rates which will apply. The income tax rate is 20% and the corporation tax rate was expected to reduce from 19% to 17% from April 2020, although this may change .

There will be, amongst other things, additional restrictions on the deductibility of interest (interest capping), deductions related to hybrid mismatches, restrictions on the amount of losses brought forward from earlier periods that can be offset and other provisions relating to the taxation of loan relationships and derivative contracts. In addition, there are late payment restrictions which can apply where interest is not paid within 12 months of the year end to certain connected recipients.

Since profits of a UK property business (for corporation tax purposes) do not take into account debits or credits from loan relationships or derivative contracts, a non-UK tax resident company which carries on a UK property business will also be chargeable to corporation tax in respect of its debits or credits that arise from loan relationships or derivative contracts that the company is a party to for the purpose of that business.

Taxing non-UK tax resident corporate landlords on the same basis as their UK tax resident counterparts has been the main driver for the change.

There are transitional provisions which, amongst other things, ensure that there is no disposal event for capital allowances purposes, no double counting of income or expenses, and 'grandfathering' of unutilised income tax losses that can be offset against UK property business profits subject to corporation tax.

## 1 Interest Capping

Broadly, under income tax principles, interest is deductible against the UK rental income to the extent that it is wholly and exclusively related to the property business and the debt advanced on arm's length terms.

However, from 6 April 2020, under corporation tax principles, the 'interest capping' rules apply. The interest capping rules were introduced in accordance with the OECD's BEPS Action 4 and, broadly, restrict finance cost deductions to 30% of 'Tax EBITDA' (as defined). There is also a £2m 'de minimis' (across companies in a group which are subject to UK corporation tax) and the option of using an alternative group ratio or a public infrastructure exemption (if applicable) if this will provide a better result.

After applying the £2m 'de minimis', the deductions are also subject to the fixed ratio debt cap (sometimes referred to as the worldwide 'modified debt cap') which is broadly equal to the 'external' interest payable by the worldwide group. For this purpose a group includes a company and any relevant subsidiaries that consolidate their financial statements together under IFRS 10 (or would do so if IFRS were applied).

## 2 Hybrid Mismatches

The UK legislation implementing the OECD BEPS Action 2 proposals for hybrid instruments/entities has been effective from 1 January 2017 for corporation tax payers, and will apply to corporate non-resident landlords from 6 April 2020.

The hybrid mismatch rules can deny interest relief completely where the non-resident corporate landlord is paying interest to a related party in circumstances where, broadly, as a result of the way that different countries treat certain entities or instruments under their domestic tax law, the recipient is not subject to tax on the receipt. The laws are focused on the treatment in different jurisdictions rather than the tax rates. E.g. so if the only reason for non-taxation is a nil rate of tax, the rules do not generally apply, but for these purposes if an entity (which is not a partnership) is a hybrid entity, that is assumed to be the reason for non-taxation.

Also, if the mismatch payment is between two companies outside the charge to UK corporation tax, but there is a separate tax deductible payment made by the non-resident corporate landlord as part of the same arrangements that funds the mismatch payment, then the deduction on the payment by non-resident corporate landlord can be denied to the extent of the mismatch (an 'imported mismatch').

## 3 Losses

As a result of coming within the charge to corporation tax from 6 April 2020, corporate non-UK tax resident landlords will be subject to the corporate loss restriction. The loss restriction limits to 50% the amount of profits against which brought forward losses in excess of £5 million can be offset. The £5 million 'de minimis' will apply to income losses and capital losses (see below) in aggregate, and on a group basis.

Existing unutilised income tax losses of a company will be available for carry forward and offset against future UK property business profits (and relevant profits that arise from loan relationships or derivative contracts) of that company, without restriction. However, those losses will not be available for offset against other types of income or to be surrendered as group relief.

It will be possible to surrender or claim eligible corporation tax losses to/from other companies in the same group which are subject to corporation tax.

## 4 Other Claims and Elections

As a result of coming within the charge to corporation tax, there are other claims and elections that may need to be made which were not previously required/possible. This includes various elections in relation to interest capping and a 'disregard' election may need to be made if there are derivative contracts (eg interest rate swaps).

## 5 Anti-Avoidance Provisions

A targeted anti-avoidance rule has been introduced with effect from 29 October 2018 where a company enters into an arrangement the main purpose or one of the main purposes is to secure for any person a tax advantage related to the coming into force of these provisions.

## 6 Capital Gains within the charge to Corporation Tax

Since 6 April 2019, gains accruing to non-UK tax resident companies on direct and certain indirect disposals of UK property are subject to UK corporation tax.

A restriction on the relief for capital losses (for corporation tax purposes) is expected to be introduced from April 2020 so that companies making capital gains will only be able to use carried forward capital losses to offset up to 50% of those gains. The £5 million 'de minimis' referred to above in respect of income losses will apply to income losses and capital losses in aggregate, and on a group basis.

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### Registration and Administration

Non-UK tax resident companies which are currently filing UK income tax returns in respect of UK property rental income need to be registered for corporation tax purposes and obtain a Unique Tax Reference ('UTR'). HMRC have yet to publish details of how this process will be managed.

Other administrative elections and registrations may also be required, including appointing a reporting company for corporation interest restriction filings, appointing a nominated company for allocating the losses allowance, applying for simplified group relief arrangements and applying for group payment arrangements.

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### Filing and Payment

Corporation tax returns will need to be completed and filed online within 12 months of the accounting period end (currently it is not possible for non-resident companies liable to income tax on UK property rental income to file electronically). Accounts may need to be submitted with the corporation tax return (with iXBRL tagging where appropriate).

Whilst income tax returns are filed for a fiscal year, companies are required to file corporation tax returns for an accounting period. For companies coming within the charge to corporation tax on 6 April 2020, the first accounting period will commence on 6 April 2020 and end on the accounting reference date of the company (or 5 April 2021, if earlier).

The corporation tax liability for the first accounting period will be due 9 months and 1 day after the end of the accounting period.

For subsequent periods, tax payment dates will depend on the size of the company (by profitability). Where the profits for an accounting period are more than £1.5 million (reduced proportionally for the 51% group companies, and the length of the accounting period if less than 12 months), the corporation tax payment date will be accelerated. Under the quarterly instalment payment rules, up to four instalment payments may be required, all four of which may be due within the accounting period.

Where there are other companies in the group which are within the scope of UK corporation tax it may be possible to enter into a 'group payment arrangement'. One of the companies is nominated to make the payments on behalf of all the companies within the arrangement.

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### Withholding Tax on Rents

Under the 'Non-Resident Landlord' (NRL) scheme, if approval from HMRC for the NRL to receive rental income gross has not been applied for and confirmed by HMRC, the letting agent (or tenant) must calculate the tax due at 20% and pay it to HMRC on a quarterly basis.

This scheme will continue to apply, with the rate of withholding tax at 20%, notwithstanding that corporate NRLs will be subject to corporation tax. To the extent that the 20% withholding exceeds their corporation tax liability in respect of their net rental income they will be able to make a reclaim.

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### Determining the 'Group'

The transition to corporation tax means that the 'group' (if any), of which the NRL is part of, must be established for various purposes. There are a number of different definitions of 'group' which may need to be considered, including for the purposes of the quarterly payment regime, the ability to group relieve losses and transfer properties between group members on a tax neutral basis, as well as various definitions of 'group' for the purposes of the interest capping provisions.

Many of these definitions will restrict the group to companies which are within the charge to UK corporation tax. However, 'group' for certain of the interest capping provisions means the group that is required to consolidate under IFRS 10 (or would be so required if IFRS were applied).

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### Next Steps

Although the provisions were enacted in the Finance Act 2019, there are still some uncertainties, particularly in respect of the practical application of the new rules. It is expected that HMRC guidance will be published before the commencement of the new rules.

If you would like to discuss this further, please get in touch with your usual PwC Real Estate contact.