Buying Residential and Commercial Property in the UK

A brief guide for overseas buyers

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Helping you exploit new opportunities

"The client care and access to partners is good, and the fees are competitive."
Chambers 2012

UK real estate is an increasingly attractive investment for overseas investors. For investors based in Central Europe, India, the Middle East and Far East, the weakness of Sterling against their currencies and the general political stability of the UK, makes UK property an attractive proposition.

However, UK real estate is now also attractive for investors based in Western Europe too. This is because their ongoing Euro and banking problems and the comparative stability of Sterling and the UK economy makes UK real estate a safe haven for their investment. This briefing note gives an overview of the purchase process and answers some of the questions an overseas investor may have when acquiring UK real estate.

What are the principal sectors of the UK commercial investment market?

- Retail - shopping centres, retail warehouses, supermarkets, department stores and standard shops
- Offices - standard offices and business parks
- Industrial - industrial estates, distribution warehousing
- Leisure - leisure parks, restaurants, pubs and hotels
- Health care properties
- Residential - development schemes, high value investment properties

Clyde & Co has a wealth of experience in these sectors and is well placed to work with overseas investors looking to diversify risk by investing outside their domestic property markets.

How is title to real estate in England and Wales evidenced?

Most real estate in England and Wales is registered on a public register, at the Land Registry. Registration provides conclusive evidence as to the identity of the owner and the owner's title to the property. The register also provides details of the extent of the land and the rights benefiting and affecting it.

Is there a state guarantee of title?

There is a state guarantee of title in relation to registered land that guarantees the accuracy of the public register. If a defect or error is found in a registered title, compensation is payable by the Land Registry in certain circumstances.

How is real estate held (what types of tenure exist)?

Freehold: An interest in land that is not time limited. The owner of a freehold generally owns the land itself

and any buildings/structures on it, the subsoil below and the airspace above it.

Leasehold: A time limited interest in land, although leasehold interests can be virtually perpetual (long leases are often granted for 999 years). Generally, flats and much central London property are held on a leasehold basis.

Investment considerations

Risk

Whilst this is a function of individual circumstances and the characteristics of the asset to be acquired, generally, investment into a single building is likely to be more risky than investment into a portfolio of properties. By spreading investment over a range of properties, in different sectors and locations, investors can mitigate over exposure in any one area.

Costs

Typical acquisition costs include:

– valuation and survey fees
– legal costs (plus value added tax (VAT))
– the cost of searches and enquiries of public bodies (carried out as part of the legal due diligence process)
– Land Registry registration fees (up to a maximum of £910 for properties of a value in excess of £1 million)
– stamp duty land tax (see below)
– VAT, although depending on the nature and use of the property, there may be no VAT or it may be a recoverable expense

In addition, investors need to factor in the cost of obtaining advice on and setting up suitable investment vehicles if these are not already in place.

What are the main stages and documents in the sale and purchase of real estate?

Marketing and making an offer

Initially, the seller will usually appoint a firm of property agents to market a property for sale. The property agent advertises the real estate in a variety of publications and media, including the internet and contacts buyers who have registered with them.

If a buyer wishes to purchase a property, an offer is submitted to the seller through the property agent. At this stage the property agent will probably want to know how the acquisition is to be a funded, proposed time scale, details of solicitors acting etc. Negotiations on price/fixtures and fittings and other matters are usually conducted through the property agent and once terms are agreed, details of those terms are submitted to each party's solicitors.

Sale agreement

The seller's solicitors draft a sale agreement. The sale agreement is negotiated by the parties' solicitors and the agreed document is then signed by both parties. The sale agreement does not become binding until the solicitors exchange the agreement and before a formal sale agreement is exchanged, the seller and buyer are not legally bound to proceed.

At what point does the agreement become legally binding?

The sale agreement becomes legally binding upon exchange. This occurs when each party's solicitor delivers to the other a signed and dated agreement. A deposit (usually 5-10% of the purchase price) is normally payable by the buyer to the seller upon exchange.

Once the exchange takes place, neither party can withdraw without incurring liability.

Completion

Completion takes place on the date agreed when the sale agreement was exchanged (this can be on the same day as exchange although usually there is a short period between exchange and completion). The balance of the purchase price is handed over on completion and the formal documents transferring the property are dated at completion.

The beneficial interest in the real estate passes to the buyer at this stage and the legal title to the property passes once the transaction is registered at the Land Registry. Stamp duty land tax (see below) is payable within 30 days of completion. The buyer's lawyer deals with registration at the Land Registry.

Does a seller have any duty to the buyer to reveal information about the property?

The general rule is 'caveat emptor' (buyer beware) in relation to real estate transactions in England and Wales. The onus is on the buyer to carry out physical, structural and environmental surveys and valuation reports on the property. Usually there will be no guarantees/warranties available in relation to the physical condition of the property.

Often a buyer will instruct a surveyor to carry out a survey to establish the physical state of the property and whether there is any disrepair or defects. The buyer's solicitor will investigate the title to the property, raise enquiries of the seller's solicitor and carry out other appropriate searches before exchange of contracts takes place. Where the property is leasehold, the terms of the lease will be carefully considered and reported upon.

What costs are usually paid by the buyer?

The buyer typically pays all of the costs listed above (see Investment considerations).

What are the main tax considerations for non-UK residents?

The non-UK resident buyer will want to structure the holding and purchase of the property to have regard to UK and relevant overseas tax considerations. Specialist tax advice should be sought from your lawyer on a case by case basis, but broadly, the following may be relevant:

– **Stamp Duty Land Tax ('SDLT')**: This is a tax payable on land transactions, such as the purchase of a freehold or leasehold interest or the grant of a new lease. The rate of SDLT payable on the purchase of property (freehold or leasehold) depends on whether the property is residential, commercial, or mixed. If the property is commercial or mixed, the maximum rate payable is 4% of the purchase price (including VAT) and applies where the consideration exceeds £500,000. In relation to residential property, if the purchaser is an individual, the rate of SDLT is: where the purchase price is more than £1million, but less than £2million – 5%; or more than £2million – 7%.

  The 2012 Budget announced new tax rules to discourage people from using companies (or "corporate envelopes" to buy high value residential property (where the value exceeds £2million). One such measure is to increase (from April 2012) the rate of SDLT to 15% where the property is purchased by a company or certain other "non-natural persons". (A special exception applies where the high value residential property is purchased by an established (for more than 2 years) property developer company in the course of a bona fide property development business).

  In appropriate circumstances it may be possible to buy a property owning company rather than the property itself and in such case it may be possible that no SDLT will be payable (although stamp duty at the rate of 0.5% may arise);

- **Capital gains tax:** If the property is acquired as an investment (and not for development or trading) capital gains tax may be relevant. Capital gains tax is chargeable on gains made by UK resident individuals at rates up to 28%. If the gain is made by a UK company (or branch of a non-UK company) it will be subject to corporation tax at the applicable rate. The main rate of corporation tax for the financial year 2012 is 24%, but will reduce to 23% in 2013 and 22% in 2014. In tax terms, the major attraction for non-UK resident owners of UK real property is that there is NO charge to UK tax in relation to a gain on an eventual disposal of an investment property. Currently, this applies irrespective of whether the owner is an individual or a company. There may, of course be a tax charge in the home jurisdiction of the individual or company but in many cases either a charge will not be levied in respect of an overseas gain or else the home jurisdiction will be a low or no tax regime.

  In the 2012 Budget the Government announced that it will enact a new capital gains tax charge (that will apply from April 2013) on gains made on the disposal of high value (£2million plus) residential properties by non-UK resident, non-natural persons, such as companies;
- **Tax on development and trading income:** If the UK property is purchased by a non-UK resident individual or company for the purposes of development or trading, the non-resident will be treated as carrying on a trade in the UK and liable to pay income tax (individuals) or corporation tax (companies) on its development or trading profits. (Special anti-avoidance rules concerning transactions in land, can also apply to certain gains realised by offshore persons);
- **Tax on rental income:** Where an investment property is owned by a non-UK resident, UK tax is payable in respect of the rental income. The income for tax purposes is computed, broadly, on commercial accounting principles. In particular, interest on an arm's length loan to purchase the property, together with expenditure incurred on repairs, are both deductible. An individual will be liable to income tax (currently at rates up to 50%, but this top rate will reduce to 45% from April 2013) in respect of the rent. A non-resident company in receipt of rent will also be liable to income tax, not corporation tax, on rent but at a restricted rate of 20%. A 20% withholding tax is applied to rent paid to a non-resident landlord. The withholding has to be operated either by the tenant or, if the rent is paid via a managing agent, then the obligation falls upon the agent. In certain circumstances it is possible to obtain a direction from the UK tax authorities for rent to be paid free of withholding tax; and
- **Value Added Tax ('VAT'):** This is a form of turnover tax and the current rate is 20%. This will not apply to residential properties. In general, standard rate (20%) VAT will be charged by a seller of a new (less than 3 years old) commercial building, or where the seller has "elected to tax" the property. If the building is not new or the seller has not elected to tax the property, the sale may be exempt from VAT. In addition, the sale of a commercially let building, where the landlord charges VAT on the rent, may qualify for "transfer of going concern relief". The VAT rules applicable to property transactions are complex and inadvertent mistakes can result in substantial VAT charges or claw-backs of tax reliefs previously claimed. Consequently, specialist advice should be sought from your lawyer;
- **Inheritance Tax ("IHT"):** IHT is a tax that may apply to gifts and to transfers on death. The maximum rate of tax is 40%. For UK IHT purposes an individual's worldwide assets will form part of their estate in calculating any IHT liability if they are domiciled in the UK. In the case of an individual who is not UK domiciled, only UK assets will be included. A person may be UK domiciled according to case law, or "deemed domiciled" under UK tax law if they have been tax resident in the UK in 17 out of 20 income tax years. From 6 April 2013 tax residence for the deemed domicile test will be determined under a new statutory residence test.

  UK real property will always be a UK asset. However, the general rule is that shares in an offshore company that owns UK real property will not be UK assets. Accordingly, it will often be beneficial for a non-UK domiciled individual to hold UK property though an off-shore company. Consequently, prior to the 2012 Budget it was often beneficial for IHT planning purposes for non-UK resident individuals to acquire and hold their UK property through an offshore company. However, the new UK tax measures (15% SDLT and the proposed new capital gains tax charge and annual holding charge – discussed below) designed to stop "enveloping" residential property in companies, means that this form of IHT planning is no longer attractive in relation to high value residential property;
- **Annual Charge:** As mentioned above, the Government plans to introduce (with effect from 1 April 2013) an annual holding charge on high-value (over £2 million) residential properties owned by non-natural persons. The proposed annual charge will range from £15,000 to £140,000 depending on the value of the property. The Government's objective for introducing this annual charge is to reduce the number of residential properties held in "corporate envelopes" and the charge is likely to apply equally to properties held in new and existing "corporate envelopes".

Tax efficient structuring

As highlighted above, non-residents can benefit from a number of tax breaks and with efficient structuring, can minimise tax on income as well as eliminating tax on any gains. The tax consequences of a particular investment depends upon a number of factors, the key ones being the status of any underlying investor (their tax residence and, if an individual, their domicile), the availability of double taxation agreements and the particular features of the vehicle chosen for the investment:

- **Residence**: The rules relating to UK residence for tax purposes are complex. However it is possible to set out broad guidelines as to what constitutes UK residence. In general terms, prior to 6 April 2013, an individual may be regarded as UK resident if he is physically present in the UK at some time in the tax year (6 April to the following 5 April). He will always be resident if:
  - he is in the UK for 183 days or more in the tax year (there is no exception to this rule)
  - he visits the UK regularly and spends an average, taken over 4 years, of 91 days or more in the UK per tax year

    After 6 April 2013, an individual's UK tax residence will be determined under a new statutory residence test (still to be enacted but in near final form). The new rules include two tests. The second test is applied if the first one is not satisfied. The individual is categorised as either an "arriver" or a "leaver". The first test is then applied to the arriver/leaver by reference to the number of days the individual spends in the UK, whether he has a property in the UK or whether he is based in or out of the UK due to his work or his spouses work. If this test is not satisfied it is then necessary to consider

the second test which operates by reference to the number of days spent in the UK by the individual and the number of "ties" (such as family, accommodation and work in the UK) he has to the UK. If neither the first nor second test is satisfied, the individual is not a UK-resident for UK tax purposes.

In the case of companies, the following will be UK resident:

- a company which is incorporated in the UK, or
- a company whose central management and control is located in the UK

Specialist advice must be taken in relation to any proposed project to determine whether or not the investor will be viewed as non resident.

- **Domicile**: An individual's domicile may have an impact on what is the most appropriate structure to use to own UK property. As explained above, for UK inheritance tax purposes an individual's worldwide assets will form part of their estate in calculating any inheritance tax liability if they are UK domiciled. This can be contrasted with an individual who is non-UK domiciled for whom only UK assets will be included.

  Under case law, a person might become UK domiciled if:

  - their father was domiciled in the UK when they were born and then have not subsequently moved to another county, made it their permanent home and sufficiently cut ties with the UK to transfer their domicile to that other country
  - their father was not domiciled in the UK when they were born but they have moved to the UK to live and made it their permanent home.

  For the purposes of UK inheritance tax a person will also be deemed to be domiciled in the UK if they have been UK tax resident for 17 out of the preceding 20 tax years. As explained above, the new UK Statutory Residence test will also be relevant for the purposes of the "deemed domicile test".

- **Double Tax Agreements (DTAs)**: These are agreements between two countries under which they grant tax concessions or reliefs to prevent taxpayers being liable for tax on the same amount under both systems and to lower the withholding tax payable in one country on dividends, interest and royalties paid to a person in the other country. The existence and terms of DTAs need to be carefully considered in order to keep to a minimum the tax liability associated with owning UK property. The Clyde & Co tax team consider the tax profile of the investor and the jurisdiction from which investment is coming. They can then advise on the most appropriate route for investment in order to benefit fully from existing DTAs.

- **Structuring**: Choosing an appropriate investment structure for the holding of UK property is a key consideration. Clyde & Co has considerable experience in advising both inward and outbound investments to and from UK, including advising on routing investments through offshore, low tax jurisdictions, such as the Channel Islands, Luxembourg, Mauritius or The British Virgin Islands, in order to maximise tax efficiency.

  The most suitable structure to use depends upon a variety of factors, including the nature of the transaction, the parties involved and their residency, funding requirements and exit strategies. The Clyde & Co team are well placed to give detailed advice and deal with establishing the necessary entities.

Conclusion

Whilst overseas buyers appear to be increasingly keen to enter the UK property market, it is important that they do so having taken proper advice. Clyde & Co is well placed to assist with both the initial acquisition and the subsequent letting of a property.

About Clyde & Co

Clyde & Co is a leading international law firm with substantial offices both in the UK and the UAE and has considerable experience working with overseas investors seeking to invest in UK property. Clyde & Co has offices across the Middle East and has had an office in Dubai since the early 1970's. With strong real estate, corporate and tax groups, Clyde & Co can advise both corporate and individual investors on the best investment structures to mitigate tax liability, liaise with the investor's chosen funder to meet their lending requirements, carry out necessary due diligence, negotiate the legal documents and ensure that the acquisition process is as smooth and quick as possible.

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