Grant Thornton

Non-resident landlords move to corporation tax

What's happening?

6 April 2020 brought further changes to the taxation of UK property as the UK government continues its effort to level the playing field between UK and offshore investors. This latest phase of measures transitions non-resident companies, that carry on a UK property business or have other UK property income, often referred to as Non-resident Landlords (NRLs), from the UK income tax regime to the UK corporation tax regime.

While this brings a reduction in the current applicable tax rate from 20% to 19%, the changing landscape means that NRLs now face heavier compliance burdens and a raft of more complex rules which can significantly impact the overall effective tax.

Investors and fund managers are likely to have questions on the new changes, particularly around the tax efficiency of financing structures and utilisation of any brought forward losses. Determining whether restructuring can optimise the position will be key.

Early evaluation of the changes can help NRLs assess how these rules impact the tax position of their investment structures and ensure reporting deadlines and compliance obligations are met.

Tax administration

NRLs continuing a UK property business will automatically be registered for corporation tax on 6 April 2020 and issued with a corporation Unique Taxpayer Reference (UTR) by 30 June 2020. Any non-resident corporates commencing a UK property business after 6 April 2020 must notify HMRC within three months of commencement normally through completion of Form NRL2 which allows rental income to be received gross with HMRC approval.

Unlike income tax, where taxable profits are calculated by reference to the tax year (ie. 5 April), corporation tax is calculated by reference to accounting periods. While in the first year, companies may see their first accounting period automatically default to 5 April 2021, the first tax return submission under corporation tax principles will be from the period 6 April 2020 to the date the company prepares its annual accounts so it may be necessary to notify HMRC of the company's correct accounting date in advance to avoid late filing penalties.

	Non-Resident Landlord regime (pre 6 April 2020)	**Corporation tax regime (from 6 April 2020)**
Tax period	Tax return for the 5 April tax year	Tax return for CT Accounting Period (AP)
Tax filing dates	Paper filing of income tax return - due 31 January from end of tax year. Not required to file supporting accounts	Online filing of corporation tax return – due 12 months from end of the AP. Required to file iXBRL tagged accounts
Tax rate and tax due dates	20% income tax rate. Payments on account due on 31 January & 31 July	19% corporation tax rate. Payment due 9 months and 1 day after end of AP or under quaterly instalments
Interest and finance costs	Generally deductible as a property expense if arm's length and revenue in nature	Finance cost deductibility assessed under the corporation tax loan relationship rules. Additional interest restrictions rules may apply under CIR and hybrid mismatch rules

Tax losses	Losses can be carried forward against property income. No group relief available	Property losses from NRL regime can be offset against post April 2020 property business profits subject to certain restrictions. Post 6 April 2020 losses can be group relieved
Derivative contracts	No tax impact on fair value movement	Fair value movements recognised in accounts but election possible to disregard
Chargeable disposals	Register with HMRC within 30 days (residential) 90 days (commercial) of disposal	Reported within the corporation tax return

A significant change between income tax and corporation tax is that under the latter, tax returns must be filed electronically no later than 12 months after the end of the accounting period. They must include:

Form CT600 – a self-assessment of corporation tax due and any relevant supplementary return pages.

Copy of accounts – these should be suitably tagged in iXBRL format and be prepared in accordance with UK GAAP, UK-IRFS / FRS, or the 'local' accounting standards of the country of incorporation (and converted to UK standards for the purposes of the corporation tax return). This is a marked change to pre April 2020 tax years when no accounts accompanying the tax return submission were required. Advice should be sought early to meet the necessary filing requirements by the due date.

Tax payment dates

It will be important for non-resident corporate landlords to understand the transitional arrangements that apply in year one. While NRLs settle tax liabilities via the Payments on Accounts (POA) regime and pay their final POA and balancing payment on 31 July 2020 and 31 January 2021, respectively, corporation tax due is generally paid within nine months and one day after the end of a company's accounting period. Exceptions apply if a company is 'large' (taxable profits over £1.5 million) or 'very large' (over £20 million) where tax payments are accelerated and payable in instalments, proportionally reduced for short accounting periods and the number of associated companies within a 'group' (broadly 51% related companies).

Deductibility of finance costs

A fundamental difference between the calculation of taxable profits under the income and corporation tax regime relates to the deductibility of finance costs. Finance costs will no longer be deductible as a property expense but will instead be treated under the more complex loan relationship rules.

Additionally, non-resident corporate landlords will have to consider provisions that seek to restrict the deductibility of interest known as the Corporate Interest Restriction (CIR) for the first time as well as the hybrid mismatch rules.

Whereas NRLs previously may have seen interest expenses being deductible in full subject to normal transfer pricing provisions, the CIR could limit tax deductions for interest expenses and similar financing costs to the lower of 30% of EBITDA and a £2 million de minimis limit (the £2 million is applicable to the 'group' which broadly comprises the ultimate parent and all of its consolidated subsidiaries). There are alternative methods to calculate any restriction where the company is part of a group that may offer a more favourable position (and there are also specific exceptions to these rules such as the public benefit infrastructure exemption). However, highly leveraged structures are likely to have deductibility for finance costs restricted for tax purposes.

Additional interest restrictions can apply under the hybrid mismatch rules which seek to address cross border arrangements that involve either a double deduction for a single expense, or deductions for an expense without any corresponding taxable income. In most cases, these rules will impact structures with US investors where 'check the box' elections have been made to treat companies as transparent for US tax purposes or structures which use hybrid financing instruments.

NRLs will need a full understanding of their structure and should seek advice on the application of these complex rules early to ensure their tax position is optimised and related tax filing obligations are met.

Losses

Specific provisions have been made to allow unrelieved income tax losses to be carried forward to the corporation tax regime and offset against future UK property business profits for so long as the company continues to carry on the UK property business.

Income tax losses must be used in priority to losses incurred on or after 6 April 2020 and cannot be group relieved or used to offset chargeable gains. While in theory the transition to corporation tax should allow for more flexibility in the use of losses arising post 6 April 2020, restrictions apply where losses exceed £5 million. There will also be a requirement to analyse expenses and split them between rental, management and non-trade expenses. Care will need to be taken to ensure these items are treated correctly in the corporation tax return.

Capital allowances

Capital allowance pools provide a valuable form of relief against taxable profits and will transfer from the income tax regime to the corporation tax regime at the tax written down value as at 5 April 2020. As such, no balancing allowance or charge will arise, provided all relevant conditions are satisfied.

Care should be taken to ensure capital allowances (together with any profits and losses) are correctly time apportioned between the income and corporation tax regimes where a company's accounting period straddles 6 April 2020.

Chargeable gains

Tax changes brought gains arising on indirect or direct disposals by non-resident investors within the UK tax net on 6 April 2019 (unless a specific election has been made or the trading exemption applies). The move to corporation tax from 6 April 2020 means net gains on disposals are included in the company's profits chargeable to corporation tax and subject to corporation tax at 19%.

What NRLs need to think about

While the company's first corporation tax return may not be due for some time, it is important to consider the impact of the changes now. In our experience, key actions include:

- submit authorisation to HMRC allowing your advisor to deal with the corporation tax compliance on your behalf;
- follow up with HMRC if a UTR has not been issued by 30 June 2020 and contact them to change the default accounting period end date being 5 April 2021;
- plan a new timetable for the preparation and completion of accounts, corporation tax returns and arrange for accounts to be prepared in iXBRL format;
- consider income tax losses carried forward under the corporation tax regime and assess the capital allowances claim in the transitional year to correctly apportion between the two tax regimes;
- gain full visibility of the holding structure and ultimate investors to ensure compliance obligations are met and reliefs such as loss allocations are maximised;
- evaluate worldwide group net-interest expense / anti-hybrid rules and assess the deductibility of interest under the corporation tax regime; and
- consider impact of fair value accounting movements for any swap arrangements or other derivative contracts entered into and whether any elections may be necessary.

The corporation tax regime applies a different set of rules which could be significantly more complex. These new rules together with the non resident capital gains tax changes introduced on 6 April 2019 should be considered when structuring new investments.

Penalties and interest can apply for non compliance and inaccurate return submissions so it is important to seek advice at an early stage. The local Grant Thornton team have significant experience in these areas and can help with your specific requirements.

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