



Non-resident landlords and the move to corporation tax

Are you ready for the transition?

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From 6 April 2020 non-UK companies owning UK property will become subject to UK corporation tax (CT), an ever evolving and increasingly complicated set of tax laws.

In this publication, we hope to address some of the practical aspects to help tax payers get ready for the change.

We will also outline the potential implications to a non-resident landlord's (NRL's) ongoing effective tax rate.

Practical aspects

HMRC will automatically register all NRLs currently subject to UK income tax for CT and notify them of their CT Unique Taxpayer Reference ('UTR'). NRLs that have not heard from HMRC by 30 June 2020 should contact HMRC directly to follow this up as it will not be possible to submit a CT return without this.



A NRL will be required to submit tagged accounts with its CT return – it is worth exploring in good time how this process will run alongside the NRL's preparation of its accounts.

Transitional provisions exist to ensure that a NRL can continue to utilise any income tax losses brought forward and its existing capital allowances pool without crystallising a balancing charge or balancing allowance following the move to CT.

One big practical change is that unlike income tax, CT returns must be submitted electronically together with all supporting information including the NRL's accounts. Furthermore the accounts must be tagged in an iXBRL format and need to be UK GAAP/IFRS/FRS compliant. The tagging process can require a bit of effort in the first year so it is worth exploring in good time how this process will run alongside the NRL's preparation of its accounts. Another significant change is that the deadline for submission of returns and payment of taxes will now be dependent on the accounting year end of the NRL. This is of particular relevance for administrators who may have multiple clients with different filing and tax payment deadlines.

CT returns should be filed within 12 months from the end of the accounting period (i.e. for the year ended 31 December 2020, the CT return is due to be filed by 31 December 2021) rather than as currently on a tax year

basis. Each NRL's first CT return will be for the period 6 April 2020 to the year-end date of the company. Tax is ordinarily payable 9 months and 1 day from the end of the accounting period, however for those NRLs that have taxable profits in excess of £1.5m ('large') or in excess of £20m ('very large') an instalment regime is operated. The £1.5m and £20m limit is proportionately reduced for short accounting periods (i.e. less than 12 months) and also the number of associated companies within the group (related 51% companies). Where an NRL's profits are large or very large, tax payments will be accelerated such that payments are more in line with when the taxable income is earned. For fund structures that are corporate SPV heavy (both UK and non-UK companies) this can very easily result in NRLs falling within the very large regime.

If you currently pay your income tax liability under the payment on account regime and the only income that the NRL generates is from its UK property rental business the last payment on account for income tax purposes will be due on 31 July 2020 with the final balancing payment due on 31 January 2021.

Impact to NRL's annual tax liability

As it stands an NRL is currently subject to a headline income tax rate of 20%. For profits earned on or after 6 April 2020 the rate will change to the applicable CT rate, which is currently 19%. However, there are a number of provisions which seek to restrict the deductibility of expenses that would otherwise be deductible for income tax purposes. Therefore it is likely that the tax liability of a NRL will be higher under CT than it is currently.

Two of the biggest changes for NRLs will be the application of the UK Corporate Interest Restriction (CIR) rules and the UK anti-hybrid rules. The CIR rules broadly restrict a company's interest expense deductions to the lower of 30% of a company's EBITDA or a de minimis of £2 million (the de minimis applies on a group basis). The CIR rules are likely to create interest expense disallowances for highly leveraged structures, where interest expenses may have been fully deductible historically under income tax rules.

This can also be problematic for those NRLs that only use shareholder debt as there is a debt cap rule that prevents groups from leveraging UK CT paying companies in excess of the group's external borrowings. Therefore from a practical perspective, if under consolidation principles the shareholder debt would be eliminated, the maximum deduction available across the group would be the £2m de minimis.

NRLs undertaking a significant capex programme can also run into issues where it is expected that rental income will be substantially reduced or nil for a period of time as tax losses would not automatically be generated on the interest expenses incurred during this time period for use against future rental income.

Where an NRL is likely to suffer a significant disallowance under the 30% EBITDA rule it is possible for a company to elect to apply one of the two alternative methods, namely the group ratio method or the public infrastructure benefit exemption. These elections may give a better result by providing relief for third party interest expenses in their entirety (subject to the conditions being met). However ultimately where real estate assets are highly leveraged with both shareholder and external financing, going forward at least part of the interest expenses are likely to be disallowed.

A further restriction comes in the form of the UK anti-hybrid rules. These rules apply to all expenses including bank debt and it can be easy to create inadvertently a UK anti-hybrid issue through structuring decisions taken at the investor/fund level. The most common scenarios whereby an expense might be disallowed under these rules is where the investment structure is completely checked open for US tax purposes or there are hybrid financing instruments above the UK structure (e.g. CPECs) that have been used to fund shareholder debt into the NRL.

Other differences to be mindful of that can impact the ongoing tax liability of a NRL following a move to CT are capitalised interest (deductible when capitalised rather than when taken to the P&L) and movements on derivative contracts. There is a special regime for derivative contracts called the disregard regulations. Consideration should be given as to whether an election should be made before 6 April 2020 to 'disregard' fair value movements that arise from the accounting of derivatives in the NRL.

Given the above, it is now critical that NRLs have visibility of the holding / fund structures that sit above them and the taxable nature of their ultimate investors to enable NRLs to comply with their own tax obligations. This will be a fundamental change for the real estate market and increase the compliance burden for large real estate funds and small real estate investment structures alike.



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Deal considerations

How these changes ultimately impact the UK real estate market are yet to be seen, however early questions on whether there is a benefit to on-shoring NRLs, the tax efficiency of financing structures and annual restrictions to the utilisation of losses are starting to be considered when structuring new investments. One key aspect it will be important to model and track in deal scenarios going forward is the impact of the change in ownership rules where CT losses start being generated by NRLs. Under CT rules, tax losses can be lost permanently where there has been a change in ownership and a major change in the nature or conduct of the UK property business at any point within 5 years of the change in ownership.



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Next steps

With the move to CT rapidly approaching, NRLs should consider speaking to their advisors sooner rather than later to assess the impact of the transition to CT and whether their current investment structure is the best structure to operate going forward.

Key considerations for the move to corporation tax



Filing obligations

- New period will start from 6 April 2020
- Tax return covers accounting period not tax year
- CT return filed on-line (no paper filing)
- iXBRL tagged accounts required to be filed with return
- Filing deadline: 12 months from end of accounting period



Payment of corporation tax

- Final income tax POA due 31 July 2020
- CT payable 9 months and 1 day after end of accounting period
- QIP regime (liability paid quarterly for large and very large groups / companies)
- Fund structures with multiple SPVs (UK and non-UK companies) likely caught in QIPs



Transitional provisions

- Income tax losses carried forward and can be used to offset against CT profits on property business however these losses are less flexible than new losses generated post 6 April 2020
- No deemed disposal of CA pools



Corporate Interest Restriction rules

- Applies to worldwide group
- Group determined under IAS consolidation principals
- General restriction to 30% EBITDA
- De minimis of £2million per group subject to debt cap restrictions
- Alternative calculation with group ratio or PBIE elections



Anti-hybrids

- Targets hybrid instruments and entities resulting in a mismatch between tax deduction and taxable income
- Structures with US CTB elections may be impacted
- Important to consider structure as a whole – imported mismatches



Tax losses

- Group relief available
- Annual restriction on brought forward CT loss utilisation (>£5million: 50%)
- Interest expenses now deducted under Non-trading loan relationship rules
- Potential restriction to brought forward CT losses on a change on ownership – major change in nature/conduct of business



Derivatives

- Fair value movements generally brought into account, but election can be made for these to be disregarded

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