Helpsheet
Anti-Avoidance Issues
For Non Resident Landlords

Once upon a time it was a relatively easy process for a non-resident corporate landlord to acquire UK property for rental, but gear the acquisition at the highest justifiable market rates in order to minimise the taxable UK rental profit. However, these days, there are a number of Anti-Avoidance rules, many of which have been recently introduced, that will impact on corporate non-resident landlords. Below you will see a brief summary of these Anti-Avoidance rules, however, we would recommend that each company should seek advice specific to its own situation.

Transfer Pricing

The UK transfer pricing rules require that, for large companies, all intercompany transactions between connected parties are carried out on an arms-length basis, and these transfer pricing rules include the finance costs charged, intercompany borrowing amounts, and intercompany guarantees.

Although an exemption from transfer pricing applies to Small and Medium Size Enterprises, HMRC can issue a directive for transfer pricing to apply to medium sized enterprises in some circumstances. Furthermore, transactions with connected companies in "non-qualifying territories" will not benefit from the transfer pricing exemption.

Transactions that were previously not caught by the transfer pricing provisions due to the SME exemption may, however, now anyway be caught by the new Profit Fragmentation rules, introduced from 1 April 2019.

Profit Fragmentation

Further anti-avoidance legislation was bought in with effect from 1 April 2019 for corporation tax purposes to capture situations where there is a tax mismatch due to profits being moved out of the UK to a jurisdiction where the recipient pays tax at a rate of less than 80% of the rate that the UK transferor would have paid. This therefore would need to be considered where the rate of tax for the recipient is 15% or lower.

There are a number of conditions that have to be met for the legislation to take effect, and a key component is whether the transaction was not at arm's length.

Unallowable Purpose

Where a company is party to a loan relationship that is considered to be for an "unallowable purpose", the finance costs associated with that loan will not be allowed as a deduction against profits for tax purposes.

An "unallowable purpose" is where the loan has no business or other commercial purposes.

Corporate Interest Restriction (CIR)

The CIR rules were introduced with effect from 1 April 2017 and seek to restrict the deductibility of the interest expense for companies chargeable to UK corporation tax.

Where the interest expense for a group companies (or a standalone company if it is not part of a group) that are chargeable to UK corporation tax is below £2 million per year (the de-minimis), then there will be no restriction to interest deductibility under the CIR rules.

If the annual cost of interest for group companies chargeable to UK tax is in excess of £2 million, then the CIR rules seeks to restrict interest deductible in the year using either the Fixed Rate Ratio (the default method) or the Group Ratio Method (an elected method).

The rules and calculations required for CIR are complex and each situation will need a careful review to ensure the rules are correctly considered.

Anti-Hybrid rules

The UK Anti-Hybrid rules seek to address "mismatches" between the tax treatment of a transaction, entity or arrangement in different jurisdictions.

The main situations that the rules are designed to combat are where:

- a payment is tax deductible in one jurisdiction, but the corresponding receipt is not taxable in the hands of the recipient in another jurisdiction
- A "double deduction" arises in respect of one transaction (e.g. by a company resident in one jurisdiction and by a permanent establishment in a different jurisdiction)
- A "hybrid entity" may also arise where the tax status of an entity is conflicting in different jurisdictions (e.g. treated as a "transparent" partnership in one jurisdiction and an "opaque" company in another jurisdiction).

Where a mismatch arises and is caught by the legislation, an adjustment would be made to disallow the deduction.

The legislation also provides that if tax charged, or a proportion of tax charged on the relevant receipt is, or falls to be refunded, then the income bought into account in calculating the profits is proportionately reduced, and a disallowance of the difference would occur.

GAAR

It should be noted that the UK does have a General Ant- Abuse Rule (GAAR) which is designed to counteract tax advantages arising from tax arrangements that are abusive. This is aimed at arrangements that are concluded to be an unreasonable course of action, where one of the main purposes was to obtain a tax advantage.

Where arrangements are not already covered by the other relevant legislation, consideration should be given to the GAAR to satisfy that the course of action would not be considered "unreasonable" by the GAAR advisory panel.

Withholding Tax (WHT)

Consideration also needs to be given to whether withholding taxes will apply, particularly on payments of interest by a non-resident landlord. It might be easy to assume that there should be no UK withholding tax concern where a non-resident company is paying interest offshore. Indeed, historically that very much used to be the assumption, not least because historic case law was thought to enable a non-resident landlord to arrange the structure of a loan to generate "non-UK source" interest payments, even where the loan was for the purchase of UK real estate. However, the more recent case of Ardmore Construction has led to a potentially wider view as to what might be considered "UK source" interest, which may now be of concern for non-resident landlords

The payment of interest to a company or individual resident outside of the UK can be subject to withholding tax at the rate of 20% (or lower if the double taxation treaty in force allows), where:

- The interest has a source in the UK
- It is yearly interest (i.e. on loans that are expected to exceed a period greater than 12 months
- It is paid (rather than accrued)

The impact of the Ardmore case has been that the question of "source" of interest, although still acknowledged as a "multi-factorial test", now has much more focus on the source of the funds used to pay the interest. As such, if it is UK rental income being used to finance the interest payments, then the non-resident landlord might be concerned as to whether a withholding tax obligation applies.

Sadly at present there is a lack of legislative clarity on this issue in relation to non-resident landlords. It will therefore make sense for non-resident landlords to take advice to see if they may be able to consider that there are enough other factors still in place to point away from a UK source or whether an approach such as preferring bank borrowing, or borrowing from lender in a suitable treaty location may be more prudent. Other possibilities such as use of a Eurobond may also exist.

As these areas of tax legislation are highly complex, each case should be individually reviewed and specific advice sought for each situation.

We would be more than happy to assist with any related queries. For more information, please contact Janet Pierce on janet.pierce@charter-tax.com, or Charlie Goss on charlie.goss@charter-tax.com; or call us on +44 (0)20 7084 5771.

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30 April 2020

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