



HM Revenue
& Customs

Profits from Trading in and Developing UK Land

16 March 2016

Technical Note

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SUMMARY

Some property developers use offshore structures to avoid UK tax on their profits from trading in property in the UK. In line with international standards, the government is acting to ensure that non-resident developers of UK property will always be brought into UK tax on the profits from that development. This will ensure a level playing field between UK developers and those based in offshore jurisdictions. Property developers already paying full UK tax should not be impacted. The measure will come into effect from Report Stage of Finance Bill 2016.

The legislation puts in place a specific set of rules to tax trading profits derived from land in the UK. Those rules will apply equally to resident and non-resident businesses, and will not depend on the existence of a 'permanent establishment' in the UK.

The legislation will be introduced at Report Stage and will take effect from the date of introduction. Anti-avoidance rules will take effect from Budget Day to counteract arrangements put in place between Budget Day and the date the new legislation is introduced that are designed to get around the charge.

The majority of the UK's international double taxation agreements (DTAs) preserve the UK's taxing rights over land in the UK and are therefore in line with the proposed changes. However, a small number of older DTAs will require some changes to put the position beyond doubt. Protocols have been agreed with Guernsey, the Isle of Man and Jersey, amending those DTAs, and these changes will have effect from Budget Day.

Chapter 1 of this note sets out the current position in more detail. Chapter 2 gives details of how the new legislation will work.

At present, some developers of UK land seek to exploit the current rules to pay much less tax than other developers undertaking the same activity. The main effect of the measure will be to level the playing field between UK and offshore property developers by ensuring that an offshore developer of UK land is taxed in the same way as a UK developer and cannot benefit from a more favourable treatment.

The Government will monitor closely whether arrangements to collect tax on behalf of non-resident businesses affected by this new legislation are satisfactory. The government will consider the introduction of a withholding tax if it proves necessary to ensure full compliance with the new rules.

Comments are invited on the issues raised in this document no later than April 29th 2016. Please send comments to: landproperty.mailbox@hmrc.gsi.gov.uk

Chapter 1 – current legislation

Background to the legislation

Land is a natural resource of the country in which it is located and the international norm is that profits from land should be taxable in the jurisdiction in which that land is located. The Government believes this is the correct approach to take in relation to trading profits arising from UK land regardless of the residence of the person carrying on the trade.

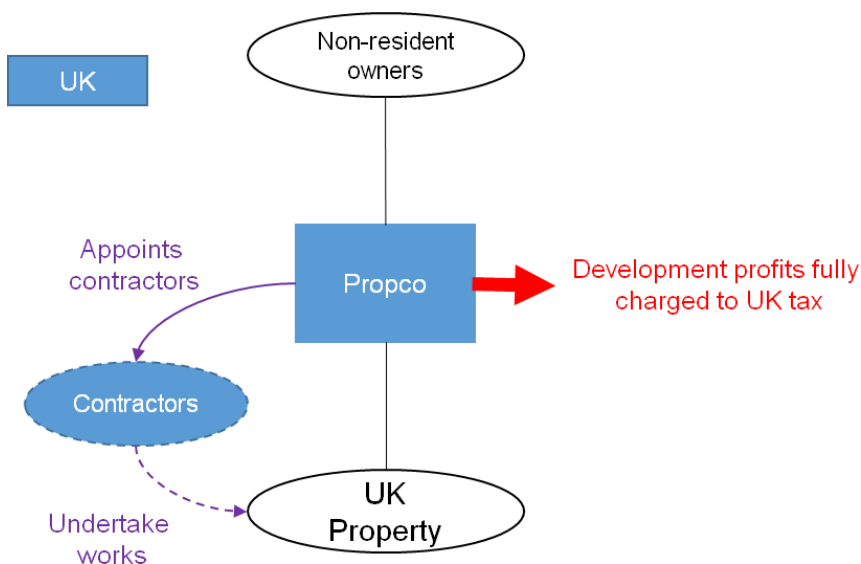
At a very high level, the territorial limits of the UK's tax system can be summarised as follows. An initial distinction is made between trading and investment activity, which give rise to income and chargeable gains respectively for tax purposes. Assuming that there is trading activity a second distinction must then be drawn between UK resident persons trading in the UK, non-resident persons trading in the UK through a permanent establishment, and non-resident persons whose activities in the UK do not amount to trading in the UK through a Permanent Establishment (PE).

UK tax charge on land: Territorial scope

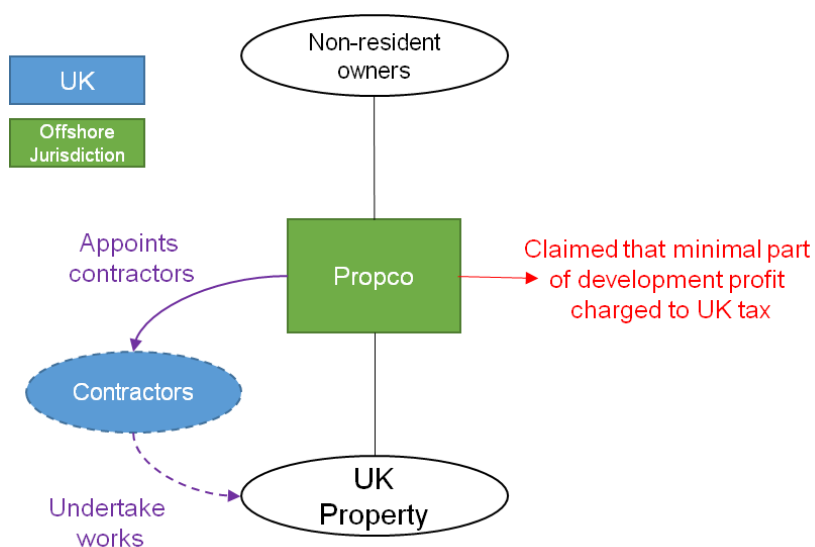
1. Where a person disposes of an investment asset, they will generally be charged to capital gains tax (or, in the case of a company, corporation tax on chargeable gains). Apart from two key exceptions, a person is only charged to capital gains tax in a year where they are resident in the UK for tax purposes (section 2 of the Taxation of Chargeable Gains Act 1992 (“TCGA”). Those exceptions are residential property (section 1(2A) of TCGA) and assets used by the UK PE of a non-resident company for the purposes of a trading activity (section 10B of TCGA 1992)
2. Where a person is trading, the UK has more extensive tax provisions. A company will be within the charge to UK tax on its trading profits if it meets one of four conditions:
 - if the company is resident for tax purposes in the UK, its worldwide profits and gains will be chargeable to corporation tax (section 5(1) of the Corporation Tax Act 2009 (CTA 2009));
 - if the company is non-resident, and if it carries on a trade in the UK through a PE situated here, the trading profits and certain gains attributable to that PE will be chargeable to UK corporation tax (sections 5(2)&(3) and 19 of CTA 2009);
 - if the company is not resident and does not carry on a trade through a PE here, it may still have a residual liability to UK income tax in respect of its UK source trading profits; or
 - in certain circumstances a company may be charged to the Diverted Profits Tax (Part 3 of FA 2015).

3. By exploiting these charging provisions, some developers of UK property argue they are able to use offshore structures to reduce the tax payable. This gives them an unfair advantage over UK developers that pay tax on the full amount of their profit. This is illustrated by the examples below.

Example 1 – UK developer carrying on development activity wholly in the UK



Example 2 - offshore developer with no UK resident company



4. The above diagrams show, firstly, a UK developer, and, secondly an offshore property development structure in its simplest form. Propco acquires UK land, and appoints contractors to build out the development. It will sell this in due course and realise, hopefully, a significant profit.
5. In order to be subject to UK taxation, Propco in example 2 historically needed to satisfy one of three conditions:
 - a. to be resident in the UK for tax purposes. If it is incorporated offshore, a company will be resident for UK tax purposes where its central management and control is located;
 - b. to be carrying on a trade through a PE in the UK. Even if Propco is non-resident, if it carries on a trade in the UK through a PE situated here, the trading profits and certain gains attributable to that PE will be chargeable to UK corporation tax;
 - c. to have UK source trading profits. Even where Propco is non-resident and does not carry on a trade through a UK PE here, it may still have a residual liability to UK income tax in respect of its UK source trading profits if there is no double taxation agreement (DTA) with a PE article in place.
6. Place of incorporation and where management and control is exercised determine whether a company is to be treated as non-resident. To avoid taxation under limbs (b) and (c) however, it is necessary for Propco to manage its affairs to avoid a PE and for Propco to be able to benefit from a DTA which prevents the residual income tax charge under limb (c) arising by imposing the PE threshold.
7. The development may be structured so that Propco is resident in a territory that has a DTA with the UK that contains a definition of PE that does not, for example, explicitly include a building site; that provides that a resident of the territory cannot be charged to UK tax on business profits in the absence of a PE in the UK; and does not include express provisions preserving the source state's rights to tax profits from land in its jurisdiction.
8. In practice it is very difficult for an overseas company to avoid creating a UK PE where it has engaged contractors to carry on construction activities at a UK building site. HMRC is challenging structures such as these and considers it has strong arguments that a UK PE exists. The Diverted Profits Tax significantly strengthens HMRC's ability to mount such an argument if it is reasonable to assume that the activities of the overseas company are designed to avoid a charge to corporation tax.
9. Where HMRC establishes the existence of a PE (or an "avoided PE" for the purposes of the Diverted Profits Tax), some business still argue that this does not allow the UK to capture the entire profit from the development. This would mean that the UK is not collecting an appropriate amount of tax from profits derived from trading in UK land.

Chapter 2: Details of the new Legislation

New approach to the taxation of trading profits from UK property

10. The key change will be to remove the current territorial restriction in UK legislation so that the profits of a trade carried on by a company are subject to corporation tax on income where the trade comprises dealing in UK land, or developing UK land with a view to disposing of it, regardless of the residence of the company carrying on the trade, regardless of where the trade is carried on and regardless of whether or not the trade is carried on through a PE (whether in the United Kingdom or elsewhere).
11. Applying this to the examples above, the new legislation will therefore ensure that the entire profit realised by Propco (determined using the rules set out in this note) from a UK property trade is chargeable to UK tax even if it is not UK resident and has no UK PE. The following text will refer mainly to companies and corporation tax – equivalent changes will be made for income tax.

Detail: Scope of new approach: trade of dealing or developing UK land

12. The new legislation will provide that non-resident companies can be taxed on trading profits from UK property regardless of whether there is a UK PE. The new rules will capture the profits of a trade (referred to in what follows as a ‘UK property trade’) carried on by a person in so far as the trade consists of:
 - dealing in any estate, interest or right in or over land in the UK; or
 - developing any land in the UK with a view to disposing of any estate, interest or right in or over the land. This will include redevelopment.
13. If the company’s only activity is a UK property trade then the taxable profits will be the full trading profits of the company regardless of the residence of the company. Normal CT trading rules in Part 3 of CTA 2009 will be used to compute the profits.
14. If the trade of the company comprises both the disposal of UK land and some other activity (such as the disposal of non-UK land), or if, unusually, the company carries on more than one trade, the new charge will apply only to that part of the company’s trade or trades that comprises trading in UK land. Again normal CT principles will be used to compute the amount to be charged.
15. The whole of the profit will be charged to CT (and foreign PE exemption will not be available).
16. This legislation will therefore extend the circumstances in which non-resident companies can be charged to CT in respect of a UK property business, and ensure the full amount of the profits is taxable in accordance with the normal CT computational rules rather than the current rules for PE profit attribution.

17. The new rules will have no effect on UK developers who are already fully within the charge to corporation tax on property development (but would prevent such companies from obtaining PE exemption if they carried on UK property development through an overseas PE). It follows that there will be no change to the basis on which the profits of UK property developers are charged or the reliefs or other tax rules they can access, so long as they are fully within the charge to UK tax on their profits.
18. The new charge will apply to disposals that occur on or after the date the legislation is introduced in Parliament at Report Stage, expected to be June 2016. To protect the core charge in the interim, anti-avoidance rules come into force with immediate effect from Budget Day, 16 March 2016.

Targeted Anti-Avoidance Rule

19. The core rule described above will be sufficient to ensure that overseas companies engaged in straightforward arrangements involving UK land development will be charged to tax on their full profits, and in the same way as UK developers. However, many of the offshore structures seen rely on sophisticated planning and HMRC anticipates that introducing the core charge in isolation would be unlikely to secure the policy objective that developers of UK land pay tax on the full amount of their profit. The government has therefore introduced a Targeted Anti-Avoidance Rule (TAAR), effective from 16 March, which will apply where either:
 - a. between 16 March and Report Stage a person transfers land to a related party who is not intended to be the ultimate recipient. This will prevent arrangements to “rebase” the land value between March 16 and Report Stage. This will apply regardless of whether there is a main purpose of avoiding tax; or
 - b. in any other case where arrangements are entered into the main or one of the main purposes of which is to secure that profits are not subject to the new charge.

Avoidance risk: fragmentation and disguised trading through selling envelopes

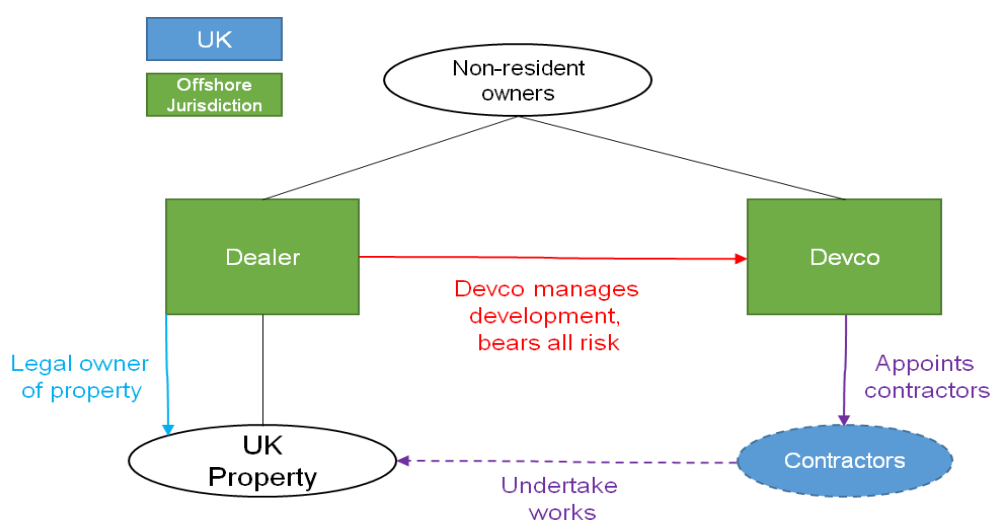
20. There are two other areas of avoidance risk – fragmentation and enveloping. The TAAR introduced with effect from 16 March will be effective against these arrangements, if they are entered into on or after 16 March where the main, or one of the main, purposes is to reduce any charge under the new provisions.
21. The main legislation introduced at Report stage will contain anti-fragmentation and anti-enveloping rules with the result that such arrangements will be counteracted without consideration of whether there is a tax avoidance purpose. Where there is both fragmentation and enveloping, then both the anti-fragmentation rules and the anti-enveloping rules will apply.

Fragmentation

Issue

22. The core charge will apply to the person trading in land – referred to below as “dealer” - i.e. the person buying and selling the land as a land dealer or property developer in the normal course of trade. However, groups could insert entities that are not subject to this main charge in order to secure that profits fall out of charge. The example below illustrates this risk:

Example 3 – Fragmentation



23. In the above structure, while Dealer (which is subject to the new charge) owns the land on which the development is taking place it has very little functionality and does not have the assets or employees to manage the risks comprised in the development. In particular, for example, it would lack the financial resources to bear the risks associated with the development which are funded by Devco. If Dealer does suffer a loss, it benefits from a “hold good” agreement with Devco to make up that amount.
24. Instead the significant people functions associated with the development are performed by another non-UK resident company (Devco). In return for performing these functions, Devco is paid the vast majority of the profit realised by Propco from the sale of the land under a pricing mechanism which, it is claimed, complies with internationally accepted transfer pricing methodologies. Devco could argue that it is not subject to the new tax regime for UK property trades because it is a service supplier, not the land owner. It does not deal in the land or dispose of the land as part of a development trade.
25. Excluding Devco’s profits from the new charge is inconsistent with the policy objective of the new measure which is that the UK should tax profits from trading in UK land regardless of whether Propco has a PE or whether it splits the profits between itself and a related entity.

26. The core charge will therefore be protected by provisions that ensure that both Propco and Devco's profits are subject to the new charge to the extent they are not otherwise chargeable.

Anti-fragmentation rule: Entry conditions

27. There will be a number of gateway conditions. In essence these are aimed at identifying a scenario where, typically, a number of connected persons act together to carry out development activity that amounts in substance to a single trade of UK property development. It is proposed that the rule would apply where:

- all or part of a *relevant amount* from the disposal of UK land arises directly or indirectly to a person "C" from a person carrying on a UK property trade ("D") as defined in the new legislation (whether D is UK resident or non-resident);
- it is reasonable to suppose C and D are acting together or concerned in a scheme, or arrangement, with a main object of realising a profit from dealing in the land, or from developing the land or from disposing directly or indirectly of the land when developed; and
- C and D meet the "economic connection" requirement.

28. In the above paragraph, "*relevant amount*" is used to refer to any amount which viewed realistically represents a share of the profits from the disposal of the land, in particular any amount that arises to C from a UK property trade carried on by D that is deductible in computing the profits of D in respect of the UK property trade that D carries on. It is not intended to represent a reward for routine services of a type which are also charged on a standard basis to third party customers and do not vary by reference to the profits of the development activity. Please note, the above describes the effect of the new legislation – the detailed drafting and terms used may differ from the above.

HMRC would welcome comments on the approach outlined above and whether there are any alternative ways in which this anti-fragmentation rule should be expressed.

29. HMRC propose that the economic connection test would be similar to that used in the OECD BEPS work on Neutralising Hybrid Mismatches, although the concept of a control group that is used there is not necessary here. Under this approach, two persons will be economically connected if:

- the first person holds, directly or indirectly, a 25% or greater investment in the second person;
- a third person holds, either directly or indirectly, a 25% or greater investment in both;
- they are consolidated for accounting purposes;

- the first person has an investment that provides that person with effective control of the second person or there is a third person with effective control over both persons; or
- the participation condition in section 148 of TIOPA 2010 is met

30. As usual there is attribution of interests where there are particular connections between parties as summarised below:

- they are members of the same family (a spouse or civil partner, brother, sister, child, parent, grandparent or grandchild);
- one person regularly acts in accordance with the wishes of the other person in respect of the relevant rights or interests (the person is legally bound to act in accordance with another's instructions or if it is established that one person is expected to act, or typically acts, in accordance with another's instructions);
- they have entered into an agreement that has a material impact on the value or control of relevant rights or interests; or
- the ownership or control of rights or interests is managed by the same person or persons.

31. Provision will be made to ensure that these rules also apply to more complex structures and entities which may not have separate legal personality.

HMRC would welcome comments on whether this test of economic connection could have any unintended consequences.

Consequences of anti-fragmentation rule applying

32. The anti-fragmentation rule is intended to preserve the UK tax base by consolidating the position of the relevant connected entities insofar as their activities amount in substance to a UK property trade and are not otherwise charged to UK tax. In the absence of the rule it would be possible for groups to arrange their affairs so that a substantial amount of profits from UK property development continued to escape any UK tax charge.

33. Where the conditions are met then to the extent that any relevant amount, other than a negligible sum, is not otherwise within the charge to CT or IT on income then it will be treated as profits of the person disposing of the land in the course of its UK property trade.

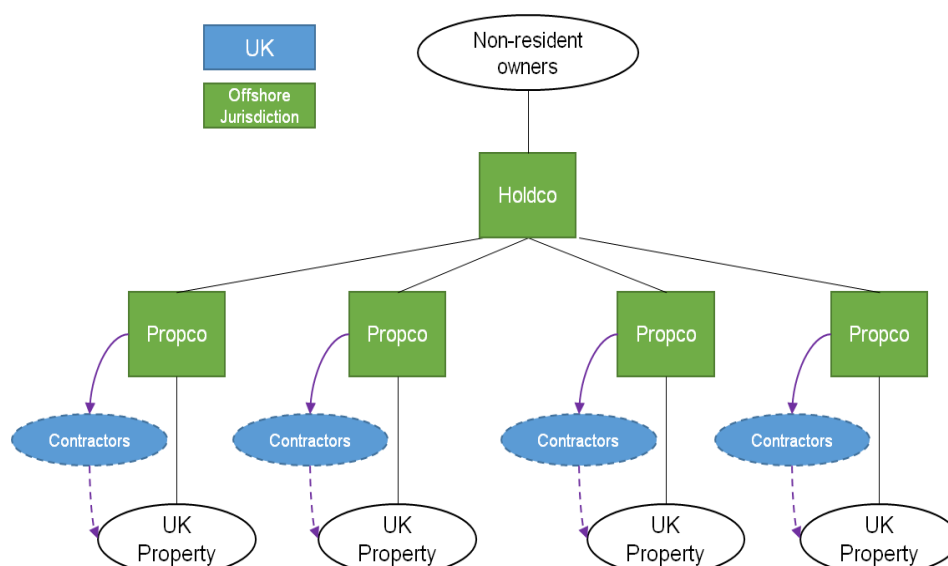
34. The rule will have no impact on wholly UK developers all of whose profits are already charged to CT, or IT, on income.

HMRC would welcome comments on the scope of this aggregation rule, how it should be framed and whether any amounts should be excluded.

Enveloping: disguised trading in land

35. Another means by which profits may be realised from land, apart from selling it directly, is by disposing of property that derives its value from land. The disposal may occur by one or more transactions, by an arrangement or other scheme – so long as the disposal of the land is effected.
36. A very simplistic example to illustrate the situation is shown below.

Example 4 - Enveloping



37. In the above structure, each development is undertaken in a separate company. It is argued that none of these companies are trading for tax purposes as it is always intended that they will hold the completed development as a long-term investment once completed. However, in economic terms the persons funding the development have no desire to hold the completed properties (which they hope to sell to long-term investors). Instead of disposing of the properties once complete, they dispose of the shares in each Propco to the end-user. It is argued that the Propcos are not trading in land as they make no disposal.

Comparison to Transactions in land rules

38. Existing tax rules, known as the transactions in land rules (Part 18 of CTA 2010, with equivalent provisions in Part 13 of the Income Tax Act 2007, and referred to in what follows as “Part 18”), are designed to ensure that enveloping does not secure a tax advantage in certain circumstances.
39. However, it is arguable that these rules do not produce the desired result with every structure or every transaction (although HMRC expects that the changes to a number of the UK’s DTAs referred to above will result in their applying to some structures which previously relied on treaty protection against a UK tax charge). It is likely that the anti-

enveloping rules needed to support the new charge on trading in UK property will use concepts that are similar to those in Part 18 (indeed the changes may be delivered by amending Part 18). The key differences are summarised below.

40. There would be no opening purpose statement as in section 815 of CTA 2010 to the effect that the rules have effect for the purpose of preventing avoidance of tax.
41. There would be no requirement for any gain of a capital nature to arise. Instead the key requirement would be that amounts are obtained from the disposal of UK land or property deriving its value from UK land are not included in the profits of a UK property trade (which includes any existing trade of dealing in or developing UK property).
42. The chargeable person would remain the same person as under the current rules in Part 18 but it would be made explicit that computing the amount of the chargeable profit would follow ordinary trading income principles. It is possible that the resulting sum will then be treated as the profit of a UK property trade, rather than miscellaneous income as currently.
43. The main gateway conditions would look like those in section 819 of CTA 2010. At least one of the following conditions would have to be met:
 - the UK land is acquired with the sole or main object of realising a profit from directly or indirectly disposing of all or part of the land;
 - any property deriving its value from the UK land is acquired with the sole or main object of realising a profit from directly or indirectly disposing of all or part of the land;
 - the UK land is held as trading stock; or
 - the UK land is developed with the sole or main object of realising a profit from directly or indirectly disposing of all or part of the UK land when developed.
44. The key difference between the proposed anti-enveloping rule and the rule currently in Part 18 would be two amendments to the meaning of disposal. The first will increase the threshold which must be met before property will be treated as deriving its value from land (which will reduce the potential for the rule to apply as compared with the current Part 18). The second involves extending the meaning of “disposal” which will potentially be wider than the scope of Part 18.

Meaning of disposal: first change

45. Part 18 already uses the concept of property that derives its value from land which is defined as including:
- any shareholding in a company deriving its value directly or indirectly from land;
 - any partnership interest deriving its value directly or indirectly from land;
 - any interest in settled property deriving its value directly or indirectly from land; and
 - any option, consent or embargo affecting the disposition of land.
46. There is currently no limit on how much land the investment vehicle must hold before this rule can apply, so that in principle a disposal of a shareholding in a company which holds only a small amount of land could be treated as a disposal of land.
47. Going forward, the new anti-enveloping rule will apply only where directly, or indirectly, more than 50% of the value of the property disposed of derives from UK land. Where it is necessary to trace value this can take place through layers of property, through entities, trusts or other arrangements to arrive at a just and reasonable attribution of value. The 50% test will be subject to the main TAAR described above. This limits the cases where a disposal of land through an envelope such as a company can be treated as a land disposal to cases where the land makes up the majority of value of entity in question.

Meaning of disposal: second change

48. A requirement for the legislation to apply is that there must be a disposal of land. This is defined in section 816 of CTA 2010 as meaning that the property in the land is disposed of or control over the land is effectively disposed of.
49. The latter concept (that is, disposing of control over the land) is more likely to be engaged where a person holds property that derives its value from land, and then loses control of that property such that control over the land is lost.
50. It is proposed that this definition of disposal is expanded so that there is also a disposal of land whenever a person disposes of any property deriving its value from land provided that it is reasonable to suppose that the person making the disposal is concerned in a scheme or arrangement with a main object of realising a profit from the disposal of the land or development of the land or in a scheme with a main object of realising a profit from directly or indirectly disposing of the land when developed.
51. For this purpose disposal would take its standard TCGA meaning; in addition, disposal will be taken to include any method, however indirect, by which any property right is transferred or transmitted, or the value of any property or right is enhanced or diminished.
52. A reference to disposal of land (or property deriving its value from land) includes a part disposal. There is a part disposal where an interest or right in or over the land (or property deriving its value from land) is created by the disposal, as well as where it subsists before the disposal, and, generally, there is a part disposal where, on a person making a disposal,

any description of property derived from the UK land (or property deriving its value from UK land) remains undisposed of.

Example 5

53. M acquires property to let out, it lets out the property for 7 years then sells the property to an independent developer for a fixed sum. None of the four conditions set out in paragraph 45 that must be present are present in this case so the profit is not in scope.

Example 6

54. Company N acquires property to let out as a storage facility, but after 7 years it decides to develop the property into high value personal residences for sale. The fourth condition in paragraph 45 is present (that is, the UK land is developed with the sole or main object of realising a profit from directly, or indirectly, disposing of all or part of the UK land when developed) so the profits from the development are within scope. Profits attributable to the period prior to the decision to develop are not in scope.

HMRC would welcome comments on the proposals on enveloping, including the possible differences from the provisions in the transactions in land rules.

Extension of charge to income tax

55. There will be equivalent changes to income tax to ensure that the charge to income tax will apply to those carrying on a trade comprising dealing in UK land, or developing UK land with a view to disposing of it, regardless of residence and regardless of where the trade is carried on. The rules will also apply appropriately to partnerships and trusts that carry on such a trade. The rules will also take effect where fragmentation includes both companies and non-corporates.
56. For non-corporates the income will be treated as UK source income.

Commencement

57. The new scope of the charge will apply from the date the legislation is introduced into Parliament. Where necessary there will be a new accounting period beginning on that day and the charge will be based on profits from disposals made on or after that date, using normal trading principles.

Targeted Anti-Avoidance Rule

58. As described in paragraph 19 above, there will be a TAAR to counteract any tax advantage that would otherwise be obtained where arrangements are entered into the main or one of the main purposes of which is to secure that profits are not subject to the new charge. The TAAR takes effect from 16 March 2016. Some examples of its application follow.

Example 7

59. After the measure has been announced, non-resident P changes its residency to a state with which the UK has a treaty that does not include the equivalent of articles 6 or 13 of the OECD Model Tax Convention, prior to disposal of land that has been developed to take advantage of the treaty benefits. The TAAR will counteract this treaty shopping abuse, and the profits will remain fully taxable in the UK.

Example 8

60. Non-resident Q disposes of developed land to related party R before the legislation is introduced at Report Stage. R then sells the land to the customer after the legislation is introduced but claims the purchase price from Q as part of its costs, reducing the profit within scope of the new measure. The TAAR will counteract the tax advantage, taxing the full amount of the profit.

Example 9

61. Non-resident S disposes of developed land to an independent party who was always intended to be the end user of the land between Budget day and Report stage, with no evidence of acceleration of timescale. The TAAR will not take effect here.

Example 10

62. Non-resident T disposes of a completed development to a related party who was always intended to be the end user of the land between Budget day and Report stage. The project was always timetabled to complete between those dates. The TAAR will not take effect here.

Example 11

63. Non-resident U acquires shares in company X, company X is free of debt and holds undeveloped land, U develops the land - at the end of which the value of the land is 100. U makes a capital contribution of 110 so that less than 50% of the value of the shares in X is derived from the land. When the shares are sold for 210 the TAAR will negate the tax advantage by recognising an indirect sale of land for 100.

Collection

64. The provisions of Chapters 6 and 7 of Part 22 of CTA 2010 will apply in respect of recovery of tax from a non-UK resident company to enable recovery from a UK representative of the company or from a related company.
65. The Government will monitor closely whether arrangements to collect tax on behalf of non-resident businesses affected by this new legislation are satisfactory. The government will consider the introduction of a withholding tax if it proves necessary to ensure full compliance with the new rules.