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**FLADGATE LLP**

Buying and Selling Real Estate in England and Wales

**ILN REAL ESTATE GROUP**



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## KEY FACTS OF REAL ESTATE ACQUISITIONS UNDER BRITISH LAW

### 1. Introduction

Historically, there has been significant investment by overseas individuals and corporations in real estate in England and Wales and in particular in central London, which is perceived as a safe haven for overseas investors. Much of the recent overseas investment has been focused on residential real estate, but there has also been substantial investment in commercial real estate.

This guide applies to real estate in England and Wales, but it is not applicable to other parts of the United Kingdom, namely Scotland and Northern Ireland; or to dependencies such as the Channel Islands or the Isle of Man, which have their own separate legal systems.

### 2. Tenure

Real estate in England and Wales may be any of the following:

#### Freehold

Freehold real estate is the absolute property of its owner, subject to any rights and title covenants in favour of third parties. These may affect how the real estate is used.

#### Leasehold

Leasehold real estate is held under a lease for a fixed period, usually subject to the payment of rent and the performance of obligations or covenants contained in the lease. The terms of the lease will dictate whether or not the leaseholder is entitled to transfer its interest to a third party or whether it can sublet either the whole or part of the real estate.

#### Commonhold

This is a relatively new type of real estate ownership. It allows perpetual “strata” ownership of a multi-occupied residential property by the individual unitholders, with joint

responsibility over common areas and facilities. However, commonhold has, for various reasons, failed to gain traction in the marketplace and is rarely used. Residential apartments are, therefore, almost always owned under a long lease.

### 3. Know your client (KYC)

It is necessary to carry out due diligence on the purchasing entity to comply with UK Anti-Money Laundering Regulations. The documents which are required will vary depending on the purchasing entity, but they need to establish the identity of the purchaser and its ultimate beneficial owner

### 4. Individual stages in a real estate purchase

It is customary for real estate to be sold by a two-stage process. Firstly, the parties enter into a contract in which the seller agrees to sell the property to the buyer. This process, known as “exchange of contracts”, has the effect of passing the beneficial interest in the property to the buyer. In the second stage, typically about 28 days later, the seller transfers the legal title to the buyer. This is known as “completion”. It is possible, however, for the parties to proceed straight to completion and this is sometimes done when timing is critical.

#### Before signing the purchase contract

After the buyer’s offer has been accepted, but before the purchase contract is “exchanged” (i.e. becomes legally binding), the buyer’s solicitors will negotiate with the solicitors acting for the seller and conduct investigations relating to various matters, such as:

- the form of the purchase contract;
- the title documents, including any leases and other matters subject to which the real estate is being sold; and



- searches with various local authorities or statutory bodies to ascertain matters which may affect the real estate or its use, including environmental matters.

It is important to note that, during this investigatory period, the seller of the real estate generally is not contractually bound to the buyer and is free to deal with other prospective buyers. It may be possible, however, to negotiate an exclusivity agreement that will prevent the seller from negotiating with a third party for a limited period.

A prudent buyer should always commission a structural survey of the real estate and this should be carried out prior to any exchange of contracts, as generally no warranties are given by the seller as to the state and condition of the real estate. It may also be advisable for the buyer to have soil or other technical investigations made, particularly where a development site is being acquired or where it is possible that the real estate has been used for purposes causing contamination. The environmental protection legislation may require the owner of a contaminated site to incur substantial clean-up costs in respect of waste left by a previous owner, and a tenant can sometimes be liable for such matters under the terms of the lease either directly or indirectly through the service charge.

#### Exchange of contracts

Once the contract has been negotiated and agreed and the buyer's investigations have been completed, the parties will then proceed to "exchange" formal written contracts. It is usual for a buyer to pay a deposit, often but not always of 10% of the purchase price on exchange, which sum is liable to be forfeited if the buyer does not "complete" (i.e. close) the purchase. Completion of the actual transfer of the real estate follows a pre-agreed period following exchange of contracts, typically about 28 days.

Once contracts have been exchanged, both parties, subject to the terms of the contract, become bound to continue with the transaction and neither party can withdraw. Where the buyer is borrowing all or part of the price, it is highly advisable that the lender's financial commitment is in place before exchange of contracts. The buyer may also need to arrange insurance as from exchange of contracts.

#### Registration of the buyer's title

Following completion, the buyer's solicitor will pay any purchase tax (in England, **SDLT** and in Wales, **LTT**) due on the purchase and apply to the Land Registry to have the change of ownership and any mortgage registered. If the buyer is a company, the mortgage will also need to be registered at Companies House.

### **5. Lender's requirements**

Each lender's requirements will vary depending on the real estate, the identity of the borrower and the nature of the transaction but, generally, on investment real estate a lender will require the following:

- a satisfactory valuation from the lender's valuers;
- a satisfactory report on title from the lender's solicitors confirming that the lender will obtain a good and marketable title to the real estate;
- full information about the proposed borrower, including company accounts (where applicable); and
- where the real estate is bought as an investment, details of the occupiers of the real estate and the passing rents.

### **6. Leasing of commercial premises**

Leases of commercial real estate generally fall into one of two categories:



- a building or “ground” lease at a premium for a long period, usually at least 125 years, possibly acquired as a capital investment to be sublet to occupational subtenants; or
- an occupational lease for a shorter term (say, up to 25 years) at an open market rent.

Long-term leases of commercial real estate are not uncommon, especially where there are plant and machinery tax benefits (capital allowances) that the freeholder wishes to retain or where the freeholder will not willingly part with the freehold (e.g. the Grosvenor Estate). Residential apartments are also owned by means of a long lease.

The liabilities of a tenant will depend on what is agreed between landlord and tenant and are subject to negotiation. Generally, however, an occupational tenant would expect to be responsible for the costs of repairs, insurance, business rates (local taxes) and outgoings. There may also be an obligation to contribute by way of service charge for services provided by the landlord. The lease is also likely to prevent the tenant from making substantial alterations. The lease may also prevent the tenant from subletting or disposing of the lease to a new tenant without the landlord’s prior written consent.

The rent under an occupational lease generally reflects the open market letting value of the premises and, depending on the length of lease term, there may be rent reviews at predetermined intervals (typically five years). The rent under a building or ground lease, however, is usually nominal, reflecting the fact that a capital premium has been paid on the grant of the lease.

The occupying tenant of business premises normally has a statutory right to renew the lease on the expiry of the contractual term. This right

can be excluded by agreement between the landlord and tenant by following a prescribed procedure. Most underleases and short-term leases (e.g. five years or less) will exclude the right to renew.

Depending on the state of the market and the particular real estate, the tenant of an occupational lease should seek to negotiate:

- an initial rent-free period;
- an unconditional right to terminate the lease early (a “break right”); and
- a limit on service charge payments.

The first draft of a lease will normally be prepared by the landlord’s solicitor and the terms will be negotiated by the tenant’s solicitor who will make similar searches and enquiries to those on a freehold purchase. A landlord will frequently require security if the tenant is an overseas company or a private limited company. This may take the form of a parent company guarantee or a “rent deposit”. A rent deposit is a sum of money equal to (say) six to 12 months’ rent, held by the landlord, to be used by the landlord in the event of a default by the tenant; it will be returned at the end of the lease or in other agreed circumstances.

A well-advised tenant will also want to commission a survey of the premises, especially where the lease requires the tenant to repair and maintain the structure.

A tenant taking a transfer of a lease from an existing tenant is unlikely to have the opportunity to negotiate the terms of the lease but will have to take it on its existing terms.

A tenant who takes a transfer of a lease originally granted before 1 January 1996 is likely to have to remain liable under its terms for the remainder of the lease period, even though it subsequently transfers it to a new tenant, if there is a subsequent default.



An original tenant or a tenant who takes a transfer of a lease granted on or after 1 January 1996 is likely to have to guarantee any new tenant to whom it transfers the lease for the period that that particular tenant remains the tenant, but its guarantee will cease if the new tenant later transfers the lease to another party.

## 7. Ownership structure

The choice of ownership structure is often tax driven. We look at tax in the next section but here we focus on the non-tax facets of different types of ownership.

### **Personal ownership / Directly held**

**Advantages:** Simple and cost effective. There is no structure to maintain and no annual running costs.

**Disadvantages:** Details of land ownership are held on a central, searchable register at the Land Registry. If owned through a nominee (be they a corporate entity or trustees of a bare trust), only the nominee's details appear on the title but UK corporate nominees have had to disclose their ultimate beneficial owner on a separate public register (see below) since June 2016 and non-UK corporate nominees will also have to do so with effect from 2021 (precise date not yet confirmed). A UK Will and UK Property and Financial Affairs Lasting Power of Attorney should be considered, to avoid a loss of control over the property in the event of death or incapacity. The asset will be exposed to claims from creditors and potentially also on divorce or relationship breakdown.

### **Company registered in UK**

**Advantages:** Annual running costs are usually less than for offshore registered companies where corporate fiduciaries located in offshore jurisdictions often provide the directors. The company affords limited liability.

**Disadvantages:** Since June 2016, those owning more than 25% of the ultimate beneficial ownership of a company must appear on a publicly searchable register held at the UK's Companies House. Corporate governance documentation, such as company articles and possibly shareholders' agreements, in addition to a Will (a UK Will may not be the most appropriate one in the circumstances) and a UK Property and Financial Affairs Lasting Power of Attorney, may be required in order to regulate who controls the company in the event of death, divorce or incapacity. The shares owned by the ultimate beneficial owner of the company will still be considered in the event of financial claims but pre-emption rights in the company's articles may prevent the shares being transferred to satisfy creditors.

### **Company registered offshore (i.e. outside UK)**

**Advantages:** The jurisdiction may not have introduced public registers of ultimate beneficial owners. The use of a nominee to hold shares may prevent the identity of the ultimate beneficial owner being disclosed.

**Disadvantages:** Annual running costs can be high. Provisions requiring the disclosure of ultimate beneficial ownership, similar to the rules that apply to UK companies, will be introduced in 2021. As with a UK company, local corporate governance documentation and the most appropriate Will and a Power of Attorney (most likely in the jurisdiction of the offshore company) may also be required to determine who controls the company in the event of death, divorce or incapacity.

### **Partnerships**

Limited partnerships are private arrangements whose terms do not appear on any central register. The identity of the partners is not disclosed unless the partnership is a Limited Liability Partnership, in which case the members



of the partnership will appear on a publicly searchable register at Companies House.

### **Trusts (UK or offshore)**

**Advantages:** Common law jurisdictions often have a significant body of law associated with trusts and their operation, providing certainty as to how they can be used. Trust assets can benefit successive generations. Often beneficiaries do not hold a fixed share of trust assets, so a beneficiary's death or incapacity does not affect the administration of the trust's assets. Appropriately structured trusts may also offer protection against claims by third parties, such as creditors or on divorce or relationship breakdown.

**Disadvantages:** Annual running costs can be high. The trust model may, in the opinion of some, confer insufficient control on the person contributing the wealth to the trust structure. In certain trust jurisdictions (especially the UK), the law may be perceived as allowing the beneficiaries to have too much influence. The trustees' fiduciary obligation to act in the best interests of the beneficiaries may prove too constraining. It is proposed that provisions requiring the disclosure of the ultimate beneficial ownership of trusts will be introduced in 2021 in addition to the Trust Registration Service, which currently requires UK and offshore trusts to register if they have a UK tax liability. The Trust Registration Service is expected to be expanded to cover additional trusts from March 2022, including those with no UK tax liability where the trust directly or indirectly holds UK property.

## **8. Tax implications of ownership structures**

A major consideration for investors. The taxes that need to be considered include:

- In England, stamp duty land tax (**SDLT**) at rates that differ significantly depending on

whether the real estate is commercial or residential.

- For commercial real estate, the rate of tax is 0% on the first £150,000 of the purchase price, 2% on the next £100,000 and 5% on the remaining amount.
- For residential real estate, the rates are 0% on the first £125,000 of the purchase price, 2% on the next £125,000, 5% on the next £675,000; 10% on the next £575,000 and 12% on the remaining amount. (For a limited period, from 8 July 2020 to 31 March 2021, the UK government has, in response to the Covid-19 pandemic, introduced a concessionary rate of 0% on the first £500,000 of the purchase price.) The relevant rates for purchasers of additional residential real estate (whether buy-to-let property or second homes) are 3%, 5%, 8%, 13% and 15% respectively. First-time buyers of properties worth up to £500,000 may pay a reduced rate of SDLT. An additional SDLT surcharge of 2% for non-residents buying residential property in England will be introduced on 1 April 2021.
- Various reliefs may apply, such as a reduced rate of tax for purchasers of multiple dwellings. These are complex and outside the scope of this guide.
- With regard to leases, a 1% rate of SDLT will be due on the net present value of the rent, above £125,000 (residential) or £150,000 (non-residential/mixed), which is calculated using a formula that takes into account various factors, including the fact that rents to be received in the future have a lower value than rents received



immediately. (For residential leases, the UK government has, in response to the Covid-19 pandemic, introduced a concessionary rate of 0% on the value of the rent up to £500,000 in respect of transactions with an effective date from 8 July 2020 to 31 March 2021.)

- For commercial leases, where the net present value exceeds £5m, the rate of SDLT for the proportion of the net present value above £5m is 2% rather than 1%
- A 15% SDLT rate applies to the entire purchase price when residential real estate costing more than £500,000 is acquired by certain “non-natural persons” (NNPs). These include companies and partnerships with a corporate partner but not trustees. Relief from the 15% charge (with the effect that the normal rates apply) may be claimed by NNPs carrying on real estate development or using real estate for commercial renting to third parties. Conditions apply.
- In Wales, land transaction tax (LTT) is payable instead of SDLT. The two taxes (and the reliefs that apply) are broadly similar but there are differences:
  - For commercial real estate, the rate of tax is 0% on the first £150,000 of the purchase price, 1% on the next £100,000, 5% on the next £750,000 and 6% on the remaining amount.
  - For residential real estate, the rates are 0% on the first £180,000 of the purchase price, 3.5% on the next £70,000, 5% on the next £150,000, 7.5% on the next £350,000; 10% on the next £750,000 and 12% on the remaining amount. (For a limited period, from 27 July 2020 to 31 March 2021, the Welsh government has, in response to the Covid-19 pandemic, introduced a concessionary rate of 0% on the first £250,000 of the purchase price.) Purchases of additional residential real estate (or purchases of residential real estate by companies) attract an additional 3% on each band as is the case for SDLT. There is no first-time buyer’s relief in Wales.
- With regard to commercial (but not residential) leases, a 1% rate of LTT is applied to the net present value of the rent above £150,000. Where the net present value exceeds £2m, the rate of LTT for the proportion of the net present value above £2m is 2% rather than 1%.
- Unlike in England, NNPs of residential real estate do not pay an enhanced rate of LTT.
- Annual Tax on Enveloped Dwellings (ATED) came into effect on 1 April 2013 and is currently payable only in respect of residential properties owned by NNPs worth in excess of £500,000 on 1 April 2012 (or at acquisition if later). From ATED tax year 2018/19, the valuation date changed to 1 April 2017 for properties held on that date. ATED is an annual charge of up to £236,250 per year (as at ATED tax year 2020/21), calculated by reference to real estate value bands. Rates increase in line with the Consumer Prices Index each year. Relief may be claimed by NNPs carrying on real estate development or





using real estate for commercial renting to third parties, commercial trade purposes or as employee accommodation. Conditions apply.

- ATED-related Capital Gains Tax (**ATED-related CGT**) has been abolished for disposals on or after 6 April 2019, in light of the extension of CGT (see below).
- For interests in UK land (residential or commercial) owned by non-resident individuals or trustees, Non-Resident Capital Gains Tax (**NRCGT**) may be payable at rates of either 18% or 28% (residential property) or 10% / 20% (non-residential property) (rate depends on total UK income and gains) on gains realised on a disposal of the real estate. Main home relief may be available to exempt some or all of the gain if relevant conditions are met.
- Disposals of interests in UK land (residential or commercial) directly owned by non-resident companies are subject to UK corporation tax. The current rate of corporation tax is 19%. No main home relief can be claimed.
- From 6 April 2019, disposals of assets deriving at least 75% of their value from UK land (commercial or residential) by non-resident persons who have a substantial (25%) indirect interest in the land are also chargeable to NRCGT or corporation rate (other conditions apply). For example, disposals of shares in 'property rich' offshore companies are caught.
- In certain situations, re-basing of assets to their 5 April 2019 market value will be applied automatically unless an election is made.
- From 6 April 2020, disposals of UK residential property interests must be reported, and any CGT paid within 30 days of completion.
- Income tax (**IT**) is payable by individuals on rental income. Various deductions are permitted against rental income, including interest payable on a loan to purchase or improve the real estate. However, from 6 April 2017 a phased withdrawal of interest deductibility applies to individuals (but not companies). Capital allowances may also be available for commercial real estate.
- UK resident companies are liable to corporation tax on their profits (rental income, capital gains or trading income). As from 6 April 2020, non-UK resident companies are subject to corporation tax on income deriving from UK properties.
- Inheritance tax (**IHT**). Non-UK domiciled individuals are liable to IHT on their UK situated assets, which includes UK real estate. Holding UK situated assets on death, or gifting them in lifetime, can give rise to IHT liabilities of 20% or 40%, based on the open market value of the asset or, in relation to lifetime gifts, the loss in value caused to the giver's estate by the gift. Since 6 April 2017, it is no longer possible to avoid an IHT exposure by holding UK residential property through an offshore company – the company is now effectively transparent for IHT purposes if it is the equivalent of a close company and its value is attributable, directly or indirectly, to UK residential property. Trusts holding shares in offshore companies with UK residential property interests require review, as they can now be subject to periodic charges to IHT and give rise to IHT issues for settlors who are also



beneficiaries. Loans made to third parties to facilitate the purchase of UK residential property can, in certain situations, cause the lender to have an IHT exposure. Certain debts, however, remain deductible when calculating the value of an asset for IHT purposes.

- Value added tax (**VAT**). This is applicable to commercial real estate only and is payable at the standard rate of VAT, which is currently 20%, unless it is possible to structure an acquisition as a transfer of a going concern (**TOGC**). A TOGC is generally

available to a purchaser of investment real estate, but there are conditions that include the buyer registering for VAT and submitting quarterly VAT returns to the UK's revenue authorities.

The interrelationship of each of these taxes and the formalities which need to be complied with are complex and careful consideration needs to be given to their application to the acquisition of any specified real estate. By way of example, the following table compares ownership by an offshore company with personal ownership.

|      | <i>Ownership by Offshore Company</i>   | <i>Ownership by Individual</i>   |
|------|--|--|
| ATED | Yes, annual charge, depending on value   | No   |
| CGT  | No   | Yes, on disposal on gains. At rates of 18% or 28% (residential) or 10% / 20% (commercial). Relief may be available if property used as main residence  |
| CT   | Yes, rental income (mortgage interest will remain deductible) and on disposal on gains at 19%. No main home relief                         | No   |
| IHT  | Participants in offshore company have IHT exposure (40% on death, subject to exemptions and reliefs)                                       | Yes, immediate exposure (40% on death, subject to exemptions and reliefs)  |
| IT   | No (see CT above)  | Rental income taxed at 20%/40%/45%. No deductibility of mortgage interest  |
| SDLT | Potentially at higher flat 15% rate if purchase price >£500,000. Additional rates apply from 1 April 2021 to purchases by non-UK residents | Stepped rates between 0% and 12%. Higher rates apply to purchases of residential buy-to-let and second residences. Additional rates apply from 1 April 2021 to purchases by non-UK residents |

## 9. Expenses

The buyer will have to meet at least the following additional expenses at completion of the transaction:

- Land Registry fees ranging from £20 to £910, depending on the value of the real

estate. This is significantly less than the registration or cadastral fees payable in most other European countries.

- Legal and other professional fees, which are generally agreed at levels to reflect the purchase price and professional input.



These fees will bear VAT at the then current rate (currently 20%), even for overseas investors. Each party usually meets its own professional advisers' fees unless agreed otherwise. A tenant who is subletting or transferring the lease will usually be required to pay the landlord's professional fees for the consent to the subletting or transfer.

- The seller, not the buyer, pays the selling agent's fees. These typically vary from 1%-3%, depending on whether the real estate is commercial or residential, with fees for auction sales generally higher than for private treaty sales. Payment of the agent's fee is normally conditional on completion of the sale.
- Some buyers may instruct a buyer's agent to help them find a suitable property. The fee payable to the agent normally varies from 1-3%. These "finder's fees" are common in the high-end London residential market, where there may be stiff competition for prime real estate.
- Fees incurred in obtaining finance.
- Miscellaneous expenses such as search fees of approximately £1,000-£1,500 per property and bank transfer fees.

## 10. Constraints on development

### Town planning legislation

Development may generally not be undertaken without planning permission obtained under the Town and Country Planning Act 1990 (although there are various exceptions).

"Development" may take one of two forms:

- the making of a material change in the use of land or of an existing building; or

- the erection of new buildings or the extension or other alteration of existing buildings.

Applications for planning permission are made to the local planning authority in the first instance and there is a right of appeal to the Planning Inspectorate against a refusal of permission.

Certain additional controls apply if development is proposed within a conservation area or if listed buildings are affected.

### Other controls

The development and use of buildings may be governed by other statutory controls that regulate the quality and form of construction. Building regulations cover the technical standard that building works need to meet and the procedures that need to be followed.

In the case of leasehold land, the lease may have controls on both kinds of development.

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