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Non-residents and real estate Budget 2017: where does this leave the JPUT?

Jersey property unit trusts (JPUTs) have long been attractive SPVs for onshore and offshore investors into UK real estate. However, we anticipate that the proposed extension of capital gains tax to non-resident investors, expected with effect from April 2019, will impact on the appetite for these vehicles.

Tax treatment

Very broadly, the position is currently as follows:

- Non-UK investors and tax exempt UK investors (such as pension funds and charities) can dispose of units in JPUTs without triggering UK tax on gains.
- The sale by a JPUT of its property is also usually outside the scope of UK tax.
- Income is regarded as arising directly to unitholders. Non-UK investor net income profits are subject to basic rate income tax (20%), subject to any unitholder exemptions.
- An acquisition of units in a JPUT is not subject to SDLT.

This mixture of transparency (as to income) and opaque treatment (as to gains), works well for many categories of investor.

JPUT acquisitions

In the period to April 2019 we expect JPUTs to remain attractive vehicles.

From a capital gains perspective JPUTs will benefit from rebasing to market value in April 2019. Assuming that the acquisition of units remains outside the scope of SDLT, there is no immediate difficulty when the new regime first applies.

However, as gains accrue in a JPUT the inherent latent CGT charge impacts on net asset value. For pension funds, charities and those benefitting from sovereign immunity, who are exempt from tax, indirect ownership results in increased tax costs. Even though such unitholders are exempt from tax on the sale of their units, a tax cost is borne economically via the net asset value.

For a non-exempt investor holding more than 25% of the units in a JPUT, or with a holding which is less than the threshold but subject to connected person or acting together extensions of it, such investor will be liable to CGT on a disposal of units. Because a selling unitholder should expect to bear their proportion of tax on latent gains within the JPUT itself, double taxation effectively arises. Not an immediate problem when the rules first apply given the effect of rebasing, but over time the tax burden may become material.

Restructuring

Investors may look to restructure from April 2019. For exempt investors, direct ownership is likely to be preferred. A partnership vehicle may be suitable. The Government has been asked to consider introducing restructuring reliefs, for example to assist investors in bringing assets onshore. Specific reliefs to facilitate restructuring would be welcome, but are very uncertain.

Unlike companies, JPUTs cannot form part of a group for SDLT group relief purposes. In the absence of group relief, it may be possible for properties to be distributed in specie, free of SDLT, depending on the precise circumstances. As a general point, indebtedness secured on the property or intermediate partnership ownership will add to the difficulties.

Collective investment vehicles ("CIVs")

The tax treatment of CIVs going forward continues to be very uncertain. We understand that the government is open to a specific tax treatment for CIVs through which UK tax exempt investors pool funds for investment. However, we do not anticipate that any special treatment will extend to the use of JPUTs as SPVs.

The future

Whether or not JPUTs continue to be a feature of the UK real estate market is likely to depend upon the treatment of exempt unitholders.

We have proposed in our consultation response that some thought should be given to ensuring that exempt investors are not prejudiced by holding properties via JPUTs. If this call goes unanswered, it is very likely that investors, including pension and sovereign wealth funds in particular, will look to other ownership vehicles.

Further information

This update should be read in conjunction with our tax guide Budget 2017: Extension of tax on capital gains.

Contacts

Phil Anderson
Partner
T +44 20 7524 6048
E phil.anderson@cms-cmno.com

Anna Burchner
Partner (LL.M International Tax)
T +44 20 7367 3077
E anna.burchner@cms-cmno.com

Nick Burt
Partner
T +44 20 7524 6338
E nick.burt@cms-cmno.com

Graham Chase
Partner
T +44 20 7067 3387
E graham.chase@cms-cmno.com

Richard Croker
Partner
T +44 20 7367 2149
E richard.croker@cms-cmno.com

Jim Hillan
Partner
T +44 20 7367 3984
E jim.hillan@cms-cmno.com

Mark Joscelyne
Partner
T +44 20 7067 3390
E mark.joscelyne@cms-cmno.com

Clíona Kirby
Partner
T +44 20 7067 3386
E cliona.kirby@cms-cmno.com