
Non-resident CGT: implications for real estate funds

The Government has published responses to the consultation released in November 2017, and draft legislation for the basic rules. Legislation is yet to be released in relation to collective investment vehicles (“CIVs”), but we now have greater clarity on how those rules are likely to work, particularly for exempt investors, such as UK pension schemes.

The headline point for CIVs is that the Government has sought to address the two key industry concerns raised in response to the consultation. That HM Treasury has listened to the industry on these points is welcome.

The first concern was that tax-exempt investors would suffer tax leakage as a result of the new rules, either by virtue of tax at the fund level on disposals of underlying property, or by way of price adjustments on indirect sales for the latent tax. The second issue was that multi-tiered fund structures could suffer multiple layers of taxation.

The Government has confirmed that notwithstanding the complexity of this area, the implementation of rules in relation to CIVs will not be deferred beyond April 2019. There remains a material amount of work to be done, but draft legislation is expected by mid-September.

“Transparent offshore funds” – tax transparency

Clarity is required as to how these funds will be defined. However, non-UK property unit trusts could be treated as tax transparent under the new rules.

While these funds will generally be treated as opaque for tax on capital gains, there will be the ability to elect to be treated as transparent. Where the election is made, the tax treatment of disposals of underlying properties will effectively mirror the existing direct tax treatment of partners in a partnership (i.e. investors would be treated as disposing of their share in the underlying property directly). It follows that where the investor is exempt, no tax should arise on the disposal.

The exemption from charge for investors with a holding of less than 25% will not apply. A specific CIV regime could not operate properly if investors could avoid non-resident CGT by simply investing less than 25% in a fund.

Offshore funds which are not close – special exemption for reporting funds

Certain funds will be entitled to a special exemption from the charge at all levels of the fund (i.e. any non-UK entities within the structure). Where funds meet the relevant criteria, the exemption will apply if fund managers agree to report information to HMRC in relation to investors, disposals by investors, and the value of those interests. Investors will then be subject to tax on disposals of their interests in the relevant funds depending on their status. To ensure value is not stripped out of the fund, untaxed, rules are likely to be included to prevent dividend returns to investors. Consideration is being given to whether a withholding tax obligation should be placed on the fund manager in relation to redemptions.

Whilst this measure is likely to be relatively burdensome for fund managers, and will have cost implications, it is clearly a sensible solution, and indeed was championed in a number of consultation responses.

Further clarity is required on how such funds will be defined. The expectation is that closeness for these purposes will be based on the requirements under the REIT rules. On that basis, provided the investors are “institutional investors” for these purposes (i.e. pension schemes, insurance businesses, charities, authorised unit trusts, open-ended investment companies and certain limited partnerships), the fund would not be close and could elect into the regime.

Transparent offshore funds will also be entitled to benefit from this special exemption.

Again, the 25% threshold will not apply to disposals of interests in these funds.

Pan-European and global funds

It is not anticipated that any special rules will be brought in to accommodate disposals by pan-European and global funds, which would not fall into the categories outlined above. Disposals of interests in those funds are unlikely to be caught as they are not UK property-rich. However, underlying disposals of property-rich entities or properties would be subject to tax.

Going forward, fund managers may choose to establish a parallel UK structure in order to achieve the UK CGT efficiency where there are a significant amount of tax-exempt investors.

No new UK fund vehicle

The Government has confirmed that it will not be introducing a new type of tax transparent UK fund, with lighter regulatory requirements. This is something that a number of respondents to the consultation had requested, with a view to attracting those investors currently investing through offshore structures to move their investments into the UK.

The promising direction of travel for CIVs (i.e. tax exemption at fund level), should hopefully go some way towards mitigating this.

Non-UK pension schemes

A number of respondents to the consultation expressed concern around whether various non-UK pension schemes would meet the definition of “offshore pension schemes” for the purposes of exemption from tax on their capital gains. The Government are committed to providing clarity on this if there is sufficient concern within the industry.

No SDLT relief for on-shoring

The Government has also confirmed that it will not be introducing an SDLT seeding relief for those investors looking to transfer property from offshore holding structures into UK entities without triggering SDLT.

This had been a material concern for transfers of properties out of vehicles such as Jersey unit trusts, where group relief from SDLT would not be available. However, given the proposals outlined above, it now looks increasingly likely that these vehicles can continue to be used, without prejudicing exempt investors.

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

Get in touch



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



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



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