

To Our Clients and Friends

Memorandum

friedfrank.com

UK Tax on Non-UK Residents' UK Property Gains – Update

Following a significant period of uncertainty for the UK real estate investment market, on November 7 the UK Government published a lengthy suite of provisions addressing the application to “collective investment vehicles” (“CIVs”) of the extension of UK tax on capital gains to non-UK residents disposing directly or indirectly of interests in UK land (“NRG Rules”). The NRG Rules will apply with full effect on and after 6 April 2019. Whilst these new provisions remove some of the uncertainty in this area that previous announcements created, and potentially favour widely-held CIVs, investors in the UK real estate market will want to give close attention to their holding structures in advance of the rules’ commencement. For some this may be an appropriate time to restructure.

How the NRG Rules will apply

At a simplified level, under the NRG Rules:

1. any gain realised by any person on a direct disposal of an “interest in UK land” (which is defined broadly, but excludes security interests) (a “Direct Disposal”) is subject to UK tax; and
2. any gain realised by a relevant person on a disposal of an asset (constituted as a right or interest in a company, including for these purposes interests in unit trusts) deriving at least 75% of its value from interests in UK land (an “Indirect Disposal”) is subject to UK tax.

In general terms, a “relevant person” for the purposes of (2) above, is someone who at any point in the two years preceding the relevant disposal has held (with certain connected persons) a 25% direct or indirect interest in the relevant company (by reference to voting power or economic entitlements). This 25% threshold doesn’t generally apply where interests are held in a CIV (rather than a non-CIV company), however.

The problem with the structure of the NRG Rules

The taxation of both Direct and Indirect Disposals under the NRG Rules creates the possibility of multiple levels of tax relating to the same gain where real estate is held indirectly through holding and joint venture entities, and also opens the possibility of tax exempt investors suffering tax indirectly where a holding vehicle they participate in makes a Direct Disposal. The legislation now addresses those concerns in the context of widely-held CIVs, but the relevant concerns remain in other circumstances.

Application of NRG Rules to CIVs

Two elections to vary the basic rules will be available to certain CIVs. CIVs that are UK income tax transparent (such as a typical Jersey Property Unit Trust or “JPUT”) may be eligible to make an irrevocable

election to be treated as a tax transparent partnership for UK capital gains purposes (the “Transparency Election”). Also, certain CIVs may be eligible to elect for an exemption from the tax charge, which may extend to their subsidiary holding entities (the “Exemption Election”).

The operation of the Exemption Election is clearly favourable, in that it eliminates the potential for multiple layers of tax on the same gain, and also protects tax exempt investors from indirectly suffering tax that would otherwise be incurred within the fund structure on Direct or Indirect Disposals. The election carries with it an obligation on the CIV to report to HM Revenue & Customs on the CIV’s investors and their gains, as well as to monitor the source of funds for returns to investors in order to ensure correct reporting and payment of tax when a lower-level gain is returned to investors by way (for example) of a distribution. The election doesn’t affect investors’ liabilities to UK tax on Indirect Disposals in relation to their disposals of interests in the CIV itself.

The Transparency Election can provide similar benefits, but by treating investors as making only Direct Disposals. Where relevant, it may be possible to combine the elections. Eligibility for the elections through CIV status is therefore a critical issue.

Definition of CIV and eligibility for elections

CIVs are defined in the NRG Rules as “collective investment schemes” (taking an existing regulatory definition), “Alternative Investment Funds” (again following a regulatory classification), companies that are UK REITs and companies resident outside the UK that have characteristics similar to those of a UK REIT.

To be eligible to make an Exemption or Transparency Election, a CIV also has to pass other requirements designed to restrict availability to widely held vehicles.

The CIV status and eligibility of a particular entity for the relevant elections may not always be clear, and careful review of the relevant circumstances will be necessary.

Conclusion

CIVs eligible for the relevant elections need to consider the appropriate approach to take under these newly proposed options. Where elections are not possible, further consideration should be given to the potential impact of the new NRG Rules, in particular the possibility of multiple charges to tax arising on future disposals and returns of proceeds to investors. It may be advisable to consider restructuring existing ownership structures, and the statutory re-basing of assets as at 5 April 2019 may provide an appropriate opportunity to effect any planned restructuring.

* * *

Primary Authors:

Nick Thornton

Will Gay

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

Contacts:

Nick Thornton	+44.20.7972.9220	nick.thornton@friedfrank.com
Will Gay	+44.20.7972.6231	will.gay@friedfrank.com
Fiona J. Kelly	+44.20.7972.9676	fiona.kelly@friedfrank.com
Darren Rogers	+44.20.7972.9141	darren.rogers@friedfrank.com
Patrick Williams	+44.20.7972.6275	patrick.williams@friedfrank.com