

Reserved Investor Fund Consultation

Response by the Chartered Institute of Taxation

1 Introduction

1.1 The government is consulting on the introduction, tax design and scope of a new unauthorised contractual scheme fund provisionally called a 'Reserved Investor Fund (Contractual Scheme)' (RIF) that is likely to be mainly used for investment in commercial real estate by professional investors rather than retail investors. The consultation follows the government's review of the UK funds regime¹. The intention is to address a gap in the UK's current offering of onshore fund structures in order to increase flexibility and reduce the additional legal, tax and regulatory costs associated with establishing a fund overseas. The consultation seeks views on tax design and regulatory matters. Our short response is limited to i) broad principles of tax design, as many of the direct tax questions are matters for the fund industry and therefore outside our remit, and ii) specific points on VAT.

1.2 Our stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

¹ Review of the UK funds regime: A call for input – 10 February 2022

2 Principles of tax design

2.1 We welcome the government's constructive consultation with the funds industry about a UK-based unauthorised contractual scheme that is intended to fill a gap in the UK's unauthorised fund structure offering.

2.2 The government's objectives for the RIF tax regime are:

- Tax neutrality, such that an investor in a RIF will be in a broadly similar tax position as if they had invested in the underlying assets of the fund directly.
- To provide investors with certainty as to their tax treatment.
- To protect against risks to the Exchequer, so any tax rules should:
 - Be compatible with the UK's existing tax regimes.
 - Ensure that the UK continues to exercise its taxing rights effectively.
 - Adhere to the government's robust approach on tax avoidance and evasion, and with the UK's international commitments.

2.3 We agree with these principles and suggest that in view of the overarching objective to ensure that investor decisions are not distorted by tax considerations, the tax treatment of a RIF should be largely equivalent, as far as possible, to comparable common offshore fund structures (such as a Jersey Property Unit Trust subject to a fund exemption election) investing in UK commercial real estate.

2.4 For the reasons stated in the consultation document (see Chapter 4 of the consultation²), however, it will not be possible for the RIF to be treated in exactly the same way as these equivalent offshore structures and therefore it is important that the investors are not adversely impacted as a result of the way the RIF rules may operate (eg additional 'dry' tax charges) compared to these comparable structures.

2.5 It will also be important to ensure that the interaction of the RIF with other tax regimes does not give rise to unwelcome uncertainty and unintended consequences including:

- a. for Real Estate Investment Trusts (REITs) (noting the consultation already considers one aspect of the REIT conditions – the listing requirement but not, for example, the non-close requirement);
- b. in relation to the Substantial Shareholding Exemption and the Qualifying Asset Holding Company regime.

3 VAT

3.1 Paragraph 1.3 in the consultation document states that an unauthorised contractual scheme 'was expected to be particularly attractive to commercial real estate investors (given that such funds would likely be able to

² The consultation explains that for CGT purposes it is proposed that disposals of units by investors will be subject to CGT with the interest in underlying assets disregarded, replicating the Co-ownership Authorised Contractual Schemes (CoACSs) regime. However, without any modification, investors and the RIF itself would not be subject to tax on gains arising from direct/indirect disposals of UK real estate when the RIF is not UK 'property rich' (at least 75% of the value of the RIF's assets derived from UK real estate) leading to concerns about the unintended use of the RIF to shelter such gains. Therefore the consultation proposes alternatives.

reclaim input VAT charged on management fees)', which assumes that the commercial property is opted to tax and taxable supplies are being made by the fund. However, real estate funds increasingly invest in a broad range of real estate assets and therefore this assumption will not always be the case. Some examples of real estate investments which would result in restricted VAT recovery include:

- a. the commercial property may have caveats that prevent an option to tax, resulting in a VAT exempt lease;
- b. the investment may be in a property with relevant residential status such as student accommodation, so the income will be exempt as 'closely connected to education'; or,
- c. the fund may invest in the 'build-to-rent' domestic accommodation sector, which would generate VAT exempt income from domestic rents.

If the property does not generate taxable income, the VAT on fund management fees would be irrecoverable. Where the fund has a mixed property type investment portfolio, with taxable and exempt income, the rules on partial exemption would apply when determining the amount of input VAT that can be recovered. The irrecoverable VAT would make the RIF a less versatile fund vehicle for investing in UK real estate and could act, in some cases, as a barrier to its use.

- 3.2 We note that in several other European Union Member States, an option to tax exists for financial services. Where a taxpayer applies this option, services that would be VAT exempt become taxable for VAT purposes. Although the UK has longstanding option to tax provisions in respect of real estate assets (ie direct interests in UK real estate), this provision (and the flexibility that it offers) has not been implemented for financial services. The implementation of an option to tax that could be applied in the context of fund management services where the underlying assets are real estate could offer a level of flexibility that would increase the versatility and, therefore, attractiveness of a RIF. This approach would be predicated on the premise that the RIF itself would qualify as a Special Investment Fund through inclusion within group 5, schedule 9 of the VAT Act 1994 (similar to the approach that was adopted on the introduction of the Authorised Contractual Scheme) – the option to tax would therefore allow the parties to opt to tax the management fee in circumstances where the real estate assets held within the RIF generate taxable supplies for VAT purposes (noting that in such circumstances although the VAT charged on the fund management fees would be recoverable by the RIF, this would be offset against the VAT payable on supplies made of the real estate assets). In this regard HMRC may want to further evaluate the potential benefits of a more versatile RIF; in particular, where the government's aims are to increase investment into the UK or to support broader policy objectives such as housebuilding. Although HMRC's existing procedures for an option to tax for property requires a business to notify HMRC and for the option to remain in place for 20 years, it may wish to compare this approach to those adopted in overseas countries where a less administratively onerous approach may be pursued.
- 3.3 From an administrative perspective, notwithstanding the above comments, we consider that it would be helpful if clear guidance could be issued concerning the process for VAT registration for a RIF and the relevant party that should be VAT registered. Currently, there is a lack of clear guidance on the VAT registration of Authorised Contractual Schemes and this can lead to uncertainty and delays in registering these types of funds for VAT. Given the expectation that RIFs would commonly invest in commercial real estate, generating taxable supplies for VAT purposes, clarity on this will be important.

4 Acknowledgement of submission

- 4.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

5 About us

- 5.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 5.2 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.
- 5.3 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.
- 5.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

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