

## Sovereign immunity from direct taxation: Consultation on policy design

### Response by the Chartered Institute of Taxation

#### 1 Executive Summary

- 1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.
- 1.2 Sovereign immunity refers to the principle that foreign governments and heads of state have exemption from liability to UK direct taxes on the basis that one sovereign State should not seek to apply its law to another sovereign State. The main proposal is to narrow the exemption to UK source interest income only and put the new restricted sovereign immunity on a statutory basis.
- 1.3 We are generally supportive of the government's proposal to put the principle of, and conditions for, sovereign immunity on a comprehensive statutory footing. However against the backdrop of recent changes to the tax treatment of non-UK residents in relation to UK real estate, our main concern is the need to consider carefully the potential for unwelcome uncertainty and unintended consequences in the operation of specific tax regimes such as Real Estate Investment Trusts (REITs), Substantial Shareholding Exemption (SSE) and the new Qualifying Asset Holding Company (QAHC) regime. We welcome the commitment in the consultation to consider these impacts carefully, preferably through the government's consultation framework.

#### 2 About us

- 2.1 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.

- 2.2 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.
- 2.3 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.
- 2.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

### 3 Introduction

- 3.1 Sovereign immunity refers to the principle that foreign governments and heads of state have exemption from liability to UK direct taxes. This immunity extends not only to monarchs and heads of state but also to state investment funds such as sovereign wealth funds and state pension funds. The main proposals are
  - to put sovereign immunity on a statutory basis replacing the current position that depends on case law and practice,
  - to narrow the exemption to UK source interest income only
  - to make the narrower statutory exemption available to a defined class of persons.

The exemption will therefore no longer apply to trading income, income and gains from UK real estate and dividends from Real Estate Investment Trusts (REITS) subject to relief under double tax treaties. The consultation indicates the government expects the greatest Exchequer impact to relate to the removal of immunity from UK property income and gains.

- 3.2 The policy objective is to recognise the unique status of sovereign investors and attracts inward investment while ensuring the approach to sovereign immunity is transparent, targeted, applied consistently and in line with the international mainstream.<sup>1</sup>
- 3.3 Our stated objectives for the tax system include a legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences and greater certainty, so businesses and individuals can plan ahead with confidence.
- 3.4 As the consultation notes there have been significant recent changes to the UK tax treatment of non-UK residents in relation to UK real estate. In particular, with effect from April 2019, disposals of UK non-residential property were brought within the charge to UK tax for non-UK residents so that disposals of both residential and non-residential property now attract a CGT or corporation tax on chargeable gains charge, subject to some exemptions including, currently, for sovereign immune investors.
- 3.5 The consultation document does not indicate whether this consultation is a stage one or stage two consultation in the government's tax policy making process<sup>2</sup>. However, given the consultation sets out a specific policy proposal it appears to be a stage two consultation (*Determining the best option and developing a framework for implementation including detailed policy design*) with stage one (*Setting out objectives and*

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<sup>1</sup> See Background in the [consultation document](#)

<sup>2</sup> [The new Budget timetable and the tax policy making process](#)

*identifying options*) omitted. We strongly support the government's consultation framework and reiterate the value in starting consultation at stage one because it allows for consideration of different potential ways of delivering objectives and for the gathering of evidence to gain the widest possible understanding of an issue before making key decisions.

We welcome the commitment to publishing draft legislation ahead of any finance bill legislation in accordance with the tax policy framework.

- 3.6 We are generally supportive of the government's proposal to put the principle of, and conditions for, sovereign immunity on a comprehensive statutory footing. The statutory definition will need to encompass both direct and indirect holdings by sovereign investors and will benefit from further consultation.

Our response is limited to considering some consequences for the treatment of sovereign immune investors for existing tax regimes (Q12) and inheritance tax (Q14).

**4 Question 12: Do you have any comments on how the government should approach existing qualifying investor status in relation to sovereign investors? In particular, are there any practical issues that could arise if this status were removed? If possible, please provide details of each area listed above in turn.**

- 4.1 We welcome the recognition that the status of sovereign immune investors in the operation of specific tax regimes such as Real Estate Investment Trusts (REITs), Substantial Shareholding Exemption (SSE) and the new Qualifying Asset Holding Company (QAHC) regime (from 1 April 2022) will need to be considered carefully.

Any changes should be considered in the context of:

- the policy intent for each regime,
- the rationale for the treatment of such investors, for example under the REITs regime the requirement for shares to be admitted to trading on a recognised stock exchange has been removed where institutional investors, including sovereign immune investors (as defined CTA 2010 section 528(4A)) hold at least 70% of the ordinary share capital of a REIT. It is understood that the rationale reflects the nature of institutional investors rather than their current exempt tax status.
- potential unintended consequences on non-sovereign investors where loss of sovereign investor exempt status affects the tax status for other investors (subject to any rebasing), and
- the need for certainty and stability, particularly in the light of the scale of recent changes as noted at 3.4 above, so investors can plan ahead with confidence.

We note however that the current definition of a sovereign immune investor for the purposes of the institutional investor definition in section 528(4A) is framed by reference to the current tax exemption ('a person who cannot be liable for corporation tax or income tax (as relevant) on the ground of sovereign immunity') and will therefore need to be amended/redrawn to reflect the limitation to interest income irrespective of any further changes.

- 4.2 The consultation proposal for a more limited exemption gives rise to some uncertainties in relation to the REITs regime. Currently, income distributed by a UK REIT under double tax treaties is treated as an ordinary dividend and such dividends are tax free and intended to remain tax free for sovereign investors. Property Income Distributions (PIDs), which form part of the income distributed by REITs, are treated as dividends under double tax treaties. However it is not clear whether PIDs, being derived from property rental income, could potentially lose that exemption. If PIDs are intended to become taxable withholding tax may be in point for sovereign investors, subject to treaty relief. It may also have potential consequences for the operation of

the holder of excessive rights rule. There is also uncertainty over how it would impact REITs forming joint ventures with sovereign wealth investors (captive REITs). It is only recently that the rules have been relaxed to allow such corporate joint ventures to benefit from full REIT status (section 528ZA).

## **5 Question 14: Do you have any comments on the proposed approach to inheritance tax ?**

- 5.1 It is proposed that sovereign immunity from inheritance tax will be restricted to state property that remains state property when it passes to a successor. Private property and property that ceases to be state property will no longer be exempt and therefore the provisions of the IHTA 1984 will apply in their entirety including for example the restriction in section 18(2) for transfers to a non-domiciled spouse or civil partner.

We note that the definition of 'state property' will need to be considered in the context of succession laws of other jurisdictions to ensure it meets the policy objective. Noting also the approach in IHTA 1984 Sch A1 para 7 the interaction with double tax treaties where another jurisdiction has exclusive taxing rights for IHT under a treaty may require consideration.

- 5.2 Where property is held in trust the calculation of the 10-year charge will presumably reflect periods (quarters) when the property was not relevant property throughout the full preceding 10 years but clarity on this point is needed.

## **6 Acknowledgement of submission**

- 6.1 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.

The Chartered Institute of Taxation

12 September 2022