AREF
The Association of Real Estate Funds

HM Treasury
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Response by email to UKfundsreview@hmtreasury.gov.uk

9 June 2023

Response to Reserved Investor Fund (RIF) Consultation

Executive Summary

We, the Association of Real Estate Funds[1] (AREF), welcome the government's RIF (for the purposes of this submission, meaning the Reserved Investor Fund (Contractual Scheme)) proposals. We have used working draft responses settled by the RIF Experts Working Group as the basis for our submission and adapted it to reflect the views of our members including tax and regulatory experts on our Tax and Public Policy Committees. We believe that these proposals are a positive start in developing workable, balanced, pragmatic and robust solutions that address the mutual goals of industry and government. We very much appreciate officials from HM Treasury, HMRC and the Financial Conduct Authority (FCA) listening to, and as much as practicable accommodating, the representations from industry in arriving at such solutions. This constructive engagement should provide a transformative and innovative fund structure.

Whilst we answer the specific questions raised in the Consultation below, we have summarised key points in this executive summary.

Reasons for a RIF

We are pleased to note legislative progress in the UK Parliament with the Financial Services and Markets Bill (FSMB) clause 60. We fully endorse the statement[2] from Andrew Griffith MP, the Economic Secretary (HM Treasury), in the House of Commons in proposing on 7th December 2022 an amendment to the Financial Services and Markets Bill (FSMB) - now contained in FSMB clause 60:

"The proposed fund has the potential to improve the competitiveness of the UK by filling a gap in the UK's existing fund offering and supporting the domestic growth agenda by facilitating greater investment in UK real estate by UK funds."

We believe that, if the technical and practical issues identified in this response are addressed, the RIF will strengthen the UK's fund offering and enhance its competitiveness as a global leader in the asset management sector. We are of the understanding that other jurisdictions are also looking to strengthen their own fund offering. For instance, the German Fund Jurisdiction Act (*Fondsstandortgesetz*) came into effect in August 2021; reflecting the German Federal Government's initiative to make Germany more competitive as a fund domicile. This included a new type of fund as a contractual closed-ended special Alternative Investment Funds (section 139 sentence 2 KAGB-E).

The RIF will enable investment in longer-term productive capital and less liquid real estate and real assets: investment which is an essential part of realising government's ambitions in levelling up the nation and accelerating the infrastructure and green industrial revolutions. AREF estimates that there is over £3trn (€3.39trn) in UK institutional funds alone: allocating even a small proportion of those funds to essential investments should have a materially positive effect.

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[1] The Association of Real Estate Funds represents the UK real estate funds industry and has over 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the AREF Property Fund Vision Handbook.

[2] Hansard, House of Commons Volume 724: debated on Wednesday 7 December 2022: https://hansard.parliament.uk/commons/2022-12-07/debates/A2855E4B-2778-490A-B649-07BED474AE3C/FinancialServicesAndMarketsBill#contribution-F1940B50-C260-427C-A5FA-31E0A275D391

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It is expected that fund management houses will use the RIF to attract professional and other investors that dovetail with the UK government's goals to level up the nation. This includes the RIF being a conduit to attract capital for social and affordable housing and the regeneration of town centres as well as accelerating the infrastructure and green industrial revolutions.

Investors' preference for an onshore fund structure that is not itself FCA authorised but is operated by an UK AIFM and UK depositary, both of whom are FCA authorised and regulated will be addressed by the RIF.

The RIF will offer an opportunity to lower the barriers for SME asset managers to launch new products which was recognised in HM Treasury's February 2022 Summary of responses to its January 2021 Call for Input: Review of the UK Fund Regime:

> Paragraph 2.171 *"(An unauthorised contractual scheme that invests in real estate) has the potential to lower the barriers for SME asset managers to launch new products"*.

As expressed in HM Treasury's Summary of responses to the Call for Input: Review of the UK Fund Regime:

> Paragraph 2.129 "*The government hopes (measures it has put in place) will pave the way for more fund administration jobs and clusters to be generated outside of London, further spreading the benefits of the UK's asset management sector across the country. The government encourages industry to seize these opportunities…..".*

We believe that the RIF represents an example of industry seizing these opportunities and contributing towards more fund related jobs and the development of existing and new fund administration clusters.

Tax

Providing a tax regime that is easy to understand and operate will be key to the success of the RIF.

Chargeable gains

The most challenging element of the RIF tax regime is clearly chargeable gains and ensuring that otherwise taxable direct and indirect disposals of UK property by non-UK investors remain taxable in the UK. This is dealt with under the Restricted RIF regime which provides for a Restricted RIF to be treated in the same way as a CoACS for chargeable gains purposes.

We consider that the three variants of the proposed Restricted RIF regime will generate significant interest from fund managers and our discussions with fund managers echo that view.

At this stage, the UK Property Rich variant of the Restricted RIF is likely to attract the greatest interest from fund managers, both in terms of the number of RIFs to be established and the market capitalisation of those RIFs. By way of context, we anticipate that 75% threshold in the 'UK property rich' condition will be acceptable to the market, subject to settling an appropriate "mechanism for minor and temporary breaches" referred to in the Consultation's paragraph 4.24. MSCI confirm (confirmation provided in May 2023) that – in light of reviewing data from the AREF/MSCI property fund index (formerly AREF/IPD property fund index) over the past 22 years - relating to funds:

- holding underlying UK property; and
- structured as being closed-ended or hybrid investment funds

the percentage of the value of total assets (including cash) that is derived from UK property:

- has always exceeded 95% percent; and
- on average represents between 95% and 100% percent.

However, in order to be successful, the UK Property Rich Restricted RIF would have to be no less advantageous (including from a chargeable gains perspective) than comparable structures, the most obvious comparator being an entity (e.g. a Jersey Property Unit Trust or Irish Common Contractual Fund) that has given an Exemption Election under Schedule 5AAA TCGA.

We look forward to working with HMRC in developing the conditions that will have to be met in order to qualify as, and continue to be treated as, a UK Property Rich Restricted RIF. We appreciate that failure to meet those conditions will at a certain point cause the RIF to leave the Restricted RIF regime such that it is subject to a form of tax transparency but strongly believe that transparency should only be applicable in exceptional circumstances. Investors would be unwilling to invest in a product which carries more than a remote risk of additional filing obligations and dry tax charges for them, as would be the case under a partnership approach. Moreover, the administrative implications of partnership treatment for managers and operators of funds are considerable in funds which have a changing investor base, such that managers may be deterred from establishing a fund which has a risk of being treated in this way.

Assuming that the UK Property Rich Restricted RIF regime may be similar to the Exemption Election regime, there is a definite risk that a Restricted RIF will occasionally be subject to minor / technical breaches of the conditions, for example in respect of any UK property rich condition:

- Additional funds are drawn down from existing investors before completion of the acquisition of a new UK property.
- UK property is sold before acquisition of a new UK property.
- Cash from a subscription by a new investor is held temporarily to be used to fund redemptions by one or more existing investors.
- UK property is sold to fund redemptions of one or more investors.

In many cases, a minor / technical breach lasts for a very short period of time (a few days, or sometimes less than one day) and is unavoidable in the context of operating a fund (even if its only assets are UK property). It will be key that technical / minor breaches do not cause the RIF to temporarily leave the Restricted RIF regime such that the Restricted RIF is not treated as being transparent for gains pending the relevant condition being met again (i.e. any disposal by the RIF would continue to be disregarded and any disposal of RIF units by an investor would continue to be treated as a disposal of units). This would be consistent with the Exemption Election regime and should not be complex to achieve (e.g. using "grace periods").

Particularly in the second case above (i.e. the proceeds of a sale being held for reinvestment in new UK property) the breach may persist for a longer period depending on factors that are outside the control of the RIF manager. In such a case, there would only be a loss of tax in the event that during this period a non-resident investor disposed of its units before the RIF had become UK property rich again and we would propose that the regime should incorporate safeguards to ensure that tax is payable in those circumstances, while having no more than minimal negative implications for other investors.

However, we recognise that it is not possible to simply duplicate the Exemption Election regime, since the default position (e.g. following exit from the regime) under the Exemption Election regime is that the fund vehicle itself ceases to benefit from exemption. In contrast, for the reasons stated in the Consultation, it is understood that this approach cannot be the case for a UK co-ownership contractual scheme, and the default position (i.e. before entry/after exit) is therefore transparency for chargeable gains purposes. As a consequence, it is inevitable that there will be some differences in the way that the UK Property Rich Restricted RIF regime must operate, compared to the Exemption Election regime as it applies to an offshore CIV. In addition, the administrative burden on the fund, and the filing requirements of investors, have to be considered.

We first consider some of the key differences in more detail:

Entry / re-entry into the regime

In relation to the Exemption Election regime, as the vehicle is deemed to be a company entry/re-entry into the regime does not of itself result in a disposal by the investors. In contrast, entry into the UK Property Rich Restricted RIF regime would (as currently proposed in the Consultation) result in a disposal of chargeable assets for both UK and non UK resident investors at that time, which would prima facie be taxable.

Any tax on entry / re-entry into the UK Property Rich Restricted RIF regime would constitute a dry tax charge and would not be acceptable to investors. In the event that a deemed disposal and reacquisition is required, tax on any deemed gain should only become payable at a later date when investors actually receive cash on disposal of units or

winding up of the RIF. We look forward to discussing with you the exact mechanism by which deferral is achieved but would have a preference for a form of rollover relief where possible.

Impact of transparency on timing of entry into the regime

Assuming that the default treatment for a RIF is transparency for gains, in the event that a RIF draws down cash from investors and uses it to acquire UK property, any subsequent drawdown of cash from new investors would cause existing investors to make part disposals of that UK property and to be subject to a dry tax charge on any gain. Therefore, it would be necessary for the RIF to enter into the Restricted RIF regime before it is fully drawn down to prevent dry tax charges, which would in all likelihood cause the RIF to breach the UK Property Rich condition on subsequent drawdowns from new investors.

That would not be the case for a fund within the Exemption Election regime. Given that the fund is treated as a company, further drawdowns do not cause existing investors to make disposals and so the fund is able to delay making the Exemption Election until it is fully drawn down (i.e. until there are no further drawdowns from investors that could result in the fund, albeit temporarily, becoming non-UK property rich). The ability for a fund in the Exemption Election regime to delay entry into the regime in this way, enables the fund to significantly reduce the risk of breaching the UK Property Rich condition at the start of the fund's life.

The ability for a RIF to be able to enter the UK Property Rich Restricted RIF regime without causing investors to suffer dry tax charges is absolutely vital to the viability of the regime.

Impact of transparency in the context of technical / minor breaches

Breach of the Exemption Election regime conditions potentially causes investors to make a deemed disposal and reacquisition of their units, with any gain being crystallised at a later date. The nature of the fund itself does not change whilst any breach is ongoing and so disposals of underlying UK properties do not impact on investors.

In the event that a similar disposal and reacquisition of units by investors were adopted for the Restricted RIF regime, that would be incompatible with the RIF being treated as transparent during the period of any breach because investors would risk being taxed twice on the same gain (i.e. on the deemed disposal of units and on any subsequent property disposal) requiring additional: legislation to prevent a double charge; operational complexity for the fund; and filings by investors. As indicated above, we consider that retaining CoACS treatment pending the conditions being satisfied again is a significantly better solution.

Ensuring there is no loss of tax

Whilst it is understood that provisions are necessary to ensure there is no loss of tax, given the additional challenges identified above that arise in the case of a RIF (compared to the Exemption Election regime) we believe that any such provisions should be more targeted at the actual loss of tax as far as possible, and any other adverse consequences for investors should be avoided.

We have not set out our detailed thinking in this response, but some of the underlying principles (and potential mechanisms for achieving this) could be:

- The ability for a RIF, whose offering documents demonstrate an intention to invest predominantly (i.e. more than 75%) in UK property, to be treated, for the purpose of the NRCGT rules, as an interest in a UK Property Rich fund notwithstanding the fact that at particular times it may not consist of more than 75% UK property. In this regard it may be noted that many of the UK's double tax treaties generally do not restrict the ability of the UK to levy capital gains taxes on disposals of entities which derive at least 50% of their value from UK real estate (although some exceptions exist where a 75% threshold applies), and anti-avoidance principles (akin to those in Part 4 of Schedule 1A TCGA 1992) could prevent the abuse of this provision, with a reversion to transparent treatment.
- The ability for the initial election into the UK Property Rich Restricted RIF regime to be retrospective (subject to potential conditions regarding exiting investors) or subject to rollover of any gains on chargeable assets on entry, to avoid dry tax charges for investors on entry into the regime (e.g. as commitments from new investors are drawn down).

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- The ability for the Restricted RIF to continue to be treated as a CoACS for a limited period (extended at HMRC discretion) in the event of a technical / minor breach (e.g. a breach of the UK property rich condition as referred to above) subject to targeted provisions where there would otherwise be a loss of tax (see below).
- Where an investor disposes of an interest in the RIF at a time when the RIF has ceased to be UK property rich (i.e. through a sale/redemption of units or on receipt of a capital distribution) there could be a deemed disposal immediately prior to the RIF ceasing to be UK property rich (noting that risk of a loss of tax may only apply in respect of non-UK tax resident investors) and a reversion to the transparent treatment.
- In relation to any remaining interest in the RIF held by that investor, or for interests held by other investors which have had no such disposal, if the RIF once again becomes UK property rich (within a prescribed period – see above), they should be effectively treated as if the deemed opaque treatment had continued throughout (e.g. by specifically targeting provisions at investors making a disposal, a general deferral/rollover mechanism applying to all investors, or re-entry into the RIF regime retrospective to the date of the breach (except in relation to investor disposals)).

In summary, we believe that modifications can and should be made to the current proposal as set out in relation to UK Property Rich Restricted RIF, so as not to disadvantage such a regime from the outset, when compared to the offshore vehicles that are able to take advantage of the Exemption Election, and to ensure that provisions safeguarding the potential loss of tax are targeted, with minimal adverse collateral consequences for investors.

Stamp taxes

The stamp tax treatment of the RIF is key. We agree that a RIF should be treated as a company for SDLT purposes and that agreements to transfer / transfers of units in a RIF should not be subject to SDRT or stamp duty.

VAT

The VAT treatment of investment management fees is the subject of an ongoing HMRC /HM Treasury public consultation process, the conclusions of which have yet to be announced. We assume that the VAT treatment of the RIF will be in line with the outcome of that consultation.

We are concerned that the Consultation does not envisage the possibility of alignment of the VAT regime of the RIF with that of the CoACS. Since the nature of an investment management service is similar whether the vehicle is authorised or not, and the CoACS and RIF are largely targeting a similar investor market, a difference in the VAT treatment is likely to be distortive. It may also deter the conversion of a RIF to a CoACS or vice versa which limits the flexibility of the product.

Please see further the answer to question 16 below.

Legislation and Regulations

There are AREF members and other parties, interested in launching a RIF. To enable them to forward plan for possible RIF launches, ideally next year, we would ask that the government assesses the Consultation responses and issues a formal response as soon as practical., Assuming this confirms the government's decision to proceed with the introduction of the RIF, we look forward, as soon as practicable, to considering: primary tax legislation that will apply to the RIF; and secondary legislation as envisaged in FSMB clause 60(3) and FSMA Section 261Z6 (1), after FSMB has received Royal Assent. Also, we will expect consultations from the FCA on the related rules and the HMRC on RIF guidance notes.

As an AIF, the RIF will require a depositary. As we share members with the Depositary and Trustee Association (DATA), we would like to support their request for change to legislation so there is not a requirement that the depositary holds title of real estate assets, held by the RIF. These should be in the name of the RIF or the RIF AIFM, acting on behalf of the RIF. The depositary would verify ownership of the assets and keep record of those assets.

During the process of ensuring the right legislation and regulations are in place to enable the introduction of the RIF, AREF will assist in publicising the attributes of the RIF. This will include sharing the model deed that constitutes the RIF and ensuring market familiarity with the practicalities of launching and operating RIFs.

Further engagement

If you would like to engage with us further regarding any aspect of our response, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat, AREF. In addition, members of our Public Policy Committee and Tax Committee are always willing to assist the FCA by sharing their wealth of knowledge and expertise in respect of real estate funds.

Yours sincerely

Paul Richards

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Responses to Questions

Chapter 2: Scope of the Reserved Investor Fund

Question 1: Do you agree that the 'Reserved Investor Fund (Contractual Scheme)', or 'RIF(CS)', is the most appropriate name for the new structure? If you disagree or suggest a different name, please give reasons for your response.

For the reasons stated in paragraph 2.5 of the Consultation, we agree 'Reserved Investor Fund (Contractual Scheme)' or 'RIF(CS)' is the most appropriate name for the new structure.

We note Footnote 4 to the Consultation. We anticipate the market will adopt 'Reserved Investor Fund' or 'RIF' as the name for the new structure until government implements legislation for any other form of unauthorised structure. Hence, we welcome paragraph 1.7 of the Consultation – and in this submission are using - 'Reserved Investor Fund' or 'RIF' - as the name for the new structure.

We understand the name previously suggested by industry 'Professional Investor Fund (Contractual Scheme)' was developed on the assumption that the fund would be restricted to professional investors. This restriction at one time was the preference of the Financial Conduct Authority (FCA) officials. In view of investor categories such as certified high net worth investors, certified sophisticated investors, and self-certified sophisticated investors will be eligible to invest in the new structure, 'Reserved Investor Fund (Contractual Scheme)' or 'RIF' is the most appropriate name for the new structure.

We would be grateful if government could confirm that elective professional investors will also be eligible to invest in a RIF. We consider it is important to the attractiveness of the RIF that local authorities and local government pension schemes that opt up to elective professional status (subject to the qualitative and quantitative opt-up tests in COBS 3.5.3) will be eligible RIF investors.

On the assumption that the FCA will proceed with the professional and retail fund categories envisaged in their Discussion Paper 23/2 (FCA DP23/2), we look forward to the RIF opting for regulatory purposes as:

- 'RIF professional fund', with only eligible professional investors; or
- 'RIF retail fund', which may include eligible professional investors as well as investor categories such as certified high net worth investors, certified sophisticated investors, and self-certified sophisticated investors.

RIF professional fund will have the advantage of operating with more flexibility, less prescriptive requirements under UK AIFMD than the RIF retail fund as envisaged under FCA DP23/2. Importantly, it will have greater efficiencies and lower costs for launching and operating in comparison to the RIF retail fund and other retail funds.

Question 2: Would a restricted RIF add value to the existing range of UK fund structures, particularly compared to a structure without such restrictions? What would the relative attractiveness be of the proposed restrictions to the RIF regime?

Restrictions proposed to apply to a restricted RIF

We believe that the Restricted RIF would add value to the existing range of UK fund structures.

We consider that the following are key to the success of the Restricted RIF regime:

- It is easy to understand and operate.
- It has equivalent treatment to similar regimes (e.g. Exemption Election).
- There is an ability to remain within Restricted RIF regime despite minor breach of the conditions (e.g. grace periods during which remain within the regime).
- In the event that a RIF does exit the regime (e.g. if no grace period applies), it should be possible for that RIF to re-join the Restricted RIF regime at a later date, assuming all relevant conditions are met (as is the case under the Exemption Election regime).
- There is no tax on chargeable gains until units in the RIF are actually disposed of (including part disposals on a return of capital) or the RIF is wound up, which should apply in respect of: (a) entry to and exit from the Restricted RIF regime; and (b) any minor breach of the Restricted RIF conditions that does not result in leaving the regime. For example, in the event that (a) or (b) were to give rise to a deemed disposal and reacquisition of either units in the RIF or the assets of the RIF.
- There is no stamp taxes on issue or transfer of units in the RIF.

We appreciate that the government will want to ensure that the RIF regime incorporates sufficient protections to ensure that the RIF is not used for avoidance and does not cause an unexpected loss of tax. We consider that this is achievable and are keen to work with HMRC to identify areas of potential concern and find appropriate solutions and/or mitigants.

We note in paragraph 4.33 that government is considering an unrestricted RIF as an "alternative". Paragraphs 1.9 and 1.10 also suggest that government is considering the unrestricted and restricted RIF proposals in the alternative. However, we note also that paragraph 4.41 suggests that government is considering them in parallel. It would be helpful if the government could clarify this point.

Whilst we consider that there may be scope for a RIF regime that incorporates the Unrestricted RIF from the outset, we are keen to ensure that the present proposal (i.e. the Restricted RIF) does not suffer undue delay in an attempt to design a RIF regime that caters perfectly for all eventualities.

Comparison with a structure without such restrictions: the relative attractiveness of the proposed restrictions to the RIF regime

The RIF has many attractions to UK managers, (especially SMEs as indicated in the Introduction). The RIF (including with the proposed restrictions) has significant benefits including:

- **The efficiencies with operating the RIF:** managers will avoid having to go offshore with all the challenges, inefficiencies, and costs, of dealing with multiple legal, tax and regulatory regimes. It is noted that the offshore funds (holding UK real estate as underlying investments) are subject to non-resident capital gains tax rules similar to the proposed RIF restrictions.
- **Speed to launch:** The UK AIFM and UK depositary enter into a compliant deed, as referred to in paragraph 2.12 of the Consultation, that constitutes the RIF (RIF Deed) and can then admit investors. There is no need for RIF prior registration. There is also no need for prior application to, nor approval from, the FCA.
- **RIF flexibilities:** for example, with investor redemption entitlements and ensuring liquidity matching with long term productive (and less liquid) investment – compared with a fund operating within the authorised open-ended regime which is required to adopt terms that are significantly more prescribed. We envisage these

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flexibilities will be available with the 'RIF professional fund' referred to in response to Consultation's Question 1 above.

- **RIF will have 'tradeable units': investors incur no transaction tax when disposing of RIF units:** This is a particular concern with limited partnerships that have underlying UK real estate investments.
- **RIF will benefit from SDLT seeding relief:** subject to our comments in response to Question 13 below, we very much welcome the RIF having parity with SDLT relief that applies to the CoACS.
- **LTAF 'launch pad' option:** Subject to manager, investor and FCA consent, the RIF (given it is structured as a contractual scheme and similar category of eligible investors) will be able to convert seamlessly into an ACS LTAF. We understand from HM Treasury and HMRC officials that no tax friction would apply to such a conversion.

  Using a RIF as a 'launch pad' for the LTAF may be a more attractive and risk-averse strategy than the fund manager looking to launch an LTAF from scratch (and incurring material costs associated with launching an LTAF).

  In addition, we hope at that later stage, there will then be established distribution solutions for the platforms to onboard non-daily dealing funds like the LTAF: see the Productive Finance Working Group 'A Call to Action for Platforms' (page 74, November 2022 PFWG Guides): https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/working-group-to-facilitate-investment-in-productive-finance/pfwg-guides-investing-in-less-liquid-assets.pdf.

We believe that the RIF benefits considerably outweigh the trade-off associated with RIF managers/investors being subject to the proposed RIF restrictions.

Challenges with marketing fund products to EEA institutional investors

We would like to highlight the fact that since 2020 UK fund managers of all UK fund structures have been hampered in their efforts to market fund products to institutional investors in the European Economic Area (EEA). UK managers now have to rely on a patchwork of National Private Placement Regimes. For instance, France, Germany, Italy and Spain are effectively 'out of bounds' jurisdictions.

UK managers are having to incur the substantial costs of establishing and operating fund structures in the EEA in order to continue marketing to EEA investors and managing EEA funds. This favours large managers who can afford to operate such structures – particularly with the European Commission planning tougher substance requirements for managers operating within the EEA. We regret that UK SME fund managers lose out.

Question 3: Are there investment asset classes besides real estate for which a RIF would be particularly attractive?

We understand that there is interest in the RIF with UK fund sectors focused on asset classes other than real estate: for instance, infrastructure, private equity and private debt.

Question 4: Do you foresee any legal or administrative issues with the proposed eligibility criteria? Would you recommend that the government include additional requirements for an unauthorised co-ownership contractual scheme that wishes to become a RIF? If so, please explain the reasons for this.

Our principal concerns in respect of the eligibility conditions in Paragraph 2.12 are as follows:

- The GDO and non-close tests will need to be considered in greater detail in the context of the RIF to ensure that they operate as intended.
- It should be possible for a RIF to hold an interest in another RIF and the detail of the eligibility conditions will need to be considered in that context.

As indicated above, we are pleased to note the legislative progress in the UK Parliament of FSMB containing clause 60 'Unauthorised co-ownership AIFs'. Following the FSMB receiving Royal Assent, which we assume will be later this year, we look forward to discussing the details of regulations envisaged in FSMA Section 261Z6 (1).

Chapter 3: Design of a new tax regime for a Reserved Investor Fund

Question 5: Are there are there any are specific tax provisions that should be considered to facilitate RIF investment in asset classes other than real estate?

We are not aware of any specific tax provisions that should be considered to facilitate RIF investment in asset classes other than real estate.

However, please also see the response to Question 22.

Question 6: Do you foresee any issues with the government's intended requirements for reporting income to investors, or with replicating the provisions related to excess reportable income arising to RIF investors from an investment in an offshore fund?

We understand, and agree with, the government's objectives for the RIF tax regime stated in the Consultation's paragraph 3.2. In this context, we consider:

- the government's intended requirements for reporting income to investors, and
- replicating the provisions related to excess reportable income arising to RIF investors from an investment in an offshore fund. registered under the UK reporting fund regime,

as pragmatic solutions which are workable for industry and would not materially adversely affect the efficient operation of the RIFs.

Question 7: Should RIFs be added to the list of permitted property categories at section 520 ITTOIA 2005 and do you consider that the structure and nature of RIFs means that individual policyholders would be effectively prevented from introducing personal assets into their life insurance policy?

As indicated, we understand - and agree with - the government's objectives for the RIF tax regime stated in the Consultation's paragraph 3.2. In this context, we consider:

- RIFs should be added to the list of permitted property categories at section 520 ITTOIA 2005; and
- that the structure and nature of RIFs means that individual policyholders would be effectively prevented from introducing personal assets into their life insurance policy.

Question 8: Do you have any views on the proposed capital allowances treatment?

We agree with the proposals in the Consultation at:

- paragraph 3.15, for a RIF to replicate the existing treatment that is available for CoACS, with the result a RIF operator (we assume the RIF UK AIFM) could make an election enabling the RIF operator to calculate and apportion the capital allowances to the investors.
- paragraph 3.16 – If an existing CoACS converted to a RIF, or vice versa, the election and simplified treatment should continue to apply as if the scheme had carried on in its previous form.

It would also be important that the status of the RIF itself should not alter its capital allowances treatment (i.e. no change to the RIF's capital allowances treatment if it were to enter or leave the Restricted RIF regime).

Question 9: Do you have any general comments on the proposed capital gains treatment of investors in a RIF, subject to the detailed questions in Chapter 4?

Please refer to the Executive Summary above.

Question 10: Do you have comments on the proposed capital gains treatment for insurance companies?

We agree with the proposals in the Consultation.

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Question 11: Would this proposed rule help facilitate a RIF's investment in REIT?

We welcome the fact that the government is considering how the RIF will be considered in the context of other tax provisions including the REIT listing requirement. The ability to trace ownership through a RIF is one potential solution. In certain circumstances, it would also be possible for the RIF itself to be treated as an institutional investor (e.g. if it meets the GDO requirement) such that the RIF is effectively equivalent to an English Limited Partnership/Scottish Limited Partnership CIS for these purposes.

In addition to considering the listing requirement it would be necessary to understand how the RIF should be treated in other contexts (e.g. non-close test and in the context of the holders of excessive rights provisions).

As a general matter, the interaction of the RIF with other tax regimes (i.e. not just the REIT regime) will be important to ensure that the use of the RIF does not create issues for managers and investors alike. Please see further the response to Question 32.

Question 11: Would any further tax provisions be required to further facilitate a RIF's investment in other property funds?

As a general matter, the interaction of the RIF with other tax regimes (i.e. not just the REIT regime) will be important to ensure that the use of the RIF does not create issues for managers and investors alike. Please see further the response to Question 32.

Question 12: Would the proposal outlined here be a viable option to achieve fair SDLT treatment of property acquired by and held by unauthorised co-ownership contractual schemes, whether or not they are within the RIF regime?

We agree with the proposal that a RIF should be treated as a company for SDLT purposes such that transfers of units in a RIF should not be subject to SDLT.

We also agree that an unauthorised co-ownership contractual scheme (e.g. before the RIF conditions are met) should also be treated as a company for SDLT purposes such that transfers of units are not subject to SDLT.

Continuity of SDLT treatment across the three forms of unauthorised co-ownership contractual scheme (i.e. non-RIF, RIF and Restricted RIF) is an important consideration for investors and will be important to the success of the RIF.

Question 13; Are there any features of the existing CoACS seeding relief that are unsuitable to be applied to RIFs?

Question 14: The length of the control period for PAIF and CoACS seeding reliefs is three years. Would a similar period be appropriate for RIF seeding relief claims?

We respond to both questions 13 and 14 below.

Seeding relief equivalent to CoACS

We welcome the principle of CoACS (SDLT) seeding relief applying to the RIF. The February 2022 Treasury responses helpfully stated that the unauthorised contractual scheme *"has the potential to lower the barriers for SME asset managers to launch new products, to increase the number of unauthorised closed-ended investment vehicles domiciled in the UK and to support the government's work to promote investment in longer-term, less liquid assets*" (paragraph 2.171, our underlining for emphasis).

In order to enhance the prospects of SME assets managers launching RIFs, we have suggested minimal legislative revisions to the existing CoACS Seeding Relief provisions, so the provisions:

- can apply to the closed-ended or hybrid RIFs; and
- ensure that the provisions continue to retain robust tax anti-avoidance measures.

The minimal revisions only substitute the current portfolio test of £100m and 20 commercial or 100 residential properties with £20m and 3 commercial or 10 residential properties. We have supplied to HM Treasury and HMRC officials supporting endorsements from managers to these suggestions.

The CoACS and the RIF are distinct vehicles that are intended to address specific needs within the funds landscape. The Restricted RIF is being adopted in the context of the Funds Review in order to make a UK fund that will be attractive to investors and managers, and we believe that the proposed changes to the seeding relief in the context of the Restricted RIF are necessary to achieve that aim.

In the event that HMRC's concern is the risk of abuse, we note that the CoACS seeding relief contains a number of protections (e.g. clawbacks and a commercial purpose test) and assume that the same suite of protections would be sufficient as regards the RIF seeding relief, including when the thresholds are reduced as requested.

Request for relief for conversion of EUUT to Restricted RIF

We understand that discussions with HM Treasury and HMRC officials included exploring a request for a general conversion relief to enable existing funds with UK real estate portfolios to convert to Restricted RIFs, but that HMRC is of the view that the officials would not currently be in a position to progress a general conversion relief request.

Nevertheless, we understand that a number of significant (e.g. AUM of more than £1bn) existing Exempt Unauthorised Unit Trusts (EUUTs) have expressed an interest in converting to the Restricted RIF structure in the event that it were possible to do so without material tax cost in respect of the conversion. The main potential tax risk on conversion would be in respect of the transfer of UK property or shares from the existing EUUT to the RIF. The inclusion of a conversion relief (i.e. equivalent to the SDLT relief on the conversion of an AUT to a PAIF under SI 2008/710) would alleviate this issue and could lead to the rapid creation of a number of significant Restricted RIF structures. Given the profile of an EUUT (i.e. investors not subject to tax on chargeable gains, essentially no tax in the EUUT and ability to sell EUUT units without stamp tax), it would seem that the risk to the Exchequer of replicating the AUT to PAIF conversion relief for an EUUT to Restricted RIF conversion would be low.

Question 15: Do you foresee any issues with the proposed Stamp Duty or SDRT treatment?

We agree with the proposal that transfers of units in a RIF should not be subject to stamp taxes (including stamp duty and SDRT) and that should be the case whether or not the RIF is within the Restricted RIF regime. Were that not the case, we do not believe that the RIF would be viable.

Question 16: Do you have any comments on the VAT treatment of the management of a RIF?

Although we would not want the momentum for legislative progress to be delayed on account of the VAT treatment of the management fees for a RIF, we note that:

- We are aware of certain industry responses to the 9th December 2022 HM Treasury consultation on VAT treatment of fund management (VAT Consultation) including the AREF response dated 3rd February 2023[3].
- In assessing the characteristics of the RIF against the principles of the HM Treasury proposed ‘SIF’ definition presents obvious conflicts which should be resolved.
- In the Consultation, government has helpfully recognised that the RIF should have a tax treatment that, so far as possible, is similar to the CoACS). The CoACS benefits from VAT exemption due to being included in VAT Consultation paragraph 9 as exempt.
- It is possible that the VAT treatment of RIFs could differ from their CoACS counterparts, with some falling under the exemption while others see their supplies of management fees as standard rated. This disparity is likely to create complexity and uncertainty regarding the management of RIFs and potentially differing treatment may weigh on operators of:

  (i) CoACSs when looking to decide on whether to convert to a RIF or

  (ii) RIFs when looking to decide on whether to convert to a CoACS, including a CoACS LTAF – given attraction of the RIF to function as an LTAF incubator.

[3] https://www.aref.org.uk/resource/vat-treatment-consultation.html

- The characteristics-based approach as set out in VAT Consultation paragraph 2.3 needs to be much more fully and plainly defined. It is especially difficult to know what the meaning of limb (d) is intended to be and what characteristics it encapsulates.
- We suggest that UCITS is an incorrect characteristic to link entitlement to the exemption and would highlight that there are a host of AIF funds which are able to avail themselves of the management fees exemption. Domestically these include open-ended vehicles within the NURS, QISs and LTAF regimes and closed-ended entities such as Investment Trust Companies.
- In Europe both Ireland with their QIAIF regime and Luxembourg with their RAIF regime offer exemption to funds covered under AIFMD. In addition, Germany is currently consulting on widening the VAT exemption to cover supplies of management to AIFs. Given the direction of travel, there must be a concern that the UK is being left behind as regards the VAT treatment of management fees.
- Looking back to the purpose of the exemption, its policy goal has been:
    - promote access by savers to collective investment:
    - avoid subjecting contract-based funds to a tax burden which self-managed investment undertakings which are legal entities do not have to bear.
- To better align the principles test with this ideal we suggest that the condition d) be expanded to include AIFs but with suitable constraints if those AIFs or their operators are already suitably regulated.

Chapter 4: Application of the non-resident capital gains (NRGC) rules to a Reserved Investor Fund

Question 17: Are there any circumstances other than that outlined in paragraph 4.11 that the government should be considering to ensure that the RIF tax regime aligns with the government's policy of taxing non-UK resident investors on gains on disposals of UK property?

Please refer to the Executive Summary above.

Question 18: Would take-up of the RIF be affected, and if so to what extent, if section 103D TCGA was disapplied where a restricted RIF breached a restriction? Are there alternative ways that a breach could be dealt with?

Please refer to the Executive Summary above.

Question 19: What, if any, legislative or administrative easements would be required for unintended breaches by a UK property rich RIF?

Please refer to the Executive Summary above.

Question 20: To what extent would such restrictions on a RIF's ability to invest more than 25% of its total asset value in non-UK property assets limit take-up?

The most logical comparable entity to the RIF would be an entity that is within the Exemption Election regime and which would, therefore, be subject to the same 25% restriction. On that basis, provided the RIF regime is no more restrictive than the Exemption Election regime, take-up should not be limited as a result of the 25% threshold.

Question 21: What commercial appetite would there be for a RIF that was only open to investors who are exempt from tax on gains?

There would be good appetite for a RIF that is restricted to investors that are exempt from gains. This would enable a RIF that intends to hold UK property but may not be or always remain UK property rich to enter into the RIF regime, subject obviously to the RIF solely having investors that are exempt from chargeable gains.

As explained in the answer to Question 14 above, there are also a number of significant (e.g. AUM of more than £1bn) existing Exempt Unauthorised Unit Trusts (EUUTs) that have expressed an interest in converting to the RIF structure in the event that it were possible to do so without material tax cost in respect of the conversion.

Question 22: Would there be appetite for a RIF that is restricted from investing in UK property?

Yes. We understand that there would be appetite for a RIF to hold shares and securities or to operate as a credit fund.

However, it may be difficult to attract investors if the risk of partnership treatment (as a consequence of the inadvertent acquisition of property assets, for example in the event of an insolvency), and consequent dry tax charges, is more than a remote risk.

Question 23: Do you have any suggestions about how the base cost of an investor could be computed on a disposal of UK property for a non-UK property rich RIF where the RIF was only transparent for gains at the point of a disposal of UK property or where there was a change of investor?

See below.

Question 24: Do you agree that the RIF would need to be deemed to be a partnership for gains throughout the period it is non-UK property rich to give a basis for capital gains computations if option 2 were applied to a RIF which transitions between UK property rich and non-UK property rich?

In the context of a RIF, disposals for chargeable gains purposes would only typically be expected when either the RIF disposes of assets or an investor disposes (or is deemed to dispose) of an interest in the RIF. On that basis, it would seem that Option 1 is effectively equivalent to ongoing transparency for chargeable gains purposes.

Option 2 is effectively what is being proposed as being the treatment in the event that a RIF were to fall outside of the Restricted RIF regime, as to which please refer to the Executive Summary above.

We would like to discuss the relative merits of Option 1 and Option 2 with HMRC.

Whilst it would seem logical for there to be a deemed disposal and reacquisition when transitioning into or out of the regime, we consider that any risk of a dry tax charge as a result of that deemed disposal would be a significant issue for potential RIF investors.

Question 25: Do you think that applying option 2 to a RIF that transitions between UK property and non-UK property rich could achieve the government's aim of taxing non-UK resident investors on gains of disposals of UK property?

Yes, we think that applying option 2 to a RIF that transitions between UK property and non-UK property rich could achieve the government's aim of taxing non-UK resident investors on gains of disposals of UK property. However, it will be key to the success of the regime that the transition does not give rise to dry tax charges.

Question 26: Do you consider that there are any more effective ways by which the government could ensure non-UK resident investors in a non-UK property rich RIF are taxed on gains on disposal of UK property? If so, please provide a detailed explanation of how this would work, and the advantages and disadvantages of applying a different treatment.

We are not aware of a better method.

Question 27: To what extent could difficulties with tax transparency for gains be overcome through the way in which the RIF is structured, for instance using a separate class of units or sub-fund in an umbrella RIF to hold UK property?

Whilst this option could be considered, it would be necessary to be able to operate the relevant sub-funds seamlessly, for example to ensure that any transfer of UK property to / from the relevant sub-fund does not cause any tax friction and there are no other adverse impacts (e.g. from a practical perspective as regards the operation of the relevant property and the flow of rental income or other returns from it).

Question 28: To what extent would transparency for gains mean that a manager would not in practice choose to establish a RIF to hold UK property where it was not anticipated that the RIF would be UK property rich?

We share the view that 'transparency for gains' would have a strong deterrent effect: given the adverse consequences in terms of the RIF investors and operational matters, we anticipate that both managers and investors would in practice require that the terms of the RIF Deed would prohibit the RIF from holding UK property where the RIF would

not be UK property rich, save to the extent that all of the investors are exempt from UK tax on chargeable gains (see our response to Question 21 above).

Question 29: Do you foresee any issues with applying similar reporting obligations to a RIF as those that apply to a non-UK CIV that has made an exemption election?

We agree with applying similar reporting obligations to a RIF as those that apply to a non-UK CIV that has made an exemption election. The only issue may be greater operational costs. We understand from fund administrator contacts (to whom non-UK CIV managers invariably pass on the reporting obligation) the parties look on a fund-to-fund basis look to negotiate which party incurs such costs. The fact that such greater operational costs arise does inhibit managers and investors proceeding with non-UK CIV launches.

Chapter 5: Unauthorised co-ownership contractual schemes that do not fall within the Reserved Investor Fund regime

Question 30: Do you have any views on the point from which a RIF should lose its status, if it fails to meet any of the eligibility criteria?

It is, of course, a very serious consequence that a RIF should lose its RIF status for the RIF manager (we assume to be a UK AIFM), investors as well as the RIF depositary. We anticipate that in a RIF Deed:

- RIF investors will insist on; and
- RIF AIFM and depositary will accept

obligations on the part of the RIF AIFM (with remedial steps being available to the RIF AIFM) to prevent the RIF losing its RIF status. Similar provisions are typically contained in deeds constituting the EUUT with obligations on the part of the EUUT Manager (with remedial steps being available to the EUUT Manager) to prevent the EUUT losing its EUUT/tax-exempt status.

We look forward to discussing details of the proposed regimes with HMRC and how they would operate in practice both from a tax technical and an operation / practical perspective (e.g. grace periods, warning mechanisms and regimes that would deal with breaches in a practical and proportionate manner).

Question 31: Do you foresee any issues with the tax treatment of a co-ownership contractual scheme that falls outside both the RIF and CoACS regimes? Should the government consider providing for the treatment of such an unauthorised co-ownership contractual scheme in legislation?

We would appreciate the opportunity to discuss further the tax treatment of an unauthorised co-ownership contractual scheme that falls outside the RIF, Restricted RIF and CoACS regimes and how that treatment should be formalised.

For example, one should consider the need for express legislation:

- governing the tax treatment of any transition between the different types of co-ownership contractual scheme; and
- confirmed that the SDLT treatment would be as suggested at paragraph 5.1 (i.e. to avoid the burdensome charges that are mentioned at paragraph 3.32).

Question 32: Do you have any further views on the viability of the RIF design proposal, not otherwise covered?

It is key to ensure that the integration of the RIF into the broader tax landscape will be as seamless as possible, both as regards:

- Any changes to the status of an individual RIF (e.g. when moving between being an unauthorised contractual scheme / RIF / Restricted RIF):
    - VAT – the RIF (or the operator on behalf of the RIF) should remain the registered entity (e.g. keeping the same registration number and option to tax position).
    - Capital Allowances – the operator should continue to be able to operate the capital allowances system (e.g. claim allowances on behalf of investors and enter into elections).

- Construction Industry Scheme – the operator should continue to operate the Construction Industry Scheme even when the RIF changes status.
- Tax administration generally – given that the RIF is transparent for income it will be the operator that will have to engage with third parties rather than the taxpayer (equivalent to a partnership) and so it will be important to empower the operator to be able to perform that role (e.g. to submit elections and effectively deal with third parties).

- The interaction of the RIF with other vehicles and tax regimes:
  - RIFs and ownership tests – the Consultation helpfully considers the REIT shareholding requirement and how the RIF would interact with the relevant test. As indicated in the response at Question 11, the Consultation only considers one aspect of the REIT conditions. In addition to the other REIT conditions, the treatment of the RIF in the context of the ownership tests applicable to other regimes (e.g. QAHC and QII SSE) will be important. We consider that it should be possible to trace through an unauthorised contractual scheme but that any RIF that meets the GDO / Non-Close Test should be considered a "good investor" for the purposes of relevant regimes (e.g. an institutional investor for REIT purposes or a Category A investor for QAHC purposes).
  - Loan Relationships Regime – the fact that the RIF (or the operator on behalf of the RIF) would be the borrower under any lending, should not prevent the investors from being able to claim deductions under the loan relationships code (subject to any applicable limits (e.g. CIR)). Ideally this would be covered off in the relevant legislation.
  - Withholding Tax – there are a number of relevant withholding tax regimes, the principal ones being: (i) withholding on payments of interest, royalties and annual payments; (ii) the non-resident landlord scheme; and (iii) withholding on REIT and PAIF dividends. We would welcome the opportunity to consider these regimes with HMRC in greater detail, with our view being that a RIF should be considered eligible to receive UK sourced income gross, recognising that a substantial part of the RIF target market would be institutions who would be eligible for gross payments under domestic law or tax treaties and that a complex reclaim process may be a deterrent to investors.