Response to Follow-up questions on Sovereign Immunity reform

23 January 2023

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INREV* has not responded to all the follow-on questions as our expertise and/or members' interests do not extend to all subject matters. Nevertheless, we hope that the comments provided below in red typeface make a constructive contribution to HMT's review of UK policy on Sovereign Immunity. We are available in case further discussion or clarification would be helpful.

Sovereign immunity reform: Follow-up questions

This document contains questions which relate to aspects of policy design that we would welcome further views from stakeholders on.

This is a working-level document and the questions and content within are not indicative of government decisions.

We would be grateful for responses in writing to as many questions you are able to respond to by 23 January. Please email these to sovereignimmunity@hmtreasury.gov.uk.

Where responses are confidential and/or commercially sensitive, please note this clearly in your email and they will be treated as such.

Commencement

Some respondents to the consultation suggested to us that a commencement date at the beginning of the calendar year would provide administrative benefits due to sovereigns typically conducting fair value assessments—relevant for rebasing the value of assets for capital gains purposes—at the end of the calendar year.

1) Do you share this assessment?
2) Are there any other considerations relevant to whether a new SI regime commences from the beginning of a calendar year or a tax year?

The commencement on a calendar year basis is likely to be more practical on the basis that the UK tax year is not a meaningful date outside of the UK – i.e. foreign sovereigns seeking to undertake relevant financial reporting etc would have to allow for change at a point in time that is likely to be arbitrary for them.

Taxation of restructured UK property

Some respondents to the consultation argued that, in the event UK property is brought into the scope of UK tax through SI reform, sovereigns should be given a window to restructure their UK property holdings without that restructuring triggering SDLT charges.

1) What restructuring might you be looking to undertake in response to SI reform – i.e., what exact structures would you be moving UK property from and to (e.g. a JPUT or ELP to a Ltd Co. or a UK REIT) – and what would the tax and non-tax motivations be for such restructuring?

In order to access their entitlement to sovereign immune status for direct tax purposes many sovereigns are likely to structure using vehicles that are tax transparent for income and gains for UK tax purposes. Sovereigns typically do not favour having tax responsibilities associated with the main sovereign body in overseas jurisdictions (i.e. tax filings). Hence it is likely that such responsibilities will be sought to be ring-fenced in an opaque vehicle such as a UK Ltd company, non-UK Ltd Company etc should sovereign immunity be removed in the way proposed.

2) What is the length of time it would take to execute such restructuring?

Very difficult to say – for an unencumbered property with no associated approval requirements from relevant stakeholders or legacy rights attached it may be relatively quick. For a property that has third party debt secured on it or requires permissions from e.g. freeholder or other stakeholders for structural change this may take a considerable period.

Properties held in joint venture with other investors with different tax status may also present difficulties.

3) In what circumstances would you not be able to benefit from SDLT group relief in respect of such restructuring?

Sovereign bodies are generally established under the legal framework of the non-UK jurisdiction. Therefore restructuring that requires parties to be 'bodies corporate' for example in order to be free from SDLT may either prima facie not be eligible for relief or the analysis may result in significant uncertainty.

4) How would you envisage those circumstances being accommodated through the design of a targeted sovereign SDLT restructuring relief – i.e. what are the qualifying conditions that you'd envisage for such a relief and how would those conditions be designed to prevent against the relief going beyond restructuring that is motivated by SI reform?

Whilst a framework would be useful for sovereigns and their advisors a clearance procedure would be the clearest way for such a system to function. Sovereign bodies come in many legal forms and seeking to cover all possible eventualities in legislation may be challenging. Alternatively a broad motive based test could conceptually function.

5) How would the absence of an SDLT restructuring relief impact on your decision-making here? Would you consider restructuring into a Property Authorised Investment Fund or Co-Ownership Authorised Contractual Scheme, in recognition that both structures currently benefit from SDLT seeding relief?

This will be entirely fact dependent. The underlying property assets may not be appropriate for restructure into being held by such legal forms that may fall into entirely different regulatory, tax and legal regimes than the properties are presently held.

To better understand the impact of decisions in this area we would be interested in the following information. Where this information is taxpayer confidential, should you prefer this to be received by HMRC only please send it to immunityconsult@hmrc.gov.uk, noting this in your email.

6) In the years 2018-19, 2019-20 and 2020-21, what was:
    a. The total value of property purchased and sold respectively in England and Northern Ireland, and how long sold properties were held for.
    b. the number of properties and total value upon which you paid SDLT, together with the total amount of SDLT paid and an estimate of the split between tax paid at the residential rates of SDLT and tax paid using the non-residential rates.

7) What is the value of your total property holdings in England and NI, together with details of the value and type (residential, non-residential or both) of property held by ownership type:
    a. Direct or joint ownership (including via a bare trust or nominee)
    b. Limited partnership where you are the sole limited partner.
    c. Other partnership.
    d. REIT.
    e. Jersey or Guernsey Property Unit Trust
    f. Other Unit Trust.
    g. Other.

Application of anti-avoidance rules

Some respondents raised concerns about the application of anti-avoidance rules, such as the loan relationship unallowable purpose rule, to planned restructuring.

1) Could you tell us more about the nature of your concerns in this area?
2) What could be done to support sovereigns' understanding of how these rules might be applied in practice?

Taxation of UK office activities

Some respondents to the consultation raised concerns about the taxation of activities sovereigns undertake in the UK in relation to their investments.

A key concern was that these activities – whether undertaken through a branch of the investing entity or through a UK resident affiliate – could lead to there being a UK permanent establishment (UK PE) of the investing entity and could lead to difficult questions regarding the appropriate amount of profit attributable to the UK PE including whether the PE should be attributed a share of the investment return.

In recognition of this concern, many respondents called for such UK activities to be exempt from tax or for there to be greater clarity as to the approach to attributing profit.

1) To what extent are your investments managed in the UK, and does this vary by investment location (e.g. UK investments, EMEA investments, global investments) and asset type?
2) How do other jurisdictions, whether or not they have a specific sovereign immunity regime, deal with local management activities undertaken by foreign sovereigns in their jurisdictions?
3) Are investments managed in the UK through in-house staff, asset managers in related entities, third party investment managers, or a combination of these?
4) Do your in-house staff, or staff in any of your related entities, manage investments for any funds not connected to you? If so, provide details.
5) Is your UK presence limited to advisory services, or does it itself make decisions about transactions to undertake and/or undertake those transactions itself?
6) To what extent would any transactions conducted in the UK be included within The Investment Transactions (Tax) Regulations 2014?
7) How are the UK presence and its employees remunerated, and how is that taxed currently? For example:
    a. Do you pay a management fee to your UK branches or subsidiaries, is this cost only, cost plus, or share of assets under management, and is any UK CT currently paid on this?
    b. How many high salary individuals (earnings > £100,000) do you employ and how much in employee taxes do they pay?
    c. Do you utilise carried interest at all, and if so how does this compare to its more typical use in private equity funds?

8) Approximately what value of assets are under the management of your UK office at any given time?

Investment funds

Absent any changes to qualifying investor status, sovereigns would continue to be able to take a controlling interest in certain investment funds such as REITs or exempt-elected overseas CIVs. In this scenario, consideration would need to be given to the appropriate tax treatment of those funds.

One such consideration is whether steps would need to be taken to protect against the possible rolling-up of untaxed property gains within such funds, and what those steps might be. One option could be an annual deemed disposal and market value reacquisition rule for specified funds in which sovereigns have a controlling interest.

1) Do you foresee any practical issues with the operation of such a charge?

It isn't clear what motivates this policy consideration. Both the REIT regime and the exemption election are specifically designed not to levy dry tax charges and allow for reinvestment within the vehicle without a charge to tax on a gain until realised by the investor. It is unclear why the ability to roll up and reinvest gains is seen as undesirable in this circumstance.

2) Would there be any benefit in spreading the chargeability of any resulting gains or losses, and if so do you consider that the rules in s.212 TCGA (which applies to life companies) would be an appropriate model? If not, what alternative would you consider more appropriate? Would any modifications improve the operability of such a provision?

There is a clear liquidity benefit to the spreading of the tax charge albeit the operation of s212 is well-understood by the UK Life Company community and may present significant complexity / operational challenges to a sovereign entity which is less expert in UK tax.

3) Would it be attractive if there was an option to elect out of any annual deemed disposal where gains on disposals of UK land are required to be distributed by the relevant fund in each accounting period?

This is a more reasonable position in the sense that the tax borne by the investor would then be linked to a realisation event rather than being a dry tax charge.

Another consideration is how to ensure that sovereigns with substantial interests in such funds, for example a sovereign with a 10%+ interest in a REIT, are subject to effective taxation on the UK property income that they realise as a result of such interests.

Some respondents argued that it would be inappropriate to rely on the Holder of Excessive Right (HoER) rules to achieve that objective for REITs. However, consideration would need to be given to how we ensure UK taxation of UK property income arising to a substantial and perhaps controlling sovereign shareholder in a REIT effective given the provisions of the UK's double tax treaties with respect to the taxation of distributions.

1) Do you have any thoughts on how this objective might be achieved?

Holding Structures

In the consultation document, the Government asked for views on whether "the definition of foreign government should extend to controlled entities, where they are wholly owned and controlled by the State."

1) Do you currently hold any of your sovereign investments in wholly owned subsidiaries? If so are these established under the laws of the sovereign state, the country of the investment or a third country, and what are the reasons for this?
2) Where countries restrict sovereign immunity to wholly owned subsidiaries established under the laws of the sovereign state, does this create any particular difficulties?

Also in the consultation document, the Government noted that it is considering where qualifying institutional investor (QII) rules might need to be changed to ensure they are in line with our objectives.

3) How might a rebasing rule apply in situations where sovereigns have been relying on the SSE QII exemption to shelter UK property gains from UK tax and how would that deal with situations in which there are other investors in the structure?

* *INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. With more than 500 members, including institutional investors such as pension funds, insurance companies and sovereign wealth funds from around the globe, as well as investment banks, investment managers, fund of funds managers and advisors, we represent all facets of institutional investment into real estate in Europe through non-listed investment funds, joint ventures, club deals and separate accounts.*