

3 February 2023

Responses to Consultation Document

1. *Do you agree that the proposed approach to refine the UK law covering the VAT treatment of fund management, set out above, achieves its stated aims?*

INREV* believes a number of issues require clarification or further consideration:

Need to take into account the particular characteristics of property funds

- The mechanics of input VAT recovery and the role VAT plays in the setup and running of UK property funds differs compared to other authorised investment funds.
- It is standard practice for most UK property funds to register for VAT and opt to tax properties within their portfolios. This allows for the imposition of VAT on rent charged to tenants which for commercial businesses is recoverable. In turn the fees for the property management of these properties does not fall within the scope of Article 135(g) exemption for the management of 'Special Investment Funds'. Any element of generic "fund management" remains exempt, but generally investment in transferable securities constitutes the minority proportions of a property fund's portfolio. This delineation in VAT treatment has been affirmed by the *Fiscale Eenheid X* judgement of the Court of Justice under C-595/13.
- This has the effect of limiting, but not eliminating, the impact VAT has on UK property funds, as well as on the managers who (as fully, or partially, taxable business) are then able to recover VAT on the taxable supplies provided to the fund.
- INREV understands that while the UK will no longer be bound by the VAT Directive, the option to tax rules contained within VAT Act 1994, Schedule 10 Part 1 will remain. To this extent, we believe the Consultation will likely maintain the practical status quo for UK property funds but we are concerned that the criteria-based test set out in paragraph 2.3 of the Consultation appears misaligned with the general concept of the exemption and the likely effect it will have for future funds types.

Narrowness of the definition of SIF

- The proposed approach in the Consultation created a narrow

interpretation of what constitutes a Special Investment Fund (“SIF”). Certain current fund types which might not be considered wholly retail in nature (such as the qualified investor scheme (“QIS”) or long-term asset fund (“LTAF”) qualify, and will continue to qualify, as a SIF because they are (and can only be) constituted as an authorised scheme (authorised unit trust, investment company with variable capital or authorised contractual scheme). Should it become possible to establish an equivalent fund in the UK outside those regimes, the new fund type would not be a SIF. This will act as a material, and unwelcome, barrier to the development of new fund types in the UK.

- The requirement in paragraph 2.3(d)¹ of the Consultation should not be linked to the concept of a UCITS. A UCITS must invest in transferable securities, must be subject to concentration limits, and must offer daily dealings in fund interests. (A UCITS is also a more narrow product description than the range of authorised funds and listed investment companies that may currently be marketed to UK retail investors). INREV considers that the attributes of a UCITS define the “conditions of competition” and “circle of investors” more narrowly than is appropriate for a SIF. The relevant element is rather how the fund is permitted to be marketed, which generally is on a full retail basis. However, we believe that the government should broaden that to other levels of marketing such as restricted mass market investment (“RMMI”). The RMMI is the basis on which LTAFs are to be marketed and therefore would address the point above in relation to similar fund types.

Need to prevent adverse changes to current expectation of VAT treatment for UK-based asset managers

- The proposals in the Consultation are not expressed to apply *only* to funds established in the UK.² The management of funds established outside the UK (unless marketed on a retail basis in the UK) is currently outside the scope of VAT, with the manager entitled to recovery of attributable input tax. It would not preserve the current position if the government were to depart from that treatment. Any deviation from the current position would risk creating a significant disadvantage for the UK asset management sector, which is clearly not the intention behind the UK Government’s funds review.

REITs need to be addressed specifically

¹ Paragraph 2.3(d) states that: “the fund must be subject to the same conditions of competition and appeal to the same circle of investors as a UCITS (Undertakings for Collective Investment in Transferable Securities), that is funds intended for retail investors.”

² We note, in particular, that on the face of it, paragraph 2.3(d) of the Consultation is not limited to UK SIFs and non-UK SIFs intended for UK retail investors.

- UK REITs are a critical part of the UK property funds industry. Recent legislative changes (in Finance Act 2022) have made the regime more attractive and announcements in the Edinburgh Reforms have continued to encourage investor interest in UK REIT structures, including private unlisted REITs. It is not clear from the Consultation whether the UK Government intends that UK REITs should be treated as a SIF. INREV considers that a clear statement on the VAT treatment of investment management fees charged to UK REITs (whether such REITs are listed or private/non-listed) should form part of the Consultation response.

2. *Do the proposed legislative reforms present any issues for your business?*

- The proposals are an issue for INREV members that are UK-based asset managers, administrators or other service providers who are concerned that the implementation of the proposals in the Consultation may harm the UK fund management sector.

Issues related to the proposed Professional Investment Fund

- INREV has participated, along with other representative bodies, in the development of a new fund type to add to the UK's offering of investment vehicles. This new fund-type is an unauthorised coownership AIF (referred to in Financial Services and Markets Bill³ being progressed through Parliament, and known in the market as a Professional Investment Fund (“**PIF**”). In assessing the characteristics of the PIF against the principles of the newly proposed SIF definition this presents obvious conflicts which we feel must be resolved in such a way as to avoid placing obstacles ahead of investor utilisation of the PIF.
- INREV considers that a PIF should benefit from the same VAT regime as other SIFs and in particular a Co-ownership Authorised Contractual Scheme. To maximize the certainty of the tax treatment of a PIF, and avoid any uncertainty over the application of ECJ case law to a form of investment vehicle established after Brexit, we would either suggest that Item 9, Group 5, Schedule 9 of the VAT Act 1994 be amended to include the PIF, or that the criteria for a SIF is amended clearly to include a PIF as a SIF.
- Furthermore, being an unauthorised scheme, it is unlikely that a PIF would meet the UCITS or UCITS-like definition covering distribution to ‘a circle’ of retail investors. This would also link UK tax statute to a European regulatory definition which will be repealed via the Retained EU Law (Revocation and Reform) Bill. INREV considers that the UK Government should broaden the scope of the SIF to permit other levels

³ https://publications.parliament.uk/pa/bills/cbill/58-03/0181/amend/fin serv_pro_rep_1207.pdf

of marketing such RMMI (as mentioned above). That would complement the investment parameters of the PIF, and align access to SIF-status to the PIF and other comparable UK real estate investment vehicles.

- In summary, these conditions could present a scenario whereby the VAT treatment of PIFs could differ from their ACS counterparts, with some falling under the exemption while other see their supplies of management fees as standard rated. This disparity is likely to create complexity and uncertainty regarding the management of PIFs in the future. INREV requests that this disparity be reconsidered by the UK Government.

3. *Do you currently rely on Items 9 and 10 of Group 5, schedule 9 of VATA or exempt any transactions using that law?*

A number of UK-based managers which are members of INREV rely on items 9 and 10, and very many managed funds established outside the UK and which are (unless marketed on a retail basis in the UK) currently outside the scope of VAT, with the manager entitled to recovery of attributable input tax (sometimes called the OSR basis).

4. *Would the legal definition for ‘Collective Investment’ in FSMA 2000 meet the intended aim of providing much greater certainty over correct application of the associated qualifying criteria?*

Section 235 FSMA 2000 defines a “collective investment scheme” and the terms “collective invest undertaking” and “collective investment” are used elsewhere in the Act without express definition. We believe that it is apparent from section 235 FSMA 2000 what the attributes are which constitute “collective investment” for the purposes of the Act. These can be adopted for the purposes of the SIF definition (discussed in item (1)) and should, once adopted, be familiar to the fund management industry.

However, we also note that for the purposes of paragraph 2.3(a) of the Consultation, the exclusions to section 235 FSMA 2000 are not applied to the definition of “collective investment”. This would allow closed-ended corporates such as UK REITs to fall within the proposed SIF regime if meeting other conditions. Following the points made above regarding UK REITs (see paragraph 1, INREV recommends that the UK Government clarifies its intention in this regard.

5. *If the answer to 4 is no, how might the government improve the definition to attain that aim?*

Not applicable

6. *Are there any further VAT related modifications the government might introduce under these or future reforms to improve the fund management regime for taxpayers?*

We note that the intention of the government is to enact the current position. However, the proposal is limited to the definition of a SIF and does not consider what constitutes “fund management”. We consider that there are currently more uncertainties on that aspect of the exemption which could be addressed to afford clarity and certainty.

The consultation is also an opportunity for the government to consider a broader interpretation of both SIF and fund management which would benefit the UK as an asset management location.

* INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. With approximately 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 the UK and Europe through non-listed investment funds, joint ventures, club deals and separate accounts.