Response to HMT and HMRC Reserved Investor Fund Consultation

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We, the European Association for Investors in Non-Listed Real Estate Vehicles[1] (INREV), welcome the opportunity to respond to the HMT and HMRC Funds Review Team's Reserved Investor Fund (RIF) Consultation Paper.

We have collaborated with other associations and regulatory and tax experts to produce this response to the Consultation and hope our comments make a constructive contribution to this important discussion.

INREV strongly supports the RIF (meaning for the purposes of this submission the Reserved Investor Fund (Contractual Scheme)) and welcomes the choice it will give institutional investors, among others, to invest through a UK domiciled and regulated unauthorised closed end vehicle. The RIF will not only fill a longstanding gap in the UK fund offering, it will also create the opportunity for investors to avoid potentially more costly and complex offshore arrangements for investing in real estate.

Following review of the responses to the Consultation and resolving any remaining open issues, we urge the government to promptly proceed with the introduction of the RIF by progressing relevant primary and secondary legislation, the FCA consulting on, and then implementing, related rules and HMRC consulting on, and then issuing RIF guidance notes

We encourage clarity as soon as practicable as to when RIFs can be launched and hope that April 2024 is achievable. This clarity would enable the market to forward plan for RIF launches. Meanwhile, we will work to support the adoption of the RIF by our members.

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[1] INREV (www.inrev.org) provides guidance, research and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe, including the UK. We have more than 500 members, comprised of institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into non-listed real estate vehicles in the UK and the rest of Europe. Our fund manager members manage hundreds of non-listed real estate investment funds, as well as joint ventures, club deals and separate accounts for institutional investors.

Overview of response to the questions raised

Although we answer the specific questions raised in the Consultation below, we thought that it would be helpful in this section to put the responses to those questions in context to help HMT and HMRC to better understand the reasoning behind our responses.

Regulatory

We are pleased to note legislative progress in the UK Parliament with the Financial Services and Markets Bill (**FSMB**) clause 60. We expect the FSMB will receive Royal Assent during 2023 and, after that, we look forward to discussing the details of regulations envisaged in FSMA Section 261Z6 (1).

Tax

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

A) 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 a 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 Consultation paragraph 4.24.

MSCI recently confirmed that data from the AREF/MSCI property fund index (formerly AREF/IPD property fund index) over the past 22 years that relate to funds which hold underlying UK property and are structured as closed-ended or hybrid investment funds, show that 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 to develop 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 and therefore to be subject to a form of tax transparency. However, we believe that transparency should only be applicable in exceptional circumstances. Investors would be unwilling to invest in a product that 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.

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; or
- 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 and therefore that the Restricted RIF is not treated as being transparent for gains pending the relevant condition being met again. For example, 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 by, for example, using "grace periods".

Particularly in the second case above, where the proceeds of a sale are 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. 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 the exemption. In contrast, for the reasons stated in the Consultation document, it is understood that this approach cannot be the case for a UK co-ownership contractual scheme, and the default position, 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 with 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, it 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 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 therefore 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 while any breach is ongoing and therefore 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). This would require additional legislation to prevent a double tax 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

While 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 with 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 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).

- 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.

B) 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.

C) 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.

Responses to Questions:

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 Consultation paragraph 2.5, 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 and 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. Therefore we welcome Consultation paragraph 1.4 – 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 the 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.

It would be helpful if government could confirm that elective professional investors will also be eligible to invest in a RIF. We consider it 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 Consultation 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 envisaged under FCA DP23/2 and, importantly, 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?

<u>Restrictions proposed to apply to a restricted RIF</u>

Yes, 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:

- Easy to understand and operate.

- Equivalent treatment to similar regimes (e.g. Exemption Election).

- 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).

- No tax on chargeable gains until units in the RIF actually disposed of or RIF 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.

- 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 4.32 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.

While 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.

  In order to enhance the efficiency of the RIF, we suggest as indicated in response to Question 4 below (and as a pre-condition that all intending RIF investors consent), the RIF would only operate – as an opt-out entitlement – with a UK AIFM instead of a UK AIFM and a UK depositary.
- **Speed to launch:** The UK AIFM and (if applicable) UK depositary enters into a compliant deed 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 flexibilities will be available with the "RIF professional fund" referred to in response to Consultation 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. The LTAF platform (which includes the ACS LTAF) is another welcomed HM Treasury funds regime review reform.

- We understand from HM Treasury and HMRC officials that no tax friction would apply to such a conversion, and look forward to discussing any legislative provisions needed to confirm this no tax friction issue.

  The RIF may be utilised in the market as a "launch pad" for the LTAF. Fund managers initially operate a RIF with cornerstone investors, build a track record and at a later stage (with the support of the cornerstone investors and attracting DC pension and other investors (that require LTAF open-ended liquidity features)):

  - with prior FCA and RIF investor approvals, convert the RIF to an ACS LTAF; and

  - be more able "to take a view" on launching an ACS LTAF, and incurring associated launch and operation costs of an LTAF.

  This 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 with the platforms 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.

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

Post-Brexit problem: UK fund managers hampered to market fund products to EEA institutional investors

We should, however, express a post-Brexit problem – that applies to all UK fund structures (and hence would apply to the RIF). Since 2020 UK fund managers 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 Consultation 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.

- In view of the nature of the intended RIF investors (professional and retail (such as certified high net worth investors, certified sophisticated investors and self-certified sophisticated investors)) it would be appropriate for there to be an option whether or not the RIF operates with a UK depositary. In other words, the RIF would be established, and will continue to operate, with either:
    - A UK AIFM and a UK depositary; or
    - Only with a UK AIFM (and not also with a UK depositary) on the pre-condition each of the RIF investors (before being admitted as a RIF investor) confirms that the RIF investor:
        - is aware of;
        - has had the opportunity to take separate advice; and
        - consents to

  the RIF operating without a UK depositary.

- 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.

We are pleased to note progress in the UK Parliament with the FSMB containing clause 60, and assume the FSMB will receive Royal Assent during 2023.

Following the FSMB receiving Royal Assent, we look forward to discussing the details of regulations envisaged in FSMA Section 261Z6 (1).

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 on Consultation 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 to be 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 Consultation paragraph 3.2. In this context, we consider that RIFs should be added to the list of permitted property categories at section 520 ITTOIA 2005 and that the structure and nature of RIFs mean 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 in paragraph 3.15, for a RIF to replicate the existing treatment that is available for CoACS, with the result a RIF operator (whom we assume would be the RIF UK AIFM) could make an election enabling the RIF operator to calculate and apportion the capital allowances to the investors. We also agree with 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.

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 or 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?

We respond to both questions 13 and 14 below.

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 HM Treasury response helpfully stated that the unauthorised contractual scheme *"has the potential <u>to lower the barriers for SME asset managers to launch new products</u>, 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 both 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 HM Treasury and HMRC officials with 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 have previously explored with HM Treasury and HMRC officials a request for a general conversion relief to enable existing funds with UK real estate portfolios to convert to Restricted RIFs, but understand 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 in the Consultation, the UK government has 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 an arrangement which is within the scope the VAT exemption as described in the VAT Consultation.

In Ireland the QIAIF regime and in Luxembourg the 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 may be a concern that the UK is at risk of being left behind as regards the VAT treatment of management fees.

Looking to the purpose of the exemption, its policy goal has been to promote access by savers to collective investment and to avoid subjecting contract-based funds to a tax burden which self-managed investment undertakings which are legal entities do not have to bear. For that reason, we would welcome the UK Government's confirmation that the supply of fund management services to a RIF would be treated for UK VAT purposes in the same way as the supply of fund management services to a CoACS. We would also welcome the confirmation that a RIF would fall clearly within the scope of a special investment fund as described in the VAT Consultation.

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.

While 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?

While 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. For example, these could arise from a practical perspective from 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, unless 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 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 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.

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 UK depositary. We anticipate that in a RIF Deed, RIF investors will insist on, and the RIF UK AIFM and (if applicable) the UK depositary will accept obligations on the part of the RIF UK AIFM (with remedial steps being available to the RIF UK 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. Some examples include 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, the need for express legislation governing the tax treatment of any transition between the different types of co-ownership contractual scheme should be considered and the SDLT treatment as suggested in the Consultation paragraph 5.1 be confirmed, to avoid the burdensome charges that are mentioned in paragraph 3.32.

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

It is critically important 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.

Financial Services and Markets Bill: RIF secondary legislation

We reiterate that we very much welcome this Consultation. In light of HM Treasury and HMRC confirming "*the government's decision on whether to proceed with the introduction of the RIF, and in what form*", we look forward to Royal Assent of the Financial Services and Markets Bill (**FSMB**), relevant 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.

We urge priority being given to deliverables including the government assessing the Consultation responses and issuing a formal response, including next steps – which hopefully confirms the government's decision to proceed with the introduction of the RIF. Thereafter, we would encourage government progressing relevant primary and secondary legislation, FCA consulting on, and then implementing, related rules, and HMRC consulting on, and then issuing RIF guidance notes.

We also urge clarity as soon as practicable as to when RIFs can be launched. We suggest April 2024 (to coincide with the new tax year) is achievable. This clarity would be a welcomed signal to the market to forward plan for RIF launches.

FCA Consultation 23/2

We are delighted, in FCA DP23/2 paragraph 2.32, the FCA indicates that HM Treasury is exploring options for the introduction of a new unauthorised contractual scheme fund structure.

We suggest that separate chapters within the FCA sourcebook should clearly distinguish and de-lineate the rules for firms that manage:

- unauthorised collective investment schemes and other alternative investment funds which admit retail investors (like RIF retail funds: RIFs that admit investor categories such as certified high net worth investors, certified sophisticated investors, and self-certified sophisticated investors); and

- unauthorised collective investment schemes and alternative investment funds which admit only professional investors (like RIF professional funds: RIFs that will only admit professional investors).

We also suggest the FCA progresses with a revised FUND sourcebook with new rules in relation to the RIF (as an additional "Specialist AIF Regime") reflecting the separate rules for 1, and 2, above.

Conclusion

We appreciate HMT and HMRC"s focus on the RIF and would be happy to discuss any aspect of this submission in further detail. Please feel free to contact me (Jeff.Rupp@inrev.org), in relation to any further engagement. In addition, members of our Public Affairs and Tax Committees are always willing to assist HMT and HMRC by sharing their knowledge and expertise in the area of UK fund regulation and taxation.

Yours sincerely,

[signed]

Jeff Rupp
Director of Public Affairs