The Association of Real Estate Funds
Camomile Court, 23 Camomile Street,
London, EC3A 7LL
+44 (0)20 7269 4677
info@aref.org.uk
www.aref.org.uk

HM Treasury & HMRC
UK Government

Response by email to financialservicesbai@hmrc.gov.uk

14 May 2024

Response to the consultation on the introduction of tax rules for the Reserved Investor Fund ("RIF")

Introduction

We, the Association of Real Estate Funds[1] ("AREF"), welcome the government's consultation on the introduction of tax rules for the Reserved Investor Fund ("RIF Regulations"). We have used a model response 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.

In addition to the above consultation, we welcome the government publishing, with the Spring Budget 2024, a summary of responses to the April 2023 HM Treasury ("HMT") and HM Revenue & Customs ("HMRC") RIF Consultation.

We are pleased the government is legislating for the RIF in the Spring 2024 Finance Bill, Finance (No. 2) Bill 2023-24 clause 20. It's good to see HMT and HMRC officials, constructively engaging with industry in progressing the RIF. This should achieve a RIF regime that is proportionate in the manner in which it encourages compliance. Which is also sufficiently robust to protect the Exchequer and provide both fund managers and investors with certainty as to the RIF's tax treatment.

We believe that the RIF will strengthen the UK's fund offering and enhance its competitiveness as a global leader in the asset management sector. 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.

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. Also, the RIF will offer an opportunity to lower the barriers for SME asset managers to launch new products.

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.

[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.

We consider that the RIF Regulations constitute a strong start in identifying a workable tax regime that could set the RIF up for success as a fund vehicle for a variety of asset classes and a broad range of investor types. However, to make the RIF a really attractive proposition for investors it is important that the tax regime has no material downsides, in terms of actual tax liability, tax administration or lack of certainty, compared to, for example, a Jersey Property Unit Trust ("JPUT"). We have set out below our key concerns regarding the proposed RIF Regulations and suggested solutions to overcome these.

Key concerns and solutions

1 Risk of change to SDLT treatment

1.1 A RIF is treated as a company such that it is opaque for SDLT purposes. The continuity and certainty of this treatment is essential for any RIF that may hold property in England or Northern Ireland.

1.2 Under previous iterations of the RIF proposals, an entity that ceases to be a RIF and reverts to being an unauthorised co-ownership contractual scheme ("UCS") would continue to be treated as a company for SDLT purposes.

1.3 However, under the RIF Regulations a UCS is treated as transparent for SDLT purposes. The change to being treated as transparent for SDLT purposes results in:

(a) issues and transfers of units being subject to SDLT;

(b) section 103 of the Finance Act 2003 applying so that investors (not the fund) would:

(i) be jointly and severally subject to SDLT on property purchases (i.e. overriding the limited liability of the RIF for SDLT purposes);

(ii) have the joint liability to submit SDLT returns; and

(iii) each have the ability to ask for a closure notice to be levied and to raise an appeal against an HMRC assessment; and

(c) a significant risk of multiple SDLT charges on the same property (e.g. on re-entering the RIF regime, subject to certain exceptions).

1.4 The above would cause material administrative and operational issues to both investors and the manager of the RIF/UCS (the "Manager"), SDLT on property purchases by the fund being borne directly by members would give them a "dry" tax charge which they would have to fund, likely by requesting a redemption of their units in the fund. More importantly, any additional SDLT (i.e. other than on the initial acquisition of a property) would directly affect the economic returns to investors and negatively impact the performance of funds and their managers.

1.5 Even where the risk of a change in SDLT treatment is low (i.e. if the risk of leaving the RIF regime is low), the potential SDLT consequences of doing so would be a material disincentive when considering whether to use the RIF instead of a comparable existing vehicle (e.g. a JPUT or Luxembourg FCP).

1.6 Solution: We agree that a RIF should be treated as a company for SDLT purposes. However, in order to make the RIF regime workable, we consider that all UCSs and RIFs should be treated as companies at all times, in accordance with the position adopted by the UK government in paragraph 5.1 of the April 2023 RIF consultation[2]. UCSs which exist and hold property prior to the commencement of the RIF Regulations could be subject to protective grandfathering provisions.

[2] https://assets.publishing.service.gov.uk/media/644a76aafaf4aa0012e12f95/Reserved_Investor_Fund_-_Consultation.pdf

1.7 When every UCS/RIF is treated as a company for SDLT purposes, any acquisition of property in England or Northern Ireland by a UCS/RIF would be subject to SDLT in the usual way (i.e. no enveloping of property without SDLT) unless seeding relief is used for a RIF.

2 Certainty and Proportionality

2.1 It is a requirement that a RIF meets the qualifying conditions on an ongoing basis in order to remain within the RIF regime. This is understood and accepted.

2.2 The RIF Regulations recognise that breaches of the qualifying conditions may happen and provides a mechanism for those breaches to be rectified without materially adversely affecting the RIF from a tax perspective. This is a positive point.

2.3 However, there is always a risk that a qualifying condition could be breached by a RIF in the ordinary course of its operation (e.g. the UK Property Rich condition) or due to unforeseen circumstances. The RIF Regulations provide for a cure period as a way to navigate minor breaches of the qualifying conditions. Whilst the proposed cure periods are potentially helpful, we believe that they are currently too restrictive and will only be sufficient to cure a small minority of potential breaches.

2.4 Cure periods are essential but are not sufficient as currently envisaged because:

(a) there is a definite risk that the Manager of the RIF may not become aware of a breach within the 30-day window and so will not be able to notify; and

(b) the breach may be entirely outside of the Manager's control such that, even if the Manager is aware of the breach, it is essentially impossible to remedy it within 30 days (e.g. if the breach is caused by its investors or requires action by investors to be resolved).

2.5 These issues are particularly acute when it comes to qualifying conditions that are dependent on, or impacted by, the status or actions of investors:

(a) Awareness: Even if the RIF documentation places obligations on investors to notify the Manager in the event that a certain event happens (e.g. a change of tax status or beneficial ownership), the Manager is reliant on investors having systems in place to identify issues and provide notifications in a timely manner.

(b) Actions: In the event that the satisfaction of a qualifying condition is dependent on investors' status and that changes (e.g. a qualifying investor divests or the investor mix of a tax transparent investor changes), curing that breach would almost certainly involve some action by investors (e.g. attracting new investment from qualifying investors or requiring non-qualifying investors to redeem units (which may require the sale of assets by the RIF)) which would inevitably take significantly longer than 30 days.

2.6 Given that background, we consider it clear that the current 30-day cure period is not sufficient and should be extended significantly. We also consider it clear that any period (whether for notification or cure) should only begin when the Manager becomes aware of the underlying issue.

2.7 The cure regime, is intended to give a RIF that breaches a qualifying condition the opportunity to cure that breach and remain within the RIF regime. There is obviously a possibility that a RIF will not manage to cure a breach within the allotted cure period and would fall out of the RIF regime. The effect of RIF Regulations 36(1)(b) and (3) is that the RIF leaves the regime from the date of the initial breach of the qualifying condition and not from the end of the cure period (or earlier date under RIF Regulation 29(5)).

2.8 Whilst this outcome is consistent with the Exemption Election regime, it creates significant additional issues in the context of the RIF regime because the fundamental tax treatment of a RIF changes when it leaves the RIF regime:

(a) for SDLT purposes, it ceases to be treated as a company and is instead treated as transparent (i.e. as a UCS); and

(b) for CGT purposes, the assets of the RIF cease to be disregarded and are instead treated as the assets of the participants, given that the UCS is treated as a partnership.

2.9 This means that the tax treatment of the RIF is uncertain between the time of the breach and the date on which it becomes certain that the breach will or will not be cured (the "Limbo Period"). The Manager's expectation would obviously be that the breach will be cured but if that is not in fact the case, any intervening transaction within the Limbo Period would retrospectively have different tax consequences and its tax treatment would have to be adjusted.

2.10 By way of example:

(a) If the RIF acquired a property during the Limbo Period it would have paid SDLT but where the RIF retrospectively leaves the regime, it would actually have been the participants that acquired the property for SDLT purposes. The wrong entity (i.e. the RIF and not the participants) would have paid SDLT and filed an SDLT return, which would have to be rectified.

(b) A participant that acquires RIF units during the Limbo Period would not pay SDLT. When the RIF retrospectively leaves the regime, the participant would suffer a retrospective SDLT charge on its acquisition of units which would in all likelihood be entirely unexpected.

(c) Disposals of assets by the RIF during the Limbo Period would have been disregarded by participants but would subsequently have to be taken into account as disposals for chargeable gains purposes.

(d) Disposals of units in the RIF by participants during the Limbo Period would also have to retrospectively be brought into charge as disposals of the underlying assets of the RIF for chargeable gains purposes rather than as disposals of units in the RIF itself.

2.11 **Solution:** Compliance conditions should be triggered by the Manager's awareness and not the breach itself. The cure periods should be extended significantly from the current 30-days which, even if triggered by awareness, would make it challenging to cure even the most straightforward breach (e.g. curing a breach requiring action by investors during a 30-day period would be next to impossible). We consider that, as a minimum, the cure period should be not less than the 9 months envisaged for breaches of the UK Property Rich condition.

2.12 In the event that the RIF is seeking to rely on a cure period, the RIF should not exit the RIF regime from the date that the qualifying condition is breached but from the date on which it becomes clear that the breach will not be rectified during the cure period.

3 Chargeable gains treatment of UCS

A RIF that becomes a UCS, or a fund that is established as a UCS from its inception, needs to have a clear chargeable gains tax treatment. We understand that the intention is that a UCS should be treated as a partnership for chargeables gains purposes with the intention that the treatment in statement of practice D12 should apply. However, the current drafting of proposed section 103D of the Taxation of Chargeable Gains Act 1992 is not clear and appears to create a new deemed asset. An approach similar to section 59A or paragraph 8 of schedule 5AAA of that Act should be taken to ensure there are no unintended consequences.

4 Comparison with existing fund vehicles

4.1 We believe that the RIF could be a successful fund vehicle that is used in a number of different contexts. However, in order to achieve its full potential, the RIF must at least be no worse than the equivalent structures that exist today (most of which are non-UK).

4.2 Where the RIF is not at least on par with its competitors it would at best be used in niche situations.

4.3 Each of the three individual "restriction conditions" in RIF Reg 24 will influence how the funds that rely on those specific conditions will be targeted and operated. The result of this is that each will likely be compared to, and judged against, different competitor fund vehicles.

4.4 By way of example, the most likely comparator vehicle in respect of:

(a) an "Exempt Investor" RIF is the Exempt Unauthorised Unit Trust ("EUUT"); and

(b) a "UK Property Rich" RIF would be a collective investment vehicle within the NRCGT exemption election regime (Schedule 5AAA TCGA), which would often be structured as a JPUT or a Luxembourg FCP.

4.5 The current draft of the RIF Regulations applies a "one size fits all" approach regardless of which "restriction condition" an individual RIF is relying on. Given that the appropriate comparator vehicle for a RIF will likely differ depending on which "restriction condition" the relevant RIF relies on, there is an argument that each "restriction condition" should be judged on its merits and, for example, have a breach and cure regime that is appropriate to that "restriction condition". This should enable RIFs that rely on each "restriction condition" to be at least as good as the relevant comparator.

4.6 See below some of the ways in which the RIF would currently seem to be less attractive than its direct comparator(s):

(a) SDLT

Essentially all fund vehicles that hold UK property are treated as companies such that they are opaque for SDLT purposes.

The risk of a change to the SDLT treatment of the RIF, even if unlikely, would make the RIF significantly less attractive as a fund vehicle if there is any intention or likelihood that the fund will acquire property in England or Northern Ireland.

This would impact both the UK Property Rich RIF and the Exempt Investor RIF but is not an issue for competitor vehicles (e.g. JPUT, FCP, CCF and EUUT).

Solution: As indicated in paragraph 1.6 above, we consider that all UCS and RIF should be treated as companies at all times for SDLT purposes.

(b) Breach regime

The RIF is required to notify HMRC of any breach of the qualifying conditions. This is not the case under the Exemption Election regime.

Notification is only required under the QAHC regime after becoming aware of the breach. Under the EUUT regime, the trustees have 28 days from becoming aware of a non-eligible investor to require that non-eligible investor to dispose of its units.

The proposed 30-day cure period for the RIF is significantly shorter than the equivalent under the Exemption Election regime (9 months) and the QAHC regime (90 days from becoming aware).

Solution: The trigger for breaches of qualifying conditions and the requirement to notify HMRC should be the Manager becoming aware of the relevant event. Cure periods should be extended to be not less than 9 months.

(c) Operational simplicity

A RIF is required to notify HMRC in a number of situations (e.g. RIF Reg 38) where other comparable funds (e.g. under the Exemption Election regime) would not be required to do so.

Whilst a fund is required to provide information to HMRC annually under the Exemption Election regime, the requirements are provided in guidance and are currently only applicable to the extent that the fund has the relevant information. The RIF Regulations include similar information requirements (see RIF Reg 46) but they are set out in the legislation rather than guidance. If a RIF were not able to provide the required information (e.g. if investors choose not to incur the cost of providing it), the RIF would be subject to penalties whereas under the Exemption Election regime one would not expect that to be the case. Whilst the financial burden of the associated "penalty" may not be significant in the context of many RIFs, reputationally speaking one would not expect a Manager to readily put itself in a position where there is a material risk of incurring a penalty.

Solution: Information requirements relating to the RIF should be set out in the guidance instead of legislation.

FCA

We understand, and are delighted, that the FCA envisage no FCA-regulatory changes (including to the FCA Handbook) on account of the RIF, given that the RIF is an FCA unauthorised structure.

Timing: UK managers entitled to launch RIFs

We believe that UK managers will be entitled to launch RIFs as soon as the Finance (No. 2) Bill, including clause 20, receives Royal Assent; and the RIF Regulations have taken effect.

We very much welcome the support of HMT and HMRC in facilitating the timing that as soon as practicable, and before the commencement of the UK Parliament 2024 Summer Recess, UK managers will be entitled to launch 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), Head of Policy, AREF. In addition, members of our Public Policy Committee and Tax Committee are always willing to assist the government by sharing their wealth of knowledge and expertise in respect of real estate funds.

Yours sincerely

Paul Richards

CEO, The Association of Real Estate Funds