Land and Buildings Transaction Tax – Property Investment Funds

Scottish Government
Riaghaltas na h-Alba

Respondent Information Form

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Full name or organisation's name

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☒ Yes

☐ No

Questionnaire

Question 1
In your view, do the clauses as drafted work as intended to prevent an LBTT liability arising on the transfer of units within the CoACS?

☐ Yes

☒ No

Please give reasons for your answer.

The proposed drafting gives rise to some ambiguity. The suggested new paragraph 9 of Schedule 1 of the Land and Buildings Transaction Tax (Scotland) Act 2013 ("The Act"), like section 45, treats units in a tax transparent entity as shares in a company for LBTT purposes. This means the transfer of those units is not within the scope of LBTT (as the transfer of shares in a company is not a land transaction). It would therefore appear odd to read the new paragraph 9(1) as treating it as a land transaction, but one that is exempt, so we consider the drafting must be referring to the underlying transfers of the interests in the Scottish properties that is being referred to here, but it is not entirely clear.

We also have a concern that where units are issued for cash in a property CoACS containing Scottish property, then the person receiving the newly issued units becomes the owner of proportionate interests in each of the Scottish properties held by the CoACS. It may be that the deemed corporate treatment in 9(2) is broad enough to protect the incoming investor from LBTT, but this is not clear, given the limited statutory exemption given in 9(1).

We are also concerned that the result of the transactions being exempt, as opposed to being outside the scope of the tax, is that there may be a tax compliance requirement which is impractical in the case of multi-investor funds.

Our preference would be for the drafting to be included as new section 45A, in a similar manner as for SDLT, to avoid the risk a court considers paragraph 9 should be interpreted differently than section 45.

We consider the Scottish Ministers retain the power to insert a new section 45A via their powers in section 67(1) of the Act. The insertion of a rule to characterise the LBTT treatment of CoACSs (and RIFs) is an "incidental, supplementary [or] consequential" provision which is "for the purposes of […] any provision made under this Act", being (a) determining what a chargeable interest is for the purposes of section 4, and (b) determining who the buyer is for the purposes of section 28 (as well as clarifying that section 48 does not apply).

Question 2

The draft clauses rely on various definitions set out in FSMA 2000. Are these definitions suitable for transactions in land and property situated in Scotland?

☒ Yes

☐ No

Please give reasons for your answer.

Yes. The FSMA 2000 definitions are regulatory definitions which govern funds across the UK, including funds operating partly or wholly in Scotland. None of the FSMA 2000 definitions are based on assumptions about English & Welsh common law or English & Welsh land law that need to be updated for land in Scotland.

Question 3

In certain circumstances, the draft legislation seeks to treat the scheme operator as the buyer for purposes of the wider LBTT framework. Do these clauses work as intended?

☒ Yes

☐ No

Please give reasons for your answer.

Question 4

Should the Scottish Government consider amendments to the draft clauses to reflect any potential differences between Scots Law and property law elsewhere in the UK?

☐ Yes

☒ No

Please give reasons for your answer.

No. Such changes are required as the relevant definitions are based on a UK-wide regulatory statutory framework.

Question 5

Do you have any other comments, or proposed amendments, in respect of the legislation as drafted?

Please give reasons for your answer.

As set out in our response to Question 1, we believe that the proposed paragraph 9(1) should be removed and the remaining sections within paragraph 9 moved to a new section 45A.

Question 6
Should the transfer of units within RIFs be exempt from LBTT? Please set out further commentary on the basis of your views.

☐ Yes

☒ No

Please give reasons for your answer.

We have answered 'No' to this question because, as we have explained in our response to Question 1, the transfer of units in RIFs should be considered to be outside the scope of LBTT, and not 'exempt' from LBTT, in the same manner as the transfer of units in a unit trust scheme, units in a CoACS, and shares in a company.

If the transfer of units in RIFs were not exempt or outside the scope of LBTT, transfers of those units would give rise to LBTT charges, disincentivising the use of RIFs to acquire Scottish property and thereby reducing investment in Scotland.

Paragraph 2 of Part 2 of the Consultation states "A Reserved Investor Fund (RIF), is a newly established contractual investment vehicle designed to offer a flexible alternative to existing authorised contractual schemes, for use exclusively by professional and institutional investors". To clarify, eligible investors in the RIF are the same as the CoACS and include both (i) the highest category of retail investors from a UK regulatory perspective; and (ii) a minimum commitment of £1million.

The introduction of the RIF opens up a welcomed new potential source of funding in Scotland and other parts of the UK.

The RIF can invest within restriction conditions which include UK real estate, and current market interest has included a focus on social and affordable housing as well as town centre regeneration projects. It aims to attract substantial capital by offering a streamlined and tax-efficient structure for institutional and other investors. The RIF is expected to enhance the UK's appeal as a global investment destination by providing greater flexibility, lower costs, and more dynamic responses to market changes.

RIF pipeline projects include large scale, mixed-use residential led regeneration which are particularly well matched to investor requirements. These projects involve affordable housing, mid-market housing, private for sale, PRS BtR, PBSA and Co-living spaces. They also deliver other societal benefits in line with national planning policy such as 20-minute neighbourhoods. The exemption from LBTT will mean that Scotland will compete on a level playing field with other parts of the UK. This change increases the likelihood of key development and infrastructure being delivered successfully.

If there is not alignment with the UK Treasury's position on RIFs, Scotland risks missing out on substantial inward investment opportunities, especially in housing and inner-city developments.

Question 7
If yes, should the LBTT treatment replicate the SDLT treatment of treating the RIF a company and units as shares? Please set out further commentary on the basis of your views.

☒ Yes

☐ No

Please give reasons for your answer.

Yes, the SDLT approach of treating the RIF as a company and its units as shares should be replicated. That approach follows the approach already taken in Scotland in relation to unit trust schemes (which is the private fund vehicle most closely similar to RIFs). This would give consistency of treatment with England and Northern Ireland and, we hope, in due course with Wales (we are aware that the Welsh Government is considering introducing this treatment). For funds looking to invest in properties across the UK, aligned treatment under the different land transaction taxes will be much easier to administer and reduce the risk of accidental non-compliance.

Further, fund managers are already familiar with the approach of treating certain non-corporate vehicles as companies for UK property transfer taxes purposes (as unit trust scheme are treated as such under the SDLT, LBTT and LTT rules, and authorised contractual schemes have that treatment for SDLT and LTT purposes), such that adopting this approach for RIFs for LBTT (as well as SDLT purposes) should be readily understandable for them.

Question 8
Are there any aspects of the existing SDLT framework which would need to be amended if equivalent LBTT arrangements were introduced?

☐ Yes

☒ No

Please give reasons for your answer.

The SDLT treatment and the LBTT treatment are technically independent. We note below in our response to Question 13 one possible amendment to SDLT seeding relief that is not required but would be welcomed if LBTT seeding relief were introduced.

We strongly support parity between the existing SDLT framework and equivalent LBTT arrangements, so the goal of parity throughout the UK is then achieved: Wales is a current (and we hope temporary) exception to this goal. Our one possible amendment to SDLT seeding relief (referred to in our response to Question 13) works within the UK parity principle.

Question 9
Are there any alternative approaches that the Scottish Government should consider?
☒ Yes

☐ No

Please give reasons for your answer.

As outlined above in our responses to Questions 1 and 6, transfer of units in a RIF should be outside the scope of LBTT rather than exempt.

Question 10
What would the impact be on investment in Scottish property if equivalent LBTT arrangements were not introduced?

Please give reasons for your answer.

If RIFs were not treated as "opaque" for LBTT purposes, it becomes practically unworkable for RIFs to invest in Scottish property. This would have two main impacts.

First, it would reduce the attractiveness of Scotland as a destination for new funds, or converted funds, which are seeking to deploy institutional capital into developing and regenerating housing in the UK, because every time a new investor joined the RIF or units changed hands an LBTT charge would arise.

If Scotland does not match LBTT policies found elsewhere in the UK, investor capital will shift to regions with more attractive stamp duty regimes. For instance, after the Housing (Scotland) Bill raised the prospect of a 0% rent cap increase in the PRS BtR sector, institutional investors redirected funds to English cities, disadvantaging Glasgow and Edinburgh. To support economic growth and key objectives, like becoming a "net zero nation," Scotland must offer competitive conditions for attracting and retaining investment.

Second, it would reduce the attractiveness of RIFs, and the UK's onshore funds industry. One of the Government's key objectives with the RIF is to enhance the attractiveness of the UK as a domicile for funds. Currently the Jersey Property Unit Trust (JPUT) and the Guernsey Property Unit Trust (GPUT), which are already afforded LBTT opacity though section 45 of the Act, are the main offshore competitors to a RIF. If a fund were formed which sought to invest in Scottish assets, it would not be able to use a RIF and would be forced into using an offshore vehicle to ensure its investors did not suffer dry LBTT charges on changes to investors.

For fund managers that plan RIFs which will hold land and buildings in Scotland, the LBTT reliefs - seeding and on the issue/transfer/redemption of units – are necessary i.e. "a must have" not "a nice-to-have". If the LBTT reliefs were not to be available, fund managers will launch RIFs to hold land and buildings in England and (possibly) Northern Ireland but will avoid holding land and buildings in Scotland: replicating the unfortunate experience with CoACSs. Scotland will be off the RIF radar. There then would be a Scottish legislative self-imposed barrier against institutional and other RIF eligible capital investing in the Scottish property market; and a negative signal to entrepreneurs and other professionals (including SMEs) involved with the Scottish asset management sector.

We strongly advocate that LBTT arrangements should be introduced in order to facilitate unleashing much needed institutional and other RIF eligible capital investment in the Scottish property market. These arrangements should also incentivise entrepreneurs and other professionals (including SMEs) involved with the Scottish asset management sector to the contribute to the growth of the Scottish economy including with regeneration, social and affordable housing and other crucial social infrastructure projects.

Question 11
Should seeding relief be introduced under LBTT? Please set out further commentary on the basis of your response.

☒ Yes

☐ No

Please give reasons for your answer.

Yes. Seeding relief should be introduced under LBTT. Seeding relief is a vital relief to ensure that assets can be pooled without a duplicate LBTT charge, on the entire Scottish portfolio. Without seeding relief Scottish properties will be at risk of being left behind in all-of-UK fund structures, reducing the benefit to Scotland of capital investment attracted by the new funds.

Seeding relief is similar in principle to group relief and the LBTT partnership rules, which provide full or partial relief for investors putting property into investment vehicles, though the rules have different restrictions – group relief requires no more than 25% of the shareholding is sold off in the 3 years following the transfer, and the LBTT partnership rules give partial relief equal to the share the partner retains though the partnership.

Without LBTT seeding relief, there then would be a Scottish legislative self-imposed barrier against institutional and other RIF eligible capital investing in the Scottish property market, as well as a negative signal to entrepreneurs and other professionals (including SMEs) involved with the Scottish asset management sector.

We strongly advocate that LBTT seeding relief must be introduced in order to facilitate:

- unleashing much needed institutional and other RIF eligible capital investment in the Scottish property market; and
- incentivising entrepreneurs and other professionals (including SMEs) involved with the Scottish asset management sector to the contribute to the growth of the Scottish economy including with regeneration, social and affordable housing and other crucial social infrastructure projects.

Question 12
If yes, should the relief replicate that in place under SDLT?

☒ Yes

☐ No

Please give reasons for your answer.

Yes, as a pragmatic UK-wide solution (and, given the UK parity goal, any reform would ordinarily involve UK/Scottish/Welsh primary legislative reforms) the SDLT seeding relief rules should be maintained, with the following changes:

1. The "portfolio test" should be tested on a UK-wide basis, not just in respect of Scottish (or English and Northern Irish) properties. So, if £100m of seeded assets were contributed to a RIF, PAIF, or CoACS and benefited from SDLT, LBTT, or (were it introduced) LTT seeding relief, the portfolio test would be met.

2. The ability to seek statutory clearance under paragraph 14(5) of the Finance Act 2003 that the "genuine diversity of ownership" condition is met in relation to a RIF or a CoACs should remain with HMRC, given it has specialist investment funds expertise and must enforce whether this condition is met in relation to direct tax too, rather than moving to Revenue Scotland. Revenue Scotland should be bound by a clearance given by HMRC that this condition is met unless the conditions in paragraph 14(6) are not met.

Question 13
Are there any aspects of the SDLT framework which would need to be amended if equivalent LBTT arrangements were introduced?

Please give reasons for your answer.

No aspects of the SDLT framework would need to be amended. However, if Scotland (and hopefully soon Wales) introduce a portfolio test along the lines suggested in our response to Question 12 above (i.e. on a "whole of UK" basis), then it would be equitable for the SDLT seeding relief portfolio test to be amended on the same basis. Our prior discussions with HM Treasury and HMRC suggest that alignment between the three taxes where possible is a key policy goal, so we would hope they would be supportive of this change.

We would also welcome discussing, particularly in relation to the RIF, the £100m portfolio test threshold being lowered to encourage SME fund managers to use these funds.

Question 14
Are there any alternative approaches that the Scottish Government should consider?

Please give reasons for your answer.

We have no alternative approaches to suggest.

Question 15
What would the impact be on investment in Scottish property if equivalent LBTT arrangements were not introduced?

Please give reasons for your answer.

Without seeding relief being introduced, it would not be possible for LGPSs and other investors, such as insurance companies, owning Scottish property to pool assets using a RIF or CoACS. This would reduce the potential for new investment in Scottish property. It would also remain an inhibiting factor for other investors wishing to establish them.

Question 16
Should the Scottish Government consider bespoke seeding arrangements for any of the investment vehicles discussed in this consultation?

☒ Yes

☐ No

Please give reasons for your answer.

The Scottish Government should consider introducing a new LBTT seeding period, commencing with the date of implementation of seeding relief, for funds which have had SDLT seeding periods which have already closed (or about to close) to allow Scottish property the opportunity to “catch up”.

Question 17
If seeding relief is introduced in Scotland, should a different approach be taken to withdrawal of relief?

☐ Yes

☒ No

Please give reasons for your answer.

No, except in respect of the portfolio test (outlined above in our responses to Questions 12 and 13).

Question 18
Are amendments required to the draft legislation to ensure the exemption does not go beyond its' intended scope – i.e. solely exempting the exchange of units within the scheme?

☐ Yes

☒ No

Please give reasons for your answer.

No amendments are needed. The approach works well under SDLT and there have been no identified avoidance opportunities in relation to using CoACSs under the SDLT regime. Setting up a new fund is a time-consuming and cost-intensive piece of work, and in the case of a RIF requiring marketing to number of external investors. Any fund that meets the definition of a CoACS which qualifies for seeding relief or a RIF cannot be limited to a number of investors under common control given the need to satisfy the genuine diversity of ownership or non-close test (RIF).

It should be noted that the offshore unit trust scheme (e.g. a Jersey Property Unit Trust (JPUT) or Guernsey Property Unit Trust (GPUT)) already benefit from LBTT opacity under section 45 of the Act and are considerably more flexible vehicles than the CoACS or the RIF. No restrictions have been made to section 45 other than, as proposed here, removing them from the scope of group and reconstruction reliefs. It would be anomalous if the LBTT legislation treated an onshore vehicle more harshly than the equivalent offshore vehicle.

Question 19
If equivalent RIF arrangements are introduced under LBTT, is it appropriate to mirror the current SDLT safeguards?

☒ Yes

☐ No

Please give reasons for your answer.

Yes, the RIF safeguards have been the subject of extensive dialogue between HM Treasury and industry bodies: Revenue Scotland can benefit from this extensive dialogue. Further, the Scottish revenue is already protected by the Scottish General Anti-Avoidance Rule.

Question 20
Should any specific or bespoke provisions be considered for the RIF framework under LBTT?

☒ Yes

☐ No

Please give reasons for your answer.

To fix what we consider an omission in regulation 29 of the RIF (Tax) Regulations, the Scottish Government may wish to consider any equivalent of that regulation provided that an eligible co-ownership scheme will not be treated as a company for the purposes of group relief and reconstruction relief.

Question 21
In order to prevent artificial enveloping of properties, should the Scottish Government consider providing for seeding relief in respect of non-residential property only?

☐ Yes

☒ No

Please give reasons for your answer.

We strongly suggest not. Seeding relief in respect of residential property is key to unlocking the unique types of investment RIFs may bring in the market. We note that the consultation document, at paragraph 10 of part 4, says that the Scottish Government is "mindful of potential impacts and effects on the residential property market, for example for first time buyers, if large numbers of properties were purchased by large institutional investors for rental purposes". We do not consider seeding relief will negatively affect the residential property market. Seeding relief requires that an existing investor contributes property to the PAIF, RIF, or CoACS in return for units (or shares) in the fund vehicle. In other words, the investor must already own the property as an investment asset before it is seeded into the RIF. There will be no reduction in the number of homes available for purchase in Scotland as a result of allowing seeding relief for LBTT: rather, the effect will likely be the improvement of existing housing stock as more capital is unlocked to invest in it.

Question 22
Are there any other avoidance risks the Scottish Government should consider in respect of seeding relief?

Please give reasons for your answer.

No. The Scottish Government says, at paragraph 8 of part 4, that seeding relief might encourage "enveloping" of residential property within a company structure, with shares traded to avoid paying SDLT. With respect, we think that is not possible, for the following reasons:

- As noted above in our response to Question 21, seeding relief only applies on the initial seeding of the portfolio. This is likely to be from cornerstone or institutional investors who hold the large number of assets (£100m+) needed to seed the fund. These assets will already be "enveloped" in their existing investor vehicles, so there will be no new enveloping opportunity afforded by seeding.

- Setting up a large fund, like a PAIF, RIF, or CoACS which qualifies for seeding relief (and so must have >£100m of assets) is not something that can be done without many months of detailed regulatory, funds, finance, and tax input from legal advisors. It is not as straightforward as establishing a company or partnership vehicle. It is therefore not likely to be within the ability of the average taxpayer seeking to avoid an LBTT liability.

- The existing anti-avoidance rules in SDLT withdraw SDLT seeding relief if the taxpayer disposes of units within 3 years of the end of the 18-month (or probably shorter) seeding period, or pursuant to arrangements put in place during that period. This effectively limits the possibility to envelop property and transfer the units in the RIF to 4½ years. LBTT group relief enables trading of shares in enveloped properties, by selling a company, within 3 years. So even if trading enveloped property were something that someone wanted to do, the corporate route existing under existing LBTT rules would be more attractive than attempting to use seeding relief to do so.

- A RIF must meet the "genuine diversity of ownership" or the "non-close" conditions, making it inappropriate for indirectly trading ownership of a property without paying LBTT, as once the RIF becomes close (e.g. owned by 5 or fewer people) it ceases to be a RIF and a deemed LBTT charge arises (assuming the safeguards in question 19 above are adopted). As a result, there would be no ability to effectively sell enveloped properties through a RIF.

- The Scottish GAAR would be likely to be an effective backstop to any attempted planning around the rules mentioned above.

- a RIF is governed by a contract between investors, the manager (which must be a regulated alternative investment fund manager), and the depositary. The RIF operates as an Alternative Investment Fund (AIF) for FCA regulatory purposes. In view of the FCA regulations that apply to regulated alternative investment fund managers and the depositaries, we would expect that these entities will manage RIFs in full compliance with their obligations under relevant tax and other legislation.