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Dear Sir/ Madam

A consultation on land and buildings transaction tax rules for property authorised investment funds

The Association of Real Estate Funds[1] welcomes the opportunity to respond to the consultation on the land and buildings transaction tax rules for property authorised investment funds.

AREF wrote to the Scottish Government on 1 May 2015 to express concern that there is no relief from land and buildings transaction tax (LBTT) when an existing authorised unit trust (AUT) invested in property converts to a property authorised investment fund (PAIF). This is despite there being an equivalent relief from stamp duty land tax (SDLT) for property situated in the rest of the UK. We are grateful that the Scottish Government has acted swiftly to consider introducing such a relief.

The lack of relief has been holding back the development of authorised funds invested in Scottish property since LBTT was introduced in April. AREF hopes to see a relief introduced shortly.

You can find answers to the particular consultation questions in the Appendix.

I look forward to hearing the outcome of this consultation. In the meantime, if you require any further information, please feel free to contact me.

Yours sincerely

John Cartwright
Chief Executive
The Association of Real Estate Funds

[1] The Association of Real Estate Funds (AREF) represents the UK unlisted real estate funds industry and has about 70 member funds with a collective net asset value of over £50 billion under management on behalf of their investors.

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Appendix

A Consultation on Land and Buildings Transaction Tax Rules for Property Authorised Investment Funds

Question 1: What are the risks and impacts for the fund management and investment sector in Scotland arising from the absence of an LBTT exemption?

A lack of relief from LBTT on conversion of an AUT invested in property to an open-ended investment company (OEIC) or on amalgamation with an existing OEIC is a problem for both property funds based in Scotland and funds with Scottish property.

PAIFs are a more attractive option for many investors wishing to invest in UK property. This is particularly true for non-taxpayers, including charities, pension funds and ISAs. They achieve the same tax result by investing in a PAIF as they would by investing directly in property.

This is achieved by means of an exemption from tax on rental income and gains within the PAIF whilst distributions from the PAIF retain the character of the underlying income. This means that investors are treated as receiving property income in relation to the proportion of property income derived from the underlying assets.

In contrast, the rental income of an authorised fund which is not a PAIF is taxed within the fund itself and this tax cost cannot be recovered by pension funds, charities or ISAs.

Conversion or amalgamation entails property and other assets being transferred from one legal entity to a PAIF, the legal form of which is a UK OEIC. LBTT would be charged on Scottish land and buildings even though there is no effective change in ownership. As you are aware, there is a relief from SDLT in relation to property situated elsewhere in the UK which was introduced to facilitate these conversions.

The PAIF regime was launched in the UK in 2008. To date, as far as we know, eight PAIFs have launched, all before 1 April 2015 when LBTT replaced SDLT in Scotland. A number of AREF's members have been working to convert existing funds to PAIFs. However, these conversions have stalled since the introduction of LBTT.

This lack of an equivalent LBTT relief is preventing existing funds from taking advantage of the PAIF regime. This is to the detriment of investors, particularly non-taxable investors such as pension funds, charities and ISAs.

Funds have an important role as vehicles for long term saving and for providing for retirement. It is important to ensure that funds invested in property are able to convert to or amalgamate with PAIFs to be able to fulfil this role.

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Question 2: What are the risks and impacts for the property sector in Scotland arising from the absence of an LBTT exemption?

A lack of relief from LBTT may have a negative impact on the Scottish property market. The capital raised by funds represents a key source of investment capital to finance economic activity. Without an appropriately structured regime for, and reliefs from, LBTT, Scottish property may become less attractive compared with property in the rest of the UK.

A number of AREF's members have been working to convert existing funds to PAIFs. However, these conversions have stalled since the introduction of LBTT in April. The conversions may ultimately go ahead, but without any LBTT relief the funds may need to remove their Scottish property exposure. Investors would not accept an LBTT cost on conversion.

Question 3: Do you think that the Scottish Government should introduce an exemption from LBTT for properties held by AUTs converting or amalgamating with an OEIC?

Yes, AREF considers that the Scottish Government should introduce an exemption from LBTT for properties held by AUTs converting or amalgamating with an OEIC. AREF's reasons are set out in the answers to questions 1 and 2.

Question 4: Do you think that an exemption as drafted in Annex A could create opportunities for tax avoidance? If so, how?

No, AREF does not consider that an exemption as drafted in Annex A could create opportunities for tax avoidance.

The proposed relief has been drafted to apply only in well-defined circumstances.

Additionally, it should be noted that PAIFs are OEICs in legal form and as such are authorised and regulated by the Financial Conduct Authority. This FCA oversight minimises the likelihood of such vehicles being used for tax avoidance.

In reality, the fund manager of a priced authorised fund is more likely to be concerned about claiming a relief for which the fund is not eligible as this would have significant reputational and practical downsides. The fund manager would not want pricing issues and, in particular, would want to guard against current investors suffering the cost of an unexpected tax liability which should have been borne by the investors at the time the relief was claimed.

Together these factors mean that the likelihood of abuse is extremely low.

Question 5: Are there any additional comments you would like to make in relation to the draft regulations in Annex A?

No