

3 February 2016

By email: catherine.dampier@hmrc.gsi.gov.uk

Dear Catherine

Stamp duty land tax: property investment funds

The Association of Real Estate Funds (AREF) welcomes the opportunity to comment on the policy paper and draft legislation on SDLT for property funds.

We welcome the proposed introduction of seeding relief for both property authorised investment funds (PAIFs) and co-ownership authorised contractual schemes (CoACSs). We consider that the lack of such a relief has been a significant barrier to the use of both PAIFs and CoACSs as vehicles for property investment. In addition, an SDLT charge arising whenever units in a CoACS are acquired, disposed of or redeemed is almost impossible to administer, which has made CoACSs an impractical choice of vehicle for property investment. The proposed SDLT rules for CoACSs, whereby CoACSs will not be transparent, will mean that CoACSs become a viable option.

One aspect of the proposals which is particularly helpful is allowing transactions to be eligible for relief during a defined seeding period. It is virtually impossible to seed an entire large property portfolio on a single occasion.

However, there remain some areas where we feel improvements could be made in order to maximise the effectiveness of PAIFs and CoACSs for property investment, without introducing a risk that they might be used to avoid SDLT. Such modifications would further encourage the growth of the UK property fund industry and the move of offshore property funds to the UK. As such they would further assist the government meet the aims of the Investment Management Strategy launched in 2013. These include:

- allowing relief on a transfer of a partnership interest
- simplifying the interaction between the seeding period and the control period
- amending the portfolio tests for both non-residential and residential property
- amending the provisions to accommodate life companies.

As drafted, it will be difficult for unit-linked funds to be able to take advantage of the PAIF and CoACS regimes as any seeding relief claimed could be withdrawn. There should be minimal risk of avoidance if the provisions were amended to accommodate unit-linked funds. A number of AREF's members are submitting comments on the implications of the proposals for the insurance industry and we support those comments.

These points are considered in more detail in the appendix.

The Association of Real Estate Funds (AREF) represents the UK real estate funds industry. It has about 65 members with a collective net asset value of around £60 billion under management on behalf of investors. This includes around £20 billion in UK authorised retail funds and similar amounts in various forms of UK unregulated collective investment vehicles (CIVs) and in offshore domiciled funds. Member funds represent about two-thirds of UK commercial real estate held in CIVs.



We would welcome the opportunity to discuss the impact of the proposals on property funds in more detail. I am available at your convenience to discuss anything in this letter.

Yours faithfully

A handwritten signature in black ink, appearing to read "John Cartwright", with a long horizontal stroke extending to the right.

John Cartwright
Chief Executive
The Association of Real Estate Funds

APPENDIX

Partnership interests

It would be helpful for seeding relief to be available on a transfer of a partnership interest. A transfer of an interest in a property investment partnership is treated as a land transaction (FA 2003 Sch 15 para 14). As such, there seems no reason for partnership interests not to be eligible.

Interaction between seeding period and control period

Seeding relief is available for land transactions taking place during a period of up to 18 months. A withdrawal of relief may be triggered by certain events during the 3 year control period which immediately follows the seeding period. The interaction between the seeding period and the control period seems unnecessarily complex. Potentially relief can be withdrawn at any time up to 4 ½ years following the first property seeding date. However, as drafted, the provisions enable this period to be shortened by issuing a single unit to an external investor and so bringing the seeding period to an end before the expiry of 18 months. It would seem simpler and more appropriate for the control period to commence on the day following the earlier of:

- The final transaction within the 18 month period eligible for seeding relief, and
- The first external investment into the PAIF or CoACS.

This would prevent the use of a single unit strategy whilst ensuring that the seeding period closes at the appropriate point. An alternative would be to allow PAIFs and CoACSs to elect to end the seeding period. This would give both the PAIF/ CoACS and HMRC certainty.

We note, however, that for CoACSs, unlike for PAIFs, the genuine diversity of ownership condition does not need to be met at the time property is seeded. It only needs to be met immediately before the end of the seeding period. If the interaction between the seeding period and the control period is simplified, as suggested, for CoACSs as well as for PAIFs, it would be worth considering whether the scope of the genuine diversity of ownership condition could be improved accordingly.

Non-residential portfolio tests

The non-residential portfolio tests require at least 10 chargeable interests in respect of which seeding relief is allowed. Meeting this test could be problematic. For example, a freehold interest in a shopping centre would be one chargeable interest despite the fact that it would be subdivided into numerous separate shops etc.

Language similar to that used in the REIT rules would seem preferable. To be a REIT, the property rental business must involve at least 3 properties and, for these purposes, a property is “a single property if it is designed, fitted or equipped for the purpose of being rented, and it is rented or available for rent, as a commercial or residential unit (separate from any other commercial or residential unit)” (CTA 2010 s529).

Alternatively, criteria as to number of interests (para 6(8)(a) and para 16(8)(a)) could be removed, and the non-residential portfolio test based purely on value.



Residential portfolio tests

For residential property it is proposed that seeding relief only be available if at least 100 properties are transferred and the value of those properties is at least £100m. In other words, relief would only be available for residential property with an average value of £1m. This seems far too high considering that data from the Land Registry for December 2015 shows the average property value in England and Wales to be £188,270¹. We suggest that the value is removed and the threshold be based on the number of properties only.

The residential portfolio test requires that at least 100 of the seeded interests are interests in or over residential property. For example, the freehold interest in a block of flats is a single chargeable interest despite comprising numerous separate dwellings. This would mean that an investor in residential flats would need a portfolio of 100 blocks of flats (each with a separate freehold interest) to be eligible for relief, which would clearly be too stringent. Equally, the test could be met through creation of subordinate interests in the same property which would defeat its intention. It would be preferable for this threshold to instead be based on the number dwellings (which is a term already in use for the purposes of relief for certain acquisitions of residential property (FA 2003 Sch 6A) and for multiple dwellings relief (FA 2003 Sch 6B).

If the test is re-drafted to depend on the number of dwellings, then 100 would seem appropriate. Otherwise the number needs to be much lower, such as 10 as for commercial properties.

Withdrawal of relief on disposal of units

The calculation to determine the SDLT charge when relief is withdrawn on a disposal of units is based on numbers of units. There may be different classes of units and/ or both income and accumulation units, and some may have a greater interest in the underlying property than others on a unit by unit basis. This means that the calculation will not necessarily give an appropriate SDLT charge.

Unit-linked funds

Investors in unit-linked funds buy policies which are linked to a pool of assets owned by a life company and the investors are entitled to the return on those assets. The current proposals would not be viable for unit-linked funds as any seeding relief claimed would be withdrawn. Allowing seeding relief in this circumstance would increase diversification of investment by being able to attract more investors.

Following seeding, the SDLT position would be the same as it is currently. Policies can usually be redeemed at short notice so the life company needs to maintain sufficient balances of cash or other liquid assets. The life company has limited ability to defer redemptions eg, if property needs to be sold to meet redemptions or subsequently be able to maintain appropriate levels of liquidity. Where cash or other liquid assets are used to meet redemptions there is no SDLT charge. If property needs to be sold, then the purchaser is liable to SDLT.

There seems little risk of avoidance for the following reasons:

- Setting up a new PAIF or CoACS involves significant cost so would only be undertaken if significant growth and external investment are expected.

¹ Land Registry: December 2015 Market Trend Data



- The policyholders are the ones who decide whether or not to redeem, with a possible need for sale of underlying property. The life company or PAIF/ CoACs is not able to control this.

Unit-linked funds need to be differentiated from with-profit funds. For with-profits funds the life company has greater control and more discretion in relation to the funding of redemptions. Whilst we consider that the risk of avoidance is low for with-profits funds too we agree that this is not as clear-cut as for unit-linked funds.