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Property Forum

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Dear Sir/Madam

## Tax treatment of asset holding companies in alternative fund structures

The Investment Property Forum (IPF) welcomes the opportunity to respond on the above second-stage consultation.

IPF is a national membership organisation of senior professionals, all active in the property investment and finance market. The organisation has a diverse membership of over 2,000, which includes fund managers, investment agents, accountants, bankers, lawyers, researchers, academics, actuaries and other related professionals.

The IPF's Mission is to enhance the understanding and efficiency of property as an investment, including public, private, debt, equity and derivatives, for its members and other interested parties, including government. The IPF's scope covers direct and indirect routes to investing in property. With regards to the latter, we have an Indirect Property Interest Group that covers issues relating to both the listed and unlisted property sector.

We are not a lobby organisation but one of our key priorities is to identify where legislation or regulation has, or will have, an impact on the market and to alert government and our members to any adverse or beneficial issues.

### General observations

In our response to the first-round consultation, we concentrated on the broad commercial aspects rather than the tax technical considerations of the consultation, particularly in respect of real estate as an asset class.

As outlined in our previous response, to be competitive with other jurisdictions, in particular Luxembourg, as an AHC regime, the UK would need to provide a tax regime that does not come with a significantly greater tax cost or complexity.

The complexity of UK tax rules is a disincentive to locating AHCs in the UK for two reasons:

- a) The cost of compliance is higher; and
- b) It creates less certainty as to tax treatment. This is a major issue for investment funds, as certainty over the value of assets and liabilities and the net distribution to investors is crucial.

Our representatives have participated in a large number of the online discussions with HMT and HMRC being run as part of this consultation process, which we have found constructive.

We are concerned that the proposals as envisaged will fall short of what is required for the UK to be competitive as the regime suggested would appear to be more complex than similar regimes elsewhere, in particular Luxembourg.

In our previous response, we also highlighted the increasing rationale for locating AHCs in the same location as the fund. The outcome of the review of the broader UK funds review will also have a direct impact on the desirability of the UK as a location for AHCs.

Our comments on those specific questions to which we feel able to respond are below. As with the previous consultation, we have not provided a technical analysis of UK law as other organisations are better positioned to do so.



*Question 1: Do you think an AHC regime should include arrangements where some or all investors invest directly at the level of the AHC, as discussed at paragraph 4.25? Can you provide evidence on how common these arrangements are?*

*Question 2: Are there situations where legal agreements involving investors who invest directly at the level of the AHC are significantly different from those where all investors invest through a CIS or AIF? For example, would different investors' interests be fungible under these arrangements or could there be differences in the way some investors participate in the results of investments?*

*Question 3: Would a broader approach to eligibility, accommodating arrangements of the type discussed in Question 1, create increased risks of abuse or avoidance? If so, how could these be mitigated?*

We believe that flexibility as to investors in the AHC is a key requirement of the regime. In respect of the key question of whether the regime should include arrangements where some or all investors invest directly at the level of the AHC, it is common for real estate funds to hold interests in joint ventures with other investors investing directly in the AHC. There are number of circumstances in which this might arise. For example, 100% of the AHC may not be available to buy or the investment may be too large for the fund to acquire in its entirety. In many cases fund documents will have co-investment rights for investors in the fund such that they can acquire interests in the AHC if an investment is too large for the fund to acquire. The arrangements between the fund and other direct investors in the AHC will be a commercial negotiation so rights will often differ.

Anti-avoidance measures should be targeted, proportionate and where possible use existing measures.

*Question 4: Is the concept of participation a suitable way to identify the investors in an AHC? Would this be consistent with the commercial reality of investment arrangements? Do you have any suggestions for an alternative approach, for example referring to the legal documents used to determine the rights of investors?*

*Question 5: How can regime rules accommodate structures where companies fulfilling the role of an AHC are not directly owned by the ultimate investors or by another AHC?*

In our view, the rules should be as flexible as possible to accommodate the widest range of structures. We note and agree with the suggestion that the provisions are based on existing rules such as the NRCGT rules. We note the desire to ensure that the exemption should not be available to companies at any level in a corporate group simply because the ultimate owner of that group is an investment fund. This would not appear to be a concern relating to real estate holding structures as envisaged in the proposed regime and we would suggest that any anti-avoidance provisions are targeted at the specific areas of concern.

*Question 6: What is the best method to identify the asset manager who provides investment management services to investors in relation to the investments held by an AHC? Do you foresee complications, for example in a structure with multiple layers of AHCs? How can regime rules address these situations?*

As our representative John Forbes has outlined in some of the online discussions referred to above, there is a concern over the terminology used. This is particularly the case for real estate where the manager responsible for management of the underlying portfolio, often described as the "asset manager" may be different from the "fund manager". Managing a fund in the UK and most other jurisdictions is a regulated activity whilst management of real estate is not. A further issue is that terminology in the United States is to use "asset management" to refer to what in Europe as "investment management".

If this route is followed, further work would be required in devising definitions.

We would question the need to restrict AHCs in this way, in which case the definitional issues become academic.



*Question 7: What tests would best ensure that investment decisions are taken by an asset manager who is subject to regulation and has genuine independence from the investors?*

As indicated above, for real estate as an asset class, investment management decisions may be delegated to an asset manager who is not subject to regulation.

We do not believe that there is a need for the manager to be independent of the investors. There are often cases where entities in the same corporate group as investment managers are also major investors in the funds, for example fund managers owned by life insurance companies. This may change over time. There have been a number of instances of institutional investors have set up funds which they have seeded with a portfolio of assets such that at the outset they may be the majority investor, with a view to reducing this over time as new investors enter the fund.

*Question 8: What would be an appropriate maximum proportion for asset managers' interests in an AHC, including interests held by individual fund executives? Can you provide details of relevant commercial arrangements?*

In our view, this can also be problematic. As indicated above, capital invested by the manager may vary over time, particularly if a fund is seeded.

The other situation that we have identified as potentially problematic are carried interest structures in which the proportion of "interests" in an AHC may increase significantly when the carried interest crystallises.

*Question 9: How should regime rules ensure that the activities of an AHC are limited to a facilitative, intermediate role between investors and investments?*

*Question 10: Can you provide evidence about any specific situations where, as part of an AHC's facilitative, intermediate role and for genuine commercial reasons, part of its activity might amount to a trade?*

As indicated in our response to Question 5, this would not appear to be a concern relating to real estate holding structures as envisaged in the proposed regime and we would suggest that any anti-avoidance provisions are targeted at the specific areas of concern. Real estate AHCs may well receive trading as well as investment income.

*Question 11: Should eligibility criteria include the requirements set out at paragraph 4.49?*

We do not believe that this would be helpful.

*Question 12: How could regime rules safeguard against assets and/or related income being ring-fenced for the benefit of a subset of investors?*

We do not understand the concern that this is seeking to address.

*Question 13: Could the proposed approach to eligibility include arrangements that you believe should not be included within an AHC regime?*

*Question 14: Could the proposed approach to eligibility exclude arrangements there is a good rationale to include within the regime? If so, how might relevant structures be defined? Are there structures designed to facilitate alternative finance arrangements that could be excluded?*

As indicated in our responses to specific questions above:

- The regime should be as accessible as possible and the eligibility criteria reflect this. It should allow for fund structures, joint ventures and club deals, as well as wholly-owned investments by institutional investors.



- Anti-avoidance rules should be targeted to prevent certain investors, including closely held structures with no institutional investment, from being able to access the regime.
- For simplicity, the tests applied under the non-resident capital gains tax or REIT regimes would be appropriate, with a focus on genuine diversity of ownership or institutional investment. Those tests are understood and currently being applied within the industry.

*Question 15: Can you provide evidence as to the methods and instruments an AHC might use to return income and capital sums to investors and the commercial, administrative and tax considerations that will inform this choice?*

*Question 16: What advantages or disadvantages could there be in allowing a broader range of deductions to calculate an AHC's profits? Do you consider that the better alternative would involve deductions for specific instruments? Or do you think the regime should take a broader approach based on the totality of amounts returned to investors?*

*Question 17: To what extent would the outcomes discussed in paragraph 4.65-4.68 be appropriate for AHCs, and to what extent do the rules contemplated as part of the regime make these outcomes more likely? If such outcomes are inappropriate, how can regime rules ensure that an AHC is subject to tax on a suitable measure of profit on taxable income?*

*Question 18: What is your view on the best method to ensure that an AHC cannot obtain relief for any payments to investors that would reduce its profit below an amount commensurate with its role?*

*Question 19: Can you provide information on how funds approach transfer pricing for any instruments where deductions are not currently available in the UK? Can you provide examples from existing companies fulfilling the role of an AHC to illustrate any areas of potential difficulty?*

We are not able to comment in detail on this section. We believe that other trade organisations are responding in more detail. However, the discussions in the calls with HMT and HMRC suggest that an approach that entails significant complexity is the expected outcome. As noted on the calls, investment managers will compare the regime with other jurisdictions, in particular Luxembourg. If the UK regime is more complicated and the outcome of tax treatment less predictable, businesses will not use it.

*Question 20: Will the proposed treatment of capital gains realised by an AHC provide an effective means of ensuring that AHCs do not pay tax on gains they reinvest or return to investors?*

*Question 21: Could the relationship between the relief proposed for gains and other potential reliefs available to an AHC create undue complexity or unintended consequences?*

*Question 22: How could rules on relief for gains be protected from abuse in a way that is simple and easy to administer? Would a requirement of the kind discussed under 'Eligibility', that AHCs have a policy or practice of reinvesting or returning capital to participants when investment assets are sold, help achieve this aim?*

We are not able to comment in detail on this section. We believe that other trade organisations are responding in more detail. However, the discussions in the calls with HMT and HMRC suggest that an approach that entails significant complexity is the expected outcome. As noted on the calls, investment managers will compare the regime with other jurisdictions, in particular Luxembourg. If the UK regime is more complicated and the outcome of tax treatment less predictable, businesses will not use it.

We would specifically note the treatment for real estate of a UK AHC owning non-UK real estate owning AHCs. It is important that the sale of such a non-UK AHC is not subject to UK tax on the gain. If it is, the regime will not be attractive. We have commented during the discussions that a holding AHC might own UK or non-UK property SPVs owning non-UK assets and directly held real estate or real estate that is regarded as directly held for UK tax purposes for example because it is held through partnerships.



*Question 23: To what extent could a WHT exemption for payments of interest by AHCs to investors create risks around the diversion of investment income to low tax territories?*

*Question 24: How could regime rules mitigate these risks? Do you think any WHT exemption for AHCs should include a purpose test and/or be limited to interest paid to recipients in qualifying territories?*

We believe that the WHT exemption for payments of interest is an attractive feature and would make the AHC competitive. Any anti-abuse measures should be targeted and based on existing provisions.

*Question 25: How can regime rules ensure that amounts of income returned to investors are treated appropriately for the purposes of UK tax?*

*Question 26: What is your view on the most appropriate method to treat amounts as capital gains in the hands of investors?*

*Question 27: How should regime rules ensure that amounts designated as gains cannot displace amounts that should be treated as income in the hands of investors?*

*Question 28: How can an investor's interest in the AHC be appropriately valued in order to determine their proportionate share of any gains? What instruments might investors hold, with what rights attached, and how might these holdings change over time?*

*Question 29: Are there other areas of the tax code that could counteract the intended effect of rules to treat amounts as gains in the hands of investors or produce unintended consequences?*

*Question 30: How could rules to treat amounts as gains in the hands of investors be protected from abuse? Is there a streamlined test the regime could use to safeguard against conversion of income to capital?*

*Question 31: Should the regime allow certain types of profit on loan relationships of an AHC, such as profit on redemption or disposal of 'distressed' debt, to be treated as capital? Is there an appropriate method that could be used for this purpose?*

We are not able to comment on this section. We believe that other trade organisations are responding to these questions.

*Question 32: Can you provide evidence on the number and type of situations where a fund might wish to use UK SPVs to own and receive overseas property income directly?*

Traditionally, property owning SPVs have been located in the same jurisdiction as the underlying property. Tax changes have made this less attractive and, for some jurisdictions, assets may be held in an overseas SPV. This will typically be in the same location as the fund and master AHC, often Luxembourg. On some of the calls, Germany and the Netherlands were cited as jurisdictions where investments are often held in an SPV outside the country. As we mentioned on the calls, the number of jurisdictions where this is the preferred ownership structure is likely to grow. The extent of this shift is impossible to predict, but we think it would be a significant underestimation of the long-term potential to base this decision purely on current examples.

*Question 33: Given the availability of relief in the UK for foreign tax paid, to what extent would the lack of an exemption for overseas property income act as a barrier to the use of UK AHCs to hold overseas property? Can you provide any examples of specific situations affected by this issue? To what extent would this affect the choice to locate master and intermediate holding companies in multi-jurisdictional real estate funds in the UK?*



Using a credit method rather than an exemption method for overseas property income will add to the complexity of the arrangements acting as a deterrent to the use of UK AHCs, without, probably, generating any additional UK tax revenues.

Many double tax treaties provide for the exemption method for the taxation of income from immoveable property, thus ensuring that it is only taxed in the jurisdiction where the property is located. This would appear to be a suitable model.

*Question 34: To protect against the risk of loss of tax on UK property income and gains, do you think it would be appropriate for regime rules to specify that an AHC should not own UK land or UK property rich assets? To what extent could this discourage use of AHCs for multi-jurisdictional real estate funds?*

This would appear to us to be a highly counter-productive step and is likely to make the regime unattractive. It would be very limiting to exclude any fund that owns or at any point in the future might own UK property.

*Question 35: If the regime permitted AHCs to own UK land and UK property rich assets, how could rules ensure that the additional deductions and reliefs available to an AHC did not lead to any erosion of the UK tax base in UK property?*

Whilst we are not able to comment in detail, this would not appear to be an insurmountable challenge.

*Question 36: How significant is the impact of Stamp Duty and SDRT on AHC location, in particular with reference to the points listed at paragraph 4.134? Please provide details of the specific situations where the lack of an exemption would have a significant impact when deciding whether to locate an AHC in the UK.*

We are not able to comment on this section. We believe that other trade organisations are responding to this question.

*Question 37: Do you have views on the government's proposed approach to group relief for AHCs?*

We are not able to comment on this section.

*Question 38: Are there other rules relating to corporate groups whose application you think should be modified for AHCs?*

We are not able to comment on this section. We believe that other trade organisations are responding to this question.

*Question 39: Should the regime accommodate entry by companies already used to hold investment assets prior to becoming AHCs? What issues could arise for these companies? How could regime rules protect against any increased risks of abuse or avoidance?*

*Question 40: In situations where a company leaves the AHC regime, how can regime rules provide against loss of tax? For example, what is the best way to ensure that gains not yet charged to tax, reinvested or returned to investors become taxable? Should this be via a deemed disposal from the perspective of the investors or via a charge in the AHC?*

*Question 41: Where a company that has claimed the benefits of the AHC regime is wound up and is subsequently found not to have met eligibility criteria, what is your view on the best method to ensure that any additional tax due can be collected?*





*Question 42: Should a new accounting period begin for tax purposes when a company enters or exits the AHC regime?*

*Question 43: Can you provide details of any situations where an AHC might temporarily cease to meet the regime eligibility conditions? How should regime rules approach situations of this type?*

We are not able to comment on this section. We believe that other trade organisations are responding to these questions.

*Question 44: What situations are there where current rules in any of the areas listed at paragraph 4.148 could act as a barrier to locating AHCs in the UK? Are there any other issues the government should consider in this regard? Please provide information to illustrate the extent to which these issues could affect take-up of an AHC regime.*

*Question 45: How should any issues identified in your answer to Question 44 be addressed?*

*Question 46: Can you provide specific examples of existing overseas companies fulfilling the role of an AHC, in order to test the full effects of the proposed regime and of draft legislation?*

We are not able to comment on this section.

*Question 47: Please highlight any inherent features of the proposed regime that you consider protect it against abuse, and set out what additional anti-avoidance rules you consider might be desirable.*

We are not able to comment on this section. We would repeat our earlier comment that anti-avoidance measures should be targeted, proportionate and where possible use existing measures.

*Question 48: What information, either listed in paragraph 4.156 or otherwise, do you think HMRC should collect to maintain the AHC regime as low risk and provide a high-level understanding of how it is used?*

*Question 49: Do you have suggestions for an XBRL taxonomy for these items? What are your views on whether tagging would be a convenient and reliable method to ensure that information is provided?*

We are not able to comment on this section.

*Question 50: Who should any relaxation of the listing requirement apply to? If there is a relaxation for institutional investors, how could this be applied? What are the benefits and risks of applying a relaxation where institutional investors hold less than 100% of the REIT and where should any cut off point be set if relaxing the requirement for REITs only partly held by institutional investors?*

*Question 51: What would be the benefits and risks of a complete removal of the requirement for listing?*

We are not able to comment on this section.

*Question 52: Are there any further investor groups who should be added to the list of institutional investors? Why should these investors be added, including the expected impact and are there any additional tax issues that would need to be considered?*

We are not able to comment on this point.



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*Question 53: When considering a look through approach as part of the close company test, should this work in a similar way to the NRCGT rules or would this need to be modified to work with the REIT rules? If the rules would need to be modified, what changes should be made?*

We are not able to comment in detail, however, as outlined in our responses to other questions, we believe that tests should where possible be based on existing rules to avoid a multiplication in the number of different tests to be applied.

*Question 54: Would a change to the rules for overseas equivalents of a REIT encourage overseas investment through UK REITs? What difficulties may there be in establishing that an overseas company satisfies the requirement to be equivalent? Are there any risks arising from such a change?*

We are supportive of this but are not in a position to comment in detail.

*Question 55: Are there any different ways in which this rule could be changed that should be considered? If so, please explain how, the reasons for such changes, and identify the impacts and risk.*

We are not best placed to comment on this.

*Question 56: Which of the reforms suggested, or combinations of them should be considered? Are there any other ways in which the balance of business rules could be reformed in order to reduce burdens while maintaining the principles of the REIT regime? How might these apply in practice?*

We are not best placed to comment on this.

Please do contact me should you wish to discuss any of the above in further detail.

Yours faithfully

**Sue Forster**  
Chief Executive