

Sovereign immunity from direct taxation:

Consultation on policy design



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Foreword

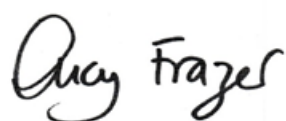
Sovereign Wealth Funds and foreign public pension funds are significant global institutional investors. The UK, as a global hub for inward investment, has long benefitted from the large amounts of capital they have available. These types of funds, and other foreign sovereign persons investing here, have also benefitted, with the UK's existing infrastructure and strong regulatory framework meaning their investments here provide them with healthy and stable returns. The government is committed to ensuring the UK remains an attractive destination for investors, and maintaining the benefits this provides for both the UK and those who invest here.

The unique status of foreign sovereign persons has meant that exemptions from direct tax have been provided to them historically by many countries, including the UK, and continue to be provided to varying degrees internationally.

When considering what the exemption provided by the UK should look like going forward, a balance must be struck. On the one hand, providing some form of exemption recognises sovereign persons' unique status and ensures that the UK's approach is comparable to what other major countries do. On the other, ensuring sovereign persons pay a broadly comparable amount of tax to both UK and non-UK residents means that they will contribute more to the infrastructure they benefit from by investing in the UK.

This consultation therefore sets out the government's proposal for how sovereign persons will be treated for direct tax purposes going forward. The proposal is more restrictive than current practice, but the government sees it as a fair and proportionate restriction which will bring the UK more in line with the exemptions that other equivalent countries provide. The government is proposing to codify this reformed exemption in legislation going forward to provide greater clarity and certainty for foreign investors, which is in line with our broader aims to ensure the UK has a fair, modern, transparent tax system.

We look forward to working with stakeholders over the consultation period to ensure the proposal is proportionate, predictable and transparent for those it affects.



The Rt Hon Lucy Frazer QC MP
Financial Secretary to the Treasury

Chapter 1

Introduction

Background

Sovereign immunity, for the purposes of this document, refers to the principle that one sovereign State should not seek to apply its law to another sovereign State. This is commonly understood in international law as the doctrine of sovereign immunity.

In the UK, the way that sovereign immunity has been interpreted in the area of tax is that foreign sovereigns have exemption from liability to direct taxes. That includes natural persons, and extensions of the State including entities such as funds or bodies corporate, hereafter referred to as “persons”.

This exemption applies to all activities of sovereign persons, including both those generally associated with their sovereign functions and those more commercial in nature. Exemption from tax operates alongside jurisdictional immunity that foreign sovereigns have from the UK courts for proceedings in respect of tax on income and gains (sometimes jointly referred to as income hereafter).

Most other comparable countries also have arrangements in place to provide tax exemptions for certain foreign government investments. This tax treatment can be seen to reflect the unique status of foreign States, different to foreign companies for example. However, the exemptions of other countries do not apply to all activities of sovereign persons; in this respect, the UK’s approach currently sits outside the international mainstream.

In recent years, the magnitude of the income exempted in the UK through sovereign immunity has increased substantially, and the significance of that exemption to UK tax revenues has become greater as the UK tax base has expanded to include non-residents to a greater extent. This has meant that, while the scope of the exemption hasn’t changed, its practical impact has.

In light of this, the government considers that there is a case to update the UK’s approach to sovereign immunity from direct tax, with a view to ensuring that it continues to recognise the unique status of sovereign investors and remains attractive

for inward investment, while at the same time ensuring that it is transparent, appropriately targeted, applied consistently, and in line with the international mainstream.

Government proposal

This consultation sets out a revised approach to sovereign immunity from direct tax.

First, the Government proposes that both the principle of, and the conditions underpinning entitlement to, sovereign immunity should be comprehensively set out in legislation. This would provide greater certainty regarding both the persons for whom, and the income in respect of which, the exemption is available for. Certainty is important for investors when considering where to invest, and legislating will allow them to confidently invest in the UK with a clear understanding of their obligations with regard to direct taxation.

It would also provide a clearer and more transparent framework for the operation and administration of sovereign immunity from direct tax in the UK, in line with the government's aims for a modern tax system. Accordingly, all subsequent references for changes to sovereign immunity from direct tax should be understood specifically to mean changes that are to be given effect through legislation.

Second, the government considers that the income sovereign immunity from direct tax is available for should be targeted. Specifically, it considers it should be targeted to income that:

- a) arises from what might constitute investment rather than trading activity;
- b) arises in respect of investments that are of a more passive nature and that are more commonly held as part of an exercise of sovereign functions; and,
- c) arises in respect of investments for which exempting it from direct taxation creates the appropriate balance between supporting investment in the UK and delivering fairness between different participants in the UK market.

The government understands there may be different options for delivering these objectives, so has considered how best to do so. In light of this, this consultation proposes that exemption be targeted at UK source interest income. Practically, this means that sovereign persons' income and gains from UK immovable property and income from UK trading activities would be brought within the scope of tax. This is comparable to the approach taken by other countries such as the US and Australia.

Consultation process

The Government is keen to seek views on the proposed reforms.

In particular, views are sought on:

- the proposed approach for identifying eligible sovereign persons
- the proposed approach to the income that should benefit from exemption
- the proposed implementation timetable and transitional considerations
- the tax consequences of reforming sovereign immunity
- the proposed tax administration processes for sovereign persons
- the impacts of the proposed changes

The government welcomes comments on this consultation before 12 September 2022. In line with the tax policy making process, the government would seek to publish draft legislation for technical consultation ahead of the inclusion of the legislation in a future Finance Bill.

Responses should be sent to sovereignimmunity@hmtreasury.gov.uk. The government will subsequently publish a response to the consultation and all respondents will be listed within that. If you wish to remain anonymous, please highlight this in your response.

The government will be consulting relevant stakeholders and interested parties on the proposals through meetings during the consultation period. If you would like to be included in a consultative meeting, please contact us via the email above before 25 July 2022.

If there are any questions on aspects of this document, please contact Jasmine Kaur at Jasmine.Kaur@hmtreasury.gov.uk or David Price at David.E.Price@hmrc.gov.uk.

Chapter 2

Policy rationale

This Chapter sets out more detail on the UK's current approach to sovereign immunity from direct tax, and the case for legislating to reform the regime, focusing on how the UK's approach compares internationally, and how the taxation of UK property has changed in recent years.

The UK's current approach

Currently, per HMRC's international manual at INTM860180¹, *"[i]ncome and gains arising to, and in the sole direct beneficial ownership of: the Head of a foreign independent State (for example a reigning Monarch or a President); the Spouse of such a Head of State; a foreign independent Government are . . . normally immune from taxation."*

The extent to which both parts of, and extensions of, a foreign government are eligible for sovereign immunity from direct tax is currently assessed by HMRC on a case-by-case basis with reference to the particular circumstances of the government or entity in question.

The extent to which the provincial or state governments of constituent territories of federal States can be considered sovereign persons, and therefore be exempted from tax, is also determined in this way.

All UK sourced income and gains, including income from commercial activities, of sovereign immune persons is currently exempt from direct tax. This means that sovereign persons who have been granted sovereign immunity will not pay any Income Tax, Capital Gains Tax or Corporation Tax to which they would otherwise be liable.

¹ HMRC Internal Manual – International Manual – INTM860180 <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm860180>

International Comparisons

The UK’s approach to sovereign immunity from taxation—both exemption from tax liability and immunity from the jurisdiction of UK courts— has its origins in the longstanding international law doctrine of sovereign immunity.

Internationally, the scope of this doctrine has developed over time from an absolute, wide-ranging immunity to a more targeted one. This is partly due to the fact that governments have become increasingly engaged in more commercial activities, to which some consider it would be inappropriate to extend sovereign immunity.

Gradually therefore, many countries have introduced more targeted sovereign immunity regimes and narrowed their interpretation of the doctrine so that a country can only benefit from sovereign immunity in respect of non-commercial activities.

This trend may also reflect the growth in sovereign wealth funds (SWFs) that are active in the global marketplace, and the changing nature of their investments, with the search for better returns leading to expansion over the last 15 years from stocks and bonds into alternative assets, including immovable property.

Over time some countries have also sought to move towards more prescriptive legislation for sovereign immunity.

The UK’s current sovereign immunity regime remains generous internationally (see table below) and given this global shift in the narrowing of sovereign immunity, the government believes that there is a strong case for reforming the UK’s rules, to bring the UK in line with the international mainstream and limiting exemption to income that relates to investment rather than trading activities, that relates to investment of a more passive nature, and that relates to assets that are more commonly held in the exercise of sovereign functions and for which the fiscal and economic impacts of exemption are proportionate.

State	Sovereign immunity can be available for:	
	Trading and property income, and income from commercial activities	Interest and dividend income
UK	Yes	Yes
Australia	No	Yes
Canada	No	Yes
China	No	No
France	Sometimes	Yes
Germany	No	No
Italy	No	No
Japan	No	No
Netherlands	No	No
New Zealand	No	No
Spain	No	No
US	No	Yes

Taking a few specific examples of other countries' practice, the United States exempts income that foreign sovereigns receive from their investments in US equity, debt and other financial securities, to the extent that this is not derived from commercial activity². Any government-controlled entities must not engage in any commercial activity at all in order to be exempt on their passive income.

Similarly, Australia enacted legislation in respect of sovereign immunity in 2019³ which exempts income that sovereigns receive from portfolio like investments in Australian companies, where the sovereign has no control or direction over the operations of the companies invested in.

France also provides sovereign immunity for income derived from portfolio investments in French companies⁴. Additionally, with the approval of the relevant Minister more expansive exemptions can be granted on a one-off basis.

These examples demonstrate that – while taking different approaches and utilising terms and concepts that might be interpreted or applied in different ways⁵ – most countries have retained some form of tax-exempt treatment for income arising from governmental functions, but with UK being distinct in extending exemption to all income from commercial activities as well.

The government therefore considers that there is a strong case for the UK to make the types of income eligible for sovereign immunity more targeted. Like other countries, the UK continues to see a case for having a more limited exemption that applies to certain types of investment income and ensuring that the exemption is appropriately targeted in line with its aims, whereby it is proportionate while continuing to both signify and facilitate the UK's openness to sovereign investment.

Market developments

As well as international developments, there have also been domestic developments in recent years which support the view that a more targeted regime for sovereign immunity would be appropriate. There have been developments in terms of how sovereign immune persons invest and also the nature of investments held, and more importantly to the wider UK tax rules for non-resident investors in relation to UK property.

SWF investment strategies

² 26 U.S. Code § 892 - Income of foreign governments and of international organizations

³ *Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures* Bill 2018

⁴ *Code général des impôts* Article 131 *Sexies* - Financial products benefiting international organisations, foreign sovereign States, their central banks or financial institutions

⁵ For the purposes of the table, the government has necessarily had to take a view on how these can be interpreted to apply with respect of specific types of income and summarised to aid comparison. This table should not be taken as an exhaustive representation of the policies of the countries included.

SWFs are some of the largest global institutional investors, with assets under management being estimated to exceed \$15 trillion in 2020⁶. The UK attracts large amounts of inwards investment relative to international counterparts, meaning SWFs are major investors into the UK. In recent years, they have been both increasing and diversifying that investment.

The UK welcomes the valuable capital they provide, with the government committed to ensuring the UK remains a leading destination for global investment through its Build Back Better plan. The newly-formed Office for Investment targets support for investment in areas which are key government priorities, such as net zero. For sovereign investment in particular, this is being achieved through the signing of Sovereign Investment Partnerships, such as the recent Partnership with The State of Qatar.

The government also recognises that this increasing amount of sovereign investment reinforces the importance of ensuring that any tax exemption it receives is proportionate to sovereign investors' structures and activities, and fair when compared to other institutional investors who may have similar structures and activities.

Tax treatment of non-residents

More generally, the tax treatment of non-UK residents has evolved in recent years, particularly in relation to UK property, with the government having expanded its taxing rights to ensure fairness and provide a level playing field for UK resident and non-UK resident investors in relation to their UK sourced income and gains.

That includes the Offshore Property Developer reforms in 2016, and the changes to bring non-resident owners of UK immovable property within scope of Capital Gains Tax and Corporation Tax on their UK property income and gains from 2015 which were significantly expanded in 2019.

While successful in their aim, these changes in the tax treatment of non-UK resident persons also have the effect of creating a disparity between the tax treatment of sovereign immune persons (who remain exempt from tax on their UK property income) and other non-UK resident persons (who are no longer exempt).

This disparity, coupled with the growth and variety of SWF investments, further demonstrates the need to reform sovereign immunity and seek to provide a level playing field and certainty for different types of investors, regardless of their residence or status.

⁶ PwC, "Sovereign investors 2020: A growing force", 2020

Chapter 3

Eligibility and scope

Background

This Chapter provides more detail as to how the government proposes that eligibility for sovereign immunity should be determined, and what tax exemptions should be available.

The proposals for eligibility and scope should be considered holistically, as a more targeted approach to the type of income eligible for immunity goes hand in hand with a broader approach to eligibility, in order for the policy to be proportionate.

Proposals for how these changes might apply, and their detailed tax consequences are covered in Chapters 4 and 5.

To what States and territories is the exemption available?

A foreign sovereign State is a country recognised by the UK government.

There may be cases where there is genuine uncertainty as to whether a State is recognised or not.

If that is the case, a certificate from the Secretary of State of the Foreign, Commonwealth and Development Office (FCDO) can be sought to confirm its status. That process is prescribed by provision in the State Immunity Act 1978⁷; the government is not seeking to alter that existing process.

Some States are federal, such as the United States of America or Switzerland. In federal systems, sovereignty can be shared between the federal government and the individual states (referred to hereon in as “constituent territories”).

The federal State itself currently qualifies as a sovereign State for the purpose of sovereign immunity from tax. Whether a particular constituent territory is deemed to be sovereign for the purposes of sovereign immunity is considered on a case-by-case basis with reference to the particular circumstances of the territory in question.

Going forward, the government proposes that all constituent territories of a federated State will be eligible for immunity from tax. This would remove the need for the current case-by-case consideration. It would therefore have the benefit of being simple to

⁷ Section 21

apply, easily understood by those affected, and, in addition, in line with the approach currently taken for Crown immunity (see Chapter 4).

However, it is not proposed to extend the scope of immunity beyond constituent territories to municipal authorities. Municipal authorities are levels of authorities below the level of constituent territories.

The establishment of a single general rule in respect of constituent territories will help to ensure that they have security and confidence in making investment decisions. In the same way as for sovereign States, certificates can be sought from the Secretary of State of the FCDO to confirm whether any territory is a constituent territory of a federal State for this purpose.

What persons or manifestations of those States benefit from exemption?

Heads of State

Each foreign sovereign State has a single Monarch, President or Head of State, who is currently eligible for sovereign immunity.

The government proposes that this approach should continue, and, given the extension of immunity to all constituent territories, the sovereign or head of a constituent territory should be eligible too.

The intended effect is that the sovereign's immunity from liability to direct tax would not apply if they were acting in a private or personal capacity.

As with the determination of a sovereign State, if there is genuine uncertainty as to whether an individual was a Head of State, a certificate could be sought from the Secretary of State of the FCDO to confirm that a person was a recognised Head of State.

The government has considered the eligibility of members of a Head of State's family forming part of their household, for example a spouse or minor children. It proposes that these should not be eligible persons for sovereign immunity purposes.

Foreign governments

Each foreign sovereign State has a government that possesses sovereignty jointly with the Head of State. It is proposed that exemption be available for governments of a State or constituent territory of that State.

The question then is how best to define what constitutes a foreign government in a way that is clear, but also appropriately captures different government manifestations, for example:

- government departments and agencies
- central banks
- government funds, such as sovereign wealth funds and social security funds

- government pension schemes.

One approach could be to have a broad definition in line with the approach taken in the US⁸. The government welcomes views on this, in particular on areas where that definition has led to uncertainty or precluded emanations of government from the benefit of exemption.

There is a question as to whether government pension schemes would benefit from being included in a reformed sovereign immunity regime, or whether they should be ineligible, since those currently benefitting from sovereign immunity may be eligible to register for tax purposes under existing alternative exemptions. These alternative exemptions will continue to exempt them from tax on their investment income and gains.

The government also welcomes views on whether the definition of foreign government should extend to controlled entities, where they are wholly owned and controlled by the State.

What income is covered by the exemption?

This section provides further detail on which income and gains are currently exempt from tax for sovereign persons, the government's proposed approach to which income should be exempt going forward, and the reasons behind this.

Currently, those eligible for sovereign immunity from taxation are exempted from liability to UK direct taxation in respect of all their UK sourced income and gains.

However, there is a growing global trend towards a more targeted form of immunity that does not cover commercial activities and, either as part of or in addition to that, limits the exemption to more passive and portfolio-like investments (so excluding real estate). As sovereign investors increasingly engage in commercial activities, the value of the tax exemption the UK provides them with increases relative to other countries. It also increases relative to other non-resident investors into the UK, particularly given the expansion of UK taxing rights on non-UK residents' UK property in recent years, which would apply to all foreign sovereign persons in the absence of sovereign immunity.

The government is therefore proposing that exemption be refocused on income from investment activity and specifically investment of a more passive nature in assets that are more commonly held as part of the undertaking of sovereign functions.

There are different ways in which this objective could be realised, with different models having been devised in other countries. However, the government believes that the most appropriate approach for the UK is to ensure income from debt and equity investments in the UK are exempt from tax.

⁸ 26 U.S. Code § 892 - Income of foreign governments and of international organizations

The UK does not tax non-residents on UK source dividend income, so that does not need to be exempted from tax for foreign sovereigns. Therefore, the government proposes an exemption for foreign sovereigns in respect of UK source interest income, over and above the existing exemptions that are available such as the Quoted Eurobond Exemption and gilts with FOTRA (Free Of Tax for Residents Abroad) status.

The government does not propose that the exemption be limited to portfolio investments (i.e. investments in debt of a person in which there is a non-controlling interest) to avoid the complexities that could come in having to administer such a test.

Question 1: Do you have any comments on the proposed eligibility for sovereign immunity, and the proposed approach to exempting UK income?

Question 2: Do you have any comments as to the best way to define what persons or manifestations of the State should be eligible?

Question 3: Should the government include controlled entities as eligible for sovereign immunity in any new legislation? If so, how should they be defined?

Question 4: Should foreign government pension schemes be specifically excluded from eligibility from Sovereign immunity, since existing alternative exemptions from tax on their income and capital gains may be available to them?

How would sovereign non-natural persons be treated for UK tax purposes?

The government proposes that qualifying foreign sovereign non-natural persons—that is, those that are not individual human beings (natural persons)—will generally be treated as non-resident companies and therefore liable to Corporation Tax (CT) on the forms of income liable to CT from which they are not exempt.

In particular, under existing CT rules, this means they could become liable to CT on:

- profits from trades carried on through a UK permanent establishment
- all profits from carrying on the trade of dealing in or developing UK land for the purposes of disposing it
- all profits from a UK property business, including Property Income Dividends arising from interests in Real Estate Investment Trusts (REITS) and Property Authorised Investment Funds (PAIFs), and UK property income arising from interests in transparent for income Collective Investment Vehicles
- chargeable gains arising from the disposal of:
 - assets that are used in or for the purposes of the UK permanent establishment's trade or the permanent establishment itself

- assets not falling within the above category which consist of interests in UK land rights to assets, including interests in Collective Investment Vehicles, that derive at least 75% of their value from UK land (indirect disposals)

Their only income which will be exempt from UK tax will be UK sourced interest income, to the extent that it does not relate to trading activities undertaken in the UK. This includes UK sourced interest on savings, interest on debt, income from government securities, bonds and debentures.

Payments of annual UK sourced interest to non-residents are subject to withholding tax representing the basic rate of Income Tax. There are exemptions to this rule, for example, when the interest is paid on a Quoted Eurobond.

Payers of UK sourced interest to sovereign entities would be relieved of their withholding tax obligation, on receipt of authorisation by HMRC.

Elsewhere, normal rules will generally apply. Notably:

- The UK does not impose a withholding tax on normal company dividends. Property Income Dividends paid by UK REITs and PAIFs are generally subject to withholding tax.
- Where the income and gains of foreign sovereign entities comes within the charge to UK CT, then the treatment of losses will also be governed by the standard CT rules.
- We do not envisage making changes to the UK's Corporate Interest Restriction.
- Trusts and personal representatives will continue to be subject to Income Tax and Capital Gains Tax in the normal way.

Question 5: Do you have any comments on the proposed approach to sovereign non-natural persons, under Corporation Tax?

How would sovereign natural persons be treated for UK tax purposes?

As set out above in the section on sovereign entities, for qualifying sovereigns who are natural persons, their only income which will be exempt will be UK sourced interest income, to the extent that it does not relate to trading activities undertaken in the UK. This includes UK sourced interest on savings, interest on debt, income from government securities, bonds and debentures.

This means that they would be taxed on trading profits arising from a trade carried on in the UK. Their trading income from dealing in or developing UK land would also be subject to Income Tax under the Offshore Property Developer's legislation.

The government proposes that they will be subject to Income Tax and Capital Gains Tax at the standard rates. Rebasing of costs for Capital Gains Tax purposes will be possible

for persons that have previously benefitted from sovereign immunity, and this is discussed later in this Chapter under “Commencement and transition”.

Like all non-residents, they will receive dividends from UK companies without deduction of withholding tax. Property Income Dividends paid by UK REITs and PAIFs are generally subject to withholding tax.

Question 6: Do you have any comments on the proposed approach to sovereign natural persons, under Income Tax and Capital Gains Tax?

Commencement and transition

The government proposes that the new rules will apply, from 1 April 2024 to income recognised in accounting periods ending on or after that date for entities chargeable to Corporation Tax, and from 6 April 2024 to sovereign natural persons. Apportionment rules would apply where a sovereign entity’s accounting period straddles 1 or 6 April.

The government sees this as a reasonable lead-in time for those affected to familiarise themselves with these changes, the result of which will be that the UK tax regime will apply to sovereign persons in a broadly comparable way as it applies to other persons liable to tax in the UK.

It is recognised that some sovereign persons would, as a result of these proposals, become liable to UK taxes for the first time. It therefore welcomes comments on any practical issues that might arise.

The government also recognises that changing the tax treatment of capital gains in particular, which could have accrued over a long time period before these changes are announced, could be unfair and create undesirable distortions, if gains that have accrued before commencement become liable to tax on post-commencement disposals. It is therefore proposing that, in line with several other capital gains tax changes, transitional rules could be introduced to ensure that those affected would not be subject to tax on capital gains accrued before the new rules came into effect.

Sovereign persons that are currently considered immune will be able to rebase the cost of their acquisitions for the purposes of tax on capital gains, to their market value on the date that the new rules come into force. This means that where an entity is coming into scope of UK tax for the first time as a result of this legislation, only the gains attributable to changes in value from 1 April 2024 (for entities) or 6 April 2024 (for natural persons) after the new legislation takes effect will be chargeable.

It is recognised that in certain cases rebasing may produce an unfair result, for example where the non-resident has made a loss on the disposal over the ownership of their asset, but a gain would accrue under the rebasing mechanism, or where the rebasing increases the gain. Consideration will be given to a mechanism to mitigate such results, such as allowing the affected person to calculate the losses or gains on disposals using the actual acquisition cost of assets as the base cost for capital gains purposes.

Question 7: Do you have any comments on the proposed commencement date? Are there any practical issues that make this date inappropriate?

Question 8: Are there any other transitional arrangements that should be considered? If so, why?

Question 9: Do you have any comments on the transitional arrangements in respect of capital gains? Do you see any issues or complications arising with respect to rebasing which need to be addressed?

Question 10: Would automatic rebasing for all sovereign persons produce unfair results? If so, what mechanism do you think should apply to mitigate these?

Chapter 4

Other tax consequences

Background

This Chapter sets out the consequences for other taxes and parts of existing tax legislation, as a result of the proposed reforms to sovereign immunity.

Sovereigns as Qualifying Investors

Currently, the tax system provides certain institutional investors with different beneficial treatment to other investors reflecting their unique status, in order to provide certainty and promote an open investment environment in the UK.

In some cases, sovereign immune investors are deemed to be qualifying investors, which ensures that their immune treatment is not disturbed when they invest indirectly in certain assets through holding or investment fund structures. Qualifying investor status ensures that large institutional investors such as sovereign wealth funds are encouraged to use UK fund structures, which brings wider economic benefits.

This is the case in the following parts of existing tax legislation:

- Real Estate Investment Trust (REIT) legislation, where a condition for a company wishing to be treated as a REIT is that it is not close, or it is close only because it is held by one or more 'institutional investors', which includes a person who cannot be liable for certain taxes on the grounds of sovereign immunity⁹
- Substantial Shareholding Exemption (SSE), where since 2017 a broader exemption from CT on gains has been available for companies owned by 'qualifying institutional investors', which includes a person that cannot be liable for certain taxes on the grounds of sovereign immunity¹⁰
- Qualifying Asset Holding Company (QAHC) Regime, where from 1 April 2022 onwards a 'relevant qualifying investor' includes a person that cannot be liable for certain taxes on the grounds of sovereign immunity¹¹

⁹ listed at s528(4A) Corporation Tax Act 2010

¹⁰ S30A (1C) of Schedule 7 AC of the Taxation of Chargeable Gains Act (TCGA) 1992

¹¹ Paragraph 10(b) of Schedule 2 of Finance Act 2022

- Long-Term Asset Funds (LTAF), where a ‘relevant investor’ satisfying the genuine diversity of ownership condition includes a person who cannot be liable for Corporation Tax or Income Tax on the grounds of sovereign immunity¹²
- Exempt Unauthorised Unit Trusts (EUUT), where one of the conditions for an unauthorised unit trust to qualify as an EUUT is that all of its unit holders are considered to be ‘eligible investors’, which is only the case if the unit holder would be wholly exempt from Capital Gains Tax or Corporation Tax on the disposal of their units¹³
- Collective Investment Vehicles (CIV), where there is a special regime for non-resident capital gains tax purposes for UK property rich CIVs and their investors, with some specific provisions having a dependency on the SSE definition of ‘qualifying institutional investors’.¹⁴

The operation of each of these regimes alongside a reformed sovereign immunity regime will need to be considered carefully.

The government is not minded to change how all of these areas of tax code operate in relation to sovereign persons, given that many are seeking to capture large institutional investors with particular structures and profiles as opposed to capturing those with tax exempt status in respect of a particular stream of income.

For example, the list of qualifying investors within the QAHC regime is not one that is driven by tax exempt status but rather one that seeks to identify genuine investors for which holding companies are commonly used in making investments.

Removing sovereign immune persons from the list of qualifying investors would not be justified in that instance and, focusing on this as an example, would have a negative impact on the objective of the QAHC reforms in making the UK a more attractive place to hold and manage large-scale assets.

However, while understanding the need for care when considering changes to these areas of tax, the government recognises that in some cases, allowing sovereign persons to remain as qualifying investors within individual regimes of the existing tax legislation could undermine the proposed reform set out in this consultation.

The government therefore welcomes further detail on the scale of foreign sovereign investment through such structures in the UK, and any practical issues that could arise if sovereign persons were no longer considered to be qualifying investors for such purposes, and any mitigating actions that could be taken.

The government does not intend to disturb the existing treatment of registered overseas pension schemes which can also benefit from qualifying investor status in existing parts

¹² Regulation 3(8F) Part 2AA of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964)

¹³ Regulation 3(2)(a) of the Unauthorised Unit Trusts (Tax) Regulations 2013 (SI 2013/2819)

¹⁴ Schedule 5AAA to the Taxation of Chargeable Gains Act 1992 (TCGA)

of tax legislation. This means that if a foreign public pension fund is benefitting from sovereign or Crown immunity currently, and is also registered as an overseas pension fund and is a qualifying investor for any of the aforementioned parts of tax legislation, that benefit would not change following the introduction of sovereign immunity legislation.

Question 11: Do you have any details on the scale of foreign sovereign investment conducted through such holding and fund structures?

Question 12: Do you have any comments on how the government should approach existing qualifying investor status in relation to sovereign investors? In particular, are there any practical issues that could arise if this status were removed? If possible, please provide details of each area listed above in turn.

Question 13: Are there other areas of tax law where the proposed changes to sovereign immunity may have knock-on impacts?

Inheritance tax

In line with the ambition to limit sovereign immunity tax exemptions to income that is derived from activities of generally sovereign functions, the government proposes to only provide sovereign immunity from Inheritance Tax where state property situated in the UK held by a foreign Sovereign or Head of State passes to his or her successor (as Sovereign), or to other persons in circumstances where it remains state property.

This means that where a foreign Sovereign or Head of State disposes of any private property situated in the UK, it will be in scope of Inheritance Tax. It also means that where a foreign Sovereign or Head of State disposes of any state property situated in the UK, that following or upon its transfer ceases to be state property, the government intends to ensure that HMRC can collect the tax from all liable people, including the foreign Sovereign or Head of State, including where he or she is acting in a representative capacity.

Question 14: Do you have any comments on the proposed approach to inheritance tax?

Stamp Duty, Stamp Duty Reserve Tax, and Stamp Duty Land Tax

The current approach is that immunity from liability to these taxes is not available. It is proposed that this approach should continue.

This does not affect the relief from SDLT which is available under existing legislation on the purchase or lease of certain diplomatic and consular premises¹⁵.

¹⁵ [Diplomatic Privileges Act 1964 \(legislation.gov.uk\)](#) & [Consular Relations Act 1968 \(legislation.gov.uk\)](#)

International Organisations

Certain international organisations, such as the United Nations or NATO are given privileges and immunities through Orders in Council. Around 30 of the less recent Orders accord to international organisations, like the OECD, “the like exemption from taxes as accorded to a foreign sovereign power”. The multilateral treaties which established those organisations, to which the UK is a signatory, provide that they would enjoy a full exemption from all direct taxes.

We propose that the applicable legislation should be amended so to maintain the existing treatment and enable the UK to comply with its international obligations in respect of these organisations.

This will be done by making the legislative changes necessary to exempt from tax those income and gains arising within the scope of the organisation’s official activities.

The existing SDLT relief will be unaffected and remain in place.

Question 15: Do you have any comments on the proposed approach to international organisations?

Crown immunity

Crown immunity is a well-established principle¹⁶ that the Crown is not bound by a statutory provision except by express words or necessary implication.

Consequently, as Sovereign, the Queen is not legally liable to pay Income tax, Capital Gains Tax or Inheritance Tax. In addition, the Prince of Wales is not legally liable to pay Income Tax on the income from the Duchy of Cornwall to which Crown immunity applies.

However, the Queen pays Income Tax and Capital Gains Tax, on a voluntary basis, and Inheritance Tax will also be paid to the extent described in the Memorandum of Understanding on Royal Taxation.¹⁷ The Prince of Wales also pays tax voluntarily on his income from the Duchy of Cornwall to the extent that is not used to meet official expenditure. None of the changes proposed in this consultation document will impact the way in which the existing Memorandum works, and it will remain in place on a non-statutory basis.

The Crown has a direct constitutional role not only at “country level” in respect of members of the Commonwealth where the Queen is Head of State, but also in relation to each of Australia’s six states and Canada’s ten provinces.

¹⁶ See *R (Black) v Secretary of State for Justice*

¹⁷ <https://www.gov.uk/government/publications/memorandum-of-understanding-on-royal-taxation>

This is reflected in the current practice of granting Crown immunity from direct tax to each of those states and provinces, as well as to Canada and Australia at the federal level.

The government proposes that, since there are so many similarities between Crown immunity for the Crown overseas and Sovereign immunity, legislation would provide that in respect of the Crown overseas, immunity from liability to direct tax is available on the same basis as the reformed sovereign immunity. This will ensure that Commonwealth States and their constituent territories where the Queen is Head of State are treated in a similar way to other countries in respect of direct tax.

Question 16: Do you agree that immunity from liability to direct tax should be removed from the Crown overseas and only the same immunities granted as those available to foreign Sovereigns?

Dominion governments

At the same time as legislating for Sovereign immunity, the Government proposes to legislate to repeal s25 of Finance Act 1925, which reduces the scope of Crown immunity in the context of tax so as to make the Dominion governments liable to tax in relation to trading activities.

This is a legacy provision that is no longer considered to have any practical effect.

Question 17: Do you have any comments in relation to the proposed approach to repealing the dominion governments provision as set out in s25 of Finance Act 1925?

Chapter 5

Administration

Background

This Chapter sets out the government's proposed approach in relation to a reformed Sovereign Immunity regime, and how the application process and ongoing administration of the regime will operate, referring to existing UK rules in large part.

Commencement and transitional arrangements are discussed in Chapter 3.

Application process

Currently where a sovereign wishes HMRC to confirm their status as immune, they make an application to HMRC.

Where the applicant is an entity connected with a sovereign government, it may be asked to answer various questions in respect of the nature and extent of that connection. Such questions might include matters of detail such as whether the entity is founded by law; its legal status; its objective; its capital position; its income sources; the disposal of its profits; the status of any employees; its tax treatment at home; its relationship with the government; whether it is an agency; who exercises control over policy; who appoints management; the control exercised by government; and beneficial ownership of the income and gains that are the subject of the claim.

It is proposed that, following legislation, immunity will be available only following approval of a formal application made to HMRC.

The application process will be based on the current one and a questionnaire will be made available online. Once a person has been granted sovereign immune or Crown immune status, they would not have to reapply each year, but would retain that status unless the relationship between the sovereign State and the entity or individual changed. It would be the responsibility of the sovereign person to inform HMRC of such changes.

A Head of State would lose the immunity at the end of their term of office, as they would no longer be sovereign.

Where a foreign government of a State has multiple embodiments that are constituted in similar ways, the application process would be abbreviated.

In terms of ongoing monitoring, the government could seek further details on the applicant's investments in the UK and seek updates at certain intervals on any changes in these. However, it is recognised that this could result in additional burdens and costs.

Question 18: Do you have any comments on the proposed application process?

Question 19: Should applicants be required to provide information about all their investments and any changes to these?

Question 20: Should only the top entity that is immune be required to register for sovereign immunity if that entity is the beneficial owner of income that flows through a number of subsidiary entities?

Reporting

The government proposes that the existing reporting requirements in the Taxes Acts should apply to sovereign persons.

Sovereign natural persons that will now be in scope of UK direct taxes will be required to file a Self-Assessment tax return if they have taxable income, including property income.

Sovereign non-natural persons will be treated as non-resident companies and therefore subject to existing Corporation Tax rules. They will have to register with HMRC for Corporation Tax.

Where a non-resident person is entitled to receive UK property income, a 20% withholding tax is payable to HMRC on that income by the non-resident's letting or other agent, or by the tenant if there is no agent, after subtracting any deductible expenses.

However, a non-resident can request HMRC authorisation to receive rent gross. If authorisation is given, the non-resident will be registered for Corporation Tax or Income Tax (if they are not already registered). In that case they should submit self-assessment returns for either Income Tax or Corporation Tax and begin to pay tax on their UK property income in the normal way.

The government is open as to whether any specific reporting requirements beyond those contained in the Taxes Acts are required.

Question 21: Do you have any comments about reporting?

Question 22: Do you have any comments on the proposal to require sovereign persons to follow the existing self-assessment processes under Income Tax, Capital Gains Tax and Corporation Tax? Are there any practical difficulties with this?

Payment

Existing payment regimes that are already in place for direct taxes will apply to sovereign persons in scope of UK tax.

Payments of Corporation Tax would be due nine months and one day after the end of the accounting period. If the entity meets the conditions for being a large company or very large company for Corporation Tax purposes, which are broadly that augmented profits exceed £1.5 million or £20 million in a given year, then it will have to pay its Corporation Tax in quarterly instalments.

Payments of Income Tax are payments on account, which means payments need to be made twice a year before 31 January and 31 July, each representing half of the previous year's tax bill.

Payments of Capital Gains Tax in respect of residential property are due within 60 days of selling the property. In respect of other chargeable assets, such as commercial property, payments can be made immediately using the real time Capital Gains Tax service, or alternatively gains can be reported in a Self-Assessment tax return in the year after disposal and make payments on account.

Question 23: Do you have any comments about tax payments?

Ongoing compliance

Existing compliance procedures and rules that are already in place for direct taxes will apply as normal to sovereign persons.

As is the position currently, those accorded immunity whose structure or relationship to the State changes would be obliged to inform HMRC. HMRC will cancel immunity if it finds that changes to the structure mean that it is no longer eligible and under existing compliance rules this may result in interest and penalties being charged.

Question 14: Do you have any comments about how to ensure compliance with the new rules?

Jurisdictional immunity

In giving effect to the proposed changes to sovereign immunity the government proposes to also ensure that a State is not to be immune from the jurisdiction of the UK courts in respect of proceedings relating to its liability for direct taxes. Once the UK has

moved away from absolute immunity from liability to tax, it is consistent to allow for UK courts to enforce any tax liabilities to which Sovereigns become subject.

Question 25: do you have any comments about the removal of jurisdictional immunity in respect of liability to direct tax?

Chapter 6

Impacts

Background

The government's ambition is to give effect to the new regime for sovereign immunity in a way that minimises detrimental impacts and distortions, and is seeking views on how to do so through this consultation.

This Chapter sets out a preliminary assessment of different impacts that could arise as a result of the proposed reforms to the UK's sovereign immunity regime.

As with all other tax measures, the government will seek to publish policy costings, certified by the Office for Budget Responsibility, at a future fiscal event which reflect the final design of the policy.

Exchequer impacts

The government expects that the proposed move to bring sovereigns into scope of direct taxation on most income will result in a positive Exchequer impact over the coming years, despite the expansion in eligibility to a broader set of sovereign persons.

The greatest Exchequer impact is expected to relate to sovereign immunity from direct tax no longer extending to UK property income and gains.

Government analysis of public data has shown a significant number of foreign sovereign wealth funds (SWFs) and public pension funds with investments in UK property.

Some of these may be benefitting from sovereign or Crown immunity, and with growing assets under management, and therefore a growing amount of income derived from them. The amount of Exchequer revenue being foregone through that income being non-taxable will also grow if the current rules are not changed.

Question 26: Do you have any comments on this analysis, particularly on the extent to which SWFs and foreign public pension funds income is currently sheltered by sovereign immunity or Crown immunity, and the extent to which the proposed new rules will increase their overall tax liability?

Question 27: What are the most common ownership structures used for SWF and foreign pension fund investments in UK property?

The government is seeking more information on a number of factors that will affect the quantum of revenue raised from these changes.

Firstly, limiting the scope of sovereign immunity might not have such a significant Exchequer impact should sovereign persons have a means by which they can be legally exempt from direct taxation on their other forms of income.

We are aware, for example, that certain public pension funds currently benefitting from sovereign immunity may be eligible to register for tax purposes. This would exempt them from tax on their investment income and gains as sovereign immunity had previously. Alternatively, they may be 'overseas pension schemes' (OPS) which exempts them from tax on their chargeable capital gains.

Question 28: Are you aware of the extent to which foreign sovereign and Crown immune public pension funds are able to register for UK tax purposes or are eligible as overseas pension schemes, or of any other alternatives to sovereign immunity which SWFs and public pension funds would look to should the proposed changes to sovereign immunity go ahead?

Question 29: Are there any unintended consequences of these changes on foreign public pension funds?

Question 30: Are there any other legitimate mechanisms through which sovereign persons could continue to benefit from tax exemptions?

Additionally, a change in the investment decisions of sovereign immune entities in response to the proposed changes would also affect their Exchequer impact, for example if investment in UK property were to reduce substantially as a result of the changes. We would welcome views on this.

Question 31: Would sovereign investors be likely to reduce their overall investment into the UK as a result of the proposals? If so, to what extent?

Question 32: Are there particular asset classes which would be particularly affected by the changes, and if so, how would this affect sovereign entities' allocations of these assets within their portfolios?

As set out above, the government expects that the majority of additional revenue raised as a result of this measure would come from SWFs.

The government understands that some foreign sovereign individuals may also hold UK property, and it would welcome further detail on the extent of this ownership and whether such properties are typically let out and generating property rental income.

Question 33: What is the scale of investment in UK property by foreign sovereign individuals? Is such property likely to be rented out with a view to generating rental income, or held for purely private occupation purposes?

Economic impacts

The government recognises the prominence of sovereign persons such as SWFs as institutional investors into the UK. They play an important and valued role, as demonstrated by Sovereign Investment Partnerships agreed with the UAE and Oman in recent years.

The government also understands that the proposed changes to sovereign immunity from tax would reduce investment returns for sovereign persons currently claiming immunity.

That said, the government does not expect these changes to have a significant macroeconomic impact. The proposed changes would bring the treatment of sovereign persons broadly in line with many other countries and still provide some level of immunity on certain income, which, given the UK's competitive tax rate, should not disincentivise investment and help to maintain the UK's attractiveness as a destination for sovereign investment.

Additionally, long term investment in the UK is likely to remain inherently attractive to sovereign investors due to factors other than tax exemptions, such as the UK's strong rule of law and stable regulatory framework. Indeed, these make the UK attractive to many other types of institutional investors as well.

Bringing sovereign investors' UK property income and gains into scope of UK tax is likely to be the most significant expansion of the tax base, given the large UK property holdings of many SWFs. However, it is worth noting that these holdings still make up a relatively small proportion of the total UK property market, and these changes are therefore unlikely to have a significant impact on the availability of property, or on property prices.

Views are sought though on this assessment and on any other macroeconomic impacts expected as a result of these changes, and where any impacts may be most concentrated. A full assessment of the economic impacts will be published at a future fiscal event.

Question 34: Do you have any comments on the government's expectations regarding economic impacts, including any potential impacts not reflected?

Question 35: With regard to property, how do you expect the proposal to impact the value of the types of properties commonly owned by sovereigns, and the rental yield required to make property investments viable when accounting for the change in tax liability?

Question 36: Aside from property, are there other types of asset class commonly invested in by sovereigns which will be affected by the proposal in a way which might materially change the market for them?

Question 37: Would other asset classes become relatively more attractive to sovereign investors as a result of the proposal?

Impact on individuals, households, and families

This proposal could impact individuals who are foreign sovereigns or heads of State, or heads of constituent territories.

One-off costs will include familiarisation with the Income Tax regime. Ongoing costs include preparing and filing Income Tax returns for those with taxable income.

Families, including those forming part of the households of individuals who are sovereigns or heads of State, will not be eligible for sovereign immunity.

This measure is not expected to directly impact UK individuals, households, and families.

Question 38: Do you have any comments on the impacts on individuals, households, and families?

Equalities impacts

This measure is not expected to directly impact on any groups with protected characteristics.

Impact on businesses and Civil Society organisations

Sovereigns with businesses that were previously exempt from taxation will now be subject to taxation as set out in this document.

Those businesses will face one off familiarisation costs which could include introducing new processes, systems and software in order to correctly account for tax. Ongoing costs will include preparing and filing Corporation Tax returns online and payment preparation costs.

Impact on HMRC and other public sector delivery organisations

Both the application process and any ongoing reporting requirements will require ongoing HMRC administration.

The scale of the impact on HMRC will depend on the final design of the policy, which will be set out at a future fiscal event.

Question 39: Do you have any comments on these impacts, or any other impacts which have not been covered here?

Annex A

List of questions

Chapter 3: Eligibility and scope

1. Do you have any comments on the proposed eligibility for sovereign immunity, and the proposed approach to exempting UK income?
2. Do you have any comments as to the best way to define what persons or manifestations of the State should be eligible?
3. Should the government include controlled entities as eligible for sovereign immunity in any new legislation? If so, how should they be defined?
4. Should foreign government pension schemes be specifically excluded from eligibility from Sovereign immunity, since existing alternative exemptions from tax on their income and capital gains may be available to them?
5. Do you have any comments on the proposed approach to sovereign non-natural persons, under Corporation Tax?
6. Do you have any comments on the proposed approach to sovereign natural persons, under Income Tax and Capital Gains Tax?
7. Do you have any comments on the proposed commencement date? Are there any practical issues that make this date inappropriate?
8. Are there any other transitional arrangements that should be considered? If so, why?
9. Do you have any comments on the transitional arrangements in respect of capital gains? Do you see any issues or complications arising with respect to rebasing which need to be addressed?
10. Would automatic rebasing for all sovereign persons produce unfair results? If so, what mechanism do you think should apply to mitigate these?

Chapter 4: Other tax consequences

11. Do you have any details on the scale of foreign sovereign investment conducted through such holding and fund structures?
12. Do you have any comments on how the government should approach existing qualifying investor status in relation to sovereign investors? In particular, are there any practical issues that could arise if this status were removed? If possible, please provide details of each area listed above in turn.
13. Are there other areas of tax law where the proposed changes to sovereign immunity may have knock-on impacts?
14. Do you have any comments on the proposed approach to Inheritance Tax?

15. Do you have any comments on the proposed approach to international organisations?
16. Do you agree that immunity from liability to direct tax should be removed from the Crown overseas and only the same immunities granted as those available to foreign Sovereigns?
17. Do you have any comments in relation to the proposed approach to repealing the dominion governments provision as set out in s25 of Finance Act 1925?

Chapter 5: Administration

18. Do you have any comments on the proposed application process?
19. Should applicants be required to provide information about all their investments and any changes to these?
20. Should only the top entity that is immune be required to register for sovereign immunity if that entity is the beneficial owner of income that flows through a number of subsidiary entities?
21. Do you have any comments about reporting?
22. Do you have any comments on the proposal to require sovereign persons to follow the existing self-assessment processes under Income Tax, Capital Gains Tax and Corporation Tax? Are there any practical difficulties with this?
23. Do you have any comments about tax payments?
24. Do you have any comments about how to ensure compliance with the new rules?
25. Do you have any comments about the removal of jurisdictional immunity in respect of liability to direct tax?

Chapter 6: Impacts

26. Do you have any comments on this analysis, particularly on the extent to which SWFs and foreign public pension funds income is currently sheltered by sovereign immunity or Crown immunity, and the extent to which the proposed new rules will increase their overall tax liability?
27. What are the most common ownership structures used for SWF and foreign pension fund investments in UK property?
28. Are you aware of the extent to which foreign sovereign and Crown immune public pension funds are able to register for UK tax purposes or are eligible as overseas pension schemes, or of any other alternatives to sovereign immunity which SWFs and public pension funds would look to should the proposed changes to sovereign immunity go ahead?
29. Are there any unintended consequences of these changes on foreign public pension funds?
30. Are there any other legitimate mechanisms through which sovereign persons could continue to benefit from tax exemptions?

31. Would sovereign investors be likely to reduce their overall investment into the UK as a result of the proposals? If so, to what extent?
32. Are there particular asset classes which would be particularly affected by the changes, and if so, how would this affect sovereign entities' allocations of these assets within their portfolios?
33. What is the scale of investment in UK property by foreign sovereign individuals? Is such property likely to be rented out with a view to generating rental income, or held for purely private occupation purposes?
34. Do you have any comments on the government's expectations regarding economic impacts, including any potential impacts not reflected?
35. With regard to property, how do you expect the proposal to impact the value of the types of properties commonly owned by sovereigns, and the rental yield required to make property investments viable when accounting for the change in tax liability?
36. Aside from property, are there other types of asset class commonly invested in by sovereigns which will be affected by the proposal in a way which might materially change the market for them?
37. Would other asset classes become relatively more attractive to sovereign investors as a result of the proposal?
38. Do you have any comments on the impacts on individuals, households, and families?
39. Do you have any comments on these impacts, or any other impacts which have not been covered here?