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Property Tax Team  
HM Treasury  
1 Horse Guards Road  
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SW1A 2HQ

17 June 2014

Dear Ms Adams

**Consultation on Implementing Capital Gains Tax on Non-Residents  
Response of Evergreen Real Estate Partners to the Consultation**

We are writing to you in response to the "Implementing a capital gains tax charge on non-residents" consultation document ("the Consultation Document") released in March 2014.

In the Appendix to this letter we have provided detailed comments and specific responses to those questions in the Consultation Document directly relevant to us.

**Background**

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#### **The impact of the proposals**

1. In August 2012 Sir Adrian Montague set out the findings of his 'Review of the barriers to institutional investment in private rented homes'. In this report he identified that there were still a number of barriers to large scale investment into new housing built specifically for rent. Furthermore, in December 2012 Boris Johnson, Mayor of London set out the importance the private rental sector plays for the London economy and the need to encourage greater investment in privately rented properties to increase the housing supply.

The Greater London Authority has a goal of building an additional 5,000 homes for the private rental sector. The Government has recognised this by trying to encourage the financial viability of private rental sector developments through initiatives such as the Build to Rent and Debt Guarantee Fund, which are welcome developments in this area.

2. Delivering purpose built private rented residential property in London entails significant upfront risk and low net yields, typically in the region of 5% with a substantial time lag in return on investment (due to planning, construction and leasing, the time period from site acquisition to full income generation is approximately 5 years). Therefore capital growth is a key component of the total return and plays a key part in investment appraisals and project approvals.
3. Given the combination of material upfront risk with low running yields in this sector and time lag on obtaining a return on investment for residential property, it is likely that **Essential Living** will be critical to meeting the Government's objectives in this area.



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Whilst the Consultation Document is unclear whether non-resident pensions fund are included within the exemption discussed in section 2.18, our discussions with yourselves at the BPF organised consultation meeting on 30 May suggests they will be. We firmly believe that is the right approach and **our key recommendation for the design of the CGT charge is that foreign pension funds should explicitly be exempted given the points above.** This should look through corporate holding structures that are often used for investment and forming JV arrangements. We strongly believe that failure to do this would be hugely detrimental to the Government's wider objectives to encourage development of a significant PRS sector.

4. We recognise the underlying principle government is aiming to achieve through these reforms is one of fairness. Therefore we do not oppose the introduction of the CGT charge on non-institutional foreign owners of UK residential at large. To the contrary, we believe that the offshore non-institutional residential sales market has been partly responsible for driving up land values, particularly in inner London, making it difficult for PRS specialists to compete on site acquisitions, resulting in development of apartment blocks for sale (where the design, materials quality and specification is usually with short term sales in mind), where flats are purchased by a diverse base of local and international owners, making coherent professional management and building maintenance challenging. We therefore believe that distinguishing between foreign institutional owners and non-institutional owners will support other government policies to encourage more institutionally owned and professionally managed PRS in the UK.

#### **Recommendations for the design of the CGT charge**

1. The Government's stated aim for introducing the proposals is to charge CGT on gains made by non-residents disposing of UK residential property, so that non-residents making gains on UK residential property are taxed in a comparable way to UK residents.
2. We would recommend that the following amendments to the proposed CGT regime are considered in order to ensure that investment in residential property is not adversely impacted in those areas where it is required most and take into account the specific investment patterns of pension funds:

##### **Investments by foreign pension funds should be exempt from the charge**

- It is unclear whether non-resident pensions fund are included within the exemption discussed in section 2.18 of the Consultation Document. We note that the exemption will include foreign REITs and funds with genuine diversity of ownership and therefore assume it will incorporate foreign pension funds in line with guidance provided at the meeting on 30 May.
- If the Government is concerned that this may cause abuse, the exemption can be limited to bona-fide pension funds constituted in OECD countries with a set minimum of beneficiaries (say 1,000).

**Indirect investments by entities which are ultimately owned (in excess of a certain threshold say 50%) by pension funds (UK or foreign) should be exempt from the charge**



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- We recommend that it is ensured that the exclusion for pension funds extends to non-resident pension funds and irrespective of the corporate structure the pension fund uses for commercial reasons to hold the properties. This recognises the investment patterns of pension funds which for commercial and legal reasons cannot often invest directly in UK real estate.
- If the intention is to continue to encourage investment from “exempt” bodies such as pension funds, REITs and GDO funds then the fact that for commercial, regulatory and legal reasons they use a corporate subsidiary to invest through, should not block this exemption or it will deter investment by such significant investors. We have seen this happen in other jurisdictions where proper allowance has not been made to look through intermediate corporate entities.

We believe that there are sufficient examples in the current legislation (for example: the terms “group” for corporation tax group relief purposes which is based on common ownership of 75% or more or “associated companies” which is based on common ownership of more than 50%) which can be used to define entities which are within the group of a pension fund.

### **Commercially operated student accommodation should be exempt from the charge**

- We recommend that the Government extends the exemption for student accommodation beyond “halls of residence attached to a University” to commercially operated student housing blocks. This would be consistent with the planning use of such buildings which typically restricts their occupation to students and more reflective of the trend towards universities increasingly using third-party providers to accommodate their students (through agreements like Urbanest has with the London School of Economics) versus traditionally providing accommodation themselves through attached halls. We believe the planning status would probably be the clearest way to define purpose built large scale commercially operated student accommodation from standalone residential dwellings that happen to be rented to students. Purpose built student accommodation buildings typically benefit from Use Class Sui Generis, specifying their use must be for students.

### **Large scale investments that are clearly more akin to commercial versus residential in their nature should be outside the scope all together**

- As a significant portion of recent Government policy has been aimed at “institutionalising” the rented residential sector in the UK and encouraging large scale ownership and professional management in the same way as happens in the commercial property sector, the Government should consider removing large scale investments that are clearly more akin to commercial versus residential in their nature from the scope all together (i.e. in excess of a set number of dwellings in each property, say 100 student accommodation beds or 50 PRS apartments that are let or being offered for let). This would also tie with the fairness objective as without such an exclusion there would be a tax advantage to investing in “commercial property” versus “residential property” even if the investments were fundamentally similar in size and scope.



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Yours sincerely,

For and on behalf of Evergreen Real Estate Partners

## Appendix 1

### Detailed Comments & Responses to Questions in Consultation Document

#### What is meant by residential property

**Question 2: Are there any other types of communal residential property that should be excluded from scope?**

- Consideration should be given to whether only excluding halls of residence attached to a university appropriately reflects the way the higher education sector has evolved with respect to accommodation.
- As stated above, universities now commonly subcontract out student housing to third party providers or assume that the accommodation will be provided by the private sector. Therefore excluding purpose built student accommodation not attached to a university, as the Consultation Document proposes, is inconsistent with the Government's aims to not adversely impact the supply of accommodation for student use. We believe the planning use for the building could be a logical way to determine large scale student accommodation blocks that should be excluded from the charge. Purpose built student accommodation buildings typically benefit from Use Class Sui Generis, specifying their use must be for students.
- In addition, to encourage large scale investment into the rental residential market, we recommend that a bona-fide investment for letting purposes is exempt from the charge where a set minimum number of dwellings per property / building (say 100 student accommodation beds or 50 PRS apartments that are let or being offered to let).

#### Different forms of residential property ownership

**Question 3: Are there any particular circumstances where including non-resident partners in the scope of the charge might lead to unintended consequences.**

and would like to confirm that this this exclusion will include both UK and overseas pension funds as this is unclear from the discussion in section 2.18 of the Consultation Document. We note that the exemption will include foreign REITs and funds with genuine diversity of ownership and



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therefore assume it will incorporate foreign pension funds as indicated at the consultation meeting on 30 May.

We appreciate the Government may need to introduce legislation to mitigate scope for avoidance to ensure overseas pension funds equate to the UK equivalent and only bona-fide pension funds benefit from the exclusion. Therefore, we would suggest that for pension funds to be exempt they may be required to be tax resident in an OECD country and satisfy a set minimum number of beneficiaries.

- Typically pension funds, for a variety of commercial and legal reasons, may not hold UK property directly, for example where the pension fund invests in a joint venture with another entity (mainly because it does not have the requisite investment expertise). We strongly hope that the drafting of the legislation would not adversely impact pension funds that wish to structure their investment in this manner and consideration is given to another test that looks at the ultimate beneficial owners above the property holding vehicle (see response to question 5).
- To ensure that this exemption does not apply to small minority stakes of pension funds, the government can adopt a minimum ownership test (say 50%) by a pension fund.

#### **Ownership through fund structures**

**Question 5: Is a genuine diversity of ownership (GDO) test an appropriate way to identify funds that should be excluded from the extended CGT regime and to ensure that small group of connected people cannot use offshore fund structures to avoid the charge?**

- The Government's concern regarding potential avoidance where property is acquired through closely held companies rather than non-resident individuals holding property directly is noted. However, our concern is that the GDO test may also catch those institutional investors like the US Pension Fund who are "widely held" by many pension fund members but do not fit the GDO test (this would not be relevant if foreign pension funds are explicitly excluded from the charge).
- We appreciate the Government's objective to deal with perceived avoidance when there may be a corporate in the structure. However, if the ultimate owner is an exempt GDO fund or pension fund we would think in order to achieve the Government's objectives an exemption should be available when, although they are not the corporate owners, they are the beneficial owners. We would therefore propose a beneficial ownership test is also introduced, which requires that the UK property is ultimately owned by a minimum number of individuals. However, we would stress the need to look beyond the immediate property holding entity to the ultimate owners which should include beneficiaries of pension funds.

**Question 7: Is there a need for a further test in addition to a GDO? If so, what would this look like and how would it be policed?**

- We believe that the GDO test should include the ultimate beneficiaries of pension schemes. Otherwise, a pension fund may be regarded as a single investment when in fact it pools the funds are explicitly excluded from the charge).



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- We believe that the test should be satisfied looking through a number of corporate and non-corporate layers recognising that investment often cannot be made through a flat holding structure.

**Question 8: What are the likely impacts of charging gains (and allowing losses) incurred on disposals of residential property by non-residential property companies that are not already operating a trade in the UK?**

- We believe that including institutional investors (such as pension funds) within the charge will adversely impact large-scale institutional investment in UK real estate and may see a shift away from institutional investment in residential property to commercial property or altogether out of the UK. We believe the impact on the emerging PRS sector in particular would be extremely adverse as foreign pension funds that are long term strategic investors with significant experience of institutional residential investment in their home markets are key to overcoming the considerable upfront risks and challenges inherent in developing purpose built PRS in the UK and particularly in London.



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## Appendix 2 Evergreen Illustrative Investment Structure

