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Your ref

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By Email

Dear Sir

HM Treasury/HM Revenue & Customs consultation – Implementing a capital gains tax charge on non-residents

1. Executive summary

- Whilst we question whether some of the policy aims will be met by the proposed measures, we accept the need for legislation to implement an appropriately focussed capital gains tax charge on non-residents investing in UK residential property.
- However, the UK needs to continue to encourage investment by institutional investors in certain types of residential property e.g. social housing and student accommodation.
- We support modified GDO and close company tests for funds/institutional investors and the use of recognised and existing statutory tests as to what constitutes student accommodation.
- We do not agree with the proposed withholding tax mechanism, which is unduly complex and will be costly to operate.

2. Introduction

2.1 We are writing to comment on the consultation document entitled "Implementing a capital gains tax charge on non-residents" released by HM Treasury on 28 March 2014. We have not commented on each question raised by HM Treasury and HMRC in the consultation but rather draw out points which are significant to our client base and areas of expertise. We have, however identified where a consultation question is relevant to our concerns.

2.2 Simmons & Simmons LLP is a leading international law firm with offices in major business and financial centres throughout Europe, the Middle East and Asia.

3. General comments

3.1 We understand the Government's view that the UK capital gains tax ("CGT") regime is currently advantageous for non UK tax residents compared with the position for UK tax residents disposing of UK residential property. However despite the clarity underlying the motivation for the proposed new charge to CGT for non-tax residents, the proposals as set out in the consultation document are far from straightforward and, having attended several of the working groups to date, our impression is that the policy direction for this new measure remains far from well formed. We suggest that the Government considers delaying the introduction of any new capital gains tax charge until April 2016 in order that the measure can be properly developed and a significant technical consultation undertaken to ensure that the legislation is in its best possible form once enacted – it will be particularly difficult to consider properly the impact of such measures ahead of the proposed introduction of the charge in April 2015 if no draft legislation and accompanying technical guidance is published prior to the Chancellor's 2014 Autumn Statement. Given the complexity of this measure, we strongly encourage the Government to build in sufficient time and scope for further consultation with stakeholders once the draft legislation and guidance is published.

3.2 In our view, the introduction of the new CGT regime will operate as a significant disincentive to much needed institutional investment in UK residential property unless appropriate exemptions are made available. We are aware of significant concerns arising amongst overseas institutional investors since the announcement of the consultation. As set out in sections 4 and 5 below we do not understand the policy rationale for including certain types of investors (e.g. institutional investors) and certain types of accommodation (e.g. student accommodation) within the scope of the new charge to CGT.

3.3 We are also of the view that introducing the new charge alongside the existing ATED related gains charge, rather than in place of it, will cause technical complications and impose a significant compliance burden on non-resident taxpayers. We strongly urge the Government to consider abolishing the ATED related capital gains tax charge in favour of a cleaner single charge introduced following this consultation.

4. Corporate owners and fund structures

Relevant consultation questions:

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 groups of connected people cannot use offshore fund structures to avoid the charge?

Question 6: Are there any practical difficulties in implementing a GDO test?

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?

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?

4.1 We note that the Government will need to consider carefully the types of entity which are treated as corporate for the purposes of the new charge to CGT. In particular, hybrid entities such as FCPs, property unit trusts and foundations, which can be treated as either

transparent or opaque for different UK tax purposes, should be identified clearly as corporate or non-corporate entities for the purposes of the new charge. The Government could adopt a straightforward approach in this regard and expand upon existing provisions which deem certain entities to be companies for the purposes of capital gains tax to make this distinction e.g. section 99 Taxation of Chargeable Gains Act 1992 for unit trust schemes.

4.2 In the interests of fairness, the Government should look to treat tax exempt non-resident investors in the same way that a similar UK resident investor would be treated without imposing significant registration or compliance burdens on that non-resident investor. In this regard we note the Governments stated intent in paragraph 2.18 of the consultation document that *"the government will mirror the treatment for non-resident funds. Therefore pension funds will be excluded from the scope of the regime."* The definition of 'pension fund' for the purpose of any such exemption is of particular importance given that under certain existing legislation pension funds only benefit from equal treatment in the UK where they are registered overseas pension schemes and not simply by virtue of their nature and purpose as pension funds.

4.3 The Government will also need to consider carefully any decision not to provide non-tax resident corporate entities with indexation on gains taxed under the new charge and the option to use losses to offset such gains in particular in light of EU principles. In our view non-tax resident corporate entities should be put in the same position and be subject to the same rate of taxation as an equivalent UK corporate entity.

4.4 We have set out in Appendix 1 to this letter certain structure diagrams reflecting commonly used structures for corporate/fund ownership of UK residential real estate which should be borne in mind by the Government when crafting the scope of the new charge to CGT to ensure that structures and entities that should not be within scope are properly carved out.

4.5 We welcome the proposal in the consultation document to exempt from the new CGT regime fund structures that meet certain conditions and for there to be no indirect charge to CGT i.e. on transfers of interests in entities owning UK residential property.

4.6 In our view it will be necessary to implement two separate exemptions for funds in order to exempt both closed ended arrangements and open ended funds. The proposal for a GDO test to be introduced will provide a suitable framework for establishing those open ended funds which should fall outside the scope of the charge and we would suggest it logical to draw on the existing GDO tests in the offshore funds legislation in order to provide a template for such exemption.

4.7 However, the offshore funds GDO test is not suitable for closed ended arrangements often entered into by institutional investors such as sovereign wealth funds and both onshore and offshore pension funds to invest in UK residential real estate (and which are likely to form the majority of fund structures holding UK residential property given the illiquid nature of the asset class). This is on the basis that such investments may not meet any actively marketed criteria and will not necessarily be documented in a manner which would meet the requirements of the GDO test currently used for the offshore funds regime. In order to ensure that such arrangements are also outside the scope of the new charge to CGT we suggest that the new legislation provide for a form of non-close company exemption based on the revised UK REIT regime provisions set out in section 528(4) and (4A) Corporation Tax Act 2010. These provisions include the concept of an 'institutional investor' carve out, which will, in our view, be crucial in trying to mitigate the harmful effect the introduction of the new CGT regime will have on the UK residential property market and in particular substantial overseas institutional investment therein.

4.8 We would also expect that any GDO or non-close company based exemption should look to the nature of ultimate beneficial owner of the investment in the fund entity, i.e. in the event that the fund is wholly owned by an SPV which in turn is owned by an investor which is widely held or an institutional investor (e.g. a pension fund or publicly listed company) then the fund should still benefit from the relevant exemption. The Government should also note the need to take care not to connect parties solely by virtue of their participation in a fund (e.g. by virtue of being partners in a fund established as a limited partnership) for the purposes of determining whether the fund benefits from any such exemption.

4.9 Critical to the usefulness of any GDO or non-close company exemption from the proposed new regime will be ensuring that, where in a property holding structure the top holding company meets either test, any underlying asset owning SPVs (whether owned directly or indirectly by that holding company) also take the benefit of the exemption from the charge (see the diagram at paragraph 1 in Appendix 1) (similar to the way in which the close company rules operate at the moment where a company that would be close is not close if it is ultimately owned by an 'open' entity or entities). Such structures are commonly adopted by funds, as opposed to owning multiple assets in one entity, to ensure that the assets can be separately financed and secured by lenders and so that cross contamination risk between the assets in a fund is minimised.

5. Purpose-built or adapted student accommodation

Relevant consultation questions:

Question 1: Would an exclusion of communal property from the scope of the new regime result in any unintended consequences?

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

5.1 We note the Government's proposal that residential accommodation for students should only be excluded from the scope of the new CGT regime if it is a *"hall of residence attached to an institution"*. In short, our view is that all purpose-built or adapted residential accommodation for further and higher education students should be excluded from the scope of this regime, even where owned and operated entirely independently of any particular institution of further or higher education. We do not see what underlying policy could justify levying tax based on lack of attachment to a particular institution and note the distortive effect this would have on the sector.

5.2 It is essential for the Government to have regard to the shortage of quality residential accommodation for students in the higher education sector and its impact on the wider UK population. The growth in the number of students attending higher education institutions has put considerable pressure on residential accommodation, yet funding constraints on universities have made it difficult for universities to finance the construction and/or operation of student accommodation themselves. Crucially, accommodating students within the private residential housing market reduces capacity for homes for the wider population and exacerbates the UK's current housing crisis, for which there is no solution other than to increase supply.

5.3 The reference to "hall of residence attached to an institution" in the consultation document is unclear for a number of reasons.

5.4 First, in its reference to "hall of residence for students in further or higher education", is the Government intending to limit the proposed exemption only to traditional-style purpose-

built student accommodation, even if it satisfies the further requirement of being "attached to an institution"? In this regard, we note in particular, the statement in paragraph 2.7 of the consultation document that *"[t]he government does not believe that disposals of multiple dwellings in a single transaction should be excluded from the CGT charge"*.

5.5 We do not see that such a distinction is justified in the context of the proposed new CGT charge, as it would be entirely arbitrary to levy CGT depending on the particular configuration of the accommodation. However, this should be clarified since in other areas of tax law there is a distinction drawn in the legislation and/or in published HMRC guidance between the tax treatment of residential accommodation depending on whether or not it constitutes "dwellings". For stamp duty land tax ("SDLT") purposes, residential accommodation for students is treated as one or more "dwellings", unless it is a "hall of residence for students in further or higher education". Based on HMRC's published guidance, much of the modern purpose-built student accommodation existing today, which comprises self-contained studio flats or "cluster flats" for multiple occupants, would qualify as dwellings for these purposes and so, not a "hall of residence".

5.6 Second, the meaning of "attached to an institution" is unclear. Other areas of tax law provide special tax treatment to student accommodation without any such requirement. In particular, property used for the residential accommodation of students attracts exemption/zero rating under the VAT legislation. Before imposing any qualification that the accommodation should be "attached to an institution", the Government should consider the spectrum of arrangements under which a particular institution may be involved in the accommodation of students and hence the complexity of seeking to create such a qualification (which, fundamentally, we cannot support).

5.7 If the Government is keen to distinguish genuine student accommodation from non-student residential dwellings it would surely be simpler to look to the nature of the occupiers rather than some form of "attachment" to an educational institution. This would also avoid any unintended distortions in the impact of such legislation on deal structures used by the institutions in their relationships with the private sector. The concept of "attachment" could also lead to the creation of unwanted short term arrangements between private sector entities and educational institutions, specifically designed to move a property outside the scope of the new charge to CGT. The concept would also create further complexity where a site at one time is attached to an institution but later is not so attached if there is a requirement to apportion any gain between exempt and chargeable periods.

5.8 We note that the Government has already implemented a statutory regime which we believe could adequately identify genuine student accommodation for the purposes of exempting such properties from the new charge to CGT, namely pursuant to section 233 of the Housing Act 2004. The relevant part of the Housing Act 2004 imposes a regulatory regime for Houses in Multiple Occupation ("HMOs"). Since that act came into force there have been further developments to ease the regulatory burden the latest one, relevant to this context, being The Housing (Codes of Management Practice) (Student Accommodation) (England) Order 2010 (2010 No. 2615). In short, this statutory instrument relates to the approval by the Secretary of State for Communities and Local Government of two codes of practice both in respect of "larger developments" of student accommodation (one for those managed by educational establishments and one for those that are not). Copies of both of these codes of practice may be obtained from the National Administrator for the ANUK/Unipol National Code of Standards.

5.9 In our experience the majority of institutional investment grade purpose built student accommodation sites are managed by parties that have signed up to one of the two codes of practice. It should be noted that either the owner of the property can sign up to the

code in respect of the site or the manager or contractor appointed by the owner of the site can sign up to the relevant code. We suggest that as long as a party has indicated adherence to the code in respect of a site that site should meet the definition of student accommodation and accordingly be exempt from the new charge to CGT. For reference, larger developments are those which comprise buildings occupied by more than 15 students. By adopting such a definition of student accommodation for the purposes of the new charge to CGT, the Government would be using a tried and tested regime which is understood across the industry rather than looking to identify a new definition which we suggest would be significantly complex to achieve.

5.10 The Government should note that any exemption for purpose-built student accommodation should be sufficiently flexible to ensure that incidental non-student use (for example, occupation by those which manage the property or wardens) does not prevent the exemption from applying. Further, to ensure that the exemption does not become unduly burdensome to administer/claim, the exemption should not be impacted by changes to the student status of the occupant after they enter into the tenancy, for example, where during a tenancy an occupant ceases to be a student due to ill health, as a result of failing examinations or otherwise. In addition, the exemption must be sufficiently flexible to ensure that use of the accommodation outside of term time or any vacancy (whether term time or vacation) does not prevent the exemption from applying in full. Both universities and private operators of student accommodation may derive income from letting rooms during the summer vacation, to attendees at conferences or summer courses, to tourists or otherwise. We do not consider there to be any reason to seek to apportion each year for the purposes of the exemption between exempt term time use and, depending on the occupants, exempt or taxable vacation use. A feature of purpose built student accommodation is that the occupational tenancies are typically between 42 and 50 weeks. There is no mischief in non-student use during vacation periods – it is essentially a means of mitigating the costs of voids over the summer vacation. Also, any attempt to apportion between summer and term time will make the regime unnecessarily complex without any clear policy rationale.

5.11 Finally, it should also be ensured that any exemption applies to residential accommodation for students which has been converted from other use, whether general residential or commercial.

6. Collection mechanism

Relevant consultation questions:

Question 13: Do you believe that solicitors, accountants or others should be responsible for the identification of the seller as non-resident, and the collection of the withholding tax? If not, please set out alternative mechanisms for collection.

Question 14: Are there ways that the withholding tax can be introduced so that it fits easily with other property transactions processes?

Question 15: Do you think that the government should offer the option of paying a withholding tax alongside an option to calculate the actual tax due on any gain made from disposal, within the same time scales as SDLT?

Question 16: Is it reasonable to ask non-residents to use self-assessment or a variant form to submit final computations within 30 days? If not, what processes would be preferable?

6.1 In our view the Government should implement the simplest possible collection mechanism available to it for the purposes of the new charge to CGT for non-residents. Given its familiarity for a significant number of non-residents, the Non-Resident Landlord ("NRL") scheme could be easily expanded and adapted to include provision for the reporting of gains on residential properties owned by overseas investors and the collection of tax related thereto.

6.2 We note that there will of course be properties owned by non-residents that are not rented out and that the proposed charge to CGT is intended to encompass these properties as well. It would therefore be necessary to expand the existing NRL scheme to include all non-resident owners of UK residential property. Such owners could be required to supply information to HMRC in order to register under the scheme and confirm that they will report income and gains made on the property to HMRC and account for the relevant tax due.

6.3 In our view a withholding tax mechanism would be an unwieldy and unwelcome mechanism for the imposition of the new charge to CGT on non-residents. In particular we do not consider it appropriate for solicitors in England and Wales to be responsible for withholding and account for such tax out of the proceeds of sale from a property. Such a withholding tax mechanism would lead to significant uncertainty and would no doubt result in a significant number of tax refund applications in relation to scenarios where the withholding tax deducted is in excess of the actual amount of tax due on the gain. This is on the basis that any such mechanism would not take into account deductible expenditure incurred by the relevant non-resident on the property being disposed of.

6.4 A withholding tax could be considered as a reserve position to deal with recalcitrant non-residents. Alternatively, should the Government still wish to provide a strong incentive for compliance, the Government could consider amending the land registry administrative process such that transfers of UK residential real estate by non-residents cannot be registered until evidence is provided that any CGT due on a disposal has been duly accounted for to HMRC or an appropriate undertaking has been given with regard to the payment of tax. This would incentivise selling non-residents as purchasers would require the evidence as part of the transaction process to ensure that their title can be registered and made effective.

7. Contact

For any queries on our comments on this consultation, please contact:

Yours faithfully

Simmons & Simmons LLP

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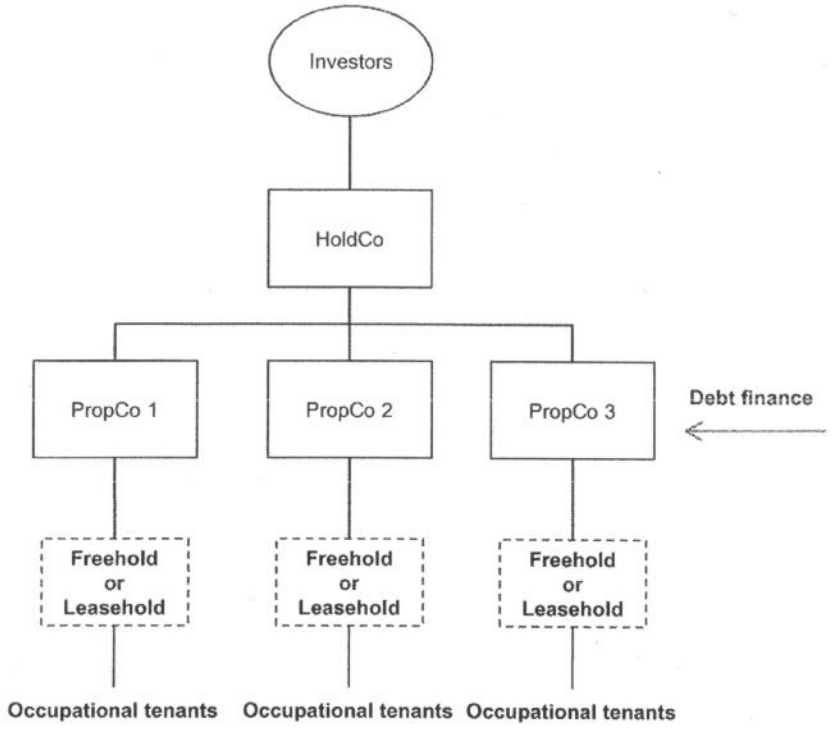
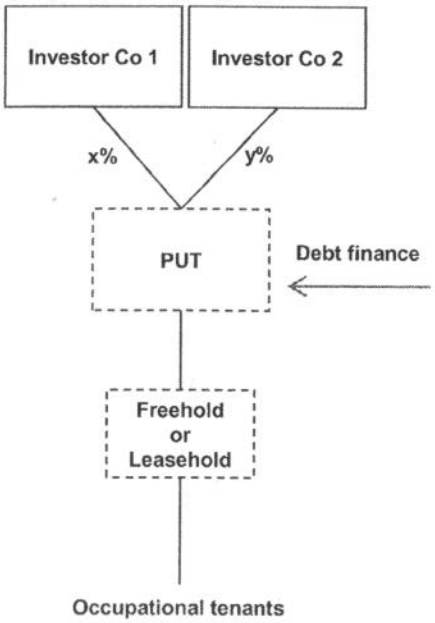
APPENDIX 1 – EXAMPLE STRUCTURES

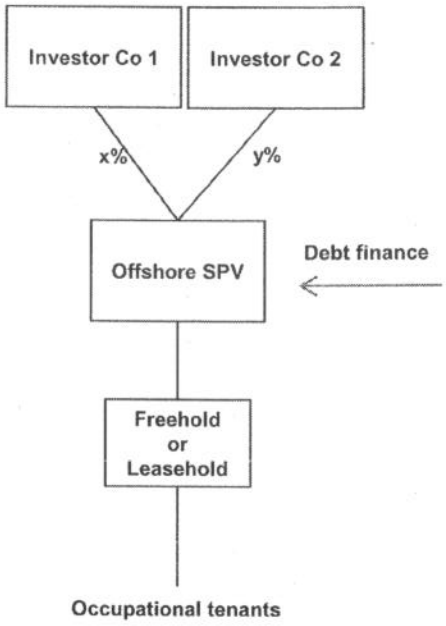
1. **Multiple asset owning fund structure**



1. **Offshore unit trust**



2. **Offshore Corporate SPV**



3. **Limited partnership**