

**EXPLANATORY MEMORANDUM TO**

**THE UK PROPERTY RICH COLLECTIVE INVESTMENT VEHICLES  
(AMENDMENT OF THE TAXATION OF CHARGEABLE GAINS ACT 1992)  
REGULATIONS**

**2019 No. [XXXX]**

**1. Introduction**

- 1.1 This explanatory memorandum has been prepared by Her Majesty's Commissioners for Revenue and Customs (HMRC) on behalf of Her Majesty's Treasury (the Treasury) and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

**2. Purpose of the instrument**

- 2.1 These regulations amend existing legislation concerning the tax treatment of capital gains arising on disposals of interests in UK land by non-UK residents, specifically rules pertaining to 'UK property rich' collective investment vehicles ('CIVs') and their investors. The amendments are made following post implementation engagement with stakeholders, and they ensure the legislation works as intended. In particular, the changes ensure that investors who are exempt from the charge to tax on capital gains can benefit from that exemption when investing in such vehicles, and that eligible CIVs may make certain elections.

**3. Matters of special interest to Parliament**

*Matters of special interest to the Select Committee on Statutory Instruments*

- 3.1 These regulations will come into force with effect from 6 April 2019 in relation to disposals made on or after that date, except as noted below.
- 3.2 Except where otherwise stated these regulations have effect in relation to disposals made on or after 6 April 2019. However, regulations 3(b), 8, 10(b) and (c) and 11 have effect in relation to disposals made on or after the day on which these regulations come into force as they could potentially create additional tax liabilities for the entities affected, either retrospectively or prospectively. Regulation 7 has effect in relation to elections made on or after that day.

*Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)*

- 3.3 As this instrument is subject to the negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

**4. Extent and Territorial Application**

- 4.1 The territorial extent of this instrument is the United Kingdom.
- 4.2 The territorial application of this instrument is the United Kingdom.

## **5. European Convention on Human Rights**

- 5.1 This instrument is being published in draft for consultation. This section will be updated after the consultation has closed.

## **6. Legislative Context**

- 6.1 Schedule 1 to Finance Act 2019 introduced new provisions extending the scope of the UK's taxation of gains accruing to non-UK residents on disposals of UK land to include gains on disposals of interests in non-residential UK property. In broad terms, it also extended the charge on gains on disposals of interests in residential property to include disposals made by widely held companies and investment funds not previously included, and to life assurance companies. The new rules apply to disposals made on or after 6 April 2019.
- 6.2 Paragraph 14 of Schedule 1 inserted a new Schedule 1A to TCGA 1992, which contains the provisions relating to disposals by non-UK residents of assets that are UK property rich, that is deriving 75% or more of their value from UK land. This includes bringing into charge gains on assets that derive at least 75% of their value from UK land where a person has a substantial indirect interest in that land.
- 6.3 Paragraph 21 inserted a new Schedule 5AAA to TCGA 1992, which contains rules pertaining to UK property rich collective investment vehicles ('CIVs'), a defined term encompassing various forms of investment funds, and their investors. Schedule 5AAA interacts with Schedule 1A to make provisions relating to disposals of interests in CIVs, and disposals by CIVs in relation to UK land.
- 6.4 Schedule 5AAA provides that all CIVs, other than partnerships, will as a default position be treated for the purposes of TCGA 1992 as if they were companies and so chargeable to Corporation Tax. An investment in a CIV will be treated as if the interests of the investors were shares in a company, so that where the CIV is UK property rich, a disposal of an interest in it by a non-UK resident investor will be chargeable to UK tax under the provisions in Schedule 1A.
- 6.5 The default position described above would, without further provision, adversely affect exempt investors such as pension funds were they to invest in a CIV that in turn suffered tax on disposal of interests in UK land. Non-exempt investors could suffer effective double taxation when disposing of an interest in such a vehicle. Schedule 5AAA therefore provides that widely held CIVs may, subject to qualifying criteria and conditions, make certain elections (for transparency or exemption) that have the effect of moving the incidence of tax on relevant gains from the relevant vehicle to its investors.
- 6.6 Paragraph 8 of Schedule 5AAA provides the rules and conditions applicable to the transparency election. Broadly, the effect of the transparency election is to treat the CIV as a partnership for the purposes of capital gains, thereby ensuring that the investors are (where they are within the charge to tax) taxed on disposals of interests in the underlying assets of the partnership. An investor who is exempt from capital gains would therefore be able to directly engage that exemption on such a disposal. This election is only available to CIVs that are already transparent for income purposes.
- 6.7 Paragraph 12 of Schedule 5AAA provides the rules and conditions applicable to the exemption election. Under the election for exemption, a CIV is still treated as a company notionally chargeable to tax on its gains but the election exempts the CIV

from that tax. The CIV's investors remain chargeable on their gains on disposals of interests in the CIV, unless they are exempt on such gains because of their own tax status, for example certain pension funds.

- 6.8 Paragraph 6 of Schedule 5AAA provides an important exception to the operation of a provision applicable to non-resident investors in other UK property rich companies, whereby broadly they do not come within the charge to tax on gains on disposals of interests in such vehicles where they hold less than 25% of the shares. This rule was introduced because it is often difficult in practice for minority investors to know whether the companies they are invested in are UK property rich. This de minimis does not apply to investors in UK property rich CIVs, however, because such vehicles are marketed on the basis that they will predominantly invest in UK property.
- 6.9 The provisions within Schedule 5AAA were developed subsequent to extensive engagement with industry, including representative bodies, investment management firms, professional advisory firms and law firms. The resulting rules can be complex in operation but have been broadly welcomed as resolving the difficulties that the default treatment for CIVs would otherwise have resulted in. Finalising the rules meant that there was insufficient time to include them in the Finance (No. 3) Bill 2018 when that was published on 6 July 2018. Direct consultation with industry continued and appropriate amendments were made to address arising issues. Powers were also provided within Schedule 5AAA to enable HM Treasury to make Regulations to address any further issues that might arise once the new rules were engaged in practice, with retrospective effect where necessary.

## **7. Policy background**

- 7.1 HMRC and HM Treasury have continued to meet with industry representatives since the new rules were introduced. A number of practical issues have been identified as professional investors and advisory firms have considered the impact of the new rules on their or their clients' UK property holdings, and these regulations are intended to address particular issues where the intended effect of the rules would not be achieved. Representations have made it clear that failing to address these issues would have an immediate impact on exempt investors, reducing their expected returns from investment in UK property, and a lack of certainty as regards operation of aspects of the rules would dampen investment in UK commercial property in particular as it is commonly held within CIV structures.
- 7.2 The issues identified are, broadly, concerned with the scope of the term collective investment vehicle as applicable to certain non-resident UK property rich companies, information reporting obligations where transparency elections have been made, rules intended to prevent closely held vehicles from benefitting from the exemption election, and ensuring that exempt investors may continue to benefit from exemption when they invest indirectly in collective investment vehicles through holding structures. There are also some minor corrections and clarifications. HMRC have received representations from advisory firms and from customers who are directly impacted by the rules, and these have provided evidence that the problems identified at 6.5 above cannot be fully addressed if the amendments made by these Regulations are not implemented.
- 7.3 The changes relating to non-resident UK property rich companies ensure that only principal, and not subsidiary, companies of non-resident property groups come within the definition of a CIV. This mirrors the position for UK real estate investment trusts,

which are a UK resident broad equivalent of such companies. The change means that subsidiary companies of such groups will not be able to make elections for exemption themselves. It was not intended that they should be able to so elect and industry representatives have said that such a change should not have adverse effects, but to provide for the possibility that such elections may have been made prior to the date these regulations take effect the change has effect from the day after that date.

- 7.4 CIVs that make transparency or exemption elections are subject to requirements to provide certain information either at the time of making the election and / or at some specified future point. The changes made by these regulations clarify the obligations with regards to HMRC giving notice to provide Partnership Returns for CIVs that have made the transparency election. This will ensure that HMRC has reliable and up to date information about the investors in such vehicles, and that returns need only provide details of relevant gains and not the income of the fund as such income that arises directly to investors. There is also a new statutory requirement to provide investors' details on the making of such an election. This last change takes effect from the day after the date that these Regulations take effect.
- 7.5 The rules that prevent closely held vehicles from benefitting from the exemption election rely on the CIV or its investee company as the case may be meeting certain conditions. For companies, a modified version of the close company test within Chapter 2 of Part 10 CTA 2010 may be relied on. Alternatively for companies, and generally for all other CIVs, there is a different test concerned with genuine diversity of ownership. CIVs wishing to make an exemption election must satisfy one or other of these conditions (in addition to other conditions). These regulations make changes to the rules so that CIVs that existed at 6 April 2019 or that are structured as partnerships, trusts or contractual schemes are not disadvantaged because they fail to meet the conditions for purely technical reasons despite being widely held in practice.
- 7.6 The existing rules, as a result of paragraph 33 of Schedule 5AAA, exempt disposals of interests in CIVs (or in some cases their investee companies) made by holding vehicles that are wholly owned by specified investors who would be exempt from tax on otherwise chargeable gains. This is because it is common for, for example, pension funds to consolidate their investments within a holding vehicle. These regulations address further structures that been identified where such investors use alternative holding structures for which the current rules make no provision.
- 7.7 Other changes made by these regulations correct minor errors or clarify the way particular rules are intended to operate. The most significant of these changes concerns clarifying that exemption elections made under paragraph 12(3) by certain tax transparent CIVs require direct ownership of an underlying investee company, and that elections in respect of indirect interests are not permissible. To deal with the possibility that such elections may have been made, the change takes effect from the day after the date that these Regulations take effect.

## **8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union**

- 8.1 These regulations do not relate to withdrawal from the European Union.

## **9. Consolidation**

- 9.1 There are no plans to consolidate the legislation.

## **10. Consultation outcome**

- 10.1 This instrument is being published in draft for consultation. This section will be updated after the consultation has closed.

## **11. Guidance**

- 11.1 HMRC published [draft guidance](#) on 31 December 2018 on the new rules introduced at Schedule 1 to Finance Act 2019. HMRC will publish updated guidance to take account of comments received on the draft guidance and to reflect changes made by these regulations before they take effect.

## **12. Impact**

- 12.1 The impact on business, charities or voluntary bodies is as follows. These regulations ensure that the new rules introduced at Schedule 1 to Finance Act 2019 operate as intended. The regulations are predominantly relieving. Businesses impacted by these changes will incur insignificant one-off costs of familiarisation with the amendment. There are not expected to be any ongoing costs to those businesses from the amendment.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 A Tax Information and Impact Note has not been prepared for this Instrument as it contains no substantive changes to tax policy.

## **13. Regulating small business**

- 13.1 The legislation applies to activities that may be undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses.
- 13.3 The basis for the final decision on what action to take to assist small businesses was that, although the changes do not discriminate between businesses few, if any, small businesses are affected. The impact on small and micro businesses is negligible.

## **14. Monitoring & review**

- 14.1 The approach to monitoring of this legislation is as follows. CIVs making elections for transparency or exemption are required to send notices to HMRC, together with required information and in the case of exempt funds there is an ongoing obligation to report details of disposals and investors annually. This information, together with ongoing engagement with industry, will allow HMRC to closely monitor the operation of the rules and to consider whether further changes may be required to ensure that they are working as intended.
- 14.2 The regulations do not include a statutory review clause. They amend United Kingdom tax legislation and therefore fall within the exceptions at section 28(3)(a), Small Business, Enterprise and Employment Act 2015.

## **15. Contact**

The draft regulations are being published for consultation. This section will be updated after the consultation has closed.