# The Association of Real Estate Funds – Position Paper

## The use of Non-Domestic Domiciles

The publication of the Panama Papers has raised serious questions about the consistency of global regulatory and tax compliance but equally has led to widespread, mis-informed, commentary about the use of "offshore" jurisdictions and some reference to real estate being used to launder money (largely focussed on the high-end, Central London, residential market).

The Association of Real Estate Funds (AREF) has long had, as one of its core objectives, the promotion and oversight of the highest levels of governance and transparency amongst member funds and their managers, as set out in the AREF Code of Practice and re-enforced by our recently introduced Self-Certification process.

Investors choose real estate investment, both commercial and residential, as part of a multi-asset portfolio for a variety of reasons but, due to the very large lot sizes, often running into hundreds of millions of pounds, all but the very largest investors are generally unable to construct well-balanced portfolios by buying directly. Real estate funds therefore offer the opportunity to invest smaller sums on a balanced basis or to access particular types of real estate, different countries, or specialist management.

One of the key functions of a fund is to put the investor in the same (or as near as possible) position as if they owned the underlying real estate themselves and fund promoters and managers will select available fund structures that best achieve this. In the case of all AREF members a key aim is to ensure that the tax payable by investors is no more than it would be if they owned the underlying real estate; it is not to artificially reduce an investor's tax burden.

Domestic structures are already available to achieve this. Pension funds have long had the availability of Exempt Property Unit Trusts and tax efficient Insurance-Linked funds. In recent years Property Authorised Investment Funds (PAIFs) have emerged catering for retail investors using ISAs and personal pensions and, more recently, Co-Ownership Authorised Contractual Schemes (ACSs) intended to put the UK on a par with funds available, for example, in Ireland and Luxembourg. In the case of PAIFs and ACSs the Treasury has made good progress in accommodating issues raised by the industry to encourage widespread take up.

Problems arise however when co-mingling different types of investor together, e.g. UK tax payers and non-tax payers or investors of different nationality with differing domestic tax regimes. This may mean that a domestic structure would result in some investors paying more tax than they otherwise would, hence the use of alternatives.

A significant proportion of AREF member funds are domiciled outside the UK. Many of those are based in Jersey or Guernsey, both of which are Crown Dependencies and are considered to be amongst the most transparent and highly-regulated jurisdictions in the world. Others are based in Dublin or Luxembourg, both of course within the EU. However, it is not just tax parity which may dictate a non-UK jursidicton; in circumstances where a fund needs to be created quickly, for example to facilitate a large transaction shared between a number of investors, regulatory regimes in the above jurisdictions can sometimes be more accommodating on timescale than the UK.

Additionally, a key feature of real estate as an asset class is that most, if not all, territories retain the ability to tax income from local real estate in the jurisdiction in which the property is located. Transfer pricing, BEPS initiatives and local tax rules should address related issues such as the amount of interest deduction available to reduce the local tax. As a result this greatly reduces the ability to avoid tax on real estate investments compared with other asset classes.

Whilst membership of AREF is, in principle, open to funds invested or domiciled anywhere globally we will continue to robustly review any new members to ensure that they meet our transparency standards, and one of the key determinants will remain the openness of the fund domicile.

July 2016