
Asset Holding Companies Consultation
Corporate Tax Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
By email: ukfundsreview@hmtreasury.gov.uk

23 February 2021

Dear Sirs,

AREF response to The Tax Treatment of Asset Holding Companies in Alternative Fund Structures consultation

We value the opportunity to engage on the second stage of HMT's consultation on Asset Holding Companies (AHCs) and agree with the view that the UK has excellent legal and regulatory infrastructure as well as a skilled workforce which makes this a competitive location for asset holding companies to be located. We also agree with the views expressed in the summary of responses that establishment of AHCs in the UK could bring economic benefits, primarily through creating additional jobs in associated service sectors which aid the servicing and administration of these vehicles.

However, we believe that there are fundamental issues with the design of the new regime as presented in the consultation and that if implemented unchanged it would be unlikely to be used by members and offer fractional benefits compared to the potential prizes in play.

Our response is not structured around the questions but offers a more generalised view of what key features would be required for a special regime for AHCs and how success has been driven in other international jurisdictions which the UK will need to compete against in the set up these types of vehicle. Also included as an appendix are examples which help illustrate issues members anticipate they under the current proposals.

Building on the frequent and detailed engagement sessions offered by Policy Leads in respect of this consultation, a model for how these interactions should be structured, AREF and its members are keen to work with HMT on each of the points raised to help communicate the operational issues and commercial reality faced by businesses in what is an established and competitive market for AHCs.

We look forward to continuing our on-going dialogue and supporting HMT in crafting an AHC regime which is truly fit for purpose and achieves its intended goals.

Yours sincerely,



Paul Richards

Managing Director, The Association of Real Estate Funds

Association of Real Estate Funds

The Association of Real Estate Funds (AREF) represents the UK real estate funds industry and has 67 member funds with a collective net asset value of more than £70 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the MSCI/AREF Property Fund Vision Handbook.

Our Response

As highlighted in our response to the original consultation document, for an Asset Holding Company (AHC) tax regime to be competitive and successful, it needs to offer a tax outcome that is internationally competitive and comparable to other popular fund locations. In addition, the regime would need to be flexible, simple to understand and apply, and offer businesses certainty of proportionate administrative and compliance costs.

Based on discussions to date with HMRC and HMT we are concerned that the regime could fall short for real estate as an asset class. That is particularly the case in relation to the taxation of overseas real estate held by a UK SPV company, and the ability to make indirect disposals of that overseas real estate.

The attached schedule highlights the principles that we would expect to see applied to a the AHC regime for it to successfully compete with jurisdictions like Luxembourg and the Channel Islands. Put simply, managers will make a direct comparison to their current structures when deciding where to establish their next fund. To be attractive the UK must match, or better, what is on offer elsewhere.

Real Estate Investments under the AHC regime

To be competitive the AHC regime should:

- be capable of owning wide a range of real estate assets, including UK and overseas properties, core through to value-add/opportunistic assets, investment and trading opportunities; and properties with varying degrees of asset management and service provisions;
- include specific modifications to the corporation tax regime to allow for real estate investment structures, in line with both the REIT and non-resident capital gains tax regimes;
- allow for both internally and externally managed investment structures; and
- allow for a fund vehicle, holding company and property holding SPVs to all be based in the UK on a tax efficient basis.

UK Real Estate

Investors will generally pay tax on UK rental income and capital gains, and we accept that the proposed AHC regime must not undermine that position. Given alternative investment structures such as REITs and unit trusts it is

unlikely that the AHC regime will be specifically adopted to hold UK real estate. However, to provide flexibility and efficiency within a wider fund structure, an AHC should be:

- able to hold UK real estate through common transparent structures such as partnerships or “Baker” unit trusts and contractual schemes (both closed and open ended, and authorised or unauthorised);
- able to continue to make an exemption election under the non-resident capital gains tax rules, where it is controlled by a collective investment scheme such as a partnership fund structure;
- able to benefit from the qualifying institutional investor exemption under the substantial shareholding regime; and
- treated as an “institutional investor” under the UK REIT regime.

Overseas Real Estate

Rental income and gains will be taxed in the jurisdiction where the real estate is situated. Therefore, it is not appropriate for further tax to be raised in the UK on that income and gains. For the regime to be attractive, the tax neutrality must be practical to obtain with administrative ease and minimal technical complexity. There is a genuine opportunity for the proposed AHC regime to be attractive for holding overseas real estate. But, if there is any risk of additional UK tax, then the AHC regime is unlikely to be used to hold overseas real estate investments.

In addition, where overseas real estate is acquired by a UK company there needs to be the ability for that real estate to be disposed of by way of an indirect sale to as wide a range of potential purchasers as possible. It follows that a general corporation tax exemption for overseas real estate income and gains would be needed separate from the AHC regime.

To the extent there is any concern that UK taxpayers could avoid taxation on overseas real estate through the AHC regime, we would support the concept of a targeted anti-avoidance rule. At present local taxes would be paid in an overseas holding structure, but it may be possible to defer any UK taxes until income and gains are ultimately remitted. A TAAR should be limited to arrangements that go beyond this, and in particular, should not treat the overseas real estate as though it is held directly.

Eligibility

The eligibility criteria to access the regime should be as wide as possible. The regime should allow for fund structures, joint ventures and club deals, as well as wholly owned investments by institutional investors. For simplicity, the tests applied under the non-resident capital gains tax or REIT regimes would be appropriate, with a focus on genuine diversity of ownership or institutional investment. Those tests are understood and currently being applied within the industry.

We support the concept of targeted anti-avoidance rules to prevent certain investors, including closely held structures with no institutional investment, from being able to access the regime. However, as described above the main exception would be overseas real estate held through a SPV UK company. In those circumstances, eligibility criteria would not be appropriate and there should be a general exemption from further UK tax.

We feel that limiting eligibility through tightly defined requirements for an independent regulated manager, will inadvertently exclude a range of commercially reasonable investment structures which are used by otherwise “good” institutional investors. We feel the focus for eligibility should be on the investor base as noted above.

Wider tax issues

That attached schedules highlights the principles that we would expect the regime to include. But in particular:

Withholding tax

We recommend a wide exemption from withholding tax on interest payments paid by an AHC so that the regime is internationally competitive. We accept that there are currently a range of domestic exemptions, but they can be expensive and onerous to implement, and compare unfavourably with alternative regimes.

The continuing absence of withholding tax on dividends is potentially a significant competitive advantage.

Capital Gains

The sale of SPVs holding overseas real estate should be tax exempt under the substantial shareholding regime, but without a requirement for the SPV to have an underlying trading activity, or be held by qualifying institutional investors. If gains on the sale of an overseas property rich SPVs are potentially subject to UK tax, the regime will be uncompetitive.

If an SPV is UK property-rich the disposal would be subject to the UK tax regime. However, the non-resident capital gains tax principles should apply, and the AHC should be able to make an exemption election within a fund structure.

VAT

We accept that the VAT treatment of management fees is subject to a separate review. However, it is important to emphasise the need for a wide-ranging exemption for VAT on fund management fees. Again, such an exemption is necessary in a fund context to ensure that the UK is internationally competitive.

Compliance & Reporting

We have significant concerns that if proposals are included that require complex tracing and ‘in-housing’ of additional investor tax compliance and reporting at the level of the fund manager will significantly disadvantage the regime when compared to alternative options. Generally, fund managers are reluctant to bring risk of investor level compliance within their responsibility unless it is necessary.

UK Fund Review

We would stress that any changes made to encourage the formation of AHCs in the UK should not be done in isolation.

We note HM Treasury's review of the UK Funds regime, and the call for input issued on 26 January 2021. We welcome the opportunity to participate in this review. The review anticipates the creation of a number of different new fund vehicles, regulated and unregulated, open- and closed-ended, tax transparent and opaque. Funds may also be constituted in other countries with a range of legal and regulatory structures and attributes.

It is crucial to the attractiveness of an asset holding company regime that any such regime is compatible with the widest possible range of investment structures. Ideally, it should be possible for a fund manager to adopt a fund vehicle, including any feeder structures, which meets the needs of the target categories of investors and reflects an appropriate level of regulation, without needing to consider whether that choice of vehicle is compatible with the AHC regime. The AHC eligibility criteria should not therefore depend on the legal or regulatory structure of the fund vehicle adopted.

It is also important that were possible these changes are made in parallel to fully understand the relevant interdependencies between the proposed AHC regime and changes which will emerge from the wider UK Fund regime. The UK Fund regime work is still at the incubation phase while work on AHCs has continued at pace. A holistic approach to change with reasonable and considered time horizons is needed to avoid the risk that the AHC regime is remade in ways which may prove to be irreconcilable with the UK Fund regime in the future. This approach must factor in the role which VAT plays in the investment structures and seek to align any changes to come out of the VAT in Fund Management review announced at the same time as the original AHC consultation in March.

Finally, with the UK Government's commitment to increasing access to the illiquid assets market, specific consideration should be made to what changes are needed to the AHC regime to ensure that new vehicles such as the Long-Term Asset Fund and proposals for an unauthorised Onshore Professional Fund can successfully utilise UK holding companies.