UK Property Rich Collective Investment Vehicles (Amendment to TCGA 1992) Regulations 2019

To: financialproductsandservices@hmrc.gov.uk
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Introduction

1. The British Property Federation (BPF) represents the real estate sector – an industry which contributed more than £100bn to the economy in 2018 and supported more than 2 million jobs.

2. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax.

3. Almost a third of UK commercial real estate is owned by overseas investment and a further third are owned by collective investment vehicles (including funds and REITs), which cater to a global investor base. We are therefore keen to ensure that the new capital gains tax rules for overseas investors in UK real estate function well and do not cause undue burden on investors – and in particular, to make sure that there are no undue technical barriers to eligible investors making appropriate elections.

4. One of the concerns we have raised previously in this regard is the need for fund managers to be able to perform the compliance and make the necessary payment of tax on behalf of their investors. We understand that, although such functionality is not included in the latest draft regulations, this is still under consideration – and we would continue to reiterate the need for such functionality in the rules.

5. We acknowledge HMRC's proactive engagement throughout this process and welcome this further opportunity to feed in our comments and raise any potential concerns with the draft regulations. Our detailed comments are included in the appendix, but we would draw out the following points:

   5.1. We would welcome further clarity in respect of the new paragraph 33A and its intended scope, in particular in relation to how paragraphs 5 and 6 of Schedule 1A are intended to apply on any deemed disposal required to be made when determining a company's UK property richness for the purposes of any election available to be made under Schedule 5AAA. We suggest that these provisions should not preclude the making of an election - with the corollary that, once an election has been made, neither paragraph 5 nor 6 can apply to a disposal by an investor of an interest in the elected entity (thereby respecting the principle of a single tax point only (at investor level) for UK property-rich funds).

   5.2. We do not think that the amendments made to paragraph 21 have addressed the policy concern – that there should only be a single tax charge on disposals where an exemption election is made. We think there is still a risk of double taxation for some distributions from exempt funds and have made suggestions within the response to resolve this concern.

6. Should you require any further information on any aspect of this submission please contact, Rachel Kelly (Senior Policy Officer), on either 020 7802 0115 or rkelly@bpf.org.uk.

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Appendix: Comments on The UK Property Rich Collective Investment Vehicles (Amendment of the Taxation of Chargeable Gains Act 1992) Regulations 2019

1. References to paragraphs are to paragraphs in Schedule 5AAA; references to regulations are to the paragraphs of the draft SI circulated by HMRC on 1 August 2019.

Regulation 1: commencement

1. We agree that the changes made by regulations 3(b), 7, 8, 10(b)(c) and 11 should be prospective.

2. In relation to the changes made by regulations 3(b), and 8 in particular, it is important that there is clarity as to the exact prospective nature of the changes. This is because these could impact the eligibility of certain entities to make an election under paragraph 12. Certain entities that are, under the original drafting of Schedule 5AAA, eligible to make an exemption election (assuming the various entitlement conditions are met) may no longer be able to do so once Schedule 5AAA has been amended. So, for example, a company that fell within the original paragraph 1(1)(d) and made a paragraph 12(2) election would no longer meet the definition of collective investment vehicle if it is not itself a principal company of a group.

3. For such an entity, please confirm whether it is intended that an election that has been validly made prior to the date of the regulations will remain in effect - and so that future disposals by a fund/company that has validly made an election (the “Existing Fund”) remain exempt from CGT.

4. We note here that where an election has been made, paragraph 17(3) states that it has effect for disposals made after the date of the election - and so this suggests that, once an election is made, the intention is that future disposals by the Existing Fund should remain exempt (subject to the various entitlement conditions continuing to be met). The issue here is that the entitlement conditions are being amended. As a result, an Existing Fund that met the entitlement conditions as and when it elected (and would continue to meet those “election” conditions) would, because of these changes in law, cease to meet them and the election would no longer apply. This follows on from paragraph 20 which provides that an election ceases to have effect if a qualifying fund/company fails to meet the “applicable exemption conditions” (which are derived from the entitlement conditions).

5. An Existing Fund that has made a paragraph 12(2) election fails to meet an applicable exemption condition if it ceases to be a collective investment vehicle (see paragraph 38(1)(b)). Similarly, an Existing Fund that is the subject of a paragraph 12(3) election fails to meet an applicable exemption condition if it fails to meet the condition as to ownership in paragraph 12(3)(a).

6. The reference in regulation 1(2) to these changes taking effect for “disposals” on or after the regulations coming into effect suggests that for an Existing Fund, it is only when it makes its first disposal after they come into force that the amendments will apply - with the consequence that it then ceases to meet the applicable exemption conditions - and so that disposal is not exempt (given paragraph 20(2) - the disposal is the “subsequent time”). Is this what is intended?

7. If so, then assume an Existing Fund elected in May 2019, the regulations come into force on 31 January 2020 and its next disposal is in January 2023. Any disposal made prior to 31 January will be exempt (and so the change is therefore not retrospective) but in January 2023, its disposal is taxable - and so the changes are retrospective in that they “undo” its election. We note here that the Explanatory Notes do not comment on

the specifics of commencement - and if it is intended that these changes will lead to an Existing Fund losing its exemption, we consider that this should be made clearer. (And, if this is not the intention, again we ask that clarity is provided within the regulations- and note that amendments to both the regulations and Schedule 5AAA may be necessary as a result).

8. Here, we note that the proposed amendments are intended to ensure that the drafting of Schedule 5AAA is in accordance with the original policy intention - and as a result we acknowledge that this outcome would (in effect) respect those policy intentions (as a fund that was not intended to benefit from exemption ceases to have that exemption for future disposals, whilst not being disadvantaged in relation to disposals it has already made).

9. However, there are additional consequences in such a case given how Schedule 5AAA is structured. First, if an election ceases to be of effect, paragraph 22 would apply, giving rise to a deemed disposal by investors - and the three year long-stop date in paragraph 23(8) could lead to investors having a dry tax charge solely as a result of corrective amendments to legislation (with the timing of that charge dependent on that first disposal). (We note here that the materiality of this issue in practice will be dependent on the number of Existing Funds that have already made an election that could be impacted by this change - information which we do not have access to.)

10. Further, by referencing the time of a disposal, some funds would appear to be able to benefit from rebasing under paragraph 32 if that first disposal takes place more than 5 years after the election was made - even though the actual “ending” of exemption is (in substance) when the regulations take effect.

11. Finally, given the reporting requirements that apply where an election is in effect, a fund that has elected may choose to revoke that election - rather than continue to report when there is no further exemption. This would again trigger a deemed disposal under paragraph 22 - and that would be the case whether or not at that time the fund had made an (exempt) disposal.

12. In relation to the amendments made by regulation 10(a), we note that paragraph 21 (1) is material to determining if there is a (deemed) disposal - does the commencement provision in regulation 1(3) mean that if, under the existing paragraph 21, a deemed disposal would arise, then there is a disposal and at that point regulation 10(a) amends paragraph 21 so there is then (possibly) no disposal? Would it be more straightforward if this amendment simply took effect from 1 April 2019?

13. We therefore suggest further consideration is given to the commencement provisions in regulation 1(2): we would be happy to discuss this with you further.

14. In relation to the other retrospective changes, please can HMRC update the draft guidance to reference that changes are to be made by the statutory instrument (for example, update the front page/introduction to the draft guidance should, if practicable, reference the fact that Schedule 5AAA is to be amended, including with retrospective effect, and link to the draft statutory instrument).

Regulation 3 - amending paragraph 1, Sch 5AAA

15. We welcome the proposed amendments made to paragraph 1.

16. In relation to UK REITs, we consider that the amendments to be made to paragraphs 1((1)(c) and 1(7) helpfully clarify the application of Schedule 5AAA to a group REIT, which is important given paragraph 6 and its relevance to investors in a REIT.

17. In relation to non-UK entities (referred to in the draft guidance at Appendix 15 to HMRC's CGT Manual as "overseas REIT equivalents") we welcome the amendments to insert new paragraphs 1(1)(d) and (e). These clarify how the definition of "collective investment vehicle" applies where the relevant non-resident entity is a member of a group and ensure that the relevant "collective investment" vehicle is the principal company of the group, both for UK REITs and "overseas REIT equivalents".

18. Given that, under paragraph 4, certain entities are deemed to be companies, we note that "group" here is defined by reference to section 170 TCGA. Under section 170, a "company" is defined in section 170(9) - and so if a company A owns 75% of the units of a JPUT (but not any other assets), company A would be potentially within paragraph 1(1)(d) and not within paragraph 1(1)(e) (and the JPUT would be potentially within paragraph 1(1)(a)). Similarly, if a JPUT owned company A (but not any other assets), then, even though the JPUT is a deemed company under section 99, company A would be potentially within paragraph 1(1)(d).

19. We note that such amendments are proposed to be prospective: this is helpful to the extent a company has relied on the existing definitions to make an election under paragraph 12, Schedule 5AAA - see here our comments on regulation 1. We also note that these definitions are also relevant to paragraph 6 - and so a person may have made a disposal in, say, 2019 of an interest in a collective investment vehicle and been liable to CGT in circumstances where, had that disposal taken place after the regulations come into effect, no CGT is chargeable because the substantial indirect interest in land requirement is governed solely by Schedule 1A. In this context, we note that the change to the definition of UK REIT in regulation 3(a) is retrospective to 1 April 2019 - whereas the change to the definition of "overseas REIT equivalent" is not, and would question whether the same commencement provision should apply to both for the purposes of paragraph 6. .

20. To qualify as a collective investment vehicle within paragraph 1(1)(d) or (1)(e), a company must meet the property income condition (as defined in paragraph 1(2). We note the proposed amendment to paragraph 1(2)(b): we agree that this is needed given the definition of "property income from long-term investments" and the need to apply the condition where the relevant company is the principal company of a group and it does not itself own UK land (it is a holding company only - and its subsidiaries, but not it, own UK land).

21. In this context, "property income from long-term investments" is defined in regulation 1(4) as "income deriving from direct or indirect investment". The draft guidance in Appendix 15 to HMRC's CGT Manual states that the test is intended "to include entities that are similar in nature to UK REITs" but states that this is not a "REIT equivalence" test.

22. We consider that further clarification is needed as to how the "property income" condition applies in relation to indirect income and the distribution condition in paragraph 1(2)(c). (It is clear that direct income would include rent from a commercial letting: we assume indirect income would include both dividends and interest received by a principal company from those of its subsidiaries that own UK land and receive direct property income.) The reason we ask for clarification (which may necessitate further amendments to paragraph 1, but is likely to require the draft guidance to be revisited) is the importance of certainty as to whether an entity is - or is not - a collective investment vehicle. For the vehicle itself, it is determinative of whether an election for exemption can be made - but for its investors, it is relevant to whether the "substantial indirect interest in UK land" means 25% or (because paragraph 6 applies) any percentage.

23. For example, given that amount of interest payable is contractual (both as to amount and timing) and the ability to pay dividends is generally subject to the availability of distributable reserves (and is likely to be discretionary), it is possible that in practice that the indirect income of the principal company that is the putative collective investment vehicle is less than the group's direct property income.

24. The inclusion of "indirect" property income in the definition of property income, and its carry-through to the distribution condition in paragraph 1(2)(c) suggests that the property income condition would apply by reference to the actual indirect income of the principal company (this is because paragraph 1(2)(b) and (c) refers to the "company" and "its" income). As a result, a non-UK property group could be within paragraph 1(1)(e) in circumstances where "substantially all" of its (direct) property income is not distributed - but retained in its subsidiaries. If this is the case, then a collective investment vehicle within paragraph 1(1)(e) will be in a different position to a UK REIT (where the 90% property income dividend requirement applies by reference to the aggregated direct property income of the group). Is this intended?

25. We also note that paragraph 1(2)(d) refers to "its" liability to tax: here, the principal company may be exempt from tax on its interest and dividend income (for example, in the latter case, through the availability of a participation exemption) but its subsidiaries that receive direct (property rental) income may be taxable. We assume it is intended that the conditions would be met in this situation.

Regulation 4 - amending paragraph 6(8), Sch 5AAA

26. No comments.

Regulation 5 - amending paragraph 7, Sch 5AAA

27. We welcome the reference to the new paragraphs 46A and 51 (in relation to which see comments below). We also welcome the dis-application of GDO regulation 75(4)(b) given the potential issues that could otherwise arise for some closed-ended funds in meeting this requirement given the manner in which they operate marketing of new funds.

28. We consider that it would be helpful if the guidance on the GDO requirement as it applies for the purposes of Schedule 5AAA could include specific examples of how the (adapted) provisions should apply in practice (whether by including examples within Appendix 15 or cross-referencing to the Investment Funds Manual).

Regulation 6 - amending paragraph 8, Sch 5AAA

29. We welcome the clarification of how the provisions in the Taxes Management Act 1970 (TMA) in relation to partnership returns are intended to apply to an offshore collective investment vehicle that makes a transparency election under paragraph 7.

30. The power under section 12AA(2) TMA is conferred by section 12AA(1) TMA. Section 12AA(1) states its purpose as being to establish liability to UK tax on income. Where HMRC has the power to issue a notice for such purpose, that notice can be extended to disposals of partnership property (see "shall also include" in the opening words of section 12AA(7) TMA).

31. The effect of a paragraph 7 election is that the collective investment vehicle is a partnership for CGT purposes only - and paragraph 7(2)(b) references the election resulting in the Management Act applying to it as a partnership "so far as relating to the taxation of chargeable gains".

32. It is not therefore a partnership for income tax purposes. However section 12AA(1) TMA is clear that HMRC, in acting under any of section 12AA92) or (3) TMA, is acting to facilitate amounts chargeable to income. Information about disposals can only be requested if a notice under section 12AA(2) or (3) has been validly given.

33. The amendments to paragraph 8 clarify the purpose (and underlying intention) of paragraph 8(2)(b) - and we acknowledge here the principle of *Marshall v Kerr*. It appears that paragraph 8((4)(a) is looking to specifically apply section 12AA to a deemed partnership to which it could not otherwise apply (given section 12AA(1)) - “adapting” section 12AA to apply in this specific circumstance.

34. If this is correct, we suggest this is clarified further in the drafting - the current language assumes section 12AA(1) (and so subsections (2) and (3)) can apply to the deemed partnership in any event due to paragraph 8(2)(b) (which may not necessarily be the case). What paragraph 8(4) does is to confer on HMRC a (new) stand-alone power to serve a notice in relation to the matters provided for in section 12AA(7) only (with that power sensibly piggy-backing off section 12AA).

35. Given the importance to taxpayers of compliance obligations being clearly signposted, we would ask that consideration is given to including a signpost to this (new) Schedule 5AAA power in section 12AA TMA.

36. Given any notice is to be given only with respect to disposals of partnership property, we assume any partnership statement required by section 12AB(1) will only require information as relating to consideration for disposals. This should be further clarified in guidance.

37. In addition, if the deemed partners in the partnership include individuals or trustees, it would be useful if the guidance could address the interaction between paragraph 8(4) and the obligations on partners under Schedule 2, Finance Act 2019 (particularly given section 12ABZB TMA).:currently, draft Appendix 15 to HMRC’s Capital Gains Manual states that “The normal rules for the 30 day reporting and payment on account provisions will apply for any disposal by the investors themselves, regardless of whether the CIV is transparent (a disposal of underlying property) or opaque (a disposal of an interest in the fund itself).”

38. Finally, we note that this provides HMRC with the power to require a CGT-only partnership return from a deemed partnership (i.e. where an election under paragraph 7 has been made). Given the language of section 12AA(1), there appears to be no equivalent power in relation to an actual partnership that makes UK land-related disposals - instead tax reporting will be made solely by the individual partners, whether under Schedule 2, Finance Act 2019 or through filing a company tax return.

Regulation 7 - amending paragraph 9, Sch 5AAA

39. We note that this makes mandatory the provision of certain information referenced by HMRC in the pro forma election form available on the gov.uk website. It is helpful that the specific requirements are set out in legislation so that there is no ambiguity as to the information required. We agree that this change should be prospective only.

Regulation 8 - amending paragraph 12, Sch 5AAA

40. We agree that “almost wholly” in this paragraph is redundant and so agree its deletion.

41. The other changes to paragraph 12(3) limit this provision to directly held subsidiaries of the "parent" collective investment scheme. We understand that this change in required to achieve the intended policy objective of these provisions. We note that the effect of this change is that if a partnership (LP) sets up a holding company (Master Holdco) that itself owns a UK property rich company (Propco), an election could not be made in relation to Propco as it is not directly held by the LP. (But if the LP only (or mainly) invests in UK property, and so Master Holdco is itself UK property rich, an election could be made in relation to Master Holdco - and each Propco it owns would benefit from exemption by virtue of paragraph 16.)

42. We agree with the approach taken in limiting paragraph 12(3) specifically to directly held companies, whilst retaining the existing definition of "wholly owned" (as applying to direct and indirect ownership) which applies elsewhere in Schedule 5AAA.

43. Further, we welcome this change to paragraph 12(3) being prospective only (as a result of regulation 1(2)) so that any election made by an indirectly owned Propco prior to these regulations coming into force remains valid in relation to disposals made prior to the regulations coming into force - but note here our comments on regulation 1.

44. We note that if a collective investment scheme has set up a subsidiary the shares of which are held legally by nominees, the effect of section 60 TCGA means that the subsidiary would be held "directly" by the collective investment scheme (i.e. nominees, or an equivalent bare trust arrangement) would not as a result be a "trust or other arrangement" within paragraph 12(3A)(b)).

45. The requirement that the company be held "directly" by the relevant collective investment scheme raises a question where a fund structure involves a series of tiered partnerships. This is because the company may be held "directly" by a collective investment scheme, although not necessarily the scheme into which external investors invest. An example would be LP1, which in turn invests in LP2 where LP2 owns one or more UK property rich companies. For example, LP1 could be a limited partner in LP2, with LP2's general partner being a subsidiary set up, on behalf of LP1, by LP1's general partner.

46. If LP2 is a collective investment scheme, we assume the UK property rich companies it owns would be eligible to have an exemption election made on their behalf under paragraph 12(3), assuming the other conditions are met. (We note here that paragraph 13(2), as amended, would allow the GDO test to be applied by reference to LP1 as a collective investment scheme that wholly owns the relevant companies and so the other conditions should be met). It would be useful if this could be addressed in the guidance.

47. The ability of LP2 to be able to make an exemption election in respect of a property-rich company that it owns directly is predicated on the new paragraph 13(2)(b). Paragraph 13(2)(b) is not however limited in its application to such tiered partnership structures.

48. Assume LP sets up Master Holdco that in turn owns one or more property owning companies. As above, if the investment strategy of the LP is to invest in UK property, it is likely that Master Holdco could itself be the subject of an exemption election as it would be UK property rich.

49. However, if LP intends to invest in property in a number of jurisdictions through (indirect) subsidiaries, Master Holdco would not be UK property rich, but some of its subsidiaries may be. In this case, if a second partnership (actual or deemed) - LP2 - were inserted between Master Holdco and a UK property owning subsidiary, and that LP2 is a collective investment scheme, would HMRC accept that an election can be made in relation to that UK property company? (If LP2 is a collective investment scheme, then paragraph 12(3)(a) is

met and provided LP1 meets the GDO condition, paragraph13(2)(b) would appear to be met as LP1 again will "wholly or almost wholly" own Propco - albeit this time through Master Holdco as well as LP2). Is this intended?

50. The reason we raise this is that, if an election in relation to Propco is possible in such circumstances, by reference to the GDO test, the UK tax condition is not relevant - and so it is possible that no tax would be payable by Master Holdco on a disposal of Propco by LP2 (depending on where Master Holdco is resident for tax purposes). Further as Master Holdco is not UK property-rich in any event, investors in LP1 would not themselves be subject to tax under the non-resident charge.

51. The issue arises because, to accommodate the changes to paragraph 12(3), paragraph 13(2)(b) has been amended to allow the GDO test to be applied both to the collective investment scheme that directly owns the property-rich company (LP2) and to any other collective scheme that wholly (or almost wholly) owns it. As "wholly owns" includes indirect ownership this would include LP1. If that indirect ownership is through a company that would not meet the UK tax condition, then the ability to make an election under paragraph 12(3) could result in no CGT being payable on disposals of UK land (direct and indirect).

52. However the position where there is a Master Holdco appears to us to be different to that where the indirect ownership of LP1 is only through other transparent entities (given that tax on a disposal of the property-rich subsidiary would continue to be chargeable on the (ultimate) investors in such a case). If the GDO test is intended to be able to be applied to (indirect ownership by) LP1 in such circumstances, then it may be possible to achieve this by amending paragraph 13(2)(b) so that it only applies where the "indirect" collective investment scheme wholly owns the relevant company through one or more partnerships (or deemed partnerships) (effectively a reversal of the new paragraph 12(3A)(b)).

53. For new funds, this question is relevant to how they structure their ownership of UK property rich subsidiaries as and when they make specific investments. For existing funds, they may consider inserting a LP2 into an existing structure if an election is possible in those circumstances. We note that the draft guidance in Appendix 15 includes a commentary on various possible types of restructuring that funds may undertake to benefit from an exemption election: it would be helpful if that commentary could also address any restructuring involving the insertion of a collective investment scheme-partnership intended to allow an exemption election to be made under paragraph 12(3).

54. This could for example include the situation where a qualifying investor (which is a company) owns a non-UK company that, but for the changes to paragraph 1(1)(e), would have been a collective investment vehicle (this is because the non-UK company would be a member of a group but the qualifying investor would be the principal company of that group). If a partnership were introduced as "parent" of the non-UK company, would that "parent" partnership be entitled to make an exemption election in relation to that company? Here, this would ensure that gains that (ultimately) accrue to the qualifying investor are exempt - in some ways, reflecting the policy of paragraph 33.

55. However, we note that there may be other situations where different considerations may apply and hence the importance of clarity as to the ability of both existing and new funds to benefit from the changes to paragraph 13(2).

56. In addition, for completeness, it is possible that in certain cases there may be a single collective investment scheme consisting of a number of partnerships given the FSMA definition. If this is the case, then it would be helpful to understand how paragraphs 12(3) and (3A) are intended to apply? This is because a Propco could be owned directly by the (single) collective investment scheme - but although the external investors acquire

interests in that collective investment scheme through an interest in one partnership (LP1) a different partnership (LP2) is the direct owner of Propco (even though LP1 and LP2 are the same scheme). Again, we consider that it would be helpful if this could be addressed in guidance.

Regulation 9 - amending paragraph 13, Sch 5AAA

57. We note that it would be helpful if the guidance could include examples demonstrating the type of structure that the (indirect) GDO test would apply to (so, in relation to paragraph 13(2)(b), this could include LP1 owning LP2 which in turn owns Propco: assuming LP2 is a collective investment scheme, the GDO test would be met if LP1 (the vehicle in which external investors invest) is widely marketed). See also our comments on regulation 8.

58. We would also ask that the guidance make clear how the GDO test (in the context of both GDO regulation 75(5) and the amendments to paragraphs 13(1) and 13(2)) applies to a fund in which investors acquire interests through one or more intermediate feeder funds - both where the feeder fund is set up by the fund manager for specific classes of investors, and also where the intermediate vehicle is set up by the investor itself. In particular, it would be helpful for the guidance to confirm the application of the GDO test to a collective investment scheme whose investors are, say, two or more feeder funds that are themselves collective investment vehicles that themselves meet the GDO test. We would be happy to discuss possible examples for inclusion if that would be helpful.

59. In relation to the proposed amendments to paragraph 13(3), please see comments above on regulation 5.

60. We welcome the proposed new paragraph 13(8) which is helpful in clarifying how the UK tax condition applies to an investor that would (assuming a valid election could be made by the fund) be a company within paragraph 33.

Regulation 10 - amending paragraph 21, Sch 5AAA

61. We understand that the amendment to paragraph 21(1)(c) is intended to address the potential for double taxation that exists under the current form of paragraph 21.

62. Paragraph 21 is intended to bring into the charge to UK tax the proceeds of a revenue distribution which represents an amount received by a company on a direct or indirect disposal of UK land that has been exempted from capital gains tax because of an exemption election. It only applies if that revenue distribution is not otherwise subject to UK tax (paragraph 21(1)(c)). The amendment is intended to ensure that regard is had not just to the taxability of the investor (recipient of the distribution) but that of any other person.

63. However, the proposed amendment to paragraph 21(1)(c) looks at whether a person is taxable on "the amount" that is regarded as being of a revenue nature. "The amount" refers to the "an amount" described in paragraph 21(1)(2) - namely, the amount of the dividend.

64. However, the double taxation risk arises from where the funds that underly the dividend (within paragraph 21, the "value derived (directly or indirectly) from a direct disposal of UK land or from the UK land component of an indirect disposal of UK land") are taxed when received by the company. The amendment to paragraph 21(1)(c) does not address this issue - the value so derived, which the dividend may represent, is different to the amount of the dividend.

65. Therefore, we ask that the drafting of paragraph 21 be revisited. We consider that paragraph 21 should contain two tests as to whether a particular "amount" gives rise to a deemed disposal.

66. The first test should apply to the "value derived" from the relevant disposal: paragraph 21 should only be in point if that "value derived" is itself exempt from CGT (reflecting the policy of Schedule 5AAA that there should be a single tax charge only on disposals where an exemption election is made).

67. As the qualifying company/fund will be exempt from tax on chargeable gains, if the "value derived" is capital in nature, then paragraph 21 should be relevant - and in that case the second test would apply (that in paragraph 21(1)(c) - this is whether the revenue distribution is brought into charge to UK tax by the recipient.

68. However if the "value derived" is subject to UK tax because is it characterised as income, then paragraph 21 should not apply to the extent that the amount distributed "represents" taxable proceeds: in effect, the test should be by reference to whether or not the consideration received for the UK land-related disposal referenced in paragraph 21(1)(b) is brought into account as income for UK tax purposes by any person. Here we note that it would not be sufficient to simply reference that the disposal from which value is derived as an "exempt" disposal (by virtue of an election under paragraph 12) given the breadth of the term "disposal" - a disposal could give rise to (taxable) income but still be exempt from chargeable gains. Instead, it may be simpler to exclude certain disposals from this provision - so it only applies if and to the extent that the consideration from the disposal is brought into account for chargeable gains purposes (and accordingly is exempt by virtue of paragraph 12/16) : the interaction with section 37 TCGA would need to be considered here (and may be of assistance). We note that where a disposal gives rise to both income and capital gain - as may be the case under the short lease premium rules - only part of the consideration should then be excluded.

69. This will be relevant if the proceeds are regarded as trading receipts, or if the transaction in land rules apply or if the short lease rules apply to treat (part) of the premium paid for a lease as income.

70. The test would need to consider the position for both direct and indirect disposals in terms of how the "taxability" test is crafted. So, for example, assume a fund that consists of company A (the parent) and company B (the subsidiary). Company B owns two UK properties - and sells one in circumstances where the transaction in land rules apply. The consideration for the disposal is taxable as income.

71. Company B remains UK property-rich. It returns the proceeds to company A by way of redeeming a class of shares. Company A makes an indirect disposal which benefits from exemption. Company A then makes a revenue distribution to its participants. In such a case, the fact that company B was subject to corporation tax on income should mean that paragraph 21 does not apply to the distribution made by company A (even though the value of that distribution derived (directly) from an amount received by company A that was not itself taxable due to an exemption election.

72. In relation to a situation where, for example, the short lease premium rules apply, it would be necessary to determine how much of the amount distributed represents the "income" element of the premium, and how much the (exempt) capital gain. Although it would be possible to prescribe this within the legislation, we note that a "just and reasonable" approach, with reference to the principles underlying paragraph 21, supported by guidance (with examples) may be preferred.

Regulation 11 - amending paragraph 22, Sch 5AAA

73. No comments.

Regulation 12 - amending paragraph 33, Sch 5AAA

74. In each of sub-paragraphs 33(1)(a) and (c) we suggest that the defined term is moved to the end of the applicable sub-paragraph - paragraph 33 is only applicable because of the fact that a transparency election is made/the PAIF is UK property rich.

75. We ask you to consider expanding paragraph 33(1) to include UK REITs. Including a UK REIT provides parity with the treatment of exempt investors in a PAIF (as well as other "exempt" funds), which seems to us consistent with broader policy on property funds.

76. Further, we understand that the exclusion of UK REITs from paragraph 33(1) was influenced by the assumed availability of QII SSE to investors within paragraph 33(4)(a). We note that this may not always be the case. First, QII SSE is subject to conditions - whereas paragraph 33 applies to exempt investors without any minimum investment condition. Here, the purpose behind paragraph 33 is to enable an exempt investor to engage its exemption in relation to UK property-rich disposals where its interest is indirect without pre-conditions - and we see no policy basis for differentiating a disposal of an indirect interest in a REIT from disposals of other indirect interests. Secondly, if there were an overlap with SSE on a disposal, Schedule 5AAA already contains priority rules to determine how to apply two or more reliefs. Thirdly, QII SSE would not be available where the paragraph 33 'company' is a CIV deemed company (rather than an actual company – e.g. a JPUT or an Irish CCF).

77. In relation to paragraph 33(2A), we note that this amendment is intended to allow an exempt investor's exemption to be engaged on disposals by a company which it owns indirectly. We are concerned that it may be too restrictive in practice - in that it only provides exemption where there are two tiers of company between investor and fund. We acknowledge that in a multi-tiered structure, the ultimate owner is likely to have discretion as to at which level a disposal is made; but note that in policy terms, if the conditions are met, there should be no difference in treatment on an indirect disposal of an interest in a CIV by a company owned by an exempt investor by reference to how removed it is (in levels of ownership) from the CIV.

78. For example, assume exempt investor (X) owns Company A, which in turn owns Company B, which in turn owns Company C. Company C holds an interest in a relevant fund. All companies are wholly owned by X.

79. Company C would be entitled to exemption under paragraph 33(2) as "wholly owned" encompasses indirect ownership and it is a participant in the fund.

80. Company B would be entitled to exemption as it is a company wholly owned by X, and it is disposing of an interest in a company (Company C) whose assets consist (wholly) of units in the CIV.

81. However, Company A is not entitled to exemption - even if Company B's only assets are shares in Company C, and notwithstanding that X itself would be exempt on selling Company A. This is because Company A is not disposing of a right or interest in a company with the required assets.

82. We consider that in policy terms a disposal by Company A of an indirect stake in the CIV should benefit from the same exemption that would apply to a disposal by Company B or C. (There is nothing to suggest that "consist wholly of units" would extend to indirect ownership.)

83. However, we note that extending the scope of the exemption could create complications if say Company B held other assets (which it could do without adversely affecting Company B's exemption under paragraph 33(2A) - as it is Company C that is required to be single purpose).

84. One possibility would be to adopt the "appropriate proportion" language used in paragraph 16 (and so a partial exemption only is conferred), albeit it is acknowledged this would add complexity. Alternatively, a company's ability to access exemption on a disposal of another company could be subject to the condition that the second company's only assets are direct or indirect interests in one or more of the funds listed in paragraph 33(1) - i.e. avoiding the need to apportion if the holding structure is used for various fund investments.

85. Finally, each of paragraph 33(2) and (2A) refer to a "unit" in the fund concerned which is defined in paragraph 1(6). "The fund concerned" can include a fund that has made a transparency election. A company that owns units in the (transparent) fund concerned would be deemed to own the underlying assets of the fund - and any disposal of units would be of those underlying assets.

86. We therefore assume that a disposal of a "unit in the fund concerned" is intended to include, in relation to a transparent fund, a disposal of the company's interest in the underlying assets represented by units. (This is because, in general, even where a fund is deemed to be a partnership as a result of an election under paragraph 8, a participant will still have units in that fund). As a result, such a disposal, when made by a company to which paragraph 33 applies, would be exempt under paragraph 33(2) - and a company who invests in a transparent fund will be regarded, for the purposes of paragraph 33(2A) as having assets that consist wholly of units in the fund concerned (i.e. ownership of underlying assets of the fund is ignored).

Regulation 13 - inserting new paragraph 33A, Sch 5AAA

87. We note that the proposed paragraph 33A addresses the position for investors that dispose (or are deemed to dispose) of an interest in a UK property-rich fund which has made an election for exemption: its purpose is to ensure that the investor is chargeable to capital gains tax on that disposal. As a result, both paragraph 5 and 6 of Schedule 1A - the effect of which is to treat a company as not being UK property rich - are dis-applied by paragraph 33A.

88. However, we understand that HMRC is considering whether additional provisions are needed to address the application of paragraphs 5 and 6 of Schedule 1A prior to a collective investment vehicle making an election under Schedule 5AAA: in such a case, the issue links to whether the vehicle is entitled to make an election (given that a pre-condition to elections under paragraphs 8 and 12 is that the vehicle is UK property-rich). We therefore comment on both possible interactions between paragraphs 5 and 6 of Schedule 1A and Schedule 5AAA.

89. In relation to the proposed paragraph 33A, this states that "nothing in paragraph 5 or 6" applies to a disposal of a unit in the relevant fund. We note that the language employed ("nothing in...") appears to be deliberately broader than a simple dis-application (such as "paragraph 6 shall not apply") which is what the explanatory note suggests the provision is about. It would be helpful to confirm if this is intended, and if so what the impact for funds could be.

90. For paragraph 5 however, we consider that this drafting approach has little effect in practice: paragraph 5 is tested by reference to the company that is the subject matter of the indirect disposal at the time of that disposal. This would be (in relation to a paragraph 12(2) election) the company that makes that election; in relation to a paragraph 12(3) election, the company that is the subject matter of the election - with no account being taken of any other company owned by the fund.

91. However, where a paragraph 12(3) election has been made, the drafting approach raises some questions about the position in relation to paragraph 6 of Schedule 1A.

92. Assume a partnership fund (LP) owns three companies, A, B and C. A and B own UK property; C owns non-UK property. Only A is the subject of a paragraph 12(3) election.

93. If a participant in LP (the relevant fund under paragraph 39) sells its partnership interest, it will dispose of each of A, B and C. Assume C represents 33% by value of LP's assets so that, if paragraph 6 applied, none of the disposals would be UK property rich.

94. The policy underlying Schedule 5AAA means that the inclusion of a linked disposal of C should not mean the disposal of A is not an indirect disposal.

95. But the language of paragraph 33A - the reference to "unit in the relevant fund" means that the disposal of B will also be an indirect disposal notwithstanding that (absent paragraph 33A) would have benefitted from paragraph 6 of Schedule 1A - even though B is fully taxable in relation to the UK property it holds -.

96. Given that B is not exempt, we cannot see a policy justification for dis-applying paragraph 6 in relation to its disposal. Instead we would suggest that paragraph 33A be amended so that the dis-application of paragraph 6 is only in relation to a qualifying company. This could be achieved by including a specific amendment such that, notwithstanding paragraph 6, a disposal of a qualifying company is always a disposal of an asset deriving at least 75% of its value from UK land. Alternatively - and more simply -the reference to "relevant fund" in paragraph 33(2A)(2) could be deleted and instead the dis-application be in respect of disposals of an interest in a qualifying fund or a qualifying company.

97. (We note here that this would only be relevant whilst A is covered by an election - if A sells its property, it would cease to be UK property rich and the election would no longer be of effect and so it would not be qualifying company).

98. Such a change is needed also to ensure that paragraph 6 applies in the normal way to B - which would be "linked" with disposals of A and C, and so whether B would be regarded as UK property-rich would depend on the relative value of the assets of each of A, B and C (and so on the example above B would not be UK property rich). This seems an appropriate policy result (the alternative would be to disregard A in applying paragraph 6 - so that B's disposal can only be linked with C's (this may be what "nothing" is intended to infer, but this does not seem to be what the draft provision is intended to achieve).

99. In this context, we have also considered the situation if the LP sold two or more of its subsidiaries. Here, the participator is selling its interest in each of A, B and C directly (given section 59 TCGA: "any partnership dealings shall be treated as dealings by the partners and not by the firm as such") and is not disposing of a "unit" (as defined in paragraph 1(6)) in the relevant fund - and so paragraph 33A(2) as drafted would not seem to apply. We would assume the dis-application of paragraph 6 should apply to a disposal by the LP (which is regarded as a disposal by the participant) as well as to a disposal by the participant of its interest in the LP) as,

in both cases, the investor is disposing of the same assets (its underlying interest in the companies owned by LP). We note that if paragraph 33(2A) was amended as we suggest above, then such a disposal by LP should be within its scope.

100. In relation to determining if an entity can make an election under Schedule 5AAA, different issues arise - both by reference to the type of election and which of paragraph 5 or 6 of Schedule 1A could apply - given that the UK property rich condition relevant to the making of an election is tested by deeming a disposal to be made (see paragraphs 3(1) and (4)).

101. In relation to interaction with paragraph 6 of Schedule 1A, we assume specific provision is not required given that the required deemed disposal of the fund/company under paragraph 3 will be of a single company (real (in relation to paragraph s12(2) and (3)) or deemed (in relation to paragraph 8) - and so paragraph 6 of Schedule 1A cannot apply.

102. In relation to interaction with paragraph 5 of Schedule 1A, the position is less clear cut. Again, the deemed disposal that is made to assess UK property-richness at the time of an election (and subsequently) is on the basis that the relevant entity is a company. For the transparency and paragraph 12(2) elections, this looks at the fund overall; but for paragraph 12(3) elections, this looks at the relevant subsidiary. This test is a snapshot test to determine status at a particular point in order to identify if there is a chargeable event: it is not necessarily apt for a notional disposal for the purposes of whether an election is possible (particularly given that the position at the time of election may be different to that on an actual future disposal).

103. First, looking at the “qualifying trade” condition in paragraph 5, this requires (i) information as to the position prior to the sale - see paragraph 5(3)(a); and (ii) information as to what will happen after the sale - see paragraph 5(3)(b).

104. Assume a fund/fund subsidiary carries on a property rich trade: depending on when it makes an election, the one-year condition in paragraph 5(3)(a) may not be met - even though, on an actual disposal in the future, it would be met.

105. Here, if the one year condition was met, we note that the fund/company may therefore be entitled to make an election - and, if the election is an exemption election, paragraph 33A should ensure that the actual disposal was chargeable (i.e. paragraph 5 did not apply). Is this correct?

106. However, transparency elections must be made within 12 months - effectively meaning paragraph 5 should rarely prevent the making of a transparency election by new funds where there is a new activity. Do you agree? (We note that once a transparency election is in place, it remains binding even if the relevant fund ceases to be UK property-rich - and likewise the investor’s ability to benefit from paragraph 5 on a disposal of any companies held by the transparent fund will depend on the circumstances at that time.)

107. A complication would arise if the fund acquires an existing business (e.g. a fund acquires a hotel business) - the fund may not then be able to make a transparency election as the one year condition may be met (this will depend on how “person connected with the company” is construed). (The same point applies to a fund in existence prior to 1 April 2019 which could meet the “one year” requirement at the time it makes an election.) However, as a policy matter, we see no reason why the application of paragraph 5 to a notional disposal of a notional company should prevent the fund making a transparency election - particularly given that a transparency election does not itself give rise to exemption.

108. In relation to an exemption election, assuming that the one-year condition is met, then there is an issue as to how to apply paragraph 5(3)(b) given it is future-looking - and also drafted with the intention of applying where there is a change of ownership. Presumably, on the hypothetical disposal required to be made under paragraph 3, the fund needs to consider its own plans for its trading activity. Assuming the fund is intending to continue a trading activity, this should be met - and so the fund/company would not be able to make an election under any of 12(2) or 12(3) - but equally, provided that trade continues to be carried on, paragraph 5 should be potentially available on an actual sale. Is this how paragraph 5 should be applied?

109. But if the one year condition was not met at the time of the election, but was then subsequently met, would the fund then cease to meet the applicable exemption conditions under paragraph 20 at that "subsequent time" - such that a deemed disposal would then arise (given paragraph 3): we assume not (although paragraph 3 references "at any time", meeting the conditions in paragraph 5 does not give rise to a disposal - and paragraph 33A indicates an intention that the election remains in effect even if paragraph 5 could be applicable on the facts).

110. We note that if the fund is a company and a paragraph 12(2) election is in point, then if assets used for the purposes of the trading activity are only part of its investments, it is unlikely that paragraph 5 will be relevant in practice given the 90% requirement. But where the fund is a partnership, and paragraph 12(3) is in point, paragraph 5 could be a material consideration given the deemed disposal required under paragraph 3 will be of a specific company owned by the partnership.

111. If that company owns the property and carries on the qualifying trade, the position should be relatively straightforward - both in relation to a deemed and an actual disposal. If paragraph 5 precludes an election, the investor should be able to benefit from paragraph 5 on an actual sale (or if an election is allowed, a disposal by the investor is taxable).

112. However, if there is a change in "activity" - so paragraph 5 applies to the fund (so it cannot elect), but the actual disposal does not meet the paragraph 5 conditions - complications could arise. This could be the case if the fund uses an Opco/Propco structure (under a common Holdco) where the trade would be carried on by a "connected company".

113. If no election could be made in relation to Holdco because of paragraph 5, an investor should benefit from paragraph 5 on a sale of Holdco.

114. However, it is possible that the fund may wish, should an opportunity arise, to realise value from Opco and Propco separately. If it sells Propco first, Holdco will be subject to tax on chargeable gains. But if it sells Opco first, at that point an election could be made in relation to Holdco, as paragraph 5 is no longer applicable, and a future sale of Propco would be exempt. Therefore, a different outcome applies to the same investment depending on the order of sale.

115. It is also possible that at some point as preparations for sale of one or the other are made, it may no longer be "reasonable to conclude" that paragraph 5(3)(b) will be met - and so on that basis, again an election may be able to be made (shortly before the time of disposal).

116. As a result, we query if it may be more straightforward if paragraph 5 did not preclude an election under paragraph 12(3) at Holdco level, with gains instead taxed at investor level on repatriation - with reliance placed on paragraph 33A to ensure such tax is able to be collected.

117. Finally, in the context of paragraph 5 of Schedule 1A, we ask for clarification of HMRC's view as to its application where the trade carried on by the relevant company is that of a property developer.

Regulation 14 - amending paragraph 39, Sch 5AAA

118. We note this follows on from the amendments to paragraph 12: no comments.

Regulation 15 - amending paragraph 46, Sch 5AAA

119. We welcome the amendments to paragraphs 46(2) and 46(12) and have no comments on them.

120. In relation to paragraph 46 generally, it would be helpful for additional guidance to expand on the application of the indirect participator test set out in paragraph 46(5)(b). Under paragraphs 7(6) and 13(5), which apply paragraph 46, and specifically paragraph 46(5), a company is said to meet the non-close condition "if .... is a close company but only because it has a qualifying investor as a direct or indirect participator".

121. Assume an exempt investor (X) owns company A which owns company B. X is an indirect participator in company B within paragraph 46(7). Company A is a direct participator.

122. Company B is close because company A is a direct participator (as section 444 of CTA 2010 is disapplied by paragraph 46(2)(b), so Company A is treated as having a single participator).

123. But if company A can be disregarded, then company B is close because it is wholly owned by an exempt investor and here the "but only" test would apply. It is unclear how the tracing rules work are intended to work in this situation - whether Company A is "looked through" so that only X is taken into account (so the "but only" test is met), or whether the "but only" test is failed because of Company A's interest. Although the policy underlying paragraph 46 suggests the former, the fact that these provisions are based on (close company) provisions that reference direct participation only means the position is not as clear-cut as it could be. Although guidance should be able to assist, we would ask if consideration could be given to possible legislative clarification of the test to be applied.

124. For example, one possibility would be to change the language such that (in effect) the (indirect) qualifying investor replaces the direct participator through which the qualifying investor's interest is traced (namely: "is a close company but only because it has a qualifying investor as a participator (and for these purposes treating any interests held by a qualifying investor as indirect participator as if they were interests of a direct participator with a corresponding adjustment to interests held by a direct participator to which the qualifying investors indirect participation relates").

Regulation 16 - inserting new paragraph 46A, Sch 5AAA

125. We welcome the inclusion of paragraph 46A, which helpfully addresses the application of the GDO test to closed-ended funds. We ask that the draft guidance be updated to reflect how the GDO test applies to such funds (particularly in relation to the nature of marketing that would be seen as acceptable in this context) - and we would be happy to propose particular examples for inclusion if that would be helpful.

Regulation 17 - inserting new paragraph 51, Sch 5AAA

126. We welcome the inclusion of paragraph 51, which helpfully addresses the application of Condition A in the GDO test to funds established prior to April 2019. We ask that the draft guidance be updated to reflect how this adapted GDO test applies to such funds - and we would be happy to propose particular examples for inclusion if that would be helpful.