RESERVED INVESTOR FUND

CONSULTATION RESPONSE

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9 June 2023

INTRODUCTION

The British Property Federation (BPF) represents the UK real estate sector, an industry that contributes more than £107bn to the economy and supports 2.3million jobs. Our members are invested in commercial and residential real estate in communities across the UK - revitalising our cities and shared spaces, re-imagining our town centres, and creating vibrant new places designed for the way we live today.

We are supportive of the government's ambitions to bolster the UK's position as a centre for asset management services and create jobs across the UK. Due to the bulky and illiquid nature of real estate investment, it naturally lends itself to collective investment – to allow investors to share risks and pool resources. Removing barriers to channelling collective investment into real estate and ensuring that the UK has appropriate fund offerings for different investors' needs will not only be helpful in bolstering the funds industry in the UK – it will be crucial to addressing some of the biggest challenges of our time – including our net zero carbon targets, the regeneration of our high streets, and the development of more high quality homes.

Executive summary

We have collaborated with a wider industry expert group on this consultation, led by Melville Rodrigues – our detailed responses to the consultation questions broadly echoes the key points coming out of this expert group engagement. We also support the responses from the Association of Real Estate Funds (AREF) and European Association for Investors in Non-Listed Real Estate Vehicles (INREV).

We would draw out the following key points:

1. There are a number of commercial scenarios where there is the potential for a new UK contractual scheme, such as the Reserved investor Fund (RIF), to be used, subject to certain concerns being addressed – these include:
    a. Existing structures "converting" to RIFs (notably CoACS (Co-Authorised Contractual Schemes) and EUUTs (Exempt Unauthorized Unit Trusts)).
    b. An onshore equivalent of a Jersey Property Unit Trust (JPUT) or the Irish or Luxembourg contractual funds – these have tended to be very popular fund and joint venture vehicles for investors that are seeking a lightly regulated and income transparent vehicle.
    c. A special Purpose Vehicle (SPV) (e.g. within a fund), which can hold a single asset.
    d. Within a REIT (Real Estate Investment Trust) structure – either feeding into a REIT or within the structure itself.
2. Ensuring the new RIF is as comparable as possible (in terms of tax and administrative ease) to contractual funds in "competitor" jurisdictions (notably, the Jersey Property Unit Trust, the Irish CCF and Lux FCP), will be critical to the successful take up of the RIF. We set out further details in relation to the AIF status of RIFs in response to question 4 - and the key tax considerations below.
3. We recognise that balancing the need to protect the NRCGT (non-resident capital gains tax) take on UK property, with the competing demand to achieve a simple tax and regulatory regime is one of the hardest challenges in implementing a new RIF regime. In this regard, the following points are important to consider in the design of the tax rules:
    a. Dry tax charges and unnecessary filing obligations must be avoided.
    b. We must find a practicable way to deal with temporary or minor breaches of the restricted RIF conditions (such as temporarily becoming non-UK property rich) such that they neither create a loss of tax to the Exchequer nor a 'cliff edge' in tax treatment for taxpayers. We do not support the proposal that a RIF should become tax transparent for gains (as suggested in paragraph 4.17 of the consultation document) should it breach the restrictions in certain circumstances. This is far more draconian than the equivalent sanction in the fund exemption election, where the offshore equivalent of a RIF could re-enter the regime later. We're happy to continue to engage on potential solutions to this issue, as this will be critical to the relative attractiveness of the RIF for investors.
4. We recognise the merits in pursuing two fund vehicles - the Restricted/Unrestricted RIF approach. This allows for a relatively simple tax and regulatory regime for the Restricted RIF, reflecting the more limited NRCGT risks. While both forms of RIF will be helpful and provide flexibility and choice to different investors, we appreciate that the added complexity of the Unrestricted RIF will take time to consider and legislate for – and this should not hold up the roll out of the Restricted RIF.

5. VAT on fund management fees – the VAT treatment of fund management fees can be an important factor in deciding on the most suitable location for a new fund vehicle. We would suggest that government should clarify that supplies of fund management services to RIFs should be treated as exempt for VAT purposes – which would help keep the RIF more aligned with comparable fund vehicles in Europe, although again, we would not want this to delay the roll out of the RIF regime.

Appendix: Responses to Questions

As noted above, we have collaborated with a wider industry expert group on this consultation, led by Melville Rodrigues – our detailed responses to the consultation questions broadly echoes the key points coming out of this expert group engagement. However, in response to question 11, we have provided a slightly more detailed and tailored response – outlining areas that will need to be considered by Government in order to support the interaction of the RIF with other existing property fund and tax regimes – notably the REIT (Real Estate Investment Trust) regime.

Question 1: Do you agree that the 'Reserved Investor Fund (Contractual Scheme)', or 'RIF(CS)', is the most appropriate name for the new structure? If you disagree or suggest a different name, please give reasons for your response.

For the reasons stated in ConDoc paragraph 2.5, we agree 'Reserved Investor Fund (Contractual Scheme)' or 'RIF(CS)' is the most appropriate name for the new structure.

We note Footnote 4 to the ConDoc. We anticipate the market will adopt 'Reserved Investor Fund' or 'RIF' as the name for the new structure until government implements legislation for any other form of unauthorised structure. Hence, we welcome ConDoc paragraph 1.4 – and in this submission are using - 'Reserved Investor Fund' or 'RIF' - as the name for the new structure.

We understand the name previously suggested by industry 'Professional Investor Fund (Contractual Scheme)' was developed on the assumption that the fund would be restricted to professional investors. This restriction at one time was the preference of the Financial Conduct Authority (FCA) officials. In view of investor categories such as certified high net worth investors, certified sophisticated investors, and self-certified sophisticated investors being eligible to invest in the new structure, 'Reserved Investor Fund (Contractual Scheme)' or 'RIF' is the most appropriate name for the new structure.

We would be grateful if government could confirm that elective professional investors will also be eligible to invest in a RIF. We consider it is important to the attractiveness of the RIF that local authorities and local government pension schemes that opt up to elective professional status (subject to the qualitative and quantitative opt-up tests in COBS 3.5.3) will be eligible RIF investors.

On the assumption that the FCA will proceed with the professional and retail fund categories envisaged in their Discussion Paper 23/2 (FCA DP23/2), we look forward to the RIF opting for regulatory purposes as:

- 'RIF professional fund', with only eligible professional investors; or

- 'RIF retail fund', which may include eligible professional investors as well as investor categories such as certified high net worth investors, certified sophisticated investors, and self-certified sophisticated investors.

RIF professional fund will have the advantage of operating with more flexibility, less prescriptive requirements under UK AIFMD than the RIF retail fund:
envisaged under FCA DP23/2; and

- importantly, greater efficiencies and lower costs for launching and operating in comparison to the RIF retail fund and other retail funds.

Question 2: Would a restricted RIF add value to the existing range of UK fund structures, particularly compared to a structure without such restrictions? What would the relative attractiveness be of the proposed restrictions to the RIF regime?

<u>Restrictions proposed to apply to a restricted RIF</u>

Yes, the Restricted RIF would add value to the existing range of UK fund structures.

We consider that the following characteristics are key to the success of the Restricted RIF regime:

- Easy to understand and operate.
- Equivalent treatment to similar regimes (e.g. Exemption Election).
- Ability to remain within Restricted RIF regime despite minor breach of the conditions (e.g. grace periods during which remain within the regime).
- In the event that a RIF does exit the regime (e.g. if no grace period applies), it should be possible for that RIF to re-join the Restricted RIF regime at a later date, assuming all relevant conditions are met (as is the case under the Exemption Election regime).
- No tax on chargeable gains until units in the RIF are actually disposed of or RIF wound up, which should apply in respect of: (a) entry to and exit from the Restricted RIF regime; and (b) any minor breach of the Restricted RIF conditions that does not result in leaving the regime. For example, in the event that (a) or (b) were to give rise to a deemed disposal and reacquisition of either units in the RIF or the assets of the RIF.
- No stamp taxes on issue or transfer of units in the RIF.

We appreciate that the government will want to ensure that the RIF regime incorporates sufficient protections to ensure that the RIF is not used for avoidance and does not cause an unexpected loss of tax. We consider that this is achievable and are keen to work with HMRC to identify areas of potential concern and find appropriate solutions and/or mitigants.

We note in ConDoc paragraph 4.32 that government is considering an unrestricted RIF as an "alternative". ConDoc paragraphs 1.9 and 1.10 also suggest that government is considering the unrestricted and

restricted RIF proposals in the alternative. However, we note also that ConDoc paragraph 4.41 suggests that government is considering them in parallel. It would be helpful if the government could clarify this point.

Whilst we consider that there may be scope for a RIF regime that incorporates the Unrestricted RIF from the outset, we are keen to ensure that the present proposal (i.e. the Restricted RIF) does not suffer undue delay in an attempt to design a RIF regime that caters perfectly for all eventualities.

Comparison with a structure without such restrictions: the relative attractiveness of the proposed restrictions to the RIF regime

The RIF has many attractions to UK managers, (especially SMEs as indicated in the Introduction). The RIF (including with the proposed restrictions) has significant benefits including:

The efficiencies with operating the RIF: managers will avoid having to go offshore with all the challenges, inefficiencies – and costs – of dealing with multiple legal, tax and regulatory regimes. It is noted that the offshore funds (holding UK real estate as underlying investments) are subject to non-resident capital gains tax rules similar to the proposed RIF restrictions. In order to enhance the efficiency of the RIF, we suggest as indicated in response to ConDoc Question 4 below (and as a pre-condition that all intending RIF investors consent), the RIF would only operate – as an opt-out entitlement - with a UK AIFM instead of a UK AIFM and a UK depositary.

- Speed to launch: The UK AIFM and (if applicable) UK depositary enters into a compliant deed that constitutes the RIF (deed referred to in ConDoc paragraph 2.12) (RIF Deed) and can then admit investors. There is no need for RIF prior registration. There is also no need for prior application to, nor approval from, the FCA.
- RIF flexibilities: for example, with investor redemption entitlements and ensuring liquidity matching with long term productive (and less liquid) investment – compared with a fund operating within the authorised open-ended regime which is required to adopt terms that are significantly more prescribed. We envisage these flexibilities will be available with the 'RIF professional fund' referred to in response to ConDoc Question 1 above.
- RIF will have 'tradeable units': investors incur no transaction tax when disposing of RIF units: This is a particular concern with limited partnerships that have underlying UK real estate investments.
- RIF will benefit from SDLT seeding relief: subject to our comments in response to Question 13 below, we very much welcome the RIF having parity with SDLT relief that applies to the CoACS.
- LTAF 'launch pad' option: Subject to manager, investor and FCA consent, the RIF (given it is structured as a contractual scheme and similar category of eligible investors) will be able to convert seamlessly into an ACS LTAF. The LTAF platform (which includes the ACS LTAF) is another welcomed HM Treasury funds regime review reform.

- We understand from HM Treasury and HMRC officials that no tax friction would apply to such a conversion, and look forward to discussing any legislative provisions needed to confirm this no tax friction issue.

  The RIF may be utilised in the market as a 'launch pad' for the LTAF. Fund managers initially operate a RIF with cornerstone investors, build a track record and at a later stage (with the support of the cornerstone investors and attracting DC pension and other investors (who require LTAF open-ended liquidity features)):

  - with prior FCA and RIF investor approvals, convert the RIF to an ACS LTAF; and
  - be more able 'to take a view' on launching an ACS LTAF, and incurring associated launch and operation costs of an LTAF.

  This may be a more attractive and risk-averse strategy than the fund manager looking to launch an LTAF from scratch (and incurring material costs associated with launching an LTAF).
  In addition, we hope at that at a later stage, there will then be established distribution solutions with the platforms for the platforms to onboard non-daily dealing funds like the LTAF: see the Productive Finance Working Group 'A Call to Action for Platforms' (page 74, November 2022 PFWG Guides): https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/working-group-to-facilitate-investment-in-productive-finance/pfwg-guides-investing-in-less-liquid-assets.pdf.

The RIF benefits considerably outweigh the trade-off associated with RIF managers/investors being subject to the proposed RIF restrictions.

Post-Brexit problem: UK fund managers hampered to market fund products to EEA institutional investors

We should, however, express a post-Brexit problem – that applies to all UK fund structures (and hence would apply to the RIF). Since 2020 UK fund managers have been hampered in their efforts to market fund products to institutional investors in the European Economic Area (EEA). UK managers now have to rely on a patchwork of National Private Placement Regimes. For instance, France, Germany, Italy and Spain are effectively 'out of bounds' jurisdictions.

UK managers are having to incur the substantial costs of establishing and operating fund structures in the EEA in order to continue marketing to EEA investors and managing EEA funds. This favours large managers who can afford to operate such structures – particularly with the European Commission planning tougher substance requirements for managers operating within the EEA. We regret that UK SME fund managers lose out.

Question 3: Are there investment asset classes besides real estate for which a RIF would be particularly attractive?

We understand that there is interest in the RIF with UK fund sectors focused on asset classes other than real estate: for instance, infrastructure, private equity and private debt.

Question 4: Do you foresee any legal or administrative issues with the proposed eligibility criteria? Would you recommend that the government include additional requirements for an unauthorised co-ownership contractual scheme that wishes to become a RIF? If so, please explain the reasons for this.

Our principal concerns in respect of the eligibility conditions in ConDoc paragraph 2.12 are as follows:

- We note that in relation to the definition of an offshore CIV for the purposes of making the para 12(2) schedule 5AAA TCGA 1992 "fund exemption election", a non-UK co-ownership contractual scheme (or for that matter a non-UK unit trust scheme such as a JPUT) could be a CIS or an AIF. The ConDoc states that a RIF would need to be an AIF as defined in regulation 3 of the Alternative Investment Fund Managers Regulations 2013. Some views have been expressed that there could be some potential uncertainty in some use cases as to whether a RIF would meet the AIF requirement, and therefore in order to ensure that the onshore RIF regime is not disadvantaged (and therefore as attractive as an offshore equivalent) we would suggest that the tax treatment of a RIF is subject to it being either an AIF or a CIS. Whilst we understand that the power to make regulations in the current Financial services and markets bill will be limited to UK co-ownership contractual schemes which are AIFs, this proposal would at least reduce any uncertainty as regards the tax treatment of the RIF in the meantime.
- The GDO and non-close tests will need to be considered in greater detail in the context of the RIF to ensure that they operate as intended. Furthermore, we understand that some existing CoACS may wish to "convert " to a RIF. As this is similar to the position where existing funds were able to make a fund exemption election, we suggest that an equivalent transitional provision to that contained in para 51 of schedule 5AAA TCGA 1992 Should also apply to a riff, so as not to prejudice the ability to satisfy the GDO requirement in the future.
- In view of the nature of the intended RIF investors (professional and retail (such as certified high net worth investors, certified sophisticated investors and self-certified sophisticated investors)) it would be appropriate for there to be an option whether or not the RIF operates with a UK depositary. In other words, the RIF would be established, and will continue to operate, with either:
    - A UK AIFM and a UK depositary; or
    - Only with a UK AIFM (and not also with a UK depositary) on the pre-condition each of the RIF investors (before being admitted as a RIF investor) confirms that the RIF investor:
        - is aware of;
        - has had the opportunity to take separate advice; and
        - consents to

  the RIF operating without a UK depositary.
- It should be possible for a RIF to hold an interest in another RIF and the detail of the eligibility conditions will need to be considered in that context.

We are pleased to note progress in the UK Parliament with the FSMB containing clause 60, and assume the FSMB will receive Royal Assent during 2023.

Following the FSMB receiving Royal Assent, we look forward to discussing the details of regulations envisaged in FSMA Section 261Z6 (1).

Question 5: Are there any are specific tax provisions that should be considered to facilitate RIF investment in asset classes other than real estate?

We are not aware of any specific tax provisions that should be considered to facilitate RIF investment in asset classes other than real estate.

However, please also see the response to Question 22.

Question 6: Do you foresee any issues with the government's intended requirements for reporting income to investors, or with replicating the provisions related to excess reportable income arising to RIF investors from an investment in an offshore fund?

We understand, and agree with, the government's objectives for the RIF tax regime stated on ConDoc paragraph 3.2. In this context, we consider:

- the government's intended requirements for reporting income to investors, and
- replicating the provisions related to excess reportable income arising to RIF investors from an investment in an offshore fund, registered under the UK reporting fund regime,

as pragmatic solutions which are workable for industry and would not materially adversely affect the efficient operation of the RIFs.

Question 7: Should RIFs be added to the list of permitted property categories at section 520 ITTOIA 2005 and do you consider that the structure and nature of RIFs means that individual policyholders would be effectively prevented from introducing personal assets into their life insurance policy?

As indicated, we understand - and agree with - the government's objectives for the RIF tax regime stated on ConDoc paragraph 3.2. In this context, we consider:

- RIFs should be added to the list of permitted property categories at section 520 ITTOIA 2005; and
- that the structure and nature of RIFs means that individual policyholders would be effectively prevented from introducing personal assets into their life insurance policy.

Question 8: Do you have any views on the proposed capital allowances treatment?

We agree with the proposals in the ConDoc at:

- paragraph 3.15, for a RIF to replicate the existing treatment that is available for CoACS, with the result a RIF operator (whom we assume would be the RIF UK AIFM) could make an election enabling the RIF operator to calculate and apportion the capital allowances to the investors.
- paragraph 3.16 – If an existing CoACS converted to a RIF, or vice versa, the election and simplified treatment should continue to apply as if the scheme had carried on in its previous form.

It would also be important that the status of the RIF itself should not alter its capital allowances treatment (i.e. no change to the RIF's capital allowances treatment if it were to enter or leave the Restricted RIF regime).

Question 9: Do you have any general comments on the proposed capital gains treatment of investors in a RIF, subject to the detailed questions in Chapter 4?

Please refer to the Executive Summary above.

Question 10: Do you have comments on the proposed capital gains treatment for insurance companies?

We agree with the proposals in the ConDoc.

Question 11: Would this proposed rule help facilitate a RIF's investment in REIT?

We welcome the fact that the government is considering how the RIF will be considered in the context of other tax provisions including the REIT listing requirement. The ability to trace ownership through a RIF is one potential solution. In certain circumstances, it would also be possible for the RIF itself to be treated as an institutional investor (e.g. if it meets the GDO requirement) such that the RIF is effectively equivalent to an English Limited Partnership or Scottish Limited Partnership CIS for these purposes.

In addition to considering the listing requirement it would be necessary to understand how the RIF should be treated in other contexts (e.g. non-close test and in the context of the holders of excessive rights provisions).

A more comprehensive summary of issues to consider for RIFs investing into REITs and vice-versa is expanded on below.

RIFs investing into REITs

1) REIT listing requirement

The consultation document refers to the proposal to allow "tracing through" a RIF, similar to a CoACS.

On the first principles, it is not entirely clear whether this explicit statutory provision would strictly be required (e.g. given HMRC's position on ownership of ordinary share capital through partnerships) but see also further comments below where the deemed treatment of the RIF may have consequences for capital gains purposes).

Given that there is no requirement to trace through a CIS partnership which meets the GDO condition, if a RIF also meets the GDO condition, it would be consistent to stop the tracing at the GDO RIF also.

2) REIT "non-close" test

Unlike partnerships, where the rights of partners are attributed to one another under the basic close company rules, there is no equivalent requirement in relation to a co-ownership contractual scheme.

However, the operator of a RIF may exercise voting control over the shares held in a REIT.

In the non-close test in para 46 schedule 5AAA TCGA 1992 (which we understand is being considered in the context of modifying the REIT non-close test) those rights are disregarded.

Also, under that test a GDO CIS partnership is treated as an institutional investor in its own right and so where a RIF also meets the same GDO requirement it would be consistent for that also to be treated as an institutional investor.

3) Availability of QII SSE under sch 7AC TCGA 1992

In certain circumstances, a REIT may claim the benefit of the QII SSE exemption. However, we understand that the deemed capital gains opaque treatment of a RIF, absent any specific provisions, would prevent tracing the ownership of ordinary share capital for the purposes of this exemption.

However, we note that there is a provision to trace through an exempt unauthorised unit trust, and therefore it would be consistent for a restricted RIF, whose participators are all exempt from tax on capital gains (other than by virtue of residence) - i.e. the same requirement as an EUUT - should also be capable of being traced through for QII SSE purposes.

However, in the case of a co-ownership unauthorised contractual scheme, which is not elected/qualified as a RIF/CoACS, it would seem that it can be traced through for QII SSE purposes (see also comments above in relation to the REIT listing requirement).

4) Withholding tax

It would appear that, under first principles, the person responsible for withholding tax would need to determine the beneficial owner of any payments made to a RIF (e.g. the payment of a PID by a REIT).

We note that there are specific provisions that deal with payments to a partnership, where not all of the partners would be entitled to gross payment. However, the proposal set out in the current Finance Bill would permit partial gross payments of PIDs to be made to other partnerships.

REITs investing into RIFs

1) Application of s.535A CTA 2010

In order to achieve consistency with the disposal of an interest in an offshore CIV, relief would need to be extended to the disposal of an interest in a RIF.

2) Impact on REIT "group" (eg where the RIF owns a company which holds a UK property).

Given the requirements to (directly or indirectly) own ordinary share capital, for the reasons noted above, the REIT capital gains exemption may not extend to shares in companies held via a RIF.

However, in the case of a co-ownership unauthorised contractual scheme, which is not elected/qualified as a RIF/CoACS, it would seem that ownership can be traced through the RIF for capital gains purposes also.

Question 11: Would any further tax provisions be required to further facilitate a RIF's investment in other property funds?

As a general matter, the interaction of the RIF with other tax regimes (i.e. not just the REIT regime) will be important to ensure that the use of the RIF does not create issues for managers and investors alike. Please see further the response to Question 32. In addition, we would draw out the following:

Tracing ownership through a RIF for NRCG/QAHC purposes

In will be necessary to allow tracing through RIFs (e.g. in relation to para 46(12) Schedule 5AAA TCGA 1992), to ensure ownership conditions can be met.

Restricted RIFs where the investment policy is not to invest in UK property

We note that the third category of Restricted RIF proposed in the consultation is a RIF which does not invest directly in UK property, or UK property rich companies, with the possible exception of minor interests in UK property rich collective investment vehicles (CIVs). It will be important to ensure that Restricted RIFs are an allowable investment in a UK property rich CIV in this regard.

Question 12: Would the proposal outlined here be a viable option to achieve fair SDLT treatment of property acquired by and held by unauthorised co-ownership contractual schemes, whether or not they are within the RIF regime?

We agree with the proposal that a RIF should be treated as a company for SDLT purposes such that transfers of units in a RIF should not be subject to SDLT.

We also agree that an unauthorised co-ownership contractual scheme (e.g. before the RIF conditions are met) should also be treated as a company for SDLT purposes such that transfers of units are not subject to SDLT.

Continuity of SDLT treatment across the three forms of unauthorised co-ownership contractual scheme (i.e. non-RIF, RIF and Restricted RIF) is an important consideration for investors and will be important to the success of the RIF.

Question 13; Are there any features of the existing CoACS seeding relief that are unsuitable to be applied to RIFs?

Question 14: The length of the control period for PAIF and CoACS seeding reliefs is three years. Would a similar period be appropriate for RIF seeding relief claims?

We respond to both questions 13 and 14.

Seeding relief equivalent to CoACS

We welcome the principle of CoACS (SDLT) seeding relief applying to the RIF. The February 2022 HM Treasury responses helpfully stated that the unauthorised contractual scheme *"has the potential <u>to lower the barriers for SME asset managers to launch new products</u>, to increase the number of unauthorised closed-ended investment vehicles domiciled in the UK and to support the government's work to promote investment in longer-term, less liquid assets*" (paragraph 2.171, our underlining for emphasis).

In order to enhance the prospects of SME assets managers launching RIFs, we have suggested minimal legislative revisions to the existing CoACS Seeding Relief provisions, so the provisions:

- can apply to the closed-ended or hybrid RIFs; and
- ensure that the provisions continue to retain robust tax anti-avoidance measures.

The minimal revisions only substitute the current portfolio test of £100m and 20 commercial or 100 residential properties with £20m and 3 commercial or 10 residential properties. We have supplied to HM Treasury and HMRC officials supporting endorsements from managers to these suggestions.

The CoACS and the RIF are distinct vehicles that are intended to address specific needs within the funds landscape. The Restricted RIF is being adopted in the context of the Funds Review in order to make a UK fund that will be attractive to investors and managers, and we believe that the proposed changes to the seeding relief in the context of the Restricted RIF are necessary to achieve that aim.

In the event that HMRC's concern is the risk of abuse, we note that the CoACS seeding relief contains a number of protections (e.g. clawbacks and a commercial purpose test) and assume that the same suite of protections would be sufficient as regards the RIF seeding relief, including when the thresholds are reduced as requested.

Request for relief for conversion of EUUT to Restricted RIF

We have previously explored with HM Treasury and HMRC officials a request for a general conversion relief to enable existing funds with UK real estate portfolios to convert to Restricted RIFs, but understand HMRC is of the view that the officials would not currently be in a position to progress a general conversion relief request.

Nevertheless, we understand that a number of significant (e.g. AUM of more than £1bn) existing Exempt Unauthorised Unit Trusts (EUUTs) have expressed an interest in converting to the Restricted RIF structure in the event that it were possible to do so without material tax cost in respect of the conversion. The main potential tax risk on conversion would be in respect of the transfer of UK property or shares from the existing EUUT to the RIF. The inclusion of a conversion relief (i.e. equivalent to the SDLT relief on the conversion of an AUT to a PAIF under SI 2008/710) would alleviate this issue and could lead to the rapid creation of a number of significant Restricted RIF structures. Given the profile of an EUUT (i.e. investors not subject to tax on chargeable gains, essentially no tax in the EUUT and ability to sell EUUT units without stamp tax), it would seem that the risk to the Exchequer of replicating the AUT to PAIF conversion relief for an EUUT to Restricted RIF conversion would be low.

Question 15: Do you foresee any issues with the proposed Stamp Duty or SDRT treatment?

We agree with the proposal that transfers of units in a RIF should not be subject to stamp taxes (including stamp duty and SDRT) and that should be the case whether or not the RIF is within the Restricted RIF regime. Were that not the case, we do not believe that the RIF would be viable.

Question 16: Do you have any comments on the VAT treatment of the management of a RIF?

Although we would not want the momentum for legislative progress to be delayed on account of the VAT treatment of the management fees for a RIF, we note that:

- We are aware of certain industry responses to the 9th December 2022 HM Treasury consultation on VAT treatment of fund management (VAT Consultation) including the AREF response dated 3rd February 2023[1].
- In assessing the characteristics of the RIF against the principles of the HM Treasury proposed ‘SIF’ definition presents obvious conflicts which should be resolved.

[1] https://www.aref.org.uk/resource/vat-treatment-consultation.html

- In the ConDoc, government has helpfully recognised that the RIF should have a tax treatment that, so far as possible, is similar to the CoACS. The CoACS benefits from VAT exemption due to being included in VAT Consultation paragraph 9 as exempt.
- It is possible that the VAT treatment of RIFs could differ from their CoACS counterparts, with some falling under the exemption while others see their supplies of management fees as standard rated. This disparity is likely to create unwelcome complexity and uncertainty regarding the management of RIFs. The potentially differing treatment may weigh on operators of:

  (i) CoACSs when looking to decide on whether to convert to a RIF; or

  (ii) RIFs when looking to decide on whether to convert to a CoACS, including a CoACS LTAF – given attraction of the RIF to function as an LTAF incubator: see our response to ConDoc paragraph 1.

- The characteristics-based approach as set out in VAT Consultation paragraph 2.3 needs to be much more fully and plainly defined as they might relate to a RIF. It is especially difficult to know what the meaning of limb (d) is intended to be and what characteristics it encapsulates.
- We suggest that UCITS is an incorrect characteristic to link entitlement to the VAT exemption and would highlight that there are a host of AIF funds which are able to avail themselves of the management fees exemption. Domestically these include open-ended vehicles within the NURS, QISs and LTAF regimes and closed-ended entities such as Investment Trust Companies.
- In Europe both Ireland with their QIAIF regime and Luxembourg with their RAIF regime offer exemption to funds covered under AIFMD.

  In addition, the German Federal Ministry of Finance and Federal Ministry of Justice have announced in April 2023 draft legislation on Financing of Future-Proof Investments (*Zukunftsfinanzierungsgesetz*) - in particular, making it easier for SME fund managers to access the capital markets - which includes extending the VAT exemption for the management of investment funds to the management of all Alternative Investment Funds established in Germany (Section 1 paragraph 3 KAGB: German Capital Investment Code). The legislation is expected to take effect on 1st January 2024.

  Given the direction of travel, there must be a concern that the UK is being left behind and considered less competitive as a fund jurisdiction in terms of the VAT treatment of management fees.

- Looking back to the purpose of the VAT exemption for management fees, its policy goal has been:
  - promote access by savers to collective investment:
  - avoid subjecting contract-based funds to a tax burden which self-managed investment undertakings which are legal entities do not have to bear.
- To better align the principles test with this ideal we suggest that the condition d) be expanded to include AIFs but with suitable constraints if those AIFs or their operators are already suitably regulated.

Question 17: Are there any circumstances other than that outlined in paragraph 4.11 that the government should be considering to ensure that the RIF tax regime aligns with the government's policy of taxing non-UK resident investors on gains on disposals of UK property?

Please refer to the Executive Summary above.

Question 18: Would take-up of the RIF be affected, and if so to what extent, if section 103D TCGA was disapplied where a restricted RIF breached a restriction? Are there alternative ways that a breach could be dealt with?

Please refer to the Executive Summary above.

Question 19: What, if any, legislative or administrative easements would be required for unintended breaches by a UK property rich RIF?

Please refer to the Executive Summary above.

Question 20: To what extent would such restrictions on a RIF's ability to invest more than 25% of its total asset value in non-UK property assets limit take-up?

The most logical comparable entity to the RIF would be an entity that is within the Exemption Election regime and which would, therefore, be subject to the same 25% restriction. On that basis, provided the RIF regime is no more restrictive than the Exemption Election regime, take-up should not be limited as a result of the 25% threshold.

Question 21: What commercial appetite would there be for a RIF that was only open to investors who are exempt from tax on gains?

There would be good appetite for a RIF that is restricted to investors that are exempt from gains. This would enable a RIF that intends to hold UK property but may not be or always remain UK property rich to enter into the RIF regime, subject obviously to the RIF solely having investors that are exempt from chargeable gains.

As explained in the answer to Question 14 above, there are also a number of significant (e.g. AUM of more than £1bn) existing Exempt Unauthorised Unit Trusts (EUUTs) that have expressed an interest in converting to the RIF structure in the event that it were possible to do so without material tax cost in respect of the conversion.

Question 22: Would there be appetite for a RIF that is restricted from investing in UK property?

Yes. We understand that there would be appetite for a RIF to hold shares and securities or to operate as a credit fund.

However, it may be difficult to attract investors if the risk of partnership treatment (as a consequence of the inadvertent acquisition of property assets, for example in the event of an insolvency), and consequent dry tax charges, is more than a remote risk.

Question 23: Do you have any suggestions about how the base cost of an investor could be computed on a disposal of UK property for a non-UK property rich RIF where the RIF was only transparent for gains at the point of a disposal of UK property or where there was a change of investor?

See below.

Question 24: Do you agree that the RIF would need to be deemed to be a partnership for gains throughout the period it is non-UK property rich to give a basis for capital gains computations if option 2 were applied to a RIF which transitions between UK property rich and non-UK property rich?

In the context of a RIF, disposals for chargeable gains purposes would only typically be expected when either the RIF disposes of assets or an investor disposes (or is deemed to dispose) of an interest in the RIF. On that basis, it would seem that Option 1 is effectively equivalent to ongoing transparency for chargeable gains purposes.

Option 2 is effectively what is being proposed as being the treatment in the event that a RIF were to fall outside of the Restricted RIF regime, as to which please refer to the Executive Summary above.

We would like to discuss the relative merits of Option 1 and Option 2 with HMRC.

Whilst it would seem logical for there to be a deemed disposal and reacquisition when transitioning into or out of the regime, we consider that any risk of a dry tax charge as a result of that deemed disposal would be a significant issue for potential RIF investors.

Question 25: Do you think that applying option 2 to a RIF that transitions between UK property and non-UK property rich could achieve the government's aim of taxing non-UK resident investors on gains of disposals of UK property?

Yes, we think that applying option 2 to a RIF that transitions between UK property and non-UK property rich could achieve the government's aim of taxing non-UK resident investors on gains of disposals of UK property. However, it will be key to the success of the regime that the transition does not give rise to dry tax charges.

Question 26: Do you consider that there are any more effective ways by which the government could ensure non-UK resident investors in a non-UK property rich RIF are taxed on gains on disposal of UK property? If so, please provide a detailed explanation of how this would work, and the advantages and disadvantages of applying a different treatment.

We are not aware of a better method.

Question 27: To what extent could difficulties with tax transparency for gains be overcome through the way in which the RIF is structured, for instance using a separate class of units or sub-fund in an umbrella RIF to hold UK property?

Whilst this option could be considered, it would be necessary to be able to operate the relevant sub-funds seamlessly, for example to ensure that any transfer of UK property to/from the relevant sub-fund does not cause any tax friction and there are no other adverse impacts (e.g. from a practical perspective as regards the operation of the relevant property and the flow of rental income or other returns from it).

Question 28: To what extent would transparency for gains mean that a manager would not in practice choose to establish a RIF to hold UK property where it was not anticipated that the RIF would be UK property rich?

We share the view that 'transparency for gains' would have a strong deterrent effect: given the adverse consequences in terms of the RIF investors and operational matters, we anticipate that both managers and investors would in practice require that the terms of the RIF Deed would prohibit the RIF from holding UK property where the RIF would not be UK property rich, save to the extent that all of the investors are exempt from UK tax on chargeable gains (see our response to Question 21 above).

Question 29: Do you foresee any issues with applying similar reporting obligations to a RIF as those that apply to a non-UK CIV that has made an exemption election?

We agree with applying similar reporting obligations to a RIF as those that apply to a non-UK CIV that has made an exemption election. The only issue may be greater operational costs. We understand from fund administrator contacts (to whom non-UK CIV managers invariably pass on the reporting obligation) the parties look on a fund-to-fund basis look to negotiate which party incurs such costs. The fact that such greater operational costs arise does inhibit managers and investors proceeding with non-UK CIV launches.

Question 30: Do you have any views on the point from which a RIF should lose its status, if it fails to meet any of the eligibility criteria?

It is, of course, a very serious consequence that a RIF should lose its RIF status for the RIF manager (we assume to be a UK AIFM), investors as well as the RIF UK depositary. We anticipate that in a RIF Deed:

- RIF investors will insist on; and
- RIF UK AIFM and (if applicable) UK depositary will accept

obligations on the part of the RIF UK AIFM (with remedial steps being available to the RIF UK AIFM) to prevent the RIF losing its RIF status. Similar provisions are typically contained in deeds constituting the EUUT with obligations on the part of the EUUT Manager (with remedial steps being available to the EUUT Manager) to prevent the EUUT losing its EUUT/tax-exempt status.

We look forward to discussing details of the proposed regimes with HMRC and how they would operate in practice both from a tax technical and an operation/practical perspective (e.g. grace periods, warning mechanisms and regimes that would deal with breaches in a practical and proportionate manner).

Question 31: Do you foresee any issues with the tax treatment of a co-ownership contractual scheme that falls outside both the RIF and CoACS regimes? Should the government consider providing for the treatment of such an unauthorised co-ownership contractual scheme in legislation?

We would appreciate the opportunity to discuss further the tax treatment of an unauthorised co-ownership contractual scheme that falls outside the RIF, Restricted RIF and CoACS regimes and how that treatment should be formalised.

For example, one should consider the need for express legislation:

- governing the tax treatment of any transition between the different types of co-ownership contractual scheme; and
- confirmed that the SDLT treatment would be as suggested at ConDoc paragraph 5.1 (i.e. to avoid the burdensome charges that are mentioned at paragraph 3.32).

Question 32: Do you have any further views on the viability of the RIF design proposal, not otherwise covered?

It is key to ensure that the integration of the RIF into the broader tax landscape will be as seamless as possible, both as regards:

- Any changes to the status of an individual RIF (e.g. when moving between being an unauthorised contractual scheme/RIF/Restricted RIF):
    - VAT – the RIF (or the operator on behalf of the RIF) should remain the registered entity (e.g. keeping the same registration number and option to tax position).
    - Capital Allowances – the operator should continue to be able to operate the capital allowances system (e.g. claim allowances on behalf of investors and enter into elections).
    - Construction Industry Scheme – the operator should continue to operate the Construction Industry Scheme even when the RIF changes status.
    - Tax administration generally – given that the RIF is transparent for income it will be the operator that will have to engage with third parties rather than the taxpayer (equivalent to a partnership) and so it will be important to empower the operator to be able to perform that role (e.g. to submit elections and effectively deal with third parties).

- The interaction of the RIF with other vehicles and tax regimes:
  - RIFs and ownership tests – the ConDoc helpfully considers the REIT shareholding requirement and how the RIF would interact with the relevant test. As indicated in the response at Question 11, the ConDoc only considers one aspect of the REIT conditions. In addition to the other REIT conditions, the treatment of the RIF in the context of the ownership tests applicable to other regimes (e.g. QAHC and QII SSE) will be important. We consider that it should be possible to trace through an unauthorised contractual scheme but that any RIF that meets the GDO/Non-Close Test should be considered a "good investor" for the purposes of relevant regimes (e.g. an institutional investor for REIT purposes or a Category A investor for QAHC purposes).
  - Loan Relationships Regime – the fact that the RIF (or the operator on behalf of the RIF) would be the borrower under any lending, should not prevent the investors from being able to claim deductions under the loan relationships code (subject to any applicable limits (e.g. CIR)). Ideally this would be covered off in the relevant legislation.
  - Withholding Tax – there are a number of relevant withholding tax regimes, the principal ones being: (i) withholding on payments of interest, royalties and annual payments; (ii) the non-resident landlord scheme; and (iii) withholding on REIT and PAIF dividends. We would welcome the opportunity to consider these regimes with HMRC in greater detail, with our view being that a RIF should be considered eligible to receive UK sourced income gross, recognising that a substantial part of the RIF target market would be institutions who would be eligible for gross payments under domestic law or tax treaties and that a complex reclaim process may be a deterrent to investors.

Financial Services and Markets Bill: RIF secondary legislation

We reiterate that we very much welcome this ConDoc. In light of HM Treasury and HMRC confirming "*the government's decision on whether to proceed with the introduction of the RIF, and in what form*", we look forward as soon as practicable to considering:

- primary tax legislation that will apply to the RIF; and
- secondary legislation as envisaged in FSMB clause 60(3) and FSMA Section 261Z6 (1), after FSMB has received Royal Assent.

We urge priority being given to deliverables (and are keen to provide any assistance):

- government assessing the ConDoc responses and issuing a formal response, including next steps – which hopefully confirms the government's decision to proceed with the introduction of the RIF;
- government progressing relevant primary and secondary legislation;
- FCA consulting on, and then implementing, related rules; as well as
- HMRC consulting on, and then issuing RIF guidance notes.

We also encourage clarity as soon as practicable when RIFs can be launched. We suggest April 2024 (to coincide with the new tax year) is achievable. This clarity would be a welcomed signal to the market to forward plan for RIF launches. In parallel, we will:

- socialise in the market the opportunities for managers and investors to progress RIF launch plans; and
- share the Model RIF Deed: as indicated, freely available to the market to improve market familiarity with the practicalities of launching and operating RIFs.

FCA Discussion Paper 23/2

We are delighted, in FCA DP23/2 paragraph 2.32, the FCA indicates that the HM Treasury is exploring options for the introduction of a new unauthorised contractual scheme fund structure.
We suggest that separate chapters within the FCA sourcebook should clearly distinguish and de-lineate the rules for firms that manage:

1. unauthorised collective investment schemes and other alternative investment funds which admit retail investors (like RIF retail funds: RIFs that admit investor categories such as certified high net worth investors, certified sophisticated investors, and self-certified sophisticated investors); and
2. unauthorised collective investment schemes and alternative investment funds which admit only professional investors (like RIF professional funds: RIFs that will only admit professional investors).

We also suggest the FCA progresses with a revised FUND sourcebook with new rules in relation to the RIF (as an additional ‘Specialist AIF Regime’) reflecting the separate rules for 1, and 2, above.