

EXPLANATORY MEMORANDUM TO
THE UK PROPERTY RICH COLLECTIVE INVESTMENT VEHICLES
(AMENDMENT OF THE TAXATION OF CHARGEABLE GAINS ACT 1992)
REGULATIONS 2020

2020 No. 315

1. Introduction

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

2. Purpose of the instrument

- 2.1 These Regulations amend legislation introduced in Finance Act 2019 concerning the tax treatment of capital gains arising on disposals of interests in United Kingdom (UK) land by non-UK residents. Specifically, they amend rules relating to 'UK property rich' collective investment vehicles (CIVs) and their investors.
- 2.2 The amendments address issues raised following implementation of the legislation to ensure that it works as intended, and to clarify certain points and correct minor errors. In particular, the changes ensure that investors who are exempt from the charge to tax on capital gains, such as pension funds, can benefit from that exemption when directly or indirectly investing in CIVs, and that eligible CIVs can make certain elections provided for by the rules.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 These Regulations will come into force and take effect from 10 April 2020 ("the commencement date"), except as noted below.
- 3.2 The amendments made by regulations 3(a), 11(b) and (c), 12 and 14 have effect in relation to disposals made on or after the commencement date.
- 3.3 The amendments made by regulations 8 and 9 have effect in relation to elections made on or after the commencement date.
- 3.4 The amendments made by regulations 5 to 7, 10, 11(a), 13, 15, 16 and 20 have effect in relation to disposals made on or after 6 April 2019. These changes are relieving and apply retrospectively to the date the original rules had effect, under powers provided in paragraph 48(3) of Schedule 5AAA to the Taxation of Chargeable Gains Act 1992 (TCGA 1992).

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

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

4. Extent and Territorial Application

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

5. European Convention on Human Rights

- 5.1 The Rt Hon Jesse Norman MP, the Financial Secretary to the Treasury, has made the following statement regarding Human Rights:

“In my view the provisions of The UK Property Rich Collective Investment Vehicles (Amendment of the Taxation of Chargeable Gains Act 1992) Regulations 2020 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 Schedule 1 to Finance Act 2019 introduced new provisions extending the scope of the UK’s taxation of capital gains arising to non-UK residents on disposals of UK land to include gains on disposals of interests in non-residential UK property. It also extended the charge on gains on disposals of interests in residential property to include disposals made by widely held companies, investment funds, and life assurance companies. Those rules apply to disposals made on or after 6 April 2019.
- 6.2 Paragraph 14 of Schedule 1 inserted a new Schedule 1A to TCGA 1992, which contains the provisions relating to disposals by non-UK residents of assets that are UK property rich (broadly, assets deriving 75% or more of their value from UK land). This brings into charge gains on disposals of assets that derive at least 75% of their value from UK land where a person has a substantial indirect interest in that land, for example shares in a company that in turn owns UK land.
- 6.3 Paragraph 21 of Schedule 1 inserted a new Schedule 5AAA to TCGA 1992, which contains rules relating specifically to UK property rich CIVs (a defined term encompassing various forms of investment funds), and their investors. Schedule 5AAA interacts with Schedule 1A to make provisions relating to disposals of interests in CIVs, and disposals by CIVs of interests in UK land.
- 6.4 Schedule 5AAA provides that all CIVs, other than partnerships, will by default be treated for the purposes of TCGA 1992 as if they were companies and so chargeable to Corporation Tax on relevant gains. Investors are deemed to hold shares in such a company where that is not already the case, so that where the CIV is UK property rich, a disposal of an interest in it by a non-UK resident investor will be chargeable to UK tax under the provisions in Schedule 1A.
- 6.5 The default treatment described above would result in tax exempt investors such as pension funds suffering indirectly the effect of tax paid by a CIV on disposal of interests in UK land. Non-exempt investors could suffer effective double taxation when disposing of an interest in such a vehicle.

- 6.6 Schedule 5AAA therefore provides that CIVs may, subject to qualifying criteria and conditions, make elections to be treated as either transparent for tax purposes or exempt from tax on disposals of interests in UK land. Making either election will generally have the effect that tax on relevant gains will fall only on non-exempt investors and not on exempt investors or the relevant CIV.
- 6.7 Paragraph 8 of Schedule 5AAA provides the rules and conditions applicable to a transparency election. Broadly, the effect of a transparency election is to treat the CIV as a partnership for the purposes of capital gains. This results in the CIV not coming within the charge to tax, and investors within the charge to tax are then taxed on gains on disposals of their interests in the underlying assets of the partnership. This ensures that an investor who is exempt from tax on capital gains is able to benefit from that exemption when the CIV makes disposals of interests in UK land. This election is only available to CIVs that are already transparent for income purposes, and it requires the consent of all of the CIV's investors as it will affect their tax position.
- 6.8 Paragraph 12 of Schedule 5AAA provides the rules and conditions applicable to the exemption election. A CIV making such an election is still treated as a company but is exempted from tax on relevant gains. The CIV's investors remain chargeable on their gains on disposals of interests in the CIV, unless they are themselves tax-exempt.
- 6.9 Paragraph 6 of Schedule 5AAA provides an exception to the operation of a provision applicable to non-resident investors in UK property rich companies that broadly provides they do not come within the charge to tax on gains on disposals of interests in such companies where they hold less than 25% of the shares. This de minimis provision does not apply to investors in UK property rich CIVs.
- 6.10 Powers are provided within Schedule 5AAA to enable the Treasury to make Regulations to amend provisions within TCGA 1992 in relation to CIVs and their investments, with retrospective effect where necessary. These Regulations are made under those powers.

7. Policy background

What is being done and why?

- 7.1 A number of practical issues were identified by institutional investors and advisory firms after the introduction of the new rules in Finance Act 2019. These Regulations are intended to address some of those issues to ensure the rules work as intended. Without them there could be adverse impacts on tax exempt investors in particular, reducing their expected returns from investment in UK property, and a lack of certainty as regards the operation of aspects of the rules which could dampen investment in UK commercial property in particular, as it is an asset commonly held within CIV structures.
- 7.2 The issues identified are concerned with: the scope of the term 'collective investment vehicle'; interaction with rules that provide exceptions from a company being UK property rich; the making of annual Partnership Tax Returns where transparency elections have been made; exemption elections by widely held or widely marketed CIVs; and ensuring that exempt investors can continue to benefit from exemption when they invest indirectly in CIVs through particular holding structures. The Regulations also contain some minor corrections and clarifications, and provide a statutory obligation on CIVs that make a transparency election to provide information to HMRC regarding their investors.

- 7.3 Paragraph 1 of Schedule 5AAA provides the definition of the term ‘collective investment vehicle’. Regulation 3 makes changes relating to non-resident UK property rich companies to ensure that only principal, and not subsidiary, companies of non-resident property groups come within the definition of a CIV. This is with one exception, so that a subsidiary company that is 99% or more owned by a qualifying investor (broadly, an institutional investor such as another type of CIV or a pension fund, for example) also comes within the definition. This broadly mirrors the position for UK real estate investment trusts (REITs), a type of UK listed company that comes within the definition of a CIV. The change means that subsidiary companies will, as intended, not be able to make elections for exemption themselves except as noted above. The change has effect from the commencement date, at which point any existing elections by affected companies will cease to have effect.
- 7.4 Paragraph 3 of Schedule 5AAA determines when a CIV or company is UK property rich. The changes made by regulation 4 provide that no account is to be taken of paragraphs 5 or 6 of Schedule 1A TCGA 1992 in making that determination. Those paragraphs provide exceptions to treating a company as UK property rich where the UK property is used in a trade or is disposed of as part of a series of linked transactions that, if treated as made by a single company, would not be subject to tax. The changes have effect from the commencement date and will not apply retrospectively because they potentially have a taxing effect in that, taken together with the changes made by regulation 14, investors in CIVs that are now to be regarded as UK property rich and elect for exemption will not be entitled to relief under paragraphs 5 or 6 of Schedule 1A. However, such CIVs will (where eligible) be able to make a transparency or exemption election so that there is no tax on gains at CIV level. The deadline for making a transparency election is extended in particular circumstances by regulations 18 and 19 to allow fund managers more time to consider the effect of these changes.
- 7.5 Regulation 14 then inserts new paragraph 33A into Schedule 5AAA, so that investors making disposals of interests in CIVs where an exemption election has been made will not be entitled to relief under paragraphs 5 or 6 of Schedule 1A, ensuring that tax is paid by non-exempt investors when they dispose of interests in a CIV that does not itself pay tax on its gains. This change also takes effect from the commencement date.
- 7.6 CIVs that make transparency or exemption elections are subject to requirements to provide certain information either at the time of making the election and /or at some specified future date. Regulation 7 clarifies rules about the provision of Partnership Tax Returns for CIVs that have made the transparency election. Regulation 8 then inserts a new statutory requirement to provide investors’ details to HMRC on the making of such an election. This last change takes effect for elections made on or after the commencement date.
- 7.7 The conditions that CIVs wishing to make an exemption election must satisfy include some that are intended to ensure that (broadly) they are not controlled by a small group of connected persons. The rules apply a modified form of the close company test in Part 10 of the Corporation Tax Act 2010, or in some circumstances a test regarding genuine diversity of ownership. Regulations 9, 10, 15, 16 and 20 make changes to ensure that the rules work as intended, so that CIVs are not disadvantaged where they fail to meet the conditions for certain purely technical reasons despite in effect being widely held or having been widely marketed.

- 7.8 It is common for institutional investors, for example pension funds, to consolidate their investments within a holding vehicle. Paragraph 33 of Schedule 5AAA exempts disposals of interests in CIVs, or in some cases companies that CIVs invest in, where those disposals are made by holding vehicles that are wholly owned by specified investors who would be exempt from tax if they had made the disposal themselves. Regulation 13 amends paragraph 33 to address further situations where such investors use certain holding structures for which the current rules make no provision.
- 7.9 Other changes made by these Regulations correct minor errors or clarify the way particular rules are intended to operate. The most significant of these changes is made by regulation 9, which clarifies that exemption elections made under paragraph 12(3) by certain tax transparent CIVs in respect of an underlying investee company require direct ownership. That change has effect from the commencement date, at which point any existing elections by affected companies will cease to have effect.

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

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

9. Consolidation

- 9.1 There are no plans to consolidate the legislation.

10. Consultation outcome

- 10.1 A draft version of these Regulations was published on 17 September 2019, and comments were invited by 25 October 2019. HMRC received 15 responses, from a variety of advisory and law firms, insurance companies, and representative bodies. The responses were largely welcoming of the government's proposed changes, with some making suggestions for further changes. HMRC and the Treasury held further discussions with representative bodies and firms before finalising the Regulations.

11. Guidance

- 11.1 HMRC published [draft guidance](#) on 31 December 2018 on the new rules introduced at Schedule 1 to Finance Act 2019. That draft guidance will be updated on or around the date the statutory instrument is published to provide further detail on the effect of the changes made, and this will be incorporated into the final guidance in due course.

12. Impact

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

13. Regulating small business

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

14. Monitoring & review

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

15. Contact

- 15.1 Wayne Strangwood at HMRC, Telephone: 03000 585493 or email: wayne.a.strangwood@hmrc.gov.uk can be contacted with any queries regarding the instrument.
- 15.2 Richard Thomas, Deputy Director for the Financial Products & Services Team, at HMRC can confirm that this explanatory memorandum meets the required standard.
- 15.3 The Rt Hon Jesse Norman MP, the Financial Secretary to the Treasury, can confirm that this explanatory memorandum meets the required standard.