NON-RESIDENT CAPITAL GAINS TAX

Exit Considerations and Elections for Collective Investment Vehicles

The introduction of Non-resident Capital Gains Tax (NRCGT) in April 2019 has significantly impacted non-UK resident investors who were historically exempt from tax on disposals of UK real estate. It is important that investors consider this carefully as part of their exit strategy, especially in light of recent changes to the UK/Luxembourg tax treaty, which extends NRCGT to another large investor population.

NRCGT

Gains made by non-UK resident corporate investors on disposals of UK real estate, whether directly or indirectly through the disposal of UK property rich companies (broadly, where 75 per cent or more of the gross value of its assets derive from UK real estate), are subject to UK corporation tax (currently at 19 per cent).

Please note that that there are separate rules that have been in place for the disposal of residential properties since 6 April 2015, which are not covered in this article.

This article discusses the specific rules which apply to UK property-rich offshore Collective Investment Vehicles (CIVs) to limit the potential for multiple layers of UK taxation and other unintended consequences of the rules for certain tax-exempt investors in such CIVs.

What Is a CIV?

Broadly, a CIV for NRCGT purposes includes the following:

- A collective investment scheme, such as partnerships, property authorised investment funds (PAIF), authorised unit trusts (AUTs), Jersey property unit trust (JPUT) and other offshore unit trusts;
- An Alternative Investment Fund;
- A UK Real Estate Investment Trust; or
- A company that resides outside the UK and meets particular conditions, including the property income condition and non-close company condition.

What Tax Elections Are Available?

Effectively, the NRCGT rules for CIVs are intended to tax investors in a way that provides a similar outcome to direct investment in the underlying assets. Qualifying CIVs may make the following elections where certain conditions are met:

- **Transparency Election –** allowing certain ultimate investors with tax-exempt status (e.g., certain sovereign wealth funds and pension scheme) to preserve the tax-exempt treatment of capital gains.
- **Exemption Election –** allowing tax charge on the gains at the level of the CIVs or its underlying companies to be deferred until the investors in the CIVs realise their investment or receive distributions out of gains from the CIVs; the crystallised gains may remain exempt for certain tax-exempt investors.

Different qualifying conditions and tax considerations, outlined below but not exhaustively, are associated with each election. These elections must be considered on a case-by-case basis according to the investor base.

Transparency Election

Conditions to Be Met

- The CIV is offshore;
- The CIV is UK property rich; and
- The CIV is already considered transparent for income tax purposes but opaque for capital gains purposes (e.g., JPUTs)

Tax Considerations

- CIVs covered by the election are also treated as transparent for capital gains purposes.
- Investors of the CIVs are treated as disposing the underlying assets directly and so tax on the gains is levied at the investors level allowing for tax exempt investors to benefit from their tax-exempt status.
- Annual partnership tax return must be submitted to HMRC.
- Election is irrevocable and requires consent of all investors of the CIV.
- Election must be made within 12 months from when the CIV acquired the UK real estate directly or indirectly.

Exemption Election

Conditions to Be Met

Who is eligible to make the election?

- An offshore CIV that is a UK property rich company (or deemed company).
- A UK property-rich company (regardless of its residence) which is not a CIV but is at least 99 per cent owned by a partnership (regardless of its residence) or a UK CoACS (Co-ownership authorised contractual schemes).

The above entities are required to meet certain qualifying conditions which include (but not limited to) the genuine diversity of ownership condition, UK tax condition, non-close condition, and/ or recognised stock exchange condition, depending on the nature of the entity making the election.

Tax Considerations

- Entities covered by the exemption election are exempt on capital gains on a direct and indirect disposal of properties as long as the qualifying conditions for the exemption election are met.
- Depending on the ownership structure, full/partial exemption for the CIV itself and the entities in which the CIV has at least a 40 per cent ownership applies.
- The base cost of the underlying property is rebased to its market value on disposal of the qualifying company within the CIV. This base cost uplift means any latent gain is removed and so there should be no need to discount the sale price for latent gains on a share sale.
- The tax charge on the gains on the direct or indirect disposal of the properties is effectively deferred and crystallise when the conditions for the election are no longer met, the election is revoked, or where broadly a distribution out of the gains is made to the ultimate investors.
- Annual exemption election report must be submitted to HMRC.
- No time limits for election.

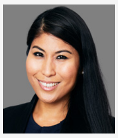
How A&M Can Help

As mentioned above, the rules regarding CIVs are complex. A&M's trusted Global Real Estate Team work closely with clients to help navigate these rules and provide expert advice on how CIV elections may benefit certain investment structures and the tax efficiencies that may be achieved.

Contact our team today to discuss how we can help your business make the most of the opportunities available.

A&M Real Estate Tax Contacts:

Kersten Muller
Managing Director
London
+44 7785 797902
kmuller@alvarezandmarsal.com



Melissa Ng
Director
London
+44 7881 292132
mng@alvarezandmarsal.com

Michael Searle
Tax Manager
London
+44 7881 297070
msearle@alvarezandmarsal.com

About ALVAREZ & MARSAL TAXAND

Alvarez & Marsal Taxand, an affiliate of Alvarez & Marsal (A&M), a leading global professional services firm, is an independent tax group made up of experienced tax professionals dedicated to providing customized tax advice to clients and investors across a broad range of industries. Its professionals extend A&M's commitment to offering clients a choice in advisors who are free from audit-based conflicts of interest, and bring an unyielding commitment to delivering responsive client service. A&M Taxand has offices in major metropolitan markets throughout the U.S., and serves the U.K. from its base in London.

Alvarez & Marsal Taxand is a founder of Taxand, the world's largest independent tax organization, which provides high quality, integrated tax advice worldwide. Taxand professionals, including almost 550 partners and more than 2,500 advisors in 50 countries, grasp both the fine points of tax and the broader strategic implications, helping you mitigate risk, manage your tax burden and drive the performance of your business.

To learn more, visit **AlvarezandMarsal.com** or **Taxand.com**

Follow A&M on:

ALVAREZ & MARSAL
TAXAND