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Insights

SOVEREIGN INVESTORS LIKELY TO START PAYING UK TAX – IMPACT ON UK REAL ESTATE INVESTMENT

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SUMMARY

The UK government is consulting on bringing overseas sovereign investors in UK real estate within the scope of UK direct tax from April 2024 as part of measures amending the scope of the sovereign immunity tax exemption. This was announced in a consultation document issued on 4 July. This would be a material change and is likely to change how sovereigns invest in UK real estate.

WHAT IS THE UK PROPOSING IN THE CONSULTATION?

The UK government is proposing to change the way that overseas sovereigns are taxed in relation to activities in the UK. This will impact heads of state, government departments, and sovereign wealth funds amongst others.

Currently they can claim immunity (a tax exemption) that applies to all of their income and gains where it would otherwise become subject to UK tax, whether the profits are generated from investment or trading activity.

The government is proposing to dramatically reduce the scope of the exemption, to just interest income from investment activity. This would bring income profits and capital gains from investment in UK real estate and profits from trading in UK real estate within the charge to UK tax.

Sovereign non-natural persons would be subject to corporation tax, which will increase to 25% from April 2023. Sovereign natural persons (e.g. heads of state) would become subject to UK income tax and capital gains tax at the standard rates. They would become subject to existing reporting regimes.

WHEN WILL THIS CHANGE?

The government proposes that the tax changes will take effect from 1 April 2024 for non-natural persons within the scope of corporation tax and 6 April 2024 for natural persons.

Capital gains incurred on disposals made on or after 1 April 2024 (for non-natural persons) and 6 April 2024 (for natural persons) would be subject to UK tax. Sovereigns will be able to rebase the cost of their assets at their market value on 1 April 2024 or 6 April 2024 (respectively) so that only capital gains accruing from those dates would be taxable. The government is considering allowing the taxpayer to use the actual acquisition cost where the taxpayer would prefer, e.g. because rebasing at April 2024 may produce a worse position than the actual cost.

WHY?

The UK government has compared the UK with other large jurisdictions and decided it is being too generous compared to its international partners, including the US, Germany and Australia. Over time other jurisdictions have reduced the scope of their sovereign immunity.

Also, recent changes levelling the playing field for non-UK residents with UK residents investing in UK real estate make the existing exemption for sovereign wealth funds look more out of line.

WHAT ABOUT INVESTMENT IN UK REITS ETC?

The government proposes that distributions of tax exempt rental profits or gains from REITs and PAIFs to sovereigns should be subject to UK tax, although double tax treaties may reduce the rate of withholding tax down from 20%. Treaties typically offer a reduced rate of at least 15%.

As such, REITs may remain attractive to sovereign investors investing in UK real estate, particularly with the increase in the corporation tax rate to 25%.

SOVEREIGN INVESTORS AS QUALIFYING INVESTORS FOR UK REGIMES

The government is considering whether to change the status of sovereigns as qualifying investors in certain types of vehicles which benefit from preferential tax treatment. The government is not minded to change this unless, in relation to some regimes, it would undermine the new tax rules for sovereigns.

PENSION SCHEMES

The government has flagged that some sovereigns may be pension schemes and may be able to benefit from other existing exemptions from UK tax, including those for registered pension schemes.

WHAT NEXT?

This is a big announcement, and unexpected. The government is seeking responses to the consultation before 12 September 2022.

Sovereigns should consider their structures to see how the changes could impact on them. Many may be holding their investments in UK real estate via tax transparent entities, such as JPUTs. There may be a better alternative.

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MEET THE TEAM

Elizabeth Bradley

London

elizabeth.bradley@bclplaw.com
+44 (0) 20 3400 2323

Anne Powell

London

anne.powell@bclplaw.com
+44 (0) 20 3400 2162

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