



Offshore Fund Investments in UK Real Estate

The regime¹ for the taxation of capital gains of non-residents disposing of interests in UK land or “UK property rich” entities introduced in 2019 imposed a UK tax charge on offshore funds making investments in UK real estate funds (such as UK REITs). In a welcome development, the government has now announced that it will legislate to change this, with retrospective effect, so that an offshore fund holding a less than 10% interest in a UK real estate fund will generally not be subject to UK tax on capital gains realised on disposals of such interests.

Currently, an offshore fund disposing of an interest in entity fund or collective investment vehicle (“CIV”) that is “UK property rich”² — which would include UK real estate funds, such as a UK REIT — is liable to UK tax on capital gains on the realisation of that interest. This charge applies irrespective of the size of the offshore fund’s interest in the “UK property rich” CIV and so significantly disincentivises offshore funds from making investments in “UK property rich” CIVs.

The government has now published for consultation³ draft regulations which provide that an offshore CIV will not be liable to UK tax on capital gains realised on disposals of less than 10% interests in “UK property rich” CIVs, provided that the offshore fund:

- Is widely-held⁴;
- Is not itself “UK property rich”; and
- Expects (and declares in its offering document) that not more than 40% of the market value of its assets will be made up of interests in UK land or “UK property rich” entities.

This change will be a welcome development for offshore funds that wish to have some part of their portfolio (40% or less) made up of minority interests in UK REITs or other “UK property rich” CIVs. Following the introduction of the new regulations (with their retrospective effect), capital gains realised on the disposal of such interests will not be subject to UK tax.

¹ Introduced with effect from 6 April 2019.

² An entity is “UK property rich” if 75% or more of the market value of its assets is derived from interests in UK land.

³ It is expected that the regulations will be introduced in a form substantially similar to the draft version.

⁴ This condition will be met if the offshore fund either meets a “genuine diversity of ownership” test, which broadly requires interests in the offshore fund to be made available to investors generally and not restricted to a narrow class of related investors, or a “non-close” test, which requires that it not be the case that 50% or more of the ownership interests in the offshore fund are held by five or fewer investors (with connected investors counting as a single investor for these purposes).