



Law Society
of Scotland

Consultation Response

A Consultation on Land and Buildings Transaction
Tax – Property Investment Funds

August 2018



Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

Our Tax Law sub-committee welcomes the opportunity to consider and respond to the Scottish Government's consultation: *Land and Buildings Transaction Tax – Property Investment Funds*¹. The sub-committee has the following comments to put forward for consideration.

Consultation questions

Question 1: Does this chapter provide an accurate picture of the Scottish property fund and investment landscape?

We have no comments to make.

Question 2: In terms of the size of managed property fund assets in Scotland, how many funds do you estimate hold Scottish property assets, what is the total value of these funds and how large (%) is their exposure to Scottish property?

We have no comments to make.

Question 3: Do you consider that the Scottish Government should introduce a seeding relief for PAIF's and CoACS?

Yes.

¹ <https://consult.gov.scot/fiscal-responsibility/seeding-relief/>

We believe that an LBTT seeding relief should be introduced so as to ensure that Scottish property is not placed at a competitive disadvantage as compared with property in the rest of the UK in relation to the establishment of Property Authorised Investment Funds (PAIFs) and Co-Ownership Authorised Contractual Scheme (CoASCs). Many funds have portfolios which include property in Scotland as well as in the rest of the UK, but the absence of a seeding relief at present means that Scottish properties cannot be included in transfers to PAIFs and CoASCs.

We understand that in some cases, this means that Scottish properties are not included in the proposals to transfer assets into PAIFs and CoASCs. In other cases fund managers may decide to, as they cannot be accommodated in UK wide structures.

As explained elsewhere in our response, a number of issues have been identified in connection with the current SDLT seeding relief, particularly in relation to the clawback arrangements. We understand from representations made by industry bodies such as British Property Federation (BPF), The Scottish Property Federation (SPF) and the Association of Real Estate Funds (AREF) that there are serious issues relating to the clawback provisions which create a challenge to the use of these seeding reliefs. The most significant of these relates to the use of CoASCs for real estate pooling particularly for life insurance companies. In broad terms, the clawback provisions mean that life insurance companies cannot contemplate transferring property portfolios into a CoASC because of the risk of an SDLT clawback if a policy holder subsequently surrendered a policy.

These current issues with the clawback provisions in the SDLT seeding relief mean that the CoASC fund structure is likely not being used as much as it could be if these deficiencies were addressed. Indeed we understand that the SDLT seeding relief has been used on very few occasions. This is despite the fact that life companies are keen to seed properties into a CoASC structure. The problem is that doing so currently would bring a tax risk thought to be unacceptable to many. This is unfortunate as life companies are ideally placed to seed CoASCs, and if the clawback issues can be addressed, and more CoASCs set up, this would provide a real engine for growth in real estate investment.

We understand that discussions are ongoing with HMRC about the CoASC clawback issues and it is hoped that amendments to the SDLT legislation will be made to address the current barriers to using the SDLT seeding relief for life companies seeding CoASCs.

There are other issues with the SDLT clawback arrangements relating to PAIFs. There is also a desire for a seeding relief for Real Estate Investment Trusts (REITs). Once the CoASC seeding relief clawback problems have been solved, it is likely that stakeholders will turn to these other questions and seek legislative change in relation to them.

Assuming that an LBTT seeding relief is introduced, we would recommend that consideration be given to include different clawback arrangements in relation to CoASCs which facilitate the pooling of property investments by life funds.

We also note that following changes which are expected to be made to deal with the CoASC seeding relief problems, the SDLT legislation is likely to be amended further to address other clawback issues. We

recommend that a form of LBTT seeding relief is introduced which takes into account the anticipated changes regarding the clawback provisions for seeding reliefs for CoASCs, but that the legislation is kept under review so that further amendments can be made in relation to the seeding reliefs for PAIFs and also any seeding relief that could be introduced for REITs.

We do not believe it would make sense for the Scottish Government to delay introducing an LBTT seeding relief until all the UK SDLT clawback and other issues have been resolved as this could take some time, and in the meantime Scottish real estate may continue to be viewed as unattractive for fund managers contemplating seeding CoASCs and PAIFs.

It is anticipated that once the problems with the SDLT clawback provisions are dealt with, there will be an increase in the number of CoASCs being established. Planning for this will start once it becomes clear that the UK government is going to take action to address the clawback issues. At that stage, if the Scottish Government has not introduced a seeding relief, or it is not clear that this is going to be introduced in the near future, we consider it likely that Scottish real estate will simply be excluded from the process, and life funds and others will sell the Scottish real estate which could otherwise have been included in the CoASC. We therefore consider that it is extremely important that LBTT is not left without a seeding relief at a time when the SDLT legislation is being amended to facilitate the establishment of CoASCs.

Question 4: Please briefly describe any positive or negative impacts that would accompany LBTT parity with SDLT for a seeding relief.

It is very unlikely that funds will be set up which invest solely in Scottish property. As many funds are set up on a cross border basis, it would make sense to have broad parity between LBTT and SDLT seeding reliefs, taking into account the changes which are required to address the concerns about clawback which have been identified by property industry bodies such as the BPF, SPF and AREF.

In other words we believe there would be benefit in broadly aligning the LBTT seeding reliefs with the SDLT relief once it has been amended to address the clawback concerns. It may be necessary to do this in a few stages.

Question 5: With regards to a seeding relief - how would a 'do nothing' approach on the part of the Scottish Government affect your business and future business decisions?

It is suggested by property industry representatives that a "do nothing" approach would put the Scottish real estate industry at a disadvantage compared to the property industry in the rest of the UK.

The SDLT seeding relief was introduced after the introduction of LBTT. Since the introduction of the SDLT seeding relief, there have been calls from the property industry for an equivalent relief from LBTT on the

seeding of CoASCs and PAIFs. As mentioned above, Scottish real estate risks becoming an unattractive asset class because of the lack of a seeding relief.

Question 6: If the Scottish Government were to proceed with a LBTT seeding relief, are there any aspects of the SDLT arrangements which you believe should be changed if replicated for LBTT purposes?

Yes.

We believe the clawback arrangements in the current SDLT seeding reliefs should not be replicated.

As discussed above, there are issues with the clawback provisions of the seeding relief for CoASCs which cause particular difficulties for life companies wishing to transfer real estate into CoASC structures. These should not be replicated in any LBTT seeding relief.

In addition there are problems with the SDLT seeding relief clawbacks relating to PAIFs. Again these challenges should not be replicated in the LBTT seeding relief. As it is not yet clear how the SDLT legislation will be amended to address the issues with PAIF seeding relief, we recommend that the LBTT seeding relief is kept under review, and that there is close liaison and co-operation between Revenue Scotland and HMRC and between the Scottish and UK governments in relation to future changes to the legislation in this area.

Question 7: Do you agree that the Scottish Government should introduce parity with SDLT by providing a relief for the exchange of CoASC units?

Yes.

Funds tend to be set up on a UK wide basis, so similarity of treatment between LBTT and SDLT is desirable.

Question 8: Please briefly describe any positive and negative impacts that would accompany such a relief.

A relief for the transfer or exchange of units in CoASC invested in Scottish real estate will encourage the development of CoASCs generally. Parity of treatment of real estate in Scotland and real estate in the rest of the UK would increase the availability of quality investments and would avoid Scottish real estate being treated as an undesirable asset class.

Question 9: With regards to a CoACS relief - how would a 'do nothing' approach on the part of the Scottish Government affect your business and future business decisions?

We note that a 'do nothing' approach by the Scottish Government has the potential to lead to Scottish real estate being treated as an undesirable asset class which needs to be excluded from the establishment of CoASCs, and probably disposed of.

Question 10: Do you have any other comments not covered by the previous questions around providing a relief for the exchange of CoACS Units?

No.

Question 11: Please identify and describe any impacts on UK taxes (non-SDLT) that could occur following the proposed amendment to LBTT.

We do not anticipate any particular impacts.

Question 12: Can you identify any potential unintended impacts or effects on the current LBTT regime through providing parity with SDLT on the treatment of CoACS or through providing a seeding relief for PAIFs and CoACS?

No.

Question 13: If the Scottish Government introduced a relief, do you believe it should introduce GDO rules for CoACS or do you believe another test could be equally as effective in combating artificial tax avoidance?

We recommend that a similar Genuine Diversity of Ownership (GDO) rule is used.

Question 14: If the Scottish Government introduced the proposed reliefs, should it introduce general portfolio tests with the same thresholds as the UK (based on the value of pan UK property) or should a more Scottish orientated threshold/measure be used?

Funds generally operate on a pan UK basis, and so thresholds based on the value of pan UK property should be used.

Question 15: If the Scottish Government introduced the proposed reliefs, should it legislate for a percentage of ownership test in the same manner as the rest of the UK?

Yes.

Question 16: Should the Scottish Government, if introducing the proposed reliefs, implement the same claw back provisions as introduced under the UK's SDLT regime? If not, what conditions should be applied and how would you suggest recovery of the tax should operate?

No.

See our responses to Questions 3, 4 and 6.

Question 17: Do you believe that the fund managers and scheme operators should be liable for the recovery of any tax liability resulting from these potential reliefs?

No.

Question 18: Please identify and describe any other areas of potential tax avoidance that you think could arise by amending LBTT legislation to provide a seeding relief and change LBTT treatment of CoACS?

We do not anticipate any particular areas of potential tax avoidance.

Question 19: If seeding relief was introduced in Scotland, should it just apply to non-residential property?

No.

Question 20: Would LBTT parity with SDLT regarding PAIFs and CoACS, in any way, impact upon equal opportunities, human rights, island communities, privacy and/or sustainable development in Scotland?

We have no comments to make.

For further information, please contact:

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