Real estate funds

Are you leaving money on the table?
In a rapidly changing tax environment, it is critical for real estate fund managers to re-evaluate their fund structures to ensure they remain fit for purpose.

Both investors and prospective purchasers of assets are increasingly extending the scope of their due diligence to identify vulnerabilities in a particular structure, and are subsequently seeking protections or price reductions depending on their findings. Identifying vulnerabilities in a structure as soon as possible can pre-empt these challenges and create the opportunity for remediation in advance of a transaction.

The following factors are having a particular impact on returns:

- The Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project
- The EU's Anti-Tax Avoidance Directive and Principal Purpose Test (PPT)
- Actual and prospective double tax treaty changes
- Domestic tax changes impacting taxation payable on rents and the sale of property
Given the raft of tax changes taking place across Europe and the US recently, it is critical that funds are regularly reviewed to ensure that structures are adapted to these changes and fund managers are not losing out in the negotiations on a sale. Investors and prospective purchasers of assets are increasingly extending the scope of their due diligence to identify vulnerabilities in a particular structure and, based on experience, subsequently seeking protections or price reductions depending on their findings.

The UK alone has seen fundamental changes to its tax environment for property over the past 18 months. As part of the Autumn Budget 2017, the UK Government announced plans for non-resident landlords to be brought into the scope of UK corporation tax from April 2020. Consequently, it is now essential for fund managers to consider the impact of corporate interest restriction (CIR) and anti-hybrid rules to identify and mitigate any disallowance as soon as possible.

Commonly used fund vehicles – for example, offshore unit trust schemes – are also impacted by recent changes in UK domestic law; in particular, with regard to how these entities are taxed on capital gains, which will need to be considered in conjunction with the NRCGT changes that will take place in parallel.

A number of other key changes taking place internationally will need to be considered to ensure that real estate platforms remain fit for purpose. In particular, consideration will need to be paid to the following developments: the OECD BEPS initiative to introduce a PPT and the Multilateral Instrument (MLI), the EU’s Anti-Tax Avoidance Directive (from January 2019) and treaty changes (such as the forthcoming change to the UK-Luxembourg treaty and the France-Luxembourg treaty). As a result of these changes, funds that typically assumed they would be able to access treaties may experience limitations.

The plans to widen the scope of non-resident capital gains tax (NRCGT) means the disposal of UK property held offshore will be subject to UK tax from April 2019. Fund managers considering forthcoming sales (at corporate or asset level) should factor this change into their exit strategy to minimise the impact it may have.
First, new tax leakages need to be identified, understood and modelled. All of these changes have increased the compliance burden and put a greater focus on substance and financing structures.

It is therefore important to highlight and understand areas of potential risk where there are vulnerabilities in a structure, in order to model future returns accurately and ahead of potential sales.

Where necessary, funds should plan to revise structures to address the above issues and mitigate risk.

This should include considering which exemptions are available, particularly in the context of UK NRCGT (including a new qualifying institutional investor exemption that gives qualifying institutional investors the opportunity for a tax-efficient holding structure and exit). Additionally, a number of options may be available in relation to the CIR and anti-hybrid regime, which should be explored.

One size will not fit all, and the appropriate solution will depend on the fund's setup and target investor profile, and a cost-benefit analysis.

The market-leading teams have knowledge in real estate funds investing in the UK and across Europe. They have the experience to help you develop solutions so that your investment structures maximise returns for you and your investors.

The team can help you with all aspects of a real estate fund life cycle, including advisory work, due diligence, and compliance services across all taxes in respect of the following:

- Establishing investment funds, including debt funds
- Establishing investment structures for separately managed accounts
- Seeding assets
- Review and restructuring of fund management structure
- Tax assistance during the operational phase including:
  - Advice on financing arrangements
  - Cash repatriation
  - Tax and VAT compliance
  - Tax and VAT reporting
  - Investor reporting
- Exit options
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