The UK’s approach to sovereign immunity from direct taxes

Large Corporate **Personal tax**

21 October 2022

The CIOT responds to aspects of the government’s recent consultation on the UK’s policy on sovereign immunity from direct tax.

Sovereign immunity refers to the principle that foreign governments and heads of state have exemption from liability to UK direct taxes. This immunity extends not only to monarchs and heads of state but also to state investment funds, such as sovereign wealth funds and state pension funds. The main proposals are to:

- put sovereign immunity on a statutory basis replacing the current position that depends on case law and practice;
- narrow the exemption to UK source interest income only; and
- make the narrower statutory exemption available to a defined class of persons.

The sovereign immunity exemption would therefore no longer apply to trading income, income and gains from UK real estate, and dividends from real estate investment trusts (REITS), though tax on such activities would be subject to relief under double tax treaties. The consultation indicates that the government expects the greatest Exchequer impact to relate to the removal of immunity from UK property income and gains.

In our response, we are generally supportive of the government’s proposal to put the principle of, and conditions for, sovereign immunity on a comprehensive statutory footing. We note that the statutory definition will need to encompass both direct and indirect holdings by sovereign investors and will benefit from further consultation.

We welcomed the recognition that the status of sovereign immune investors in the operation of specific tax regimes such as REITs, the substantial shareholding exemption and the new qualifying asset holding company regime will need to be considered carefully. Any changes should be considered in the context of the policy intent for each regime, the rationale for the treatment of sovereign immune investors, and potential unintended consequences where loss of sovereign investor exempt status affects the tax status for other investors. Consideration should also be given to the need for certainty and stability, particularly in the light of the scale of recent changes to the UK tax treatment of non-UK residents in relation to UK real estate, so investors can plan ahead with confidence.

For inheritance tax, it is proposed that sovereign immunity will be restricted to state property that remains state property when it passes to a successor. We note that the definition of ‘state property’ will need to be considered in the context of succession laws of other jurisdictions to ensure it meets the policy objective. The interaction with double tax treaties where another jurisdiction has exclusive taxing rights for inheritance tax under a treaty may require consideration. Where property is held in trust the calculation of the 10-year charge for periods (quarters) will also require clarification.

The full CIOT response is available here: www.tax.org.uk/ref975

Kate Willis *kwillis@ciot.org.uk*