Jersey Property Unit Trusts: Key Considerations for Trustees

Jersey Property Unit Trusts, known as JPUTs, continue to be popular investment vehicles because they are easy to establish and offer several tax advantages, even after the regime for taxing non-residents' gains on UK commercial real estate came into force on 6 April 2019.

The purpose of this article is to highlight the role, responsibilities and decisions which trustees make in respect of a JPUT, as well as exploring the future of JPUTs from a legislative perspective.

What is a JPUT and who can act as Trustee?

A JPUT is a specific type of Jersey trust used to acquire and hold interests in both commercial and residential UK real estate. The structure of a JPUT differs from that of a company because it is not a separate legal entity. Instead, the assets within the JPUT are held by its trustees – who are the legal owners – and the unitholders are the beneficial owners of those assets.

The Trustee(s) will usually be a Jersey special purpose company (SPV Trustee) incorporated specifically to act as trustee of the JPUT. Although an 'in-house' trustee can be used, SPV trustees allow for a cleaner exit route, as the ownership can be transferred to the new shareholders and directors changed if required. The asset level agreements and title would therefore not require novation to new trustees, which would be the case if 'in-house' administrator trustees are used. Any entity which acts as trustee will need to be regulated by the Jersey Financial Services Commission under the Financial Services (Jersey) Law 1998 or fall within an exemption from such regulation.

While there's no Jersey-based legal or regulatory requirement for JPUTs to have more than one trustee, English property law has a doctrine of 'overreaching', which makes it preferable for UK property to be held by two trustees. This means that any lender or purchaser carrying out transactions with the trustees can deal with them without any obligations to consider the equitable interests of the trust's beneficiaries.

JPUTs have earned a good reputation for being highly flexible and capable of meeting a range of different commercial and operational requirements. As you would expect, the JPUT structure is most notable for its tax advantages. For example, there is no Income or Capital Gains Tax (CGT) payable in Jersey by a JPUT trustee, and stamp duty on the transfer of units in a JPUT is not payable either in Jersey or the UK. In addition, as JPUTs are usually established as 'Baker Trusts' (discussed further below), the JPUT is treated as transparent for UK income tax purposes.

UK CGT considerations: To elect or not elect

Following the introduction of the 6 April 2019 non-resident CGT regime, a JPUT would not suffer UK CGT on gains of its underlying property should the trustee decide to file a 'transparency election' with HMRC within 12 months from the date the JPUT becomes property rich. Instead, its unitholders would be subject to CGT, however in the context of fund structures, unitholders tend to be tax exempt investors rather than individuals. Furthermore, the filing of a transparency election puts the JPUT in the same position in respect of CGT as pre the 6 April 2019 regime.

Such an election can be made online and should be carefully considered by trustees, even if the JPUT is part of a wider fund structure, which may have already filed an 'exemption election' if it meets the HMRC definition of a Collective Investment Scheme. An exemption election would only exempt the JPUT from UK CGT whilst it is an affiliate of the fund for which the exemption election has been filed, and only to the extent of the ownership interest held by the fund. Therefore, if a JPUT does not have a transparency election in its own right, if at a later date its ownership were to change to remove it from the fund structure, it would then become an opaque vehicle and be subject to UK CGT on disposal of its UK property.

Therefore, separately electing a JPUT would not only ensure that the current tax position in respect of capital gains remains, trustees may also consider commercially that the JPUT would be more marketable for sale in the future as a transparent entity, given that the regime does not allow for a transparency election to be made past the initial 12 month period of the JPUT becoming property rich, even on change of ownership.

Trustee responsibilities: Distributions and solvency

Trustees are required under Jersey law to act with due diligence, to the best of their ability and skill, and to carry out actions that comply with the terms laid out in the trust instrument. Additionally, trustees are expected to exercise their powers solely for the benefit of the unitholders as beneficiaries.

The trust instrument for a JPUT will often be drafted to ensure it meets the requirements of a 'Baker Trust'. This refers to the 1927 case of Baker vs Archer-Shee, and simply means the income generated by the assets within the JPUT accrue directly to the unitholders as it arises, instead of forming part of the fund for later distribution by the trustees. As touched earlier in this article, the Baker Trust nature of a JPUT is what makes it transparent for income tax purposes. Income is directly attributable to the unitholders and a JPUT offers a lot of flexibility when it comes to distributions, for example there are no restrictions on the maintenance of capital, and trustees are not required to issue formal solvency statements. However, such flexibility does not preclude trustees from carefully considering the level of distributions to be made; the trustee should consider the current liabilities of the trust, as well as to forecast known and potential liabilities, or any significant capital expenditure needed in the future. The trustee is also expected to consider commercial aspects relating to the property held by the JPUT, such as reviewing the provision for bad debt collection, as well as any tenant-specific issues which may call into question ability to collect contracted rents.

Although the trustees are expected to act in the best interests of the unitholders by increasing investor returns, should income available for distribution not fully consider the overall financial position of the JPUT, then an over-distribution may then call into question the JPUTs ability to continue in operation, which ultimately would not be accretive to investors.

Trustee liability

The case First Tower Trustees Limited v CDS (Superstores International) Limited held that standard trustee limited recourse provision did not exclude liability arising under statute or tort. Following this case, Article 32 of the Trusts (Jersey)

Law 1984 (Trust Law), in the context of Jersey law and non-Jersey law governed contracts, states that any claim by a third party will be against the trustee and will extend to the trust property, rather than the personal property of the trustee.

Notwithstanding the provision within Trust Law, when entering into agreements, trustees should ensure that specific wording is included around limited recourse, which should reflect Article 32. It should also be clear in the agreement that the trustee is not acting in their own capacity but in their capacity as trustee of the relevant JPUT.

The impact of COVID-19 on UK real estate

The COVID-19 pandemic has had a considerable effect on the UK real estate market, and therefore many JPUTs will have felt those effects from both an income and valuation perspective.

Many landlords have been unable to collect contractual rents from tenants. This has resulted in the need to frequently review bad debt provisions and consequently, the impact on the JPUT's cashflow projections. The increase in tenants facing Compulsory Voluntary Arrangements (CVAs) has led to increased vacant space, which impacts property valuations and security of income, as leases are not enforceable. The impact of CVAs on property portfolios have been compounded by the UK government's extension to the moratorium around commercial forfeiture and evicting tenants for non-payment of rent until 25 March 2022 (something which was originally only intended to be place for three months until 30 June 2020). Landlords have also had to find a difficult balance between enforcing legal contracts and offering those tenants facing financial hardship a degree of understanding and flexibility. This is not only a consideration in the commercial space, but in the Built-to-Rent sector, some landlords have chosen to waive service charges, especially in units where facilities have had to close.

The stop-start nature of the pandemic and changing nature of how people work has also made it harder to find and rent to new tenants, increasing the need to offer incentives for new tenants, including rent-free periods.

High street retail and hotels have fared the worst in terms of asset sectors. Although the leisure industry will likely bounce back and the rise in staycations has helped the short-term recovery of the hotel sector, the focus on ESG is likely to impact short stay business travel. It is also believed that the conference market is likely to take much longer to recover, which will continue to detract from the performance of hotels.

The impact of the pandemic on the retail market is likely to be permanent, however for many, the view is that COVID-19 was just an accelerant of the trends that were already emerging, such as the increase in e-commerce and the consequential impact on the demand for high-street space. The biggest longer-term impact in this sector will be around lease structures. For retail and leisure in particular, leases will likely have a performance top-up in addition to index linked rent reviews, to ensure base rent is fair. Any performance base elements in leases will require greater transparency and partnership between tenants, landlords and operators and of course, trustees will have a key role to play in these discussions.

The future of the JPUT

In October 2021, Chancellor Rishi Sunak delivered his Autumn Budget, which included provisions for a new tax regime for asset-holding companies. This was first flagged in the 2020 Budget, after the government announced plans to enhance the UK's competitiveness as a location for asset management, and for investment funds specifically.

The intention behind the new regime is to ensure asset-holding companies pay no more tax than is proportionate to the activities they perform. As a result, the new regime outlines several measures on taxing 'qualifying asset holding companies' (QAHCs) as well as the payments made by QAHCs. For a company to qualify as a QAHC, it must be primarily carrying out investment activity and investing its funds with the aim of diversifying investment risk.

In practice, this could mean the transparency of income and gains available through a JPUT could become less significant, as the same tax-neutral result could in future be achieved by using a UK Real Estate Investment Trust (REIT) as an asset holding company. UK REITs are also exempt from income and capital gains tax, and the REIT structure is internationally recognised. However it is likely that QAHCs will be more common place in PE structures, as opposed to those holding UK real estate. Furthermore, even though a QAHC will have certain tax advantages, using Jersey vehicles as opposed to UK companies may still appeal, given the CA 2006 requirements around filing of accounts and restrictions around distributable reserves to name a few.

Summary

JPUTs are highly flexible investment vehicles that are quick to set up and carry several tax advantages. The trust instrument can also be very specific when it comes to determining the distributions made by the trust, as well as the rights of unitholders. While the pandemic-related difficulties faced by the UK property sector have naturally impacted JPUTs, and incoming legislation may narrow the gap between JPUTs and other property investment structures, the adaptable nature of the JPUT should ensure it remains popular with principals, legal advisors, investors and lenders.