

UK Government Proposal to “Modernize” the Taxation of Foreign Sovereign Investments

October 28, 2026

In an unexpected move, the UK Government announced today that it will be creating a new sovereign tax status, putting the taxation of foreign sovereigns on a statutory footing for the first time. Under the heading of modernization, the new regime (due to take effect from January 1, 2029) will extend to certain persons not previously entitled to sovereign immunity from taxation, but will bring returns from UK real estate into the charge to tax, as well as trading income in certain circumstances.

Sovereign Immunity Under Current UK Law

Based on a principle of public international law that one sovereign should not subject another to its domestic laws, the UK has traditionally provided foreign sovereigns with broad immunity from direct taxation (i.e., income tax, capital gains tax and corporation tax). This immunity, which has never been formally codified, covers all UK source income and gains, provided they arise to and for the sole benefit of a foreign Head of State (such as a reigning Monarch or President), the spouse of a foreign Head of State, or a foreign independent government.

In the case of foreign governments, there can be some complexity in determining which parts of the government, and which extensions of the government, are eligible; and some challenges in seeking exemption for entities that are owned by foreign governments. But once eligibility has been established, the UK version of sovereign immunity is broader than the targeted forms of exemption available in many other countries that attract sovereign investment.

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What is Being Proposed?

In the summer of 2022, the last UK Government consulted on potential changes to the taxation of foreign sovereigns. But the conclusion (after considering responses to the consultation) was that no changes would be made.

The current UK Government has taken a different tack, notwithstanding its express desire for the UK to be an attractive location for sovereign investors. As announced in a fresh consultation document released in connection with today's Budget, a new "sovereign tax status" regime will take effect from January 1, 2029. The consultation is not about the idea of introducing a regime (implementation seems to be a foregone conclusion), rather on certain design aspects of the new regime.

The new proposals have some similarities with the approach contemplated in the previous consultation but also a number of notable differences.

Who Will Be Within the New Regime?

Sovereign tax status under the new regime will apply to a broader range of persons than currently, including:

- foreign sovereign states and constituent territories of federal states;
- Heads of State acting in their sovereign capacity;
- governments and integral parts of governments;
- the central bank, currency authority or monetary authority of the sovereign state;
- a separate entity incorporated and resident in the foreign sovereign's home country where the state owns 100% of the shares (although the UK Government has specifically asked stakeholders what the impact will be of limiting the country of incorporation and residence to the sovereign's home country);
- sovereign wealth funds;
- state-operated pension funds (SOPFs), including certain entities established to invest funds on their behalf, that meet certain conditions;

- organizations fulfilling a government function on behalf of the government and which are subject to direction by the government; and
- government export credit agencies that are 100% owned by the relevant government.

In order to establish a comprehensive regime, the current practice of "Crown immunity" from direct UK tax for members of the Commonwealth where the King is Head of State, and for the six states of Australia and the ten provinces of Canada, will also be replaced with the new sovereign tax status.

What Are the Main Consequences of Being Within the New Regime?

As a general rule, but subject to specific exemptions, those eligible for sovereign tax status will be liable to UK tax in the same way as other non-UK residents. The overall effect, in summary and subject to consultation, will be as follows:

- income arising from UK land will be liable to UK tax;
- chargeable gains on disposals of direct holdings of UK land, and chargeable gains on disposals of interests in certain UK property rich vehicles will be liable to UK tax;
- UK trading income will be liable to UK tax;
- UK source interest income will be exempt (including an exemption from UK withholding tax), as will UK source dividends;
- other investment returns to UK branches or subsidiaries of sovereign tax status investors will be exempt; and
- SOPFs will be exempt from UK tax on chargeable gains.

What Other Consequences Will There Be?

The consultation also considers the fact that some sovereign investors are able (together with other kinds of institutional investors) to access (or allow vehicles in which they invest to access) various other UK tax benefits. For example, companies wishing to qualify as UK "Qualifying Asset Holding Companies" have more

flexibility in meeting applicable ownership conditions where they are held by certain categories of qualifying investor. The consultation confirms that those with sovereign status will generally continue to qualify for these purposes.

“Qualifying institutional investor” status for the UK substantial shareholding exemption will also remain for those with sovereign tax status, other than in relation to disposals of interests in UK property rich vehicles (unless the entity with sovereign tax status is a SOPF).

In one of the more complex aspects of the consultation, bespoke rules are also proposed to allow those with sovereign tax status to access a Real Estate Investment Trust (REIT) structure to enable sovereigns to hold a controlling interest in a REIT through a UK company, whilst obtaining a 15% tax rate on income from a property business held in that REIT. The UK Government recognizes that it will need to continue to work with stakeholders to develop the detailed design of this aspect of the new rules before legislating.

How Is Sovereign Tax Status Secured?

Sovereign tax status will be accessed through a formal application process administered by HMRC, involving the provision of evidence of the basis on which eligibility is claimed. Annual reapplication will not be required, although HMRC may require periodic confirmation that relevant facts and circumstances have not materially changed.

Sovereigns whose status has been accepted under the current regime will be required to reapply for sovereign tax status, although it is intended for the transition to be streamlined with minimization of duplication of information already provided to HMRC.

Although HMRC has statutory confidentiality obligations, the UK Government has said it will work with sovereigns to minimize the need to provide sensitive information.

Commencement and Transition

The new regime will apply from January 1, 2029, with sovereigns’ current immunity continuing to apply until then.

Various transition rules will also be introduced, including a rebasing of assets brought within the new charge to UK tax on chargeable gains to their market value on January 1, 2029. There will also be a form of relief from stamp duty land tax on certain real estate transfers effected if sovereigns wish to restructure the way in which they hold their real estate.

Next Steps

The consultation on the new regime runs until January 20, 2027, and a technical consultation on draft legislation will follow before its introduction in Finance Bill 2027-28.

HMRC will also host online sessions and targeted roundtables on the reforms, in which we intend to participate.

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