

Real estate investment trusts investing in real estate investment trusts

Who is likely to be affected?

UK real estate investment trusts (REITs)(tax advantaged vehicles introduced to encourage investment in the property sector) which invest in other UK REITs.

General description of the measure

The measure will allow the income from UK REITs investing in other UK REITs to be treated as income of the investing REIT's tax exempt property rental business. The property income distribution (PID) that a UK REIT receives from another UK REIT in which it invests will be tax exempt. For the purpose of the balance of business test, the investment by a REIT in another REIT will be included as an asset of the investing REIT's property rental business.

Policy objective

The measure is aimed at providing three benefits to the REIT sector: investment diversification, cash management flexibility and tax simplification. The combined impact of allowing REITs to diversify and better manage their cash assets within a simplified tax regime is expected to help support the REIT business environment and help remove potential barriers to further future investment activity.

Background to the measure

At Budget 2012 the Government announced that it was to undertake a formal consultation on reforms to the REIT regime to consider the tax treatment of REITs investing in REITs and to explore the potential role social housing REITs could play to support the social housing sector. The consultation on the measure took place between 4 April 2012 and 27 June 2012.

For the REITs investing in REITs aspect of the consultation, there was consensus that introducing this measure would generate positive benefits both for the REIT industry and wider Government objectives.

Detailed proposal

Operative date

The measure will have effect for accounting periods beginning on and after the date that Finance Bill 2013 receives Royal Assent.

Current law

The legislation is within part 12 Corporation Taxes Act 2010 (CTA 2010).

A REIT is exempt from corporation tax (CT) on its profits from a property rental business (section 534 CTA 2010). It is required to distribute 90 per cent of its profits (section 530 CTA 2010) by way of a property income distribution (PID). A PID is treated in the hands of investors as income from property and taxed accordingly (section 548 CTA 2010).

If a REIT invests in another REIT then the PID income received by the investor REIT is taxed as income from property on which the main rate of CT will be paid and it is not treated as part of the investor REIT's tax exempt property rental business. Consequently, a REIT investing in a REIT is subject to tax on the PID and can pay this taxed income out as an ordinary dividend, not a PID. The investment is not within the tax exempt property rental business for the purpose of the balance of business test.

Proposed revisions

Legislation will be introduced in Finance Bill 2013 to ensure that the property income distribution (PID) that a UK REIT receives from another UK REIT in which it invests will be treated as income of the investing REIT's tax exempt property rental business; that the investment by a REIT in another REIT will be included as an asset of the investing REIT's property rental business for the purpose of the balance of business test; and that the investing REIT must distribute 100 per cent of the PID it receives from investing in another REIT to its investors.

Summary of impacts

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	-	negligible	negligible	negligible	negligible	negligible
	This measure is expected to have a negligible impact on the Exchequer. Any impact will be set out at Budget 2013.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals and households	The measure would have no impact on individuals and households.					
Equalities impacts	The measure does not have a direct equalities impact as it focuses on institutional rather than protected groups. It is not expected that the measure will have an indirect impact on any protected equality group.					
Impact on business including civil society organisations	This measure is expected to have no impact on businesses or civil society organisations. The measure will allow existing REITs to diversify their investments and make more productive use of their cash holding.					
Operational impact (£m) (HMRC or other)	This measure is expected to have a negligible operational impact.					
Other impacts	Other impacts have been considered and none have been identified.					

Monitoring and evaluation

This measure will be kept under review through communication with affected taxpayer groups.

Further advice

If you have any questions about this change, please contact Allana Sheil on 020 7147 2565 (email: allana.sheil@hmrc.gsi.gov.uk).

- 1 Real estate investment trusts: UK REITs which invest in other UK REITs**
Schedule 1 amends Part 12 of CTA 2010 (real estate investment trusts).

SCHEDULES

SCHEDULE 1

Section 1

REAL ESTATE INVESTMENT TRUSTS: UK REITs WHICH INVEST IN OTHER UK REITs

- 1 Part 12 of CTA 2010 (real estate investment trusts) is amended as follows.
- 2 (1) Section 530 (condition as to distribution of profits) is amended as follows.
 - (2) For subsection (1) substitute –
 - “(1) In the case of a group UK REIT, the condition in this section is met in relation to an accounting period if –
 - (a) so much of the group’s UK profits arising in the period as are UK REIT investment profits (see section 549A), and
 - (b) at least 90% of the rest of the group’s UK profits arising in the period,
 are distributed by the principal company of the group on or before the filing date for the principal company’s tax return for the period (see paragraph 14 of Schedule 18 to FA 1998).”
 - (3) For subsection (4) substitute –
 - “(4) In the case of a company UK REIT, the condition in this section is met in relation to an accounting period if –
 - (a) so much of the profits of the company’s property rental business arising in the period as are UK REIT investment profits (see section 549A), and
 - (b) at least 90% of the rest of the profits of the company’s property rental business arising in the period,
 are distributed on or before the filing date for the company’s tax return for the period (see paragraph 14 of Schedule 18 to FA 1998).
 - (4A) For the purposes of subsection (4) profits of the company’s property rental business are to be calculated in accordance with section 599.”
- 3 (1) Section 530A (condition as to distribution of profits: increase in profits after delivery of tax return) is amended as follows.
 - (2) In subsection (2) for “530(1)(c)” substitute “530(1)”.
 - (3) In subsection (6) for “530(4)(b)” substitute “530(4)”.
 - (4) After subsection (9) insert –
 - “(10) This section cannot be relied upon to satisfy the requirement of section 530(1)(a) or (4)(a).”
- 4 (1) Section 531 (conditions as to balance of business) is amended as follows.

- (2) In subsection (5)(b) after “cash” insert “or relevant UK REIT shares”.
- (3) In subsection (6)(b) after “cash” insert “and relevant UK REIT shares”.
- (4) After subsection (8) insert –

“(9) In this section “relevant UK REIT shares” means –

- (a) in the case of a group UK REIT, shares held by a member of the group in the principal company of another group UK REIT or in a company UK REIT, and
- (b) in the case of a company UK REIT, shares held by the company in the principal company of a group UK REIT or in another company UK REIT.”

- 5 In section 548 (distributions: liability to tax) in subsections (1) and (3) after “distribution” insert “(other than one falling within section 549A(5) or (7))”.
- 6 In section 549 (distributions: supplementary) in subsection (3)(a) and (b) after “distribution” insert “(other than one falling within section 549A(5) or (7))”.
- 7 After section 549 insert –

“549A Distributions from one UK REIT to another UK REIT

- (1) If a company receives a distribution falling within subsection (5) or (7), the distribution is to be treated as profits of a property rental business carried on by the company in the United Kingdom.
Such profits are referred to in this Part as “UK REIT investment profits”.
- (2) The property rental business mentioned in subsection (1) is to be treated as separate from any other property rental business of the company.
- (3) References to profits of property rental business or UK property rental business are to be read as including UK REIT investment profits accordingly, including where the profits referred to are otherwise profits calculated in accordance with international accounting standards or section 599.
- (4) Section 549(2) and (2A) applies in relation to distributions falling within subsection (5) or (7) as it applies in relation to relevant distributions.
- (5) A distribution falls within this subsection if –
 - (a) it is made by the principal company of a group UK REIT to a shareholder of the company which is –
 - (i) a member of another group UK REIT, or
 - (ii) a company UK REIT, and
 - (b) it is a distribution of amounts shown in the financial statements under section 532(2)(a) (statement of group’s property rental business) as –
 - (i) profits or gains (or both) of UK members of the group, or
 - (ii) profits or gains (or both) of UK property rental business of non-UK members of the group.

- (6) In subsection (5) the reference to a distribution made by the principal company includes a reference to a distribution made by the principal company of the post-cessation group.
- (7) A distribution falls within this subsection if –
- (a) it is made by a company UK REIT to a shareholder of the company which is –
 - (i) a member of a group UK REIT, or
 - (ii) another company UK REIT, and
 - (b) it is a distribution in respect of profits or gains (or both) of property rental business of the company.
- (8) In subsection (7) the reference to a distribution made by a company UK REIT includes a reference to a distribution made by the post-cessation company.”
- 8 In section 550 (attribution of distributions) in subsection (2) –
- (a) for paragraph (a) substitute –
 - “(a) first, to distributions in satisfaction of the requirement of section 530(1)(a) or 530(4)(a) (as the case may be),
 - (aa) second, to distributions in satisfaction of the requirement of section 530(1)(b) or 530(4)(b) (as the case may be),”,
 - (b) in paragraph (b) for “second” substitute “third”,
 - (c) in paragraph (c) for “third” substitute “fourth”,
 - (d) in paragraph (d) for “fourth” substitute “fifth”, and
 - (e) in paragraph (e) for “fifth” substitute “sixth”.
- 9 In section 588 (joint ventures: effect of notice under section 586) after subsection (6) insert –
- “(7) Subsections (3) to (6) apply (in particular) for the purpose of interpreting section 549A(5)(a)(i) and (7)(a)(i).”
- 10 In section 589 (joint ventures: effect of notice under section 587) after subsection (6) insert –
- “(7) Subsections (3) to (6) apply (in particular) for the purpose of interpreting section 549A(5)(a)(i) and (7)(a)(i).”
- 11 In section 605 (property rental business: exclusion of business producing listed income) after subsection (1) insert –
- “(1A) But see section 549A which treats income falling within class 7 of the table as profits of property rental business.”
- 12 In Chapter 18 of Part 15 of ITA 2007 (deduction of income tax at source) in sections 973 and 974 (which relate to distributions made by UK REITs) after subsection (6) insert –
- “(7) In relation to references to profits of property rental business, see section 549A of CTA 2010.”
- 13 The amendment made by paragraph 7 above has effect in relation to distributions as follows –
- (a) in the case of a distribution received by a member of a group UK REIT, the amendment has effect if the distribution is received in an

accounting period of the principal company of the group beginning on or after the day on which this Act is passed, and

- (b) in the case of a distribution received by a company UK REIT, the amendment has effect if the distribution is received in an accounting period of the company beginning on or after the day on which this Act is passed,

and the other amendments made by this Schedule have effect accordingly.

EXPLANATORY NOTE

REAL ESTATE INVESTMENT TRUSTS: UK REITS WHICH INVEST IN OTHER UK REITS

SUMMARY

1. This clause and Schedule allows the income from UK real estate investment trusts (REITs) investing in other UK REITs to be treated as income of the investing REIT's tax exempt property rental business. The property income distribution (PID) that a UK REIT receives from another UK REIT in which it invests will be tax exempt. For the purpose of the balance of business test, the investment by a REIT in another REIT will be included as an asset of the investing REIT's property rental business. The investing REIT must distribute 100 per cent of the PID it receives from investing in another REIT to its investors.

DETAILS OF THE SCHEDULE

2. Paragraph 2 amends section 530 Corporation Tax Act 2010 (CTA 2010). This section sets out the percentage of UK profits from a property rental business that a group or company UK REIT must distribute in an accounting period in order to fulfil the distribution of profits condition.
3. Paragraph 2(2) introduces a new requirement (new section 530(1) CTA 2010) that all of a group UK REIT's profits that are UK REIT investment profits must be distributed. UK REIT investment profits are defined at paragraph 7. The existing requirement to distribute at least 90 per cent of the rest of the profits is at new section 530 (1) (b) CTA 2010.
4. Paragraph 2(3) introduces the same requirement for company UK REITs as for a group UK REIT in respect of UK REIT investment profits.
5. Paragraph 3 makes consequential amendments to section 530A CTA 2010. This section was introduced in Finance Act 2012 and sets out the distribution of profits condition where there has been an increase in profits after the delivery of a tax return.
6. Paragraph 4 amends the balance of business condition in section 531 CTA 2010 to include relevant UK REIT shares within the balance of

business assets condition for both group and company UK REITs. Relevant UK REIT shares are defined at subparagraph 4.

7. Paragraphs 5 and 6 make consequential amendments.
8. Paragraph 7 inserts new section 549A into CTA 2010. This section introduces the term “UK REIT investment profits” and defines it at for a group in new section 549A(5) and for a company is new section 549A (7). UK REIT investment profits are treated as profits of a UK property rental business and new section 549A(3) explains that references to property rental profits and similar terms within part 12 CTA 2010 include UK REIT investment profits. They are, however, treated as separate from other property rental business profits (new section 549A(2)).
9. Paragraph 8 makes consequential amendments to section 550 CTA 2010 required by the introduction of “UK REIT investment profits”.
10. Paragraphs 9 (company) and 10 (group) apply Chapter 10 (joint ventures) to distributions that are UK REIT investment profits within new section 549A.
11. Paragraph 11 amends section 605 to ensure that UK REIT investment profits are not excluded from the definition of a property rental business.
12. Paragraph 12 is a consequential amendment required to ensure that UK REIT investment profits are included when considering deduction of tax at source.
13. Paragraph 13 sets out the operational date for the changes within the schedule.

BACKGROUND

14. UK REITs are tax advantaged vehicles introduced to encourage investment in the property sector.
15. A REIT is exempt from corporation tax on its profits from a property rental business. It is required to distribute 90 per cent of its profits by way of a property income distribution (PID). A PID is treated in the hands of investors as income from property and taxed accordingly.
16. If you have any questions about this change, or comments on the legislation, please contact Allana Sheil on 020 7147 2565 (email: allana.sheil@hmrc.gsi.gov.uk).