

International Fiscal Association

Investment in Land in the UK and in UK REITs

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Sydney, 24th May 2007

Basic Elements of Ownership

- Nature of ownership
 - Dealing?
 - Investment?
 - Development?
- Location of ownership
 - Onshore?
 - Offshore?
- Form of ownership
 - Company?
 - Limited partnership?
 - Unauthorised unit trust?
 - REIT?

Basic Elements of Tax Liability

- UK treaties always preserve UK's taxing rights over UK land
- What are these?
 - CT at 30% (FY08 28%) on income + gains if resident corporate ownership
 - IT at 22% (TY08/09 20%) on income + 0% on gains if non-resident corporate ownership
 - Non-resident can be onshore as CT/CGT only if UK trading PE
 - Non-corporate 22/40% (TY08/09 20/40%)

Relief for buildings expenditure

- Capital allowances for industrial buildings, hotels and agricultural buildings being phased out – 4-3-2-1-0
- Capital allowances for machinery and plant reduced from 25% to 20% reducing balance basis from 2008
- Long-life equipment and fixtures qualify at 10% reducing balance basis

Offshore Investors

- Treaty-protected non-resident dealers may incur no UK tax liability if have no UK PE
- Non-resident investors will not be subject to CGT on any gain
- UK property business profits subject to income tax at 22% (20% from 6.4.08)
 - Subject to withholding at source via agent or tenant
 - Unless HMRC permission to pay gross
- Interest relief under income tax rules rather than loan relationship rules

UK property businesses (Schedule A) of non-residents

- Ss.971/972 ITA 2007 and SI1995/2902
- Tax collected from relevant prescribed persons
- i.e. persons paying receipts to non-resident or acting as agent in the management or administration of the business
- A non-resident is a person with his “usual place of abode” abroad
- Recovery by withholding and with benefit of indemnity by non-resident

“Prescribed Persons”

- SI1995/2902 Regulation 3
- The person prescribed by HMRC for that part of the business
- Agent with power to receive income or with control over it
 - legal advisers excluded (Reg 4(1)(a))
 - ‘elected agent’ if more than one (Reg 4(1)(b), (c))
- The tenant
 - Provided annual rent exceeds £5,200

Prescribed Persons' Obligations

- Liability to register (Reg 7)
- Collection of tax by non-agents:
 - Quarterly basis of accounting
 - Tax at the basic rate on
 - Aggregate of payments unless deductible expense to third party
- Collection of tax by agents:
 - Quarterly basis of accounting
 - Tax at the basic rate on
 - Net income under his control

Gross Payment of Property Income

- Liability is on fiscal year accruals but withholding is based on payment
- Interest expense can be deducted
- Non-resident must self-assess and can apply for payment gross
- Must have fully complied with prior UK tax obligations (if any) or have no liability
- If accepted, prescribed person is no longer obliged to collect tax

Other UK Land Issues

- No capital gains provided non-resident
- Potential charge to Case VI income under s.776 ICTA (CT) or Ch 3 Pt 13 ITA 2007 (IT)
- SDLT cost up to 4%
- If borrow to finance should be able to deduct interest as expense
 - Issue if partner rather than partnership borrowing
 - Unauthorised unit trusts may be problematic
 - WHT if lender non-resident and UK source interest

UK REITs

- Finance Act 2006 (sections 103 – 144, Schedules 16 and 17) and Regulations SI2006/2864 – 2867
- Elect to enter regime (single company or group REIT) on or after 1.1.07
- Fundamental that exempt activities are ring fenced from taxable activities of the company or group
 - No relief for losses of tax exempt part to offset taxable profits or vice versa (relevant to distribution requirement)
- Exempt activity is property rental business, not developing property for sale, land dealing, hotel or farming trades:
 - basically Sch A (UK) & Sch D Case V (foreign) property income with some exclusions
 - Group REIT looks to worldwide property rental activities but exempt element is worldwide UKRC activities + UK activities of NRC

UK REITs – Qualifying Conditions

- To enter and remain within regime REIT must be:
 - listed
 - UK resident (and not resident elsewhere)
 - not open-ended
- To remain within the regime in each A/P, REIT must:
 - not be ‘close’
 - have a single class of ordinary shares plus non-voting FRPs
 - no profit related borrowings
- For group REIT must be satisfied by parent company
- Group REIT must also meet specific accounting requirements
- Provisions allowing joint venture participation by REITs

UK REITs – Property Business Qualifications

- 75% or more of pre-tax IAS profits (excluding gains) and assets from property rental business
 - Various exclusions, e.g. incidental letting of a property trade, temporarily surplus accommodation, services to tenants of overseas properties, “owner occupied” under GAAP, REIT dividends
- At least 3 properties, none of which is more than 40% of value of portfolio or owner occupied
- Failure may not lead to automatic disqualification provided minor and not repeated
- Group treated as single business for this purpose

UK REITs – Required Distributions

- Must distribute at least 90% of exempt rental income but can retain gains (but taxed on investor if distributed)
- In some circumstances, the company may distribute less than 90% of the tax-exempt profits and remain in the regime:
 - Where there is a legal impediment to distribution
 - The finally agreed measure of tax-exempt profits is higher than the amount returned
 - Regulation 6 of the UK-REIT (Breach of Conditions) (SI 2006/2864) regulations is relied on
 - Sufficient distributions are declared but not paid out to certain shareholders as a result of reasonable steps taken in connection with the 10% rule
- Applies to group holding company but not subsidiaries

UK REITs – Taxation and Exemption

- Exempt on property rental business income and gains
- Residual 30% (FY08 28%) charge on other income and gains
 - Exclude development properties sold within 3 years and trading properties
- 2% ‘conversion charge’ on entry, payable in instalments, on market value of property assets
- 1.25 limit on interest deduction to prevent over-gearing based on ratio of profits (before capital allowances) and finance costs (tax charge on excess interest if breached)

UK REIT Investors - Taxation

- REIT dividends treated as property rental income
 - No dividend tax credit
 - Not subject to foreign landlords' scheme
- Subject to deduction of income tax at source at 22% (20% - 2008), unless
 - UK resident coy or UK PE of non-resident company
 - Charity/pension fund/ISA
 - Crown/local authority
- REIT dividends aggregated but separate from other property income
- Dividend article of DTC may apply but if a company owns 10% or more of REIT this may lead to excessive shareholding charge if not taken reasonable steps to prevent