



**EPRA** | REPORTING

European Public Real Estate Association

## Global REIT Survey 2016

EUROPE



# United Kingdom – REIT



A COMPARISON OF THE MAJOR REIT REGIMES AROUND THE WORLD

# 1 General introduction

	Enacted year	Citation	REIT type
UK-REIT	2007	Finance Act 2006, and subsequently issued regulations. Legislation re-written with enactment during Spring 2010.	Corporate entity.

The UK REIT was introduced in the UK with effect from January 01, 2007 by the Finance Act 2006. On January 01, 2007 nine companies elected to become REITs – a number which grew significantly within the first year of the regime, but since then the increase has been small each year, however it has increased recently due to new REIT launches and channel island property companies managed by asset managers converting to REIT status.

The UK REIT regime operates through a combination of legislation (primary and secondary) plus guidance. The primary legislation has been rewritten as part of a project to simplify the UK's tax legislation, it should be noted that the rewrite project tried not to amend the effect of the original legislation, but merely improve the legibility. The rewritten legislation forms part of the Corporation Tax Act 2010. Updated guidance to accompany the legislation, and subsequent amendments are long awaited. The legislation now refers to the property rental business (previously referred to as "tax exempt") and the residual business (which relates to all other business activities).

Amendments to the REIT rules have been introduced which came into effect in Finance Act 2012. Such changes have made the UK REIT regime more attractive. Entry to the REIT regime is now cheaper – the entry charge has been abolished, new REITs can list on AIM and there is a three year grace period for REITs to become widely held and not "close". Furthermore, certain institutions are encouraged to invest in REITs given their shareholdings in a REIT will be treated as widely held. More recently in Finance Act 2013 and 2014, the Government has introduced further amendments in relation to UK REITs investing in other UK REITs. The measure allows 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, and REITs shareholders to be ignored when considering "close" status. These changes provide three benefits to the REIT sector: investment diversification, cash management flexibility and tax simplification.

## Sector summary\*

Listing Country	Number of REITs	Number in EPRA REIT Index	Sector mkt cap (EUR€m)	% of Global REIT Index
UK	36	23	€ 56.585	4.58%

## Top five REITs\*

Company name	Mkt Cap (EUR€m)	1 yr return (EUR€) %	Div Yield	% of Global REIT Index
Land Securities Group plc	€ 10.105	-13.01%	3.20%	0.92%
British Land Co plc	€ 7.927	-16.84%	4.23%	0.72%
Hammerson plc	€ 5.147	-11.88%	4.00%	0.47%
Intu Properties plc	€ 4.808	-4.79%	4.57%	0.31%
SEGRO	€ 3.885	2.18%	3.52%	0.35%



\* All market caps and returns are rebased in EUR and are correct as at 29 July 2016. The Global REIT Index is the FTSE EPRA/NAREIT Global REITs Index. EPRA, August 2016.

## Sector summary\*

Listing Country	Number of REITs	Number in EPRA REIT Index	Sector mkt cap (EUR€m)
UK – AIM	4	1	€ 1.545

## Top REITs\*

Company name	Mkt Cap (EUR€m)	1 yr return (EUR€) %	Div Yield	% of AIM Index
Real Estate Investors plc	€ 117	-13.01%	4.91%	7.82%



\* All market caps and returns are rebased in EUR and are correct as at 29 July 2016. EPRA, August 2016.

## 2 Requirements

### 2.1 Formalities / procedure

Key requirements
<ul style="list-style-type: none"> <li>- Election must be filed prior to conversion.</li> <li>- Certain conditions for REIT status.</li> </ul>

An election must be filed prior to conversion. In order to become a UK REIT, a group of companies has to confirm that the parent company:

- is UK resident and not resident elsewhere;
- has shares traded on a recognised stock exchange (does not apply for first three years);
- is not an open-ended investment company;
- is not a close company (does not apply for first three years);

- has only one class of ordinary shares (i.e., non-voting fixed rate preference shares which may be convertible are permitted);
- has no performance-related loans and
- that the parent company will produce financial statements.

Strictly, two tax returns (relating to property rental business and residual business of the UK REIT group) should be filed annually, although HMRC may not insist on a return in respect of the exempt property rental business. Three sets of financial statements (which demonstrate that the UK REIT group fulfils the various qualifying tests and conditions) need to be filed annually.

## 2.2 Legal form / minimum share capital

Legal form	Minimum share capital
Listed closed-ended company.	GBP 50,000 (if listed in UK).

### Legal form

The parent company of a UK REIT must be a closed-ended company which is either listed or actively trading on a stock exchange which is recognised by the UK tax authorities within three years of entry into the regime. However, there is no requirement as to where it is incorporated. It must be tax resident in UK and must not be tax resident in another country.

Subsidiary entities can be tax resident outside the UK, but such entities are subject to the local tax regime in that overseas jurisdiction and may suffer tax.

Management may be internal or external.

### Minimum share capital

The normal listing requirements in respect of share capital are applicable. A UK REIT may only have one class of ordinary shares, but it can also offer non-voting preference shares, convertible non-voting preference shares, and convertible loan stock.

A UK company that lists on the UK stock exchange must have a share capital of at least GBP 50,000.

## 2.3 Shareholder requirements / listing requirements

Shareholder requirements	Listing mandatory
<ul style="list-style-type: none"> <li>- Not a 'close company'.</li> <li>- A single corporate shareholder may not own 10% or more of the shares/voting rights.</li> <li>- No restriction on foreign shareholders.</li> </ul>	Yes, but can be on any Stock Exchange recognised by the UK tax authorities (within three years).

### Shareholder requirements

A UK REIT cannot be a 'close company'. A company is "close" where it is controlled by five or fewer shareholders. A listed company will not be close if at least 35% of the shares are owned by the public. "Public" for this purpose includes shareholders owning less than 5% and pension funds (who do not provide pensions for the employees of that REIT) but excludes non-close companies. Institutional investors are also excluded, including charities, registered providers of social housing, sovereign wealth funds, pension funds, managers/trustees of authorized unit trusts and OEICs and since 2014 UK REITs and overseas equivalents to UK REITs. HMRC guidance on what constitutes an overseas equivalent is currently being drafted.

No corporate shareholder, wherever tax resident, should hold 10% or more of the shares or voting rights in a UK REIT, otherwise a penalty tax charge will arise if it pays any dividend to such a corporate shareholder without having taken reasonable steps to prevent the payment of such a

dividend. UK REITs therefore usually have restrictions in their Articles of Association that prevent distributions from being made to corporate shareholders who hold 10% or more of share capital or voting rights and allow a UK REIT to force shareholders to sell stock if they are in danger of breaching the 10% limit.

There are no restrictions on foreign shareholders.

#### Listing requirements

Listing on the LSE or any other 'recognised stock exchange' (which now includes AIM following FA 2012) is required. HM Revenue & Customs maintain a list of recognised stock exchanges across the world.

## 2.4 Asset level / activity test

Restrictions on activities / investments
<ul style="list-style-type: none"> <li>- At least 75% of a REIT's net profits must be derived from the property rental business (measured using financial statements).</li> <li>- At least 75% of a REIT's assets must be used in the property rental business (measured using financial statements).</li> <li>- The REIT must hold at least three separate assets.</li> <li>- No one asset may exceed 40% of the total assets.</li> <li>- May invest outside the UK in real estate wherever located.</li> </ul>

Restrictions are imposed by the balance of business tests, which limit the amount of investment permitted in non-rental generating assets and the amount of non-rental income. However, other activities are permitted subject to these restrictions. Essentially, only rental profits and gains realized on the disposal of properties used in the UK property rental business will be exempt from UK tax.

The balance of business tests state that:

- at least 75% of a UK REIT's net profits must be derived from the property rental business;
- at least 75% of a UK REIT's assets must be used in the property rental business.

A UK REIT must hold at least three separate assets directly (note that interests held via partnerships would not count for this test), and no one asset can exceed 40% of the market value of the total portfolio. (Note that a single property which can be multi-tenanted, e.g. a shopping centre will count as more than one asset). Qualifying properties may be residential or commercial and in any location worldwide.

Cash counts as a good asset for the balance of business test, whereas interest is still taxable and is income of the residual business. These changes apply for the accounting period starting after July 17, 2012.

Owner occupied assets (that is property used by the UK REIT, e.g. a head-office building) are not qualifying rental assets for the purposes of the balance of business test. Certain land rich groups were seeking to use planning to structure group businesses in such a way that the operating companies could claim tax relief for rents paid to a group rental company which was not taxed on the rent. The restructuring relied on treating the operating company as outside the UK REIT group for tax purposes only; therefore there was no need to separate economic ownership of the operating and rental businesses. Anti-avoidance legislation was introduced by the Finance Act 2009 to counter such tax planning.

Development by the UK REIT for investment on its own account is permitted, and is generally included within the property rental business unless development costs exceed 30% of the acquisition cost (or the property's value at the time of entry to the UK REIT regime if higher) and the property is sold within three years of completion (see 3.1). Property trading is permitted but is

taxable, and falls outside of the property rental business for the purpose of the balance of business restrictions.

The parent company must own at least 75% of a subsidiary company for the subsidiary to be a member of the UK REIT group; such members can in turn own at least 75% subsidiaries but the parent must ultimately more than 50% of the shares of all the subsidiaries in a group. Where a UK REIT has the right to at least 40% of the profits of a joint venture company then the proportion of rental exempt income and gains that are attributable to the UK REIT will be exempt from tax, if an election is made.

Where UK REITs are partners in a partnership with share of 20% or less, the share of assets and income are treated as outside the ring-fence for the balance of business tests although the income and gains will be treated as tax-exempt. Similar provisions apply where the UK REIT has an interest of 20% or less in a unit trust such as a Jersey Property Unit Trust which is a 'Baker trust' (where the income belongs to the investor but the capital is under the control of the trustees).

## 2.5 Leverage

Leverage
Interest cover test.

Borrowing of money is limited by the Financing Cost Ratio. The ratio is defined as "property profits" that is, profits of the property rental business before a deduction for interest, losses from a previous accounting period and tax depreciation (capital allowances) divided by the property financing costs (that is finance related to the property rental business which is broadly defined). Finance costs are limited to interest costs and amortisation of discounts relating to financing. They no longer include SWAP break costs or normal SWAP payments. The property profits must be at least 1.25 times the property financing costs. Where income cover is less than 1.25 times, a tax charge will arise based on the amount of the property financing costs that cause the ratio to fall below 1.25 times.

As the test looks only at the relationship between rental income and interest costs, a sudden unexpected increase in interest rates or a drop in income may result in a tax penalty. HMRC has the power to waive this penalty charge if the UK REIT is in severe financial difficulty, the ratio is breached due to unexpected circumstances and the UK REIT could not reasonably have taken action to avoid the ratio falling below 1.25 income cover.

## 2.6 Profit distribution obligations

Operative income	Capital gains	Timing
90% of tax-property rental profits. 100% of PID from other REITs.	Not included in the distribution obligation.	Within 12 months of the end of the year.

A distribution out of the property rental business of the REIT (rental income and capital gains) is called a Property Income Distribution – a 'PID'.

### Operative income

90% of the income from the property rental business must be distributed within 12 months of the end of the accounting period (however profit from the residual business income does not have to be distributed). Measures were introduced in Finance (No 3) Act 2010 to permit REITs to issue stock dividends (i.e. to issue new shares to shareholders) in lieu of cash dividends which would be treated as qualifying distributions.

Where a REIT invests in another REIT, 100% of the PID dividends received by the investing REIT must be distributed within 12 months of the end of the accounting period. This revision to the legislation was introduced in Finance Act 2013.

### Capital gains

Gains arising from the disposal of real estate used in the property rental business do not have to be distributed.

## 2.7 Sanctions

Penalties / loss of status rules
Tax penalties and the potential loss of the REIT status.

The legislation makes provision for penalties or the withdrawal of UK REIT status where certain requirements are breached. These provisions have been rewritten in the CTA 2010, are complex and the HMRC guidance has not yet been updated for the 2010 changes. There are differing remedies and time limits, plus some breaches may occur a number of times whereas others may be only breached once before UK REIT status is lost. Consequently, care needs to be exercised to determine how a particular breach may be dealt with. Here is an outline of the rules which will be applied.

Where the parent company of a group UK REIT or a single company UK REIT loses its stock exchange listing or becomes close, then its UK REIT status may be withdrawn with effect from the end of the previous accounting period. In certain circumstances there will not be a breach, for example:

- if the loss of a stock exchange listing arises from the takeover by another group or single UK REIT or
- where the group UK REIT or single company UK REIT becomes close as the result of the action of others, but this is remedied by the end of the next accounting period.

Failure to meet the property rental business tests (at least three properties must be held by the REIT and no property can be worth more than 40%) is a breach which can occur more than once.

Failure to distribute 90% of the taxable profits of a property rental business and 100% of any PIDs received from other UK REITs is a breach. Where the profit distribution obligation is not complied with within three months after the point at which the group's results are agreed with HMRC, then a tax charge (currently 20% but reducing to 17% by 2020) will arise on the UK REIT and will be based on the shortfall of the distribution.

It is possible to breach the balance of business test for assets at the beginning of the first accounting period of a UK REIT so long as the test is complied with at the beginning of the next accounting period.

Thereafter, failure to meet the 75% assets test is assessed as a minor breach if more than 50% of the assets are qualifying assets at the beginning of the accounting period, but a major breach if less than 50% of the assets are qualifying assets at that time. Similar provisions apply to the balance of business tests when considering what proportion of the UK REIT's income is rental income.

The UK REIT will incur a 20% tax charge on the amount equivalent to a PID paid to a corporate shareholder which holds 10% or more of the shares in UK REIT. It is therefore usual for the REIT to take steps to discourage such a level of investment (e.g. by amending the company's Articles of Association to prevent such distributions).

There are special rules to deal with multiple breaches which are too detailed to deal with here, but note that in the event of breaches of a number of differing requirements in a ten-year period, HMRC can require the group UK REIT or single company UK REIT to leave the REIT regime.

HMRC have significant powers which permit them to make a UK REIT group or single UK REIT company leave the UK REIT regime and can also levy additional taxes if they consider that the UK REIT has entered into arrangements with the sole or main purpose of obtaining a major tax advantage.

Where HMRC issue a notice to leave the UK REIT regime, the UK REIT rules will cease to apply from the start of the current accounting period and for future years; however the taxpayer can appeal.

## 3 Tax treatment at REIT level

### 3.1 Corporate tax / withholding tax

Current income	Capital gains	Withholding tax
<ul style="list-style-type: none"> <li>- Income from a property rental business is exempt from corporation tax.</li> <li>- Residual business income is taxable at the highest rate of corporation tax (currently 20%).</li> </ul>	<p>Gains realised on disposals of assets used in the property rental business are not subject to tax.</p>	<ul style="list-style-type: none"> <li>- In principle, no withholding tax levied on distributions that are made out of the residual business income.</li> <li>- Distributions out of the property rental business profits (PIDs) are generally subject to 20% withholding tax unless the recipient is a UK corporate, UK charity or UK pension fund.</li> <li>- Withholding tax suffered by a UK REIT on its property rental income from directly held non-UK real estate will be deducted in the calculation of the required PID.</li> <li>- Withholding taxes suffered on distributions in respect of shares will be part of the REIT's residual business and tax credit relief may be available.</li> </ul>

#### Current income

Income from the property rental business is not subject to UK corporation tax. Investment by a UK REIT in another UK REIT will be included as an asset of the investing REIT's property rental business. PIDs received will be included as part of the property rental business and tax exempt, but 100% of PIDs received must be distributed. Non-rental business income (residual income) is taxable in the ordinary manner at the highest rate of corporation tax which is currently 20%. Corporation tax rates will reduce to 17% by 2020. The property rental business of the UK REIT is ring-fenced for corporation tax purposes, which means that it is not possible to offset profits and losses of the property rental business against profits and losses of its residual activities.

#### Capital gains

Capital gains or losses that arise on disposal of property used in a UK REIT's property rental business are not chargeable to tax. The sale of 'developed properties' may be subject to tax if they are disposed of within three years of the completion of any development activities conducted by the UK REIT. Any property whose cost of development (where the development is conducted by the UK REIT) exceeds 30% of the fair value of the property's acquisition cost (or value at entry, if later) is deemed to be a 'developed property'. The disposal of property which is used for non-eligible business is taxable. Gains realised on property used partly for the rental business, and also for taxable business, may be partially exempt from tax.

#### Withholding tax

The UK does not levy dividend withholding taxes in case of a normal distribution to any investor, regardless of tax residence, but in the case of a distribution by a UK REIT out of its exempt property rental business profits (a PID), tax of 20% will be withheld by the UK REIT and paid to HMRC (although PIDs can be paid to UK companies, UK charities and UK pension funds gross). Overseas investors may be entitled to treaty relief and have to reclaim tax from HMRC.



If an overseas jurisdiction levies a withholding tax on payment of a dividend to a UK REIT, the UK REIT is unlikely to be able to obtain a credit for such tax if the income is exempt in the UK. If, however, the income is taxable it may be possible for the UK REIT to credit this against any UK tax due.

#### Other taxes

Stamp duty, stamp duty land tax, employee taxes, uniform business rates and value added tax apply to UK REITs in the same way that they apply to ordinary property companies.

#### Accounting rules

A UK REIT is taxed based on UK entity accounts for each group company (either UK GAAP or IFRS). Group UK REITs are required to present financial statements under IFRS for the purposes of calculating the balance of business tests.

### 3.2 Transition regulations

Conversion into REIT status
No conversion charge from July 17, 2012

Companies entering the UK REIT regime are no longer subject to an entry charge equal to 2% of the gross market value of properties; abolished by FA 2012. For UK tax purposes only, a new accounting period begins at the time of conversion, and the base cost of property rental assets are re-based to market value. Any latent capital gains on property within the UK REIT at the date of conversion are extinguished.

### 3.3 Registration duties

Registration duties
Stamp Duty Land Tax (SDLT) of between 1% and 5% for commercial property and 0%-15% for residential property. Scotland has a Land and Buildings Transactions Tax with rates of 3% between £150k and £350k and 4.5% above for commercial property, and between 0% and 15% for residential property.

## 4 Tax treatment at the shareholder's level

### 4.1 Domestic shareholder

Corporate shareholder	Individual shareholder	Withholding tax
<ul style="list-style-type: none"> <li>- Distributions out of property rental business income (PIDs) are treated as rental profits currently taxable at 20% (for a large company).</li> <li>- Distributions out of residual business profits (non-PIDs) will be tax-exempt.</li> <li>- Capital gains on disposal of UK REIT shares are taxable under normal capital gains rules.</li> </ul>	<ul style="list-style-type: none"> <li>- 20% tax on PIDs (collected by way of the withholding tax).</li> <li>- Higher rate tax payers pay additional tax (the amount of which depends on their personal tax position) through their tax returns.</li> <li>- Capital gains on disposal of REIT shares taxable in ordinary manner.</li> </ul>	<ul style="list-style-type: none"> <li>- Withholding tax is deducted at 20% on PIDs to individual shareholders.</li> <li>- Where the distribution is a PID, there is a withholding tax exemption where the REIT has a reasonable belief that the person entitled to the PID is a UK corporate, UK charity or UK pension fund.</li> <li>- UK REIT shares held via a 'tax wrapper' such as an ISA can be paid gross.</li> </ul>

#### Corporate shareholder

Distributions relating to property rental business (PIDs) are treated as rental profits in the hands of the recipient. These are taxed at the corporation tax rate applying to that company, currently 20% for a large company. Distribution of taxed profits (distributions out of the residual business) is likely to be tax-exempt in the hands of UK corporate shareholders.

Distributions of gains from UK REITs are taxed as if they were a distribution of property rental business income.

Capital gains on disposal of shares of a UK REIT are taxable under normal capital gains tax rules.

#### Individual shareholder

PIDs are taxed as rental profits received from direct property, whether the PID represents distributed rental profits or capital gains. The shareholder will be taxed at either 20% (already levied with the withholding tax) or at 40% or 45% for higher rate taxpayers and additional higher rate tax payers. In this case the shareholder will pay 20% via withholding tax and the remaining amount through his tax return. Individuals are not entitled to an imputed tax credit, as was the case with normal dividends. Distribution of taxed profits (distributions out of the residual business) will be taxable in the same way as ordinary dividends. The taxation of ordinary dividends has been changed from April 2016 onwards, where individual shareholders receiving total dividends above £5,000 will be taxed at the marginal rates of 7.5%, 32.5% and 38.1%. These changes do not impact taxation of PIDs.

Capital gains on disposal of UK REIT shares are fully taxable in the ordinary manner. Note that from April 2016 the rate of tax on capital gains on shares for individuals is 10% rising to 20% for higher rate taxpayers.

A share buy-back will be a disposal for capital gains purposes and taxable in the ordinary manner.

#### Withholding tax

Withholding tax is not deducted where a PID payment is made to a UK corporate shareholder, UK charity or a UK pension fund. A withholding tax of 20% is levied on PIDs to individual shareholders by the UK REIT.

## 4.2 Foreign shareholder

Corporate shareholder	Individual shareholder	Withholding tax
<ul style="list-style-type: none"> <li>- 20% final withholding tax for PIDs.</li> <li>- Disposal of shares in a UK REIT is outside the scope of UK capital gains tax.</li> </ul>	<ul style="list-style-type: none"> <li>- 20% final withholding tax for PIDs.</li> <li>- Disposal of shares in a UK REIT is outside the scope of UK capital gains tax.</li> </ul>	<ul style="list-style-type: none"> <li>- Tax treaty relief available if claimed following receipt.</li> <li>- Will be treated as a dividend distribution under most treaties.</li> <li>- Parent-Subsidiary Directive not applicable.</li> </ul>

### Corporate shareholder

Foreign shareholders receive dividends from the tax-exempt property rental business (PIDs) net of basic rate income tax (20%).

### Individual shareholders

Foreign shareholders receive dividends from the tax-exempt property rental business (PIDs) net of basic rate income tax (20%).

### Withholding tax

A corporate or individual non-resident shareholder suffers withholding tax of 20%. Treaty relief may only be claimed retrospectively from HMRC. The PID is only taxed as rental income in the UK; it is likely that the PID will be treated as a dividend distribution under most treaties. The EU Parent – Subsidiary Directive is not applicable (see under no. 2.3 above).

## 5 Tax treatment of foreign REITs and its domestic shareholders

Foreign REIT	UK Corporate shareholder	Individual shareholder
Taxed under normal UK tax rules.	May be tax-exempt.	20% or 40% or 45% tax on foreign income.

### Foreign REIT

A REIT resident outside the UK and investing in UK property will be taxable under normal UK rules as a non-resident landlord with tax at 20% on income only and not capital gains for commercial property.

### Corporate shareholder

A foreign REIT distribution of income from property in the UK to a UK corporate shareholder is likely to be treated as a normal dividend from an overseas company. This will depend on structure of the foreign REIT and may benefit from tax exemption.

### Individual shareholder

A foreign REIT distribution of income from property in the UK to a UK individual shareholder is likely to be treated as a normal dividend from an overseas company (this will depend on the structure of foreign REIT). ■

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