



## Pre-Budget Report '06

# REITs: Times They Are Changing

### Background

The Government is clearly keen to make the REIT regime work, has identified various implementational issues and has amended the existing regime to iron out these potential problems. These amendments will have effect on and after the start date of the REIT regime on 1 January 2007.

To become a REIT, a company must issue a notice stating that it satisfies a number of conditions. Originally, the conditions were that the company was UK tax resident, not an open-ended investment company (OEIC) and, furthermore that the company's ordinary shares were listed on a recognised stock exchange (RSE). Now, it is no longer necessary for a company (seeking REIT status) to have its shares listed on an RSE at the date of serving the relevant notice. It is sufficient if the company believes that it will satisfy this test on the date it actually enters the REIT regime and thereafter.

After giving the requisite notice to HM Revenue & Customs and entering the regime, a company then needed to ensure that it satisfied the "remainder of business test" i.e. that at least 75 per cent of its assets (by value) and its profits related to its investment properties. These tests were potentially challenging for a start-up REIT and it is now permissible for a REIT to fail these tests in the first year, if it is willing to pay an additional tax charge equal to 2 per cent of the difference in value of its investment property at the beginning and end of its first accounting period.

Other positive changes to the REIT regime as follows:

- REITs may be able to enter into joint venture arrangements other than through a limited company;

- charities will be exempt from tax on distributions from UK-REITs in the same way they are exempt from tax on UK dividends;
- REITs will be able to de-merge without necessarily leaving and reentering the REIT regime, and crystallizing the REIT entry charge.

Various definitions will also be changed.

A negative change to the taxation of shareholders of a REIT is that investment – regulated pension schemes holding 10 per cent or more of a UK-REIT will be treated as having an indirect holding in taxable property. The effect of this is that they will be subject to property tax charges for pension schemes of up to 70 per cent. Those penalty tax charges were introduced by the Finance Act 2006 to discourage the use of tax-relieved pension funds for investing in residential property primarily for the use of the scheme members, and so it seems harsh that such a tax charge applies if a pension fund has invested in a REIT whose tax free profits would in any event not include owner occupied property.

If you have any queries or wish to take any action on the basis of the Pre-Budget Report '06, please contact:

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