

Insights

PROMOTING UK FUNDS - POTENTIAL REFORM OF THE UK REIT REGIME

5 February 2021

As part of an initiative to promote UK funds the government is consulting on changes to the UK REIT regime. These changes are intended to make the UK REIT regime more attractive and simpler. In particular, the following are under consideration:

- relaxing the listing requirement where the REIT is owned by widely held institutional investors. The industry (ourselves included) have repeatedly lobbied the government to relax this unnecessary requirement and expense of the current regime;
- review of the list of institutional investors that can allow a closely held company to benefit from REIT treatment. On the whole this is expected to be beneficial but may have adverse consequences for shareholders relying on a technical reading of the rules (such as relying on the general partner of a limited partnership). The most likely outcome is that the rules borrow from the more sophisticated look-through approach in the non-resident capital gains tax rules to establish if a REIT is widely-held;
- relaxing the rule that distributions to shareholders of at least 10% bear tax – so that it would apply only on distributions to entities where withholding tax would be required. This would mean that there would be no tax charge under this rule where the recipient is entitled to receive distributions gross and would avoid the need for the common practice of ‘disaggregating’ holdings across multiple subsidiaries. Historically, this fix has been particularly problematic for life companies as their subsidiaries are likely to have a less beneficial tax rate;
- reforming the requirement that 75% of a REIT’s assets and income derives from property investment assets, e.g. possibly dealing with anomalous years;
- the ‘interest cover test’, which requires a ratio of profits to financing costs of at least 1.25:1 and creates a tax charge where the required ratio is not met. It has been suggested that the interest cover test may no longer be necessary given the subsequent introduction of the Corporate Interest restriction, which applies where a group or company has net interest and other financing costs of over £2 million;

- the three-year development rule, which means transactions do not benefit from the REIT exemption where it applies. This rule may be revisited to reflect the '*commercial reality of these transactions*'. It applies in respect of sales of certain development properties (or companies holding development properties) within three years of practical completion. It remains to be seen if this will be a positive or negative change given HMRC's previous suggested approach to transactions looking to stay outside these rules;
- the requirement for the REIT to hold at least three '*properties*'. It has been suggested that this should be reduced to a single property. In our experience, this rule has not been a significant barrier to entry given each separately lettable floor of a property is a '*property*' for these purposes (such that a three floor building could constitute three '*properties*'), but we acknowledge three properties is an arbitrary figure; and
- the position where a REIT holds non-UK property in a UK company. Under the current rules it is likely to suffer tax in the overseas jurisdiction as well as UK tax withheld on paying the property income distribution to investors. This acts as a barrier to REITs holding non-UK property in a UK company. Amendment of the rules to remove this barrier will make the UK REIT regime more attractive to investors wishing to hold property across wide geographical areas via a UK REIT.

We commend the government for actively reviewing the regime and looking to make the UK more competitive. Hopefully, the end result lives up to the intention as the REIT legislation would benefit from refinement to remove unnecessary barriers to entry and to put current HMRC practice on a statutory footing.

In terms of timing the government is prioritising consultation on the first four changes outlined above. This consultation will run until 23 February 2021, with the draft legislation expected during 2021. This would allow for a period of technical consultation ahead of inclusion in the Finance Bill 2022. These changes are being considered alongside a new regime to attract asset holding companies ([see our separate blog on this regime](#)).

The government is seeking views on the remaining REIT changes as part of a wider review of the UK funds regime, with comments due by 20 April 2021. It is less clear at this stage when these changes would be introduced if the government adopts them.

RELATED CAPABILITIES

- Tax & Private Client
- Real Estate Tax
- Tax Advice & Controversy

MEET THE TEAM



Elizabeth Bradley

London

elizabeth.bradley@bclplaw.com

+44 (0) 20 3400 2323

This material is not comprehensive, is for informational purposes only, and is not legal advice. Your use or receipt of this material does not create an attorney-client relationship between us. If you require legal advice, you should consult an attorney regarding your particular circumstances. The choice of a lawyer is an important decision and should not be based solely upon advertisements. This material may be “Attorney Advertising” under the ethics and professional rules of certain jurisdictions. For advertising purposes, St. Louis, Missouri, is designated BCLP’s principal office and Kathrine Dixon (kathrine.dixon@bclplaw.com) as the responsible attorney.