The Real Estate Investment Structure Taxation Review

Third Edition

Editors
Giuseppe Andrea Giannantonio and Tobias Steinmann

The Law Reviews

THE REAL ESTATE INVESTMENT STRUCTURE TAXATION REVIEW

THIRD EDITION

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CONTENTS

PREFACE

The real estate sector plays a crucial role in the global economy and social environment.

In particular, the commercial property sector offers the infrastructure needed for the growth and development of entrepreneurship and business, including offices, shops, industrial and logistics premises, and hotels. In Europe alone, commercial real estate represents a business of €7 trillion.

Business operators often prefer to rent the spaces used for carrying out their activity. Therefore, commercial properties are generally held as investments by third-party investors, who buy commercial properties and rent them to business operators.

The real estate sector is also a fundamental source of employment. In 2017, the European real estate sector employed four million people – more than the car manufacturing and telecommunications sectors combined. Moreover, it provides residential accommodation and is seen as a tool to meet social and public needs. New types of properties are emerging and have increasingly been included in investment portfolios, such as healthcare, senior living, education and student accommodation. In addition, urban regeneration has become a key element of all the decisions taken at EU level, boosting city renovation and the residential sector. In such respect, the recovery fund and NextGenerationEU will play a key role in supporting this transformation.

In this context, attracting new resources and investment from institutional investors such as pension funds, insurance companies and sovereign wealth funds is crucial for the improvement of the real estate sector. In particular, it is desirable that those investors are involved in both financing large development projects and investing in properties held for rent.

Based on market practice, investments from foreign institutional investors are mainly carried out indirectly rather than through direct acquisitions, and especially through specialised vehicles like non-listed real estate funds, listed property companies and real estate investment trusts.

The pandemic emergency caused by covid-19 in 2020 has also affected the real estate sector. Although, generally, any disturbance to private real estate valuations is normally only revealed over time, listed real estate stocks suffered sharp falls in 2020 now restarting to peak in 2021. This is because of the role the sector plays in the real economy and for this specific reason it is widely considered that the coronavirus crisis may also have lasting effects on real estate usage; for example, because new public health regulations will be introduced. Accordingly, the post-crisis landscape in which we are now starting to live would be characterised by higher demand in alternative real estate sectors and for alternative assets, accelerating a process of transformation that was already ongoing. It is considered therefore that, in the long run, this will all contribute to the fundamental attractiveness of real estate as a long-term investment asset class.

We agree that within Europe, the role of the real estate sector as an economic, employment and social catalyst needs to be supported by a legislative framework that increases transparency and competitiveness, and simplifies and standardises bureaucratic processes.

However, within the European Union, the differing impact of the covid-19 crisis is exacerbating differences between the interventions made by legislators in the individual jurisdictions, with allowances, tax credits and other tax provisions introduced and applied very differently from one state to another. Generally, these disparities reflect the level of impact the pandemic has had in particular jurisdictions, the economic policies followed by their respective governments and the level of resources available to achieve those aims.

Correlatively, national legislators will need to adapt any new provisions to those pre-existing types of specialised real estate investment vehicles that currently benefit from tax exemptions or other advantageous tax allowances, for both direct and indirect tax purposes.

Given this presently rather fragmented scenario, the aim of this volume is to provide a useful guide to those international and institutional investors willing to invest in real estate properties located in Europe, and to illustrate in a comparative manner possible alternatives for the establishment of investment platforms in Europe and investment vehicles at a local level. In particular, each country-specific chapter provides insights from leading experts on key tax considerations and investment opportunities based on the relevant national legislation. Furthermore, in this edition, we have sought to provide indications of any allowances and facilitations introduced temporarily in response to the current economic crisis that may also present investors with investment opportunities in specific countries.

We would like to thank the authors of this volume for their extensive expertise and for their efforts to ensure the successful outcome of this work. We hope that the reader finds this volume useful and we welcome any comments and suggestions for its improvement.

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June 2021

Chapter 12

UNITED KINGDOM

Alex Tostevin and Andrew Cromb[1]

I OVERVIEW

i Investment vehicles in UK real estate

Investors have considerable flexibility when selecting a vehicle to invest in UK real estate. There are no restrictions on foreign ownership, and commercial real estate generally remains an attractive asset class.

Many different vehicles, both foreign and domestic, are used. Often, the choice is driven by the investor's tax status.

More common vehicles include:

a offshore companies;
b regulated structures, such as real estate investment trusts (REITS); and
c tax transparent entities such as unit trusts.

ii Property taxes

Corporation tax

A company holding real estate is subject to corporation tax on its UK property income and gains from direct disposals of UK land regardless of where the company is registered or tax resident. Gains from disposing of indirect interests in land (such as shares in a property-rich company) can also be taxable.

The rules differ depending on whether the property owner is an investor or trader in the property, with the broad distinction being whether the property is being held to generate a rental yield or is being acquired to be developed and sold. It is important to get this distinction right from the outset. The rest of this chapter focuses on a person holding property as an investment.

Broadly, rents are taxed as property business profits, while gains from a direct or indirect disposal are subject to corporation tax on chargeable gains.

Income tax and capital gains tax

Rents from property are subject to income tax in the hands of non-corporate investors (such as an individual or the trustee of a trust). A non-resident is taxed on property income in the same way as a resident taxpayer.

Gains made by non-corporate investors are subject to capital gains tax (CGT), potentially at rates of up to 28 per cent for residential property.

1 Alex Tostevin is a partner and Andrew Cromb is a senior associate at Dentons.

Withholding taxes

The UK has several withholding tax regimes that are relevant to real estate, namely on interest, on rental payments to non-residents and to certain persons undertaking construction work.

Annual tax on enveloped dwellings

Annual tax on enveloped dwellings (ATED) is an annual tax payable primarily by companies that own residential property valued at more than £500,000. Its purpose is to dissuade companies from reducing the residential housing stock. It is imposed at a fixed amount depending on the property's value. There are some limited exemptions available.

Value added tax

Value added tax (VAT) at 20 per cent currently applies to most goods and services supplied in the UK if the supplier is VAT registered unless the supply is exempt. Real estate is generally exempt unless opted into the regime.

Property transfer taxes

UK property transfer taxes are charged on the acquisition of UK property. The applicable tax depends on whether the land is in England, Northern Ireland, Scotland or Wales.

Stamp duty and stamp duty reserve tax

Stamp duty is charged on documents effecting a transfer of stock or marketable securities (e.g., shares and certain debt securities). In practice, the tax is mostly charged on transfers of unlisted UK shares.

Stamp duty reserve tax (SDRT) is a similar tax, albeit it is generally charged on unconditional agreements to acquire shares. However, it is rarely paid on an acquisition of unlisted shares as the SDRT liability is cancelled if stamp duty is paid instead.

Business rates and council tax

UK property users must also pay certain local area and governmental taxes, and the taxes differ depending on whether the property is commercial or residential.

II ASSET DEALS VERSUS SHARE DEALS

i Legal framework

The UK has an open economy, with no foreign exchange controls or restrictions on foreign investment.

It has tried to dissuade the acquisition of UK residential property by corporates and non-UK residents to address perceived capacity constraints and encourage residential property ownership by UK individuals; however, these measures do not prohibit foreign ownership.

The legal form of a property transaction normally involves a sale and purchase agreement (SPA), which is a private contract. The SPA contains the main commercial terms of the transaction.

The SPA may incorporate some industry standard common terms when it is an asset sale. There are no common terms for share deals.

An asset deal involves an application to the Land Registry to update the title registration because the buyer only takes full legal title once the register has been updated.

Completion of a share deal normally involves the parties executing an instrument that transfers legal title to the shares.

An important difference between an asset deal and a share deal is that a buyer may be exposed to historical risks in the target company on a share deal. The SPA will contain some protection against this. It is generally common for any warranties or covenants for historic risks to be backed by a warranty and indemnity insurance policy, rather than the buyer having recourse against the seller.

ii Corporate forms and corporate tax framework

The most common entities investors use to hold UK property investments are non-resident corporates (tax-opaque), offshore property unit trusts (tax-transparent for income purposes and potentially tax-transparent for gains made on any disposal) and UK REITs.

As discussed above, there is much flexibility for property holding structures, with the commercial objectives and any special tax attributes of the investor often driving the structure.

For example, a tax-exempt investor may prefer a tax-transparent structure to be able to claim a tax exemption. A partnership may suit these requirements; however, the buying and selling of partnership interests in a partnership that owns property may trigger property taxes. Therefore, the use of a partnership may be fine for a sovereign who intends to hold the property for its entire lifespan, but it may be less efficient if more frequent sales are anticipated, as often a purchaser would take any property transfer taxes into account when pricing.

iii Direct investment in real estate

Acquisition

Property transfer taxes and VAT may apply when buying UK land.

Ordinarily, supplies of land are exempt from VAT; however, a seller can bring commercial property within the scope of VAT by 'opting it to tax'. A seller may wish to opt to tax the land to recover VAT they have incurred in respect of the property. For example, a developer is likely to do this to recover the VAT incurred in respect of the development costs. Sales of new build commercial properties are also automatically subject to VAT for a certain period.

There are a couple of exemptions to remove a sale from the scope of VAT. Firstly, if certain conditions are satisfied, the sale can qualify as a 'transfer of a business as a going concern' (the TOGC regime) – the primary example of this would be where the seller is selling a property that has been leased to a tenant. The TOGC regime minimises VAT fraud given the potentially large sums representing VAT that would otherwise need to be paid. Secondly, there is an anti-avoidance regime that can disapply the seller's 'option to tax' in certain scenarios.

The acquisition of an interest in land can also be subject to property transfer tax, which takes the form of stamp duty land tax, land and transaction tax or land and buildings transaction tax, depending on whether the property is located in England, Wales or Scotland.

UK property transfer tax is paid on top of the consideration, including any VAT, so if VAT is charged at 20 per cent it will increase the UK property tax that the investor must pay.

All three taxes have different rates for commercial property and residential property. Rates for residential property are higher, and increase further in certain situations (for example, where the purchaser is a company or is not resident in the UK). In all cases, tax is charged on all the consideration given to acquire the property, including non-cash consideration such as development works or the exchange of other land.

There are some exemptions and reliefs depending on the purchaser (for example, if it is a charity) or the type of transaction. Transactions that may benefit from relief include:

a the movement of a property within a corporate group;

b sale and leaseback transactions; and

c Islamic finance transactions.

There are also some other measures to reduce the property tax that is potentially applicable if, for example, the investor is acquiring multiple residential properties at the same time from the same seller.

Holding

During the holding phase, the investor is generally subject to UK tax on the rental income it receives. The broad position is that, irrespective of the location of the investor, an individual will pay income tax on rental profits (the top rate is currently 45 per cent) and corporate investors would usually pay corporation tax on those profits at 19 per cent (intended to be increased to 25 per cent in April 2023).

Where an investor is not UK-tax resident, a withholding tax regime applies to payments of rent made by the tenant. This is called the 'non-resident landlord scheme'. This requires the tenant to withhold 20 per cent of the rent and pay that directly to the UK tax authority. It is possible for the investor to obtain a direction from the tax authority so that the tenant pays the investor on a gross basis. Any withholding tax collected is credited against the income tax or corporation tax charge that the investor must pay.

When computing the profit that is subject to tax, different rules apply depending on whether the investor is subject to income or corporation tax. Generally, most non-UK investors are likely to hold property via a vehicle that is subject to corporation tax.

The corporation tax rules typically begin with the accounting treatment and then overlay certain rules on top that introduce different rules for tax depreciation and deductibility of certain expenses. For example, an expense is only deductible for tax purposes if it has been incurred for the purposes of the investor's property rental business.

There are also rules that disallow or limit the amount of interest that is deductible for corporation tax purposes – these rules include transfer pricing, the corporate interest restriction, limited recourse debt, the anti-hybrid rules and tax avoidance rules. In relation to the corporate interest restriction, there is an exemption for certain UK real estate owning companies if conditions are satisfied – this is a very important exemption because property owning companies are often highly geared with third-party bank debt, so interest deductibility is important.

An investor will often have debt financed the acquisition. The UK imposes withholding tax at 20 per cent in relation to yearly interest payments that have a UK source, and where a loan is secured on UK real estate this is usually the case. An investor will need to establish whether it must withhold in relation to the interest payments it makes and, in particular, whether the lender is able to benefit from any withholding tax exemptions or reliefs. Generally speaking, most lenders are able to benefit from some form of exemption; however, this may not always be the case.

While the investor's accounting profit will take account of any depreciation, UK corporation tax does not allow any deduction for such depreciation. Instead, the UK operates an alternative tax depreciation regime called 'capital allowances'.

A property rental business qualifies for this regime and capital allowances are allowed for certain types of capital expenditure. There are two main rates, depending largely on the expected lifespan of the relevant asset: the main rate is aimed at assets with a shorter lifespan and is 18 per cent; assets with longer lifespans typically fall within the long-life and integral features pools with a yearly allowance of 6 per cent. The way this works is that, when acquired, an asset is added to the relevant 'pool' and each year the relevant pool may be written down by either 18 per cent or 6 per cent.

There is also a relatively new structures and buildings allowance (another form of tax depreciation) that provides a 3 per cent per annum deduction over a period of 33.3 years.

Where the investor undertakes work to the property, it may also be subject to the construction industry scheme withholding tax regime, which essentially requires withholding on certain payments to contractors.

Sale

The key consideration for the investor when selling a property is whether it will be required to pay tax on any proceeds it receives from the sale.

The general thrust is that, when a non-UK investor sells a property, it will be paying either CGT or corporation tax on any gain that it makes (other than the limited class of investors that may be exempt from tax such as sovereigns, pension funds or charities). UK investors have always been subject to tax on any gains made.

Precisely how much of the gain is subject to tax by the non-UK investor depends on the nature of the property because residential property was brought within this regime before commercial property. The broad takeaway is that calculating a gain on residential property can be more involved than for commercial property given the various changes in law that have occurred during the past 10 years, whereas for commercial property it is typically just the gain that has arisen since April 2019 that is subject to tax unless the investor elects otherwise.

An investor selling real estate will need to establish whether it must charge VAT on the sale. In this respect, the same considerations apply as discussed above for the acquisition.

iv Acquisition of shares in a real estate company

Acquisition

There are no property transfer taxes when buying a company. Similarly, there is no VAT.

If the company is a UK company, the acquisition will attract stamp duty at 0.5 per cent of the consideration (rounded up to the nearest £5). This is one reason for the popularity of non-UK corporate vehicles for holding UK property, as no such charge often arises.

Tax considerations can be relevant when pricing a share acquisition:

a a purchaser may seek to discount the price to take account of any latent capital gain that the company may have in relation to the property asset were it to sell it directly; and

b similarly, the seller may wish to share in some of the upside that the purchaser may obtain from not paying property transfer tax.

Holding

Rental and similar profits from the property are taxed within the property owning entity in manner outlined in the context of a direct acquisition.

The UK does not impose dividend withholding tax other than for certain distributions by REITs or property authorised investment funds (PAIFs) (see below).

Yearly interest on shareholder loans attracts an interest withholding obligation when it has a UK source (which it commonly would do if secured on UK real estate).

Dividends paid to a UK resident company are subject to corporation tax in principle, but are generally exempt in practice under the UK dividend exemption unless the dividends come from certain vehicles such as REITs. This means that profits can generally be extracted as dividends to a UK resident company without suffering additional UK tax if (unusually) a UK resident company is the acquisition vehicle.

Sale phase

The UK imposes a tax on the sale by non-UK residents of shares or interests in a 'property-rich' vehicle. Broadly, this means an entity if at least 75 per cent of the gross market value of its assets derives from UK real estate. Therefore, if an entity just holds one UK property that entity in isolation is likely to be UK 'property-rich'. The rates are the same as for UK resident investors.

Gains are only taxable if the investor (together with any connected persons) holds interests of 25 per cent or more in the vehicle. This means that smaller holdings will sometimes fall outside the scope of UK tax.

There are some exemptions to this general approach, but the exemptions are rather limited in scope.

Tax on non-resident gains can cause complexity in a funds context, as sale proceeds could potentially be taxed at multiple levels as the proceeds are extracted to investors. To mitigate this risk, the rules allow certain vehicles to elect to be treated as partnerships (i.e., transparent) or exempt for the purposes of non-resident taxation on property gains. The elections provide options for real estate funds to structure their UK real estate investments such that, broadly, investors are not subject to a tax cost in addition to that which they would have suffered had they invested directly.

A transparent or exempt structure ensures no leakage within the structure, with investors who are themselves exempt (or entitled to credit) being able to maintain the tax profile that they otherwise would have had investing directly. These options do, however, require investors to file UK tax returns.

In a transparent structure, no reporting obligations are imposed on the vehicles that elect to be transparent – investors making a disposal will be required to file UK tax returns (as they are within the ambit of the charge) even if it is just to claim exemption from the charge based on their own tax position.

The position with exempt structures is slightly different. Funds making the exemption election must provide information relating to their investors and fund disposals for each accounting period in which they wish the exemption to apply (and the two years prior to the election, or the period since the fund was constituted, if shorter).

III REGULATED REAL ESTATE INVESTMENT VEHICLES

i Regulatory framework

The UK regulates the promotion and marketing of financial products and other 'regulated activities' in the UK. This includes:

a providing investment advice;
b managing investments;
c arranging deals in investments; and

d establishing, operating or winding up a collective investment scheme, such as an undertaking for collective investment in transferable securities (UCITS) or an alternative investment fund (AIF).

The basic position is that a person cannot undertake a regulated activity without prior authorisation from the Financial Conduct Authority (FCA), which has regulatory oversight. While there are some exceptions, a person who undertakes regulated activities without prior authorisation risks committing a criminal offence and risks exposure to both civil and criminal liability.

Regulated property vehicles in the UK are collective investment schemes, which means that fund sponsors will normally require prior authorisation. Some fund vehicles, particularly those offered to retail investors (such as UCITS), must also be approved by the FCA before the sponsor seeks external investors.

Most collective investment vehicles that are not marketed to retail investors qualify as AIFs. AIFs are collective investment undertakings that raise capital from investors for investing in accordance with a defined investment policy that is not a UCITS. AIFs can take various legal forms, as the term refers to regulatory status rather than a distinct type of entity.

There is a regulatory framework for alternative investment fund managers (AIFMs), which covers the management, administration and marketing of the relevant AIF. UK AIFMs must be either authorised or registered with the FCA, depending on the size of the assets under management.

ii Overview of the different regulated investment vehicles

Closed-ended real estate AIFs may adopt a limited partnership structure. This structure is attractive for private funds as it provides flexibility in terms of control and management due to the partnership agreement, which provides for the partnership's constitution, being open to negotiation between investors and the managers of the fund. A private fund structured in this manner will typically hold UK property via a series of corporate subsidiaries underneath it. As these companies are normally tax-resident outside the UK, care needs to be taken in light of the UK's offshore fund tax rules, which are intended to prevent the rolling up of income offshore and the conversion of that income into capital. Funds with a UK investor base generally manage the position by extracting rental profits as income returns to investors on a regular basis.

Retail funds may utilise the REIT regime where there is scope for the fund vehicle to be listed. REITs are discussed separately below. Retail investors also often invest via open-ended investment companies for various reasons and tax efficiencies.

Various other fund vehicles are available under UK domestic law. The main vehicles are unit trusts, open-ended investment companies, authorised contractual schemes (ACSs), investment trusts and PAIFs.

The following paragraphs focus on ACSs, PAIFs and Jersey property unit trusts (JPUTs).

PAIFs

A PAIF must be an open-ended investment company that meets certain conditions, including:

a having an investment portfolio comprising property rental investments, shares in UK REITs or interests in overseas equivalents;

b obtaining 60 per cent of its net income from its property income business;

c having shares that are genuinely available to a large number of unconnected persons; and *d* taking reasonable steps to prevent corporate investors from holding 10 per cent or more of its ownership interests.

ACSs

ACSs are formed either as contractual co-ownership schemes or as limited partnerships.

JPUTs

In addition to these schemes, one of the more popular tax transparent vehicles for holding UK real estate is a JPUT. More information on JPUTs is given below.

iii Tax payable on acquisition of real estate assets

The UK's ordinary rules for acquiring real estate assets, as discussed above, apply equally here. One exception relates to PAIFs, where there is a relief from stamp duty land tax; however, the relief is relatively narrow in scope and is focused on when the PAIF is being seeded with assets in exchange for granting units. There is also a similar relief available for seeding assets in an ACS, which is a co-ownership scheme.

iv Tax regime for the investment vehicle

PAIFs

Broadly, the property investment business income of a PAIF is exempt from UK corporation tax in a similar way to a REIT; its other income is subject to UK corporation tax at the rate applicable to open-ended investment companies (currently 20 per cent). PAIFs also generally benefit from a UK corporation tax exemption on gains from the sale of assets. Given the tax advantages of a PAIF, there are various conditions that must be adhered to, which, if infringed, could trigger tax charges.

ACSs

An ACS is transparent for the purposes of the UK taxation of income, and the income is treated as arising in the hands of the unit holders. An ACS is not subject to tax on gains.

JPUTs

A JPUT is treated as tax transparent for income purposes, and is treated as a company for the purposes of chargeable gains.

However, as discussed above, it is possible for a JPUT to make an election also to be treated as transparent for the purposes of chargeable gains. Where this is the case, the JPUT is not subject to tax when it sells UK property.

v Tax regime for the investors

PAIFs

A PAIF may make different types of distribution, and UK resident investors will be taxed depending on the nature of the distribution. If the distribution is a property income distribution, the PAIF is generally required to withhold UK income at the basic rate (currently 20 per cent).

ACSs

As discussed above, an ACS is tax-transparent for income purposes, so the investors would be taxed directly on the income received.

In relation to gains made by the ACS, an ACS is not subject to UK tax. However, when the ACS is a contractual arrangement the investors are subject to gains on the disposals of their units, and when the ACS is a partnership it is treated as tax-transparent for gains purposes and the investor would be regarded as selling directly a fractional interest in the underlying property.

JPUTs

In relation to income, the investors will be treated as if they have received the income directly from the property given the tax transparency.

In relation to gains, the investor's own account taxation position will depend on whether the JPUT has filed the transparency election referred to above or made an exemption election where applicable.

IV UK REAL ESTATE INVESTMENT TRUSTS

i Legal framework

A company (or corporate group) can opt into the REIT regime if it meets the relevant conditions.

ii Requirements to access the regime

A company or (or the parent company of a group) can access the regime if it (among other conditions):

a is resident solely in the UK;
b has its shares admitted to a recognised stock exchange;
c is not an open-ended investment company and has more than five shareholders;
d has only has one class of share; and
e holds at least three properties for rental (although three leases of different floors in a property should still suffice).

It is possible, given the criteria, to have both public REITs, which are listed on public stock exchanges, and private REITs, which are listed on other stock exchanges.

Once within the regime, all of the conditions must continue to be met.

The general compliance obligations of a REIT make it more costly to operate and maintain than an ordinary corporate vehicle.

Usually, REITs are subject to the AIFM regulatory framework, and its managers will need to be authorised or registered with the FCA as necessary and comply with the relevant requirements summarised above.

iii Tax regime

The benefit of the regime is that a REIT is exempt from UK corporation tax on income and gains from its qualifying property rental business.

This qualifying property rental business is ring-fenced from its other activities, and its other activities are subject to corporation tax in the usual way.

However, there are penalty tax charges in relation to the qualifying property rental business if, for example, the income profits from its tax-exempt business do not cover its relating financing costs by at least 1.25 times.

Furthermore, a REIT is required to pay out 90 per cent of the profits from its property rental business by way of property income distributions, and is required to withhold tax at a rate of 20 per cent on these distributions, unless there is an exception, for example, the recipient of the distribution is a pension fund.

Failure to meet the 90 per cent distribution requirement, along with failure to meet certain other conditions, may result in a tax charge being levied. The tax authority also has the power to charge a penalty tax if it believes the REIT in question is involved in tax avoidance arrangements.

iv Tax regime for investors

Investors in a REIT may find that dividends received by them are subject to withholding tax at the level of the REIT. It is possible to mitigate the rate of withholding if relief is available pursuant to a double tax treaty (but generally no lower than 15 per cent) or if an alternative exemption is available such as sovereign immunity from UK taxes.

If the REIT is a UK company, the sale of its shares will be subject to UK stamp duty at 0.5 per cent.

A non-resident investor may find that any gain made on selling their interest in a REIT also falls within the UK tax net.

v Forfeiture of REIT status

If a REIT leaves the regime, there is generally no immediate adverse effect and there is a readjustment of the base cost that the REIT holds in its various assets. However, when a REIT leaves the regime involuntarily within 10 years, the UK tax authority does have wide powers to direct how the group should be taxed, including in relation to the period when the group was a REIT. This is a tax avoidance-motivated power.

V INTERNATIONAL AND CROSS-BORDER ASPECTS

i Tax treaties

The UK has the largest tax treaty network of any jurisdiction. Its treaties largely track the OECD Model.

The UK has generally retained its right to tax gains from UK real estate, even though it only asserted that right recently. None of the UK's treaties that deal with gains expressly prevent UK tax on a direct disposal of UK land.

Most UK treaties also contain a securitised land article that allows UK tax on disposals of interests in property-rich companies. Some treaties exclude gains from sales of listed securities, which has the effect of protecting any gain from UK tax. Further, a few treaties (including those with Ireland and Israel) use the 'old' form of the securitised land article and do not expressly refer to interests that derive their value indirectly from underlying UK land. It is unclear whether these treaties prevent UK tax on the sale of a property-rich company that sits higher up in the ownership chain and does not itself hold any real estate assets.

A few treaties do not include a securitised land article and prevent UK tax on an indirect disposal (e.g., a sale of shares in a property-rich company). Notable examples include the treaties with Belgium, Italy and Luxembourg. Luxembourg companies often hold

UK property or interests in a property owning vehicle for this reason. However, the UK announced it was renegotiating its treaty with Luxembourg shortly after it changed the rules, so these structures are anticipated to become ineffective.

ii Cross-border considerations

The UK has significant levels of foreign investment in UK real estate assets, and there are no foreign restrictions.

iii Locally domiciled vehicles investing abroad

The UK is rarely used to hold foreign real estate-owning vehicles, as gains on disposal are likely to be subject to UK tax.

A UK resident company can often access the substantial shareholding exemption (SSE) to exempt gains made from selling shares in a foreign subsidiary. However, the conditions normally require the subsidiary to be a trading company. Property holding vehicles rarely carry on a trade, so it is unusual for the SSE to apply in a real estate context.

A more generous version of the SSE exists for qualifying institutional investors. A resident company that is owned at least 80 per cent by qualifying instructional investors can access the SSE regardless of whether the underlying subsidiary carries on a trade; qualifying institutional investors are sovereign wealth funds, pension funds, life assurance businesses, investment trusts, charities, authorised investment funds and exempt unauthorised unit trusts. The measure can eliminate UK tax leakage on foreign real estate investments held through the UK, and may increase the amount of outbound investment in real estate over time.

VI YEAR IN REVIEW

There have been some changes in rates and bands for property transfer taxes in light of covid-19 as well as the introduction of a 2 per cent non-resident surcharge for acquiring residential property. Tenants and landlords have also been grappling with potential changes to rents, again driven by the fallout from covid-19, with such changes potentially causing tax implications.

VII OUTLOOK

Post-Brexit, the UK is exploring how it can ensure that the UK is a competitive jurisdiction in the international playing field. In this respect, it is exploring changes to the funds regime, the VAT treatment of fund management services and introducing a new asset-holding company regime. It is also evaluating relaxing the REIT conditions as well as potentially extending the UK's narrow securitisation tax regime to non-financial asset classes and consulting on a new residential property developer tax.

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Andrew assists clients with group reorganisations, international tax planning, M&A transactions, capital market transactions, fund formations and structured finance arrangements. He works with a range of clients including multinational corporate groups, financial institutions, private equity houses, sovereign wealth funds and similar institutional investors.

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