



UK REITs

A summary of the regime

March 2023

The UK REIT regime

The UK Real Estate Investment Trust (“REIT”) regime launched on 1 January 2007 and immediately saw a number of the UK’s largest listed property companies convert to REITs. Since then, the regime has continued to evolve, increasing the attractiveness and accessibility of the regime to a wider pool of property investors and providers of capital, including the introduction of institutionally owned REITs. Further changes to the regime are due to take effect from April 2023.

Key benefits of REIT status

REIT status affords a number of commercial and tax benefits, including:

Access to the global REIT “brand”

REITs are known and understood by both investors and analysts worldwide as tax efficient structures for investment in real estate. There are currently c.40 countries worldwide that have REIT or ‘REIT-like’ regimes in place.

Attractors of international capital

REITs have a proven track record of attracting international capital. There are significant investment pools and fund allocations specifically designated for investment in REITs. Conversion to REIT status can often unlock new sources of funding.

Effective elimination of latent capital gains

REIT status may reduce or potentially eliminate any discount to net asset value caused by latent capital gains.

REITs often have a competitive advantage on corporate acquisitions, as other non-REIT bidders may have to discount their purchase price for latent capital gains. REITs are therefore able to make commercial decisions in a tax-exempt environment, based on the commercial performance of individual assets.

An attractive vehicle for investing capital from a wide range of sources

REITs may be attractive to investors for the following reasons:

- Attractive for UK and overseas retail and institutional investors.
- Easier access to a tradable property investment compared to purchasing a property directly.
- Enhanced after-tax returns compared to a UK taxable company (see table below).
- Access to parts of the property sector that private investors cannot usually access e.g. shopping centres or industrial property.
- Regular income returns.
- Lower transaction costs, e.g. 0.5% stamp duty on shares compared to 5% stamp duty land tax on direct property.

Comparison of after tax returns in a UK taxable company and a UK REIT			
Investor type	After tax return from UK company	After tax return from UK REIT	Enhancement of return
UK pension funds and Sovereign investors	75	100	33.3%
Overseas corporate investor (beneficial tax treaty)	75	85	13.3%
Overseas corporate investor (no beneficial tax treaty)	75	80	6.7%
UK individual basic rate (20%) tax payer	69	80	15.8%
UK individual higher rate (40%) tax payer	51	60	18.5%
UK individual additional rate (45%) tax payer	46	55	18.5%
UK company	75	75	Nil

The table above assumes distributions to investors of underlying property rental business profits of £100 earned by a UK fully taxable company vs. a UK REIT, based on a UK corporation tax rate of 25% (applicable from 1 April 2023), ignoring capital gains and assuming no dividend tax allowance. Some small investors who are holding their shares outside an ISA/SIPP (and have unused annual dividend tax allowance), may enjoy higher after tax returns under the UK corporate structure rather than a REIT. This is because property income distributions (PIDs) from a REIT are not eligible for the annual dividend tax allowance (which is £2k in 2022/23 and £1k in 2023/24).

Requirements to achieve and maintain REIT status

There are a number of conditions that a company (or principal company of a group REIT) needs to satisfy in order to become a REIT and remain within the regime. If these conditions are breached, the penalty can potentially range from automatic expulsion from the regime to additional tax liabilities for the REIT. Some of the key conditions are summarised below. (Certain changes to the regime are due to take effect from April 2023. These are discussed on page 5.)

- **Admitted to trading on a 'recognised stock exchange':**

The REIT must be 'admitted to trading' on a recognised stock exchange and either:

- 'listed' on such an exchange; or
- 'traded' on such an exchange in every accounting period, except the first three.

This requirement may be removed where institutional investors (as defined under the 'not a close company' section below) hold at least 70% of the ordinary share capital in the REIT principal company.

Both direct and indirect ownership can be taken into account when considering this holding. In this regard:

- Ownership can be traced through bodies corporate with ordinary share capital (which may be 'deemed' in certain circumstances).
- Ownership is generally traced through limited partnerships.

- **Not a close company:**

The principal company must either:

- Not be a close company (which means, broadly, it must not be controlled by five or fewer 'participants' taking into account aggregation of the holdings of associated persons, or it must meet the 'quoted company' exception (see below); or

- Be a close company only because it has as a participator one or more 'institutional investors' as specified in the legislation, which includes: a person acting on behalf of a limited partnership which is a collective investment scheme; UK or overseas pension schemes, life insurance businesses, open-ended investment companies, authorised unit trust schemes, or REITs; UK charities; or sovereign immunity investors.

The 'quoted company' exception: If at least 35% of the voting power is beneficially held by the 'public' (as defined in the legislation) and those shares have been the subject of dealings on a recognised stock exchange (within the preceding 12 months), the company will not be close.

A three year grace period exists for new REITs to meet this condition. If the close company rules are not met by the end of the grace period, there should be no further penalty other than a loss of REIT status.

- **Distribution condition:**

The REIT must distribute 90% or more of its tax-exempt income profits (not capital gains), as well as 100% of any property income distributions received from other UK REITs, by the filing date of the company's tax return (usually twelve months after each accounting period end).

- **Property rental business conditions:**

The REIT must hold at least three properties. Of these, no single property can exceed 40% of the total value of the properties in the property rental business. For these purposes, properties that would be regarded as 'owner-occupied' for accounting purposes in the REIT's consolidated accounts do not count as property rental business properties. However, each unit or floor that is designed, fitted or equipped for separate rental will be regarded as a separate property (e.g. in an office building or shopping centre). See also proposed April 2023 amendments on page 5.



Requirements to achieve and maintain REIT status (cont.)

- **Balance of business condition:**

At least 75% of the REIT's gross assets and at least 75% of the REIT's accounting profits, on an IFRS accounting basis, must relate to the property rental business.

Non-rental residual business profits arising because of a REIT has to comply with certain planning obligations in the course of its property rental business are disregarded when assessing the balance of business profits condition.

In addition, if group accounts for a period show that property rental business profits and assets comprise of at least 80% of group totals, a REIT will be assumed to meet the balance of business profits condition and can provide simplified REIT financial statements.

- **Financing cost ratio:**

REITs are required to maintain a profit:financing cost ratio of greater than 1.25:1, otherwise a tax penalty may arise.

- **Holder of Excessive Rights**

Whilst technically not a condition, the principal company of a REIT may become subject to an additional tax charge if it pays a dividend to, or in respect of, a company that:

- Is beneficially entitled, directly or indirectly, to 10% or more of the company's dividends; or
- Is beneficially entitled, directly or indirectly, to 10% or more of the company's share capital; or
- Controls, directly or indirectly, 10% or more of the voting rights of the company ("Holders of Excessive Rights").

This charge is not applicable where property income distributions ("PIDs") are paid to investors entitled to gross payment (i.e. without deduction of withholding tax).

- **REIT financial statements condition:**

The principal company must prepare and submit to HMRC certain REIT financial statements within 12 months of each accounting period end.

Factors to consider when deciding whether to become a REIT

Companies will need to carefully consider a number of factors before deciding whether to become a REIT, such as:

- The impact of REIT conversion on shareholders' after-tax returns.
- The ongoing benefits of REIT status, together with costs of complying with the regime's requirements.
- The requirement for diversity of ownership (subject to the three year grace period and institutional investor diverse ownership rule).
- The requirement for the REIT's shares to be admitted to trading on a recognised stock exchange (subject to the exception where $\geq 70\%$ of the shares are held by institutional investors).
- Implications of complying with the company, distribution, balance of business and financing cost ratio conditions and tests.
- Whether the company needs to increase operational efficiency in order to provide attractive income yields to investors.
- Whether the company's existing reporting tools provide the outputs that will be required as a REIT (monitoring of conditions, accurate forecasting, accounting information etc.)

Changes to the REIT regime expected from April 2023

Certain changes to the REIT regime were confirmed in the UK Spring Budget on 15 March 2023 and proposed legislation was included in the Finance Bill published on 23 March 2023. In summary, subject to receiving Royal Assent, the changes will:

- i. Allow a REIT to hold a single property, where that property is a commercial building with a minimum value of £20 million.
- ii. Amend the '3-year development rule' (that deems a disposal of property within 3 years of being significantly developed as being outside the exempt property rental business) so that the valuation used when calculating what constitutes a significant development is the greater of the value at entry, acquisition of the property, or the start of the accounting period in which development commences (rather than the value at the later of acquisition or entry to the REIT regime, as currently).
- iii. Amend the REIT withholding tax rules to allow property income distributions to be paid to a partnership partly gross and partly with tax withheld. The distribution will be permitted to be paid gross to the extent that it is the income of partners that would be entitled to gross payment if they held an interest in the REIT directly (e.g. UK companies, UK charities and UK pension schemes).

These changes will generally take effect from Royal Assent of the Spring Finance Bill 2023 (other than the changes to the '3-year development' rule which will take effect in relation to disposals made from 1 April 2023, assuming Royal Assent occurs).



Taxation of a UK REIT

A UK REIT needs to carry on a 'property rental business', and meet the various conditions for REIT status. This allows it to benefit from exemptions from UK corporation tax on profits and gains arising from its property rental business.



Property rental business

Profits and gains are **tax-exempt**

- Property rental business profits and gains (on direct disposals of property or on sales of shares in UK property-rich entities¹) are tax-exempt within the REIT itself.
- Distributions to investors derived from tax-exempt rental profits or gains are generally subject to basic rate withholding tax at 20% except, for example, where paid to a UK pension scheme or UK resident company. Overseas investors may be able to reclaim part (or all) of the withholding tax under a tax treaty or because of sovereign immunity.
- Investors are taxed on the distributions of tax-exempt profits and gains at their normal tax rate on income (as profits of a UK property business, rather than as a normal dividend receipt), with a credit for any tax withheld. However for overseas investors they will be taxed as a dividend under tax treaties.
- To ensure a regular flow of income is subject to tax at the investor level, REITs are required to distribute 90% of their tax-exempt profits. This distribution requirement does not include capital gains which can be retained within the REIT. REITs can satisfy this 90% distribution requirement by issuing shares in lieu of cash dividends.

Distributions taxed in the hands of investors as UK property income (generally 20% tax withheld)



Residual business

Profits and gains are subject to **UK corporation tax**

- Any profits and gains which are not derived from property rental activities are part of the residual business and will be subject to UK corporation tax in the normal way. This would include property trading activities, development and asset management fees and capital gains on disposals of shares that do not meet the conditions for the REIT share sale exemption.
- Distributions of profits and gains from the residual business will represent normal company dividends in the hands of investors when distributed.
- The majority of REITs will therefore have both a tax exempt business and a smaller residual taxable business.

Distributions taxed in the hands of investors as normal company dividends (no tax withheld)

¹ The UK REIT tax exemption was extended to apply to disposals of shares in UK property-rich entities (as well as to direct disposals of property) from 6 April 2019, subject to certain conditions.

The REIT journey

A number of steps are needed to launch a REIT and a range of advisers will need to be appointed.



1

REIT feasibility study

A review of the current or proposed business should be undertaken to ascertain whether the various conditions of the REIT regime can be met and maintained.

2

REIT conversion process

Once the decision has been taken to move ahead with REIT launch or conversion, a detailed workplan will need to be agreed. Support will be required from a number of advisers, which may include (depending on the circumstance):

- pre-conversion tax advice and HMRC clearances
- IPO readiness advice and / or listing process support
- accounting support, including reporting accountant, prospectus support and accounting opinions
- capital market strategy and capital raising strategy
- legal advice

3

Discussions with HMRC

Liaison with HMRC may be required regarding the proposed REIT structure and the company must give notice in writing to HMRC specifying the date from which the REIT regime is to apply.

4

IPO assistance and capital raising

Assistance may be required with listing the REIT entity and completion of any IPO and capital raising process.

5

Launch of the REIT

After launch of the REIT, ongoing advice will be required in relation to monitoring and managing compliance with the REIT regime conditions and filing requirements. Transactions advice may also be needed for e.g. acquisitions and disposals.



Contacts



Adam Jobson

REITs Tax Partner

020 7007 2718

ajobson@deloitte.co.uk



Aisling Colgan

REITs Tax Partner

020 7007 4848

acolgan@deloitte.co.uk



Samuel Campbell

REITs Associate Director

020 7303 0377

sacampbell@deloitte.co.uk



Richard Thornhill

**REITs Financial Advisory
Partner**

020 7007 3247

rthornhill@deloitte.co.uk



Abhishek Jaiswal

**REITs Financial Advisory
Partner**

020 7007 2204

abhishekjaiswal@deloitte.co.uk

Deloitte.

This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2023 Deloitte LLP. All rights reserved.

Designed and produced by The Creative Studio at Deloitte, London. J30846