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Insights

REIT REFORM IN THE UK – FURTHER MODERNISATION

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SUMMARY

The Government has announced a further series of proposed changes to the UK REIT rules as part of the wider review of the UK funds regime and published draft legislation.

This third set of changes are earmarked for Finance Act 2024 and keep to the program of reform to modernise the REIT regime and generally to make it more accessible.

Arguably, the biggest change concerns institutional investors in REITs. Under the current rules, a REIT can pass the "non-close" condition for REIT status (broadly, being widely held) if the only reason it would otherwise fail this test is that the REIT has one or a few "institutional investors" making it closely held for tax purposes. The Government is proposing three significant changes:

- The first introduces a restriction: some of the currently designated "institutional investors" will, once the changes are introduced, need to be either non-close themselves or satisfy the genuine diversity of ownership ("GDO") condition to qualify. The institutional investors affected are authorised unit trusts, open-ended investment companies (including, in both cases, overseas equivalents) and (as noted below) collective investment scheme limited partnerships. Also affected are persons acting in the course of a long-term insurance business; they will need to be non-close. Sensibly, the Government is suggesting a saving provision for this change so that existing structures will continue to meet the non-close condition after the change of law where they do so immediately before, but there are caveats to consider.
- The second loosens the rules by allowing the "non-close" condition to be satisfied by tracing through a body corporate to "institutional investors" higher up the holding structure. This change will be retrospective and will be treated as always having had effect.
- A third change updates the approach to collective investment scheme limited partnerships that owns a REIT. Currently, there is a degree of uncertainty as to the correct analysis of investment in a REIT through a limited partnership, and investors often seek confirmation of their treatment from HMRC. The revised legislation provides that collective investment scheme

limited partnerships that are GDO or non-close (non-close being defined as if the partnership were a company) are regarded as "institutional investors" in their own right, but (assuming HMRC follow the approach they adopt for the equivalent non-resident chargeable gains legislation) this should not prevent such a partnership being looked through by investors in the alternative if desired. These changes, as with the changes in the first bullet point, will benefit from a saving provision, so that existing structures will continue to meet the non-close condition after the change of law where they do so immediately before.

These three changes are broadly (but not exactly) in line with concepts introduced into the non-resident chargeable gains tax rules and are not unexpected.

A more limited change, but very important for insurance companies, is that insurance companies will be able to have an interest of 75% or more in a group REIT.

The 'interest cover test' calculation will also be amended. This test requires a ratio of profits to financing costs of at least 1.25:1 (put another way, requires that financing costs do not exceed 80% of profits) and creates a tax charge where the required ratio is not met. One amendment clarifies that financing costs does not include financing costs from non-UK properties held by non-UK resident companies. This amendment puts HMRC's published practice on a statutory footing and it will be regarded as always having effect. The other amendment provides that financing costs (other than costs prevented from being deductible by the corporate interest restriction rules) are only taken into account to the extent that they would be tax deductible but for the REIT exemption. This change is to take effect for all accounting periods ending on or after 1 April 2023.

The large single property rule, introduced in Finance (no. 2) Act 2023 as an exception to the usual requirement to hold three properties, will be changed to deal with the situation where there is a change in the property held. The rule as drafted currently requires the single property to be worth at least £20m at the time the REIT ceased to hold three or more properties. The revised rule clarifies that where the REIT disposes of a single property and acquires a replacement single property, the valuation date is updated to the date of the disposal of the previous single property. The Government has not earmarked this change as retrospective potentially because property values could go up or down between now and royal assent of Finance Act 2024. However, it is hoped that the absence of retrospectivity, if it remains, will not be a problem as the three property rule was often not a problem in practice.

Finally, the REIT's tax exemption on disposing of a UK property rich company will be extended to the disposal of an interest in a UK property rich CoACS.

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