Tax Law Rewrite.

Response to Paper CC/SC (08) 15

Real Estate Investment Trusts ("UK REITs")

This document is available on the internet at:

http://www.hmrc.gov.uk/rewrite 30 October 2008

INTRODUCTION

1. We published Committee Paper CC/SC (08) 15 in April 2008 on the HMRC internet website www.hmrc.gov.uk/rewrite. The closing date for responses was 23 July 2008. The draft clauses rewrite the UK REIT provisions in Part 4 of, and Schedules 17 to, FA 2006.

2. The purpose of this response document is to provide details of the substantive points made and to explain our analysis and proposals in respect of them. Minor points such as suggestions to improve punctuation are not covered, but all comments received have been carefully considered.

3. The Committee Paper contained a large number of questions about proposals. In this paper we comment on responses only if they were not simply in favour of the proposals.

4. A number of respondents made the point that there is a need to keep the departmental guidance up to date. We accept this point and acknowledge in particular that the guidance will need to reflect any rewritten legislation.

5. Our plans are that a draft Bill will be published in Spring 2009. The clauses in that draft Bill will reflect changes to be made as a result of this consultation process.

6. We received written responses from the following:

- BDO Stoy Hayward
- The British Property Federation
- The Chartered Institute of Taxation
- Ernst & Young
- Freshfields
- The Institute of Chartered Accountants in England and Wales
- KPMG
- PricewaterhouseCoopers
- One individual

7. We are very grateful for all the comments made, many of which were detailed and we appreciate the time and effort that went into them. We have sent each respondent a copy of this response document.

8. The following abbreviations for tax legislation are used:

- CAA the Capital Allowances Act 2001
- FA the Finance Act
- ICTA the Income and Corporation Taxes Act 1988
- ITTOIA the Income Tax (Trading and Other Income) Act 2005
- TCGA the Taxation of Chargeable Gains Act 1992
- TMA the Taxes Management Act 1970

Overview

Q1. We welcome comments on the refocusing of the legislation, making the position of group UK REITs more prominent and clearer .

Rules (such as those in clauses 5, 11 and 29) which apply to both group UK REITs and company UK REITs should be split into separate clauses.

9. This suggestion is likely to lead to a great deal of repetition but we recognise that in one or two cases the suggestion might lead to greater clarity.

10. ***We will consider splitting the clauses affected.***

Q3. We welcome comments on the proposal to enact and revoke SI 2006/2864 (except for regulation 11), SI 2006/2866, SI 2007/3425 and SI 2007/3540.

Regulation 11 of SI 2006/2864 should be rewritten, with SI 2006/2865, SI 2007/3536 and SI 2006/2867.

11. We have had to draw a line between the rules that affect tax liabilities and those that deal with administrative matters. The division is in part a consequence of the decision not to rewrite TMA. It is a matter of judgement where the line lies. But most respondents were content with the proposal to leave regulation 11 (and the other SIs) on one side.

12. ***We do not propose to rewrite regulation 11 of SI 2006/2864.***

Section 139 of FA 2006 should be rewritten in Bill 6.

13. A draft clause (numbered 9) rewriting this section was published in May 2008 as an attachment to committee paper CC/SC (08) 20 (manufactured payments and repos).

14. ***We do not propose to rewrite the section in the UK REITs Part of Bill 6.***

The regulation-making powers should be retained to enable modifications to be made at short notice.

15. This is a minority view. Most respondents welcomed the inclusion of the regulations in primary legislation.

Q4. We welcome comments on the organisation of the rewritten legislation.

We suggest that definitions should be in one place at the beginning of the Part. This is particularly true of "UK company", which is defined for the purposes of this Part of the Bill to exclude a dual resident company.

16. The rewrite style has been to put definitions where we think they are most helpful to the reader. That is why, for instance, the definitions of "group UK REIT", "company UK REIT" and "UK REIT" are in clause 5(7). But, to help a reader find a particular definition, there is an "index" at the end of the Part – see clause 83, which includes entries for all the clause 5(7) definitions. The same style leads to a Bill-wide index at the end of the Bill, in Schedule 4.

17. Experience of previous consultations leads us to believe that the beginning of a Part of a Bill reads more easily if not cluttered with definitions which can be left until the end of the Part. But we will think again about where to put the definition of "UK company".

18. ***We do not propose to move the definitions.***

Clause 1: Overview of Part

The application of the whole of Part 4 of FA 2006 to joint venture companies brings into play the rule in clause 64 about early exit. This cancels the uplift in the tax value of assets. There is nothing in SI 2006/2866 to say that this rule (in section 132 of FA 2006) applies to joint venture companies.

19. The regulations were made on the basis that they "provide for this Part to apply" (section 138(1) of FA 2006). So it must follow that that is what they do. There is a power (in section 138(2)) for the regulations to modify or disapply the rules in Part 4. But, as no such modification or disapplication is made in relation to section 132 of FA 2006, it must also follow that the rules about early exit apply.

20. We believe that the clauses accurately rewrite the law as it applies to joint venture companies.

21. ***We do not propose to disapply clause 64 for joint venture companies.***

Clause 3: "UK property rental business" of non-UK companies

Q7. We welcome comments on the proposal to rewrite paragraph 32(3) of Schedule 17 to FA 2006 so that it only applies to profits of UK property rental business.

The clause should be amended so that it is clear that only the proportion of profits of the non-UK company that arise to the group UK REIT are charged to corporation tax.

22. The rule in this clause applies only *for the purposes of this Part*. It follows that for other purposes, such as the charge to income tax and the charge to corporation tax on the profits of a permanent establishment, the usual rules apply. (See also paragraph 59 of this document.)

23. ***We do not propose to amend the clause but paragraph 38 of the explanatory notes will be re-drafted.***

Clause 5: Becoming a UK REIT: notice

Q9. We welcome comments on the proposal to clarify that the notice must specify an accounting period of the principal company.

The clause should refer simply to "an accounting period".

24. A notice given by a principal company under section 109(1) of FA 2006 (as modified by paragraph 8(1) of Schedule 17 to that Act) produces a new accounting period for each UK resident member of the group (see section 111(5) of FA 2006, as modified by paragraph 9(3) of Schedule 17 to that Act). So we now think that it makes no difference which company's accounting period is specified.

A notice under subsection (1) or (3) should be required to specify any date, rather than the beginning of an accounting period.

25. In accordance with clause 17(6) a new accounting period begins when a group or company becomes a UK REIT. So it seems that a notice specifying any date would comply with the requirement.

26. ***We will consider amending the clause to make this point clear.***

Clause 6: Supplementary provision about notices under section 5

The clause should cater for the possibility that the company fails the balance of business test in clause 12 at the start of its first accounting period but expects to do so by the end of the period.

The condition in subsection (2)(a) should be widened to include other reasons (such as being a family company before entry) for not meeting condition D in clause 9.

The clause should deal with the case where a company fails the balance of business test in clause 12 on entry but expects to meet it by the end of the first accounting period.

27. ***These suggestions are outside the remit of this project but will be passed to our policy colleagues for consideration.***

The opening words of subsection (3) should be changed from "in such a case".

28. ***We will consider amending the opening words of subsection (3).***

Clause 9: Conditions for company

The clause should be brought into line with clause 6(4)(b) and (c) and brought into line with, or made subject to, clauses 40 and 41.

29. A company may enter the UK REITs regime on the basis of assertions under clause 6(4) about the company becoming quoted. But that result is achieved by disapplying clause 6(1)(c); it does not treat conditions C and D in this clause as met.

30. Similarly, on a demerger clauses 40 and 41 allow a company to give a clause 5 notice even though it does not expect to meet conditions C to F in clause 9 throughout its first accounting period. Again, the rules go no further than allowing a notice to be given; they do not treat conditions C and D in this clause as met.

31. The result is apparently that, in the first accounting period, there is a breach of one of more of the conditions in clause 9. And any such breach is not one covered by the relaxations in regulation 2 or 3 of SI 2006/2864 (rewritten in clause 45). This is clearly not the intended result. So the rewritten rules should not treat as a breach an event which is disregarded by clause 9, 40 or 41 for the purposes of giving a clause 5 notice.

32. ***We will consider amending the clauses to meet this point.***

Subsection (4)(b) should make clear the basis on which shareholdings through a limited partnership are to be ignored.

33. ***We will consider whether the rule should be clarified.***

Subsection (7) should make clear that the rule is concerned with a loan in relation to which the company is a debtor.

34. ***We will consider amending the clause to meet this point.***

Clause 10: Conditions as to property rental business

Subsection (2) refers to no "one property" but subsection (4) says what is meant by a "single property"

35. ***We will make the wording consistent.***

In clause 10(4), the definition of a property "involved" in a business is arguably wide enough to include a property which is occupied for the purposes of a business (for example by management staff).

36. We do not agree. If the property is "involved" it is exploited by the business (see subsection (4)(a) of the clause). A property which is merely occupied by the business is not exploited.

37. ***We do not propose to amend the clause to meet this point.***

In the application of this clause to a deemed UK REIT or to a group UK REIT of which a joint venture company is treated as a member the rules should apply to the group UK REIT rather than to the group.

38. "Group UK REIT" and "group" are defined in clauses 5(7) and 79 respectively. The former includes a joint venture company; the latter does not. It is intended that the test in this clause should apply to the group (or deemed) UK REIT; and we consider that this is the only way in which the clause can be construed as applying to a group UK REIT of which a joint venture company is treated as a member or to a deemed UK REIT. (See also paragraph 50 of this document about clause 12.) But there may be scope for clarification.

39. ***We will consider amending the clause.***

Q14. We welcome comments on the proposal to take into account […] 100% of all properties, rather than only the relevant percentage.

The effect of bringing into account 100% of the value of the asset, for UK REIT qualification purposes, would be distortive and could cause the group to breach the 40% test. We propose that only a member's proportionate interest in an asset is brought into account for the purposes the 40% test in clause 10(2).

40. It is not always the case that one approach is more "generous" than the other.

Example 1

41. Company A (the principal of the group) has property worth £40. Company B (wholly owned subsidiary of A) has property worth £20. Company C (75% subsidiary of A) has property worth £40. If 100% of the value of C's property is taken into account, the 40% test is passed. If only 75% of the value of C's property is taken into account, the 40% test is failed because A's property accounts for 44.4% of the total value of the properties.

Example 2

42. Company A (the principal of the group) has property worth £25. Company B (wholly owned subsidiary of A) has property worth £30. Company C (75% subsidiary of A) has property worth £45. If 100% of the value of C's property is taken into account, the 40% test is failed. If only 75% of the value of C's property is taken into account, the values of the holdings are 30/25/33.8 (total 88.8). So the percentages are 28/34/38 and the test is passed.

43. It is easier in general to pass the 40% test if the interest in the subsidiary's property is restricted to the extent of the parent's holding. And applying the test in that way follows the economic reality of the relationship.

44. ***We propose to amend the clause to take into account the interest in the property held by the subsidiary only so far as the subsidiary is owned by other members of the group.***

> *The test should also take into account interests of less than 100% in properties held in partnership or through unit trust.*

45. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

> *Q15. We welcome comments on the proposal to include properties owned by joint venture companies for the purposes of satisfying the property rental business conditions.*

> *The same point arises as in connection with Q14.*

46. ***We propose to ensure that the Part applies to joint ventures so that account is taken of the interest in the property held by the joint venture company only so far as the joint venture company is owned by other members of the group.***

Clause 12: Conditions as to balance of business

> *Q18. We welcome comments on the proposal to rewrite section 108(2)(b) of FA 2006 so that it only applies to company UK REITs.*
>
> *Section 108(2)(b) needs to apply to group UK REITs, not least because regulation 7 of SI 2006/2865 (as substituted by regulation 3 of SI 2007/3536) refers to the section.*

47. We do not agree. Determinations relating to "profits" and "total profits" in the case of a group UK REIT are governed by paragraph 7 of Schedule 17 to FA 2006. That paragraph cross-refers to amounts shown in the financial statements under paragraph 31 of Schedule 17 to FA 2006, and impliedly supersedes section 108(2)(b) of FA 2006 for groups. So the exclusion of the items set out in section 108(2)(b) of FA 2006 needs to apply only to a company which is not (or does not propose to be) part of the UK REIT regime as part of a group.

48. ***We take the view that separate rules are used for group UK REITs and company UK REITs and that the way in which we have rewritten section 108(2)(b) of FA 2006 (including that section as modified by paragraph 7 of Schedule 17 to that Act) produces the correct result.***

> *Q19. We welcome comments on the proposal to include the worldwide profits and assets of property rental business of non-UK companies for the purpose of satisfying the balance of business tests.*
>
> *The words "of property rental business" are superfluous in this question.*

49. ***We agree and regret the error. But the respondent supported the proposal.***

> *In the application of this clause to a deemed UK REIT or to a group UK REIT of which a joint venture company is treated as a member the rules should apply to the group UK REIT rather than to the group.*

50. It is intended that the test in this clause should apply to the group (or deemed) UK REIT of which a joint venture company is treated as a member. It is clear from the context – see clause 8(2) – that this is how the clause applies in such a case. (See also paragraph 38 of this document about clause 10.)

51. ***We do not propose to amend the clause.***

> *In subsection (5) the "assets involved in property rental business" are compared with the "total assets" of the group or company. It should be made clear that the comparison is made between assets defined in the same way.*

52. We do not agree. As the respondent points out, the definition of "assets" includes debtors, motor vehicles and cash (see clause 82(2), rewriting section 142 of FA 2006). On the other hand "assets involved in property rental business" do not include such items because they are not exploited by the conduct of the business (see clause 10(4)(a), rewriting section 107(6)(a) of FA 2006, which is applied by clause 82(3)).

53. We believe that this is a deliberate distinction, to be preserved in the rewritten clauses.

54. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 13: Financial statements for group UK REITs

Q20. We welcome comments on the proposal to draft subsection (2)(a) so that it includes worldwide property rental business of non-UK companies.

The bracketed commentary in paragraph 79 of the explanatory notes is misleading.

55. We agree. The effect of paragraph 32(8)(d) of Schedule 17 to FA 2006 is to include the UK property rental business of a non-UK company in the profits to be reported under paragraph 31(2)(b) of Schedule 17 to FA 2006 as part of the group's UK business. Any overseas property business of the non-UK company is part of the group's property rental business as a result of section 104(1) of, and paragraph 32(2) of Schedule 17 to, FA 2006. So that overseas income has in any event to be reported under paragraph 31(2)(a) of the Schedule.

56. ***We will amend the explanatory notes.***

Clause 15: Profits

Q22. We welcome comments on the proposal to retain subsection (3)(b).

Remove the subsection because it could be misleading.

57. The problem with simply removing paragraph (b) is that the subsection would probably look more like a charging provision ("Profits which arise from … business … are charged"). In fact, subsection (3) is a rate-setting, rather than a charging, provision, and we think that paragraph (b) helps to clarify the fact that the profits in question are charged to corporation tax otherwise than by virtue of this provision.

58. ***So we propose not to amend subsection (3).***

Q23. We welcome comments on the proposal that subsection (3) should not apply to non-UK companies.

Q24. We welcome comments on the proposal to apply subsection (4) to non-UK companies.

The clause should make clear that the UK REIT rules do not alter the treatment of the non-REIT income of non-UK companies.

It should be made clear in the rewrite what effect clause 15(4) has on non-UK companies. It seems that the small companies' rate should be excluded for non-UK companies.

59. Subsection (4) does not impose a charge to corporation tax on profits which are not otherwise within the charge. So the usual rules apply. If the profits of a non-UK company are within the charge they are charged at the full rate because the small companies' rate does not (subject to double taxation relief) apply to non-residents. We propose to mention this point in the explanatory notes. (See also paragraphs 22 and 23 of this document.)

60. ***We do not propose to amend the clause.***

Q25. We welcome comments on the proposal to apply subsection (3) to the non-member percentage of profits of property rental business carried on by UK joint venture companies and [for] subsection (4) to joint venture companies.

The rate of tax applied to the non-member's share of the income should not be the full rate. This makes a REIT an unattractive co-investor.

61. It is a general principle of Part 4 of FA 2006 that, if any profits of a company are sheltered by the special rules, any chargeable profits are charged at the full rate. (See also paragraphs 73 and 74 of this document.)

62. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

It should be made clearer that "profits" in this clause do not include chargeable gains.

63. The results of a property business are a balance of receipts and expenditure. The most natural word to describe such a balance is "profits". It seems sensible to take that word from Part 4 of Bill 5 which is devoted to property income. A problem arises because, for corporation tax purposes, "profits" is used also to describe the total of a

company's income (including trading income and property income) and chargeable gains. This is why section 142(f) of FA 2006 defines "profits" in Part 4 of that Act as "income".

64. In this clause "profits" exclude gains and losses on the disposal of property. That exclusion applies equally to the profits of a property rental business and to those of residual business. So we think it is clear enough that chargeable gains are not included in this clause – a conclusion reinforced by the next clause which is devoted to such gains.

65. ***We do not propose to amend the clause.***

Clause 16: Gains

> *This clause refers to a gain on the disposal of an asset which accrues to a company. The disposal of an asset and the accrual of any gain in respect of that disposal normally occur at the same time. But the clause should focus on the time of disposal.*

66. We agree that it makes more sense to focus on the time of disposal. This is because the condition relating to use of the asset only makes sense if measured up to the time of disposal.

67. ***We propose to amend the clause to meet this point.***

> *Q26. We welcome comments on the proposal that non-UK companies caught by section 10B of TCGA are subject to corporation tax at the main rate and that other non-UK companies are not subject to corporation tax on gains of residual business.*
>
> *The draft legislation is unnecessarily complicated where it tries to deal with gains realised by non-UK companies. It is unlikely that assets held in connection with a trade are qualifying assets for the purposes of the REITs regime.*

68. We have reconsidered this point. If an asset is used wholly and exclusively (subject to the limited exception in subsection (3)) for the purposes of property rental business, it cannot be within section 10B of TCGA. So there is no need for a gain on its disposal to be exempted by this clause. The same point arises in connection with clauses 17 and 62.

69. There is no need for this clause to exempt the chargeable gains of non-UK companies. We think that it may be possible to amend this clause and clauses 17 and 62 to make it clear that they have no application to the assets of non-UK companies.

70. ***We will consider amending the clause to meet this point.***

Subsection (7) of the clause might be construed as imposing tax on the member's gains whether or not they are held or used in connection with a United Kingdom permanent establishment.

71. We think that it is reasonably clear that to treat gains as arising from the member's residual business is not to impose tax on them. The rule is in subsection (6) and subsection (6)(b) is in effect a separate condition, that the gains are charged to corporation tax. That is the case only if section 10B of TCGA applies.

72. ***This point disappears if the clause is amended to exclude the assets of non-UK companies.***

The rate of tax applied to the non-member's share of gains should not be the full rate. This makes a REIT an unattractive co-investor.

73. It is a general principle of Part 4 of FA 2006 that, if any profits of a company are sheltered by the special rules, any chargeable profits are charged at the full rate. (See also paragraphs 61 and 62 of this document.)

74. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Subsection (8) is confusing because it seems to provide an exemption for gains on UK property rental business assets of a non-UK member of a group UK REIT. Such gains would not usually be within the charge to corporation tax anyway.

75. ***This point disappears if the clause is amended to exclude the assets of non-UK companies.***

Clause 17: Effects of entry: corporation tax

The defined term "incoming company" is not used outside this clause and is not needed.

76. We do not agree. The term is used twice in this clause, in subsections (2) and (6) and is a useful device for referring to the company in view in subsection (1) without the need to repeat the full form of words used in that subsection.

77. ***We do not propose to amend the clause to meet this point.***

Q30. We welcome comments on the proposal to apply subsection (1) to all non-UK companies.

Surely these companies are not within the charge to corporation tax until they are brought with the REIT regime. If there is an existing property business it should cease for income tax purposes.

78. We agree that non-UK companies may not be within the charge to corporation tax. It is not clear that there is a need to treat any income tax business as ceasing.

79. ***We are considering whether the clause should be amended.***

Q31. We welcome comments on the proposal to apply subsections (2) to (4) to gains of non-UK companies arising in respect of a trade or permanent establishment in the UK.

The deemed disposal in subsection (2) should be explicitly confined to assets within section 10B of TCGA.

80. The disposal is deemed to be made *for corporation tax purposes* (see subsection (2)). If a gain on the assets is not within the charge to corporation tax (because section 10B of TCGA does not apply or for any other reason) we think it is clear that subsection (4) has no effect.

81. Please see the discussion in paragraphs 68 and 69 of this document.

82. ***This point disappears if the clause is amended to exclude the assets of non-UK companies.***

Is subsection (8) necessary, in view of the way in which subsection (1) is drafted?

83. We think that this explanation is needed because, for the Part generally, "entry" is defined by clause 81(1) only in terms of a company on its own, or a (whole) group becoming a UK REIT. In this clause, the word has to cover the additional case of a company joining an existing group UK REIT (or forming a group UK REIT with an existing company UK REIT). The same point arises in connection with clause 18(5).

84. ***We do not propose to amend the clause to meet this point.***

Clauses 17(9), 18(6) and 19(6) should apply not only to the case of a company becoming a member of a group (paragraph (b) of each subsection) but also on a demerger.

85. We think that the respondent's point is met by clauses 40(3) and 41(8). Those clauses disapply clauses 17, 18 and 19 in the case of a demerger (as defined in clause 40(1) or 41(2) to (4)).

86. ***We do not propose to amend the clause to meet this point..***

Clause 18: Effects of entry: CAA 2001

Subsection (6) is not necessary. It operates through clause 17 which, in the circumstances described in clause 18(6) is wholly disapplied by clause 17(9).

87. We agree that subsection (6) is not strictly necessary and it is questionable whether or not it is useful. A similar point arises in connection with clause 63 (see paragraph 182 of this document).

88. ***We will consider dropping this subsection.***

The clause should provide rules for calculating capital allowances in the year in which a non-UK resident company enters the UK REITs regime.

89. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 19: Entry charge

The legislation should make clear that a double entry charge does not apply when a member of a group UK REIT becomes a joint venture company.

90. A charge arises only when a company becomes, or becomes a member of, a UK REIT. If the company is already a member of a group UK REIT there can be no charge under this clause. And none of the special rules in clause 70 applies. We do not think it is helpful to exclude specifically what would in any event be a surprising result.

91. We will do some more work on this point to see whether the respondent's point can be addressed.

92. ***We will reconsider the drafting of this clause.***

Q37. We welcome comments on the proposal [that] non-UK companies, operating through a permanent establishment in the United Kingdom, are treated in the same [way] as UK companies for the purposes of the entry charge.

This is academic, in view of the fact that the tax is 2% anyway.

93. ***We agree and do not propose to amend the clause.***

Clause 23: Disapplication of certain provisions

We suggest that the clause should refer to "company" rather than "UK company".

94. This change would allow relief to a dual resident company for losses of its overseas property business. This is neither the policy nor the current law.

95. ***We do not propose to amend the clause.***

<u>*Q43. We welcome comments on the proposal to apply this subsection to UK resident joint venture companies.*</u>

The removal of the exemption for small or medium joint venture companies creates a market distortion.

96. We do not agree that the clause removes an exemption. As is explained in paragraph 143 of the explanatory notes, there is little doubt that section 113(6) of FA 2006 applies to joint venture companies. So we think that the clause accurately rewrites the law and we do not propose to amend the clause.

97. ***We will pass this suggestion to our policy colleagues for consideration.***

Clause 25: Meaning of "property profits" and "property financing costs"

In subsection (3)(a) the "property financing costs" should be restricted to those in respect of the group UK REIT's UK property rental business (see paragraph 14 of Schedule 17 to FA 2006). This is on the basis that the profits that are taken into account are those in respect of the UK property rental business.

98. We do not agree. The property profits taken into account are those of whole of the group UK REIT's property rental business and they include profits from an overseas property business (see clause 2(1)).

99. ***We do not propose to amend the clause.***

If finance costs include costs of financing a partly-owned subsidiary surely the costs taken into account in subsection (3)(a) should include only the appropriate percentage of the costs.

100. We agree. But the minority shareholders' interest in the subsidiary is excluded by clause 14(3). So the "financing costs … as set out in the financial statements" also exclude the minority shareholders' percentage of the financing costs.

101. ***We do not propose to amend the clause to meet this point.***

Clause 26: Notice to cancel tax advantage

Q46. We welcome comments on whether we should remove the word "additional" from the second line of subsection (4), or whether subsection (4) should be extended to allow for an assessment to be made to either income tax or corporation tax.

The consensus is that "additional" should be removed and that the clause should refer to income tax.

102. ***We propose to make the amendments.***

Clause 26 provides a wide power for an officer of Revenue & Customs to issue a notice to cancel a tax advantage. Clause 27 gives the company a right to appeal to the Special Commissioners. An appeal will presumably have to be made on the basis that the officer's notice was issued on unreasonable grounds. So "reasonably" should be inserted before "thinks" in sub clauses (1) and (4).

103. We do not agree. The suggestion would narrow the company's right of appeal. It is not enough that the officer's opinions and actions are reasonable. The officer must also be right. The Commissioners on appeal may reach a different conclusion from the officer as to whether the company has obtained a tax advantage. In that case their conclusion stands, however reasonable the conclusion reached by the officer.

104. ***We do not propose to amend the clause to meet this point.***

In subsection (6)(a) "incurred" is preferable to "made".

105. We agree that "incurred" is appropriate in relation to an expense. But a deduction is "made". So we will use "made or incurred".

106. ***We will amend the clause.***

The opening words of subsection (6) should be changed to reflect the original policy.

107. The clause reproduces the source legislation.

108. ***We do not propose to amend the clause.***

Clause 28: Funds awaiting reinvestment

Q47. We welcome comments on the proposal that this clause applies also to individual members of a group UK REIT.

The treatment of a group UK REIT's property rental business as a single business means that the rule in this clause should apply to the group as a whole, allowing the cash to be held by a group member other than the company that makes the disposal.

109. The effect of section 134 of FA 2006 on section 118 of FA 2006 is not clear because a group can neither dispose of an asset nor hold proceeds; only a company can do those things. It is arguable that the rule should be applied to the group as a whole, so that there need not be identity between the company making the disposal and the company holding the proceeds.

110. We need to consider, among other things, how the rule would work on a group-wide basis if one of the companies leaves the group.

111. ***We are considering amending the clause to meet this point.***

In subsection (3)(a) the proceeds should be treated as assets "involved" in property rental business.

112. It is not clear that treating the proceeds as assets held "in connection with" property rental business (see section 118(3)(a) of FA 2006) has any effect on condition 2 in section 108 of FA 2006, where the test is whether the asset is "property involved" (see section 108(3)(a) of FA 2006).

113. ***We will consider amending the clause to meet this point.***

In subsection (3)(b) the reference to "income" should be to "profits".

114. We think that the first reference to "income" reads more naturally than profits. But, to match the drafting of clause 15(3), we agree that the second reference should be changed.

115. ***We will consider amending the clause to meet this point.***

Subsection (5) should be amended to make it clear that the limit of one year for periods of mixed use should be applied to the aggregate of such periods.

116. It is clear from section 118(5) of FA 2006 that each period of mixed use should be at least a year. This approach is different from that of section 124(1)(b) of FA 2006

(rewritten as clause 16(4)). But the guidance (GREIT 09005) suggests that the limit in this clause should be applied to the aggregate of the periods. It may be possible to make the suggested change but that would involve a change in the law.

117. ***We will consider whether to amend the clause.***

The subsection (5) treatment should be extended to assets the mixed use of which does not extend to as long as a year.

118. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 29: Distributions: liability to tax

The financial statement under clause 13(2)(b) does not include chargeable gains (see the rules about the calculation of profits in clause 73, which apply to clause 14(2)). So it is not right to refer to "profits and gains" shown in such a statement.

119. It is clear from section 121(8) of FA 2006 that the special treatment of distributions out of the profits of a property rental business extends to gains exempted from tax by section 124 of FA 2006.

120. The rules about calculating profits in clause 73 do not explicitly apply to clause 13 (see clause 73(2)) and the word "profits" does not appear in clause 13. So it is arguable that the financial statement of the group's property rental business within clause 13(2)(b) *does* include gains. This view is not inconsistent with the requirement in clause 14 that the statement should specify the profits excluding gains. We will review the description of the profits in respect of which a distribution is make.

121. The same point arises in connection with clause 33 (see paragraph 130 of this document).

122. ***We will consider amending the clauses to meet this point.***

Clause 30: Distributions: further provision

Q56. We welcome comments on the proposal to refer to "premium trust fund" in subsection (1)(d)(i).

123. We regret that this question was misconceived. Section 222 of FA 2004 was amended by article 87 of SI 2004/3269 to change "premium" to "premiums". So the clause must refer to "premiums trust fund".

124. ***We propose to retain "premiums".***

Q57. We welcome comments on the proposal that subsection (3) applies to gains (as well as profits) of property rental business.

The rewrite should reflect what paragraph 32(7) of Schedule 17 to FA 2006 provides.

Subsection (4) should refer to "profits or gains (or both)", to make it clear that the distribution does not have to be of one or the other.

125. Please see paragraph 119 of this document where we consider the identification of distributions that are out of gains. If we decide that the financial statements in clause 13 include gains we will consider using the suggested words (to bring them into line with section 973(2)(b) of ITA).

126. ***We are considering amending the clause.***

Clause 31: Dividends representing profits of UK property rental business

Can the explanatory notes explain the purpose of this clause.

127. Dividends from a UK resident company are not generally charged to corporation tax (see section 208 of ICTA). But dividends from a non-UK resident company are charged to tax under Schedule D Case V. The rule in this clause removes the charge to corporation tax on dividends from a non-UK member of a group UK REIT.

128. ***We will include this explanation in the explanatory notes.***

Clause 32: Attribution of distributions

The exemption for gains in section 124 of FA 2006 does not apply to non-UK members of the group (see paragraph 21(1) of Schedule 17 to FA 2006). So such gains are not within section 123(d) of FA 2006. But they are within subsection (2)(d) of this clause. Subject to the clarification of the position of non-UK members (see paragraphs 68 and 69 of this document), this has no adverse consequences.

129. ***We do not propose to amend the clause.***

Clause 33: Tax consequences of distribution to holder of excessive rights

It is not clear that the calculation in subsection (3) takes into account distributions of gains, as well as distributions of income.

130. This is the same point as is raised in connection with clause 29 (see paragraph 119 of this document).

131. ***We will consider amending the clauses to meet this point.***

Clause 34: "The section 34 amount"

The section 34 amount should include distributions of chargeable gains, as well as distributions of income.

132. Unlike the distributions considered in clauses 29 and 30, it is clear from the source legislation that the distributions considered in this clause are purely income distributions. That position is preserved in this clause by the references to the UK profits of a group UK REIT (see clause 11(2)) and to profits of property rental business of a company UK REIT.

133. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 37: Movement of assets out of ring-fence

Should not subsection (1)(b) retain the words "wholly and exclusively" in relation to use for the purposes of residual business?

134. We are grateful to the respondent for drawing our attention to the words, which have been inadvertently omitted.

135. ***We propose to reinstate the words in the clause.***

Could the clause make clearer the circumstances in which subsection (5) applies?

136. The respondent suggests that the subsection applies when the asset begins to be used for the purposes of the residual business. But that is the case dealt with in subsections (1) to (3). Subsection (5) deals with a later event, namely the eventual disposal in the course of a trade for the purposes of the residual business. We think that it is not easy to clarify the circumstances in which subsection (5) applies but we may be able to make the point in the explanatory notes.

137. ***We will consider adding something to the explanatory notes.***

The clause should reflect current HMRC guidance on movements of assets out of the ring fence.

138. In particular, the respondent suggests that the clause should make clear:

- that the disposal in subsection (4) need not be in the course of a trade;
- that the clause does not apply if development is complete before entry into the UK REIT regime;
- how the "30%" test in subsection (6)(b) is to be applied;
- what "completion" in subsection (6)(c) is;
- that the disposal in subsection (4)(b) does not include an intra-group transfer;
- that the repayment under subsection (7) of the entry charge may include part of the "notional amount" within clause 50; and
- that the percentage of assets excluded by subsection (8) as not owned by the member is ignored, rather than treated as part of the member's residual business.

139. ***Most of these suggestions are likely to be outside the remit of this project. In those cases the suggestions will be passed to our policy colleagues for consideration. But we will consider whether anything can be done in the clause.***

> *Subsection (9) should make clear that income from assets moving out of the ring-fence ceases to be within the charge to corporation tax.*

140. We do not think that such a rule is needed. The rules in clauses 3(3) and 15(2) (which impose a charge to corporation tax, remove the charge to income tax and exempt profits from corporation tax) apply only to profits of the UK property rental business. An asset which begins to be used for the purposes of residual business of a company (subsection (1) of this clause) no longer produces profits of a UK property rental business. So the usual rules apply.

141. If the asset is used in a trade carried on through a permanent establishment in the United Kingdom, the profits of the trade are within the charge to corporation tax. In the absence of a United Kingdom permanent establishment, the profits are charged to income tax.

142. ***We do not propose to amend the clause to meet this point.***

Clause 39: Movement of assets into ring-fence

Does the deemed sale in subsection (2) result in a charge to tax?

The application of the clause to non-UK companies should be clarified.

143. The answer to the question depends on the status of the company disposing of the asset. The clause does not impose a charge to tax. So, in the case of a non-UK company, any gain on the deemed disposal is chargeable only if the asset is within section 10B of TCGA. (See also the comments on clause 16 in paragraph 71 of this document.)

144. But if the company is a UK company, any gain on the deemed disposal is charged as a gain accruing to the company's residual business. Subsection (7) is intended to signpost this result.

145. ***We do not propose to amend the clause.***

The percentage of assets excluded by subsection (5) as not owned by the member should be ignored, rather than treated as part of the member's residual business.

146. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Does the drafting of subsection (6) need to be aligned with that of clause 37(9)?

147. We agree that there is a need for consistency of wording.

148. ***We propose to amend one of the subsections so that they are consistent with each other.***

Clause 40: Demergers: disposal of assets

In subsection (1)(c) it would be helpful to make clear that the disposal is by C.

149. ***We will consider amending the clause as suggested.***

Clause 41: Demergers: company leaving group UK REIT

It is not possible for the company to meet the conditions set out in subsection (3) "immediately after it ceases to be a member of Group 1" because those conditions have to be met throughout an accounting period.

150. We do not agree. Each of the conditions describes a state of affairs, for instance, the company's being a UK company (condition A in clause 9(1)). For the purposes of

clause 8(2)(a) that condition must be met throughout an accounting period. But that is not part of the condition itself. So it is possible to say whether the condition is met at a moment in time.

151. The position is not so clear in relation to the conditions is clauses 11 and 12.

152. ***We will consider whether the clause can be clarified..***

In subsection (9) conditions C to F in clause 9 are to be met by the company giving the notice in accordance with subsection (4), not necessarily the exiting company.

153. ***We propose to amend the clause to meet this point.***

The clause should make clear that the insertion of a new holding company above the existing principal company is not a breach of the conditions.

The clause should cater for the possibility that the conditions are not met immediately, following the example of clause 6(3)

154. ***These suggestions are outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 42: Interpretation of Chapter

Q61. We welcome comments on the proposal to apply clause 42 to clauses 17, 41 and 62.

Clauses 41 and 62 apply only in part to chargeable gains.

Clause 38 applies only to capital allowances.

155. ***We will remove clause 38 from the application of clause 42; we will consider whether clause 42 should apply only to the relevant parts of clause 41; and we will consider whether provision similar to clause 42 should apply to clause 62.***

156. ***so that it applies only to the relevant parts of clauses 41 and 62 and not at all to clause 38.***

Clause 45: Breach of certain conditions for company

Subsection (2) should be retained for the avoidance of doubt in the case of a takeover of one UK REIT by another.

157. ***We will consider retaining the subsection.***

There is uncertainty about the interaction of subsections (3) and (5).

158. A breach of condition D may fall within subsection (3), leading to a cessation at the end of the period of the breach. A later breach of condition C (but in the same accounting period) may be within subsection (5), leading to a cessation in the period before the breach. The consequences of the later event depend on whether or not the "case" is one to which subsection (5)(b) applies.

159. ***We will consider whether the clause can be clarified.***

Clause 46: Breach of condition as to property rental business

This clause does not include the rule about a limited number of breaches of the conditions in regulation 5 of SI 2006/2864.

160. This clause provides that the breaches are to be ignored. But clause 58 sets a limit on the number of breaches that can be ignored under this clause. And clause 60, under which an officer of Revenue and Customs may give a notice terminating UK REIT status in the event of multiple breaches of the conditions in Chapter 2, may also be relevant.

161. ***We do not propose to amend the clause.***

Clause 48: "The section 48 amount"

Should subsections (2)(b) and (3)(b) refer to the "relevant period" in clause 47(5)?

162. We think not. If a (further) distribution is made within the relevant period, there is no charge under clause 47 and this clause is not relevant. It is logical to tie the measurement of the distributed profits to the filing date (with a discretionary extension).

163. ***We do not propose to amend the clause.***

Clause 49: Initial breach of condition B in section 12

This clause should mirror clause 51 and deal with a breach of condition A (profits) as well as condition B (assets).

164. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 50: Meaning of "the notional amount"

The amount calculated is unduly punitive because it reflects not just assets newly acquired but also any increase in value of the original assets.

165. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 58: Notice under section 55: breach of conditions as to property rental business

Regulation 5 of SI 2006/2864 allows two breaches of each of condition 1 and condition 2. So there may be a total of four breaches in the ten year period. Subsection (2) allows only two.

166. ***We propose to amend the clause to meet this point.***

Is it considered unnecessary to rewrite the proviso "but a breach of Condition 1 giving rise to a breach of Condition 2 shall not be so disregarded" (regulation 5(3) of SI 2006/2864)?

167. If at any stage there are fewer than three properties (with the result that Condition A[1] is breached), one of the remaining properties must represent more than 40% of the total value of the properties (with the result that Condition B[2] is breached). It would be unduly harsh to treat this as two breaches.

168. The regulation makes clear that, in these circumstances, the breach of Condition 2 is disregarded but the breach of Condition 1 is not disregarded. So the clause goes no further than to say that Condition 2[B] is disregarded.

169. ***We do not propose to amend the clause.***

Clause 59: Notice under section 55: breach of conditions as to balance of business

Subsections (2) and (7) (which both exclude the initial accounting period from the period to be considered for the purposes of the clause) should be combined.

170. It may be that it is clearer and safer to keep the two subsections.

171. ***We will consider amending the clause.***

Clause 60: Notice under section 55: multiple breaches of conditions in Chapter 2

Subsection (7)(a) (and clause 45(2)) should be retained to provide certainty.

172. If a rule is redundant, it makes no sense to rewrite it. In the event that any rule such as that in subsection (7)(a) is removed, the explanatory notes will provide a full explanation of the position.

173. ***We will consider retaining the rules.***

> *A breach of the distribution condition in clause 11 should not be taken into account because it already results in a tax penalty.*

174. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 62: Effects of cessation

> *Q64. We welcome comments on the proposal to apply this clause to non-UK companies.*

> *This clause should apply only to non-UK companies trading through a United Kingdom permanent establishment.*

175. As with clause 16 (see paragraph 71 of this document) this clause does not impose a charge to corporation tax. Rather it sets out how to determine such a charge (if there is one). Unless a non-UK company is within section 10B of TCGA, there is no corporation tax charge on the disposal of its assets.

176. We are considering (see paragraphs 68 and 69 of this document) whether this clause should apply to the assets of non-UK companies.

177. ***This point disappears if the clause is amended to exclude the assets of non-UK companies.***

> *The rule for non-UK companies should apply to all assets rather than just those involved in UK property rental business.*

178. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

> *Does "ceasing to be a member of a group" in subsection (8) mean leaving the group or ceasing to be a UK REIT (or both)?*

179. The latter case (the group ceasing to be a UK REIT) is dealt with in subsection (1). The aim of subsection (8) is to extend the cessation treatment to any

company that ceases to be member of the group (while the rest of the group continues to be a UK REIT).

180. ***We do not propose to amend the clause.***

The clause would be clearer if subsection (1) mentioned the extension in subsection (8).

181. ***We will consider amending the clause to meet this point.***

Clause 63: Effects of cessation: CAA 2001

Subsection (6) is not necessary. It operates through clause 62 which, in the circumstances described in clause 63(6) is wholly disapplied by clause 62(9).

182. We agree that subsection (6) is not strictly necessary and it is questionable whether or not it is useful. A similar point arises in connection with clause 18 (see paragraph 87 of this document).

183. ***We will consider dropping this subsection.***

Clause 64: Early exit by notice

Paragraph 302 of the explanatory notes is misleading. It is very unlikely that the clause applies to non-UK companies.

184. ***We will amend the explanatory notes.***

If subsection (6) is merely intended to remove the benefit (or detriment) of any rebasing of the base cost, it would be helpful if the provision were clarified.

185. The respondent suggests that the effect of section 179 of TCGA may be that an asset is treated as sold and reacquired at market value on exit from the UK REIT regime. Such a sale may produce a chargeable gain. We do not think that that is the case.

186. The deemed disposal under section 179(3) of TCGA takes place at the time of the intra-group transfer. It produces a chargeable gain equal to the accrued gain at the time of the transfer. The gain is treated as arising when the company leaves the group.

187. The effect of this clause is that, for chargeable gains purposes, all the relevant UK REITs rules are disapplied. The company leaving the group is charged as if neither it nor the other members of the group had ever been within the UK REITs regime. So there may be a chargeable gain under section 179 of TCGA.

188. We do not think that there is any implication in the clause that section 179 of TCGA should not apply, or that any actual disposal should not produce a chargeable gain. Subsection (6) merely ensures that the usual chargeable gains rules apply.

189. ***We do not propose to amend the clause.***

Clause 65: Early exit

Why has paragraph 29(1)(b) of Schedule 17 to FA 2006 not been rewritten?

190. This rule merely reinforces the rule in section 133(2) of FA 2006 that a direction my modify "this Part". Schedule 17 is part of Part 4 of FA 2006. As the rewritten rules are all together in a Part of Bill 6 there is no need to repeat the rule.

191. ***We do not propose to amend the clause.***

Clause 67: Notice for Part to apply

Q67. We welcome comments on the proposal to treat a joint venture company as a member of a group UK REIT for the purposes of the Part.

The treatment of a joint venture company as a member of a group UK REIT "so far as it carries on property rental business" is inconsistent with the financial statement requirements in clause 13. The quoted words should be dropped.

192. The quoted words (in clause 67(1)) derive from section 138(1) of FA 2006. But the joint venture regulations (SI 2006/2866) make provision in relation to residual business of a joint venture company (see regulation 5). And respondents were in favour of the proposal outlined in the question, which involves treating a joint venture company as a member of a group UK REIT for all purposes of the Part. This approach makes no difference to the tax treatment of the profits arising from the joint venture.

193. ***We do not propose to amend the clause.***

A joint venture company should be allowed to join the group from a specified date.

194. This is a variation on the comments made in relation to clause 5 (see paragraphs 25 and 26 of this document).

195. ***We will consider amending the clause to make this point clear.***

It is wrong in principle to require a joint venture company to meet (effectively in advance) the conditions in clause 12. So subsection (4)(b) of this clause should be dropped.

196. We agree.

197. ***We are considering amending the clause to meet this point.***

A joint venture company should be allowed to make an election which is to be effective from a date (before the election) when the REIT conditions were satisfied.

The rules should allow a joint venture company to enter the REIT regime from the date it is acquired or formed.

Does the clause apply to a company in which the joint venture company has a 40% interest?

198. ***These comments are outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 69: General modifications of Part

199. Please see the general comment on the enactment of SI 2006/2866 in paragraphs 19 to 21 of this document.

Clause 70: Specific modifications of Part

Subsections (3) to (7) (and regulation 14(2) of SI 2006/2866 on which they are based) are difficult to apply. The drafting should be simplified.

200. ***We agree that the provisions of this clause are complex (as they are in the source legislation) and will consider whether any simplification is possible.***

The order of subsections (6) and (7) should be changed to make the provision easier to read.

201. The current order reflects the consistent approach of the Part in dealing first with the (more common) group case and then with the single company case. We think that on balance it is preferable to retain this approach.

202. ***We do not think that the order of the subsections is problematic. But we are rewriting SI 2007/3425 and so some reorganisation of Chapter 10 is likely.***

The additional entry charge should be based on the additional percentage of interest that is to benefit from the regime.

203. The example given by the respondent assumes that a REIT has a 40% interest in an asset worth £100m on original entry. The entry charge is £800,000. If the interest increases to 75% there is an additional charge under this clause, but it is based on the current market value of the asset. That value may have increased, perhaps as a result of development, to (say) £300m. The additional charge is £3.7m (£4.5m less the original charge of £0.8m).

204. If the additional charge were based on the interest newly within the regime it would be based on 35% of £300m, giving an additional charge of £1.3m.

205. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

No additional entry charge should be paid when a group member moves out of the group and becomes a joint venture company.

206. This is closely related to the point made in connection with clauses 17(9), 18(9) and 19(6) (see paragraph 86 of this document).

207. ***This suggestion is outside the remit of this project but will be passed to our policy colleagues for consideration.***

Clause 71: Duration of UK REIT status in joint venture cases

Subsection (1) should refer to the venturing group instead of the principal company (see regulation 11 of SI 2006/2866).

208. ***We agree that the test relates to the venturing group as a whole and will amend the clause accordingly.***

Clause 78: Property rental business: excluded income

Class (7)(a) in subsection (2) should refer to the principal company of a group UK REIT rather than a member of such a group.

209. The answer to this point depends on the position of a minority shareholder in a company (A) that is a member of a group UK REIT. A is closely controlled (by the principal company of the group) but may be prevented from being a close company only because it is controlled by a non-close company. In that case, clause 9(5) results in A being treated as a close company.

210. A close company cannot be a UK REIT (but it may be a member of a UK REIT). So a distribution by it is not property income within clause 29(5) or (6). It follows that a member of a group UK REIT other than the principal company cannot be a "company to which this Part of this Act applies" for the purposes of paragraph 12 of Schedule 16 to FA 2006.

211. ***We will amend the clause so that it refers to the principal company of a group UK REIT.***

Clause 79: Groups

Subsection (3) may need to apply to joint venture companies which are also members of more than one group.

212. We will look again at the effect section 134(6) of FA 2006. It is not clear that SI 2006/2866 displaces anything in section 134(5) of FA 2006. So the effect of subsection (5) being "subject to" section 138 of FA 2006 is uncertain.

213. In particular, it is possible for a joint venture company to be owned to the extent of, say, 50% by two different group UK REITs. In that case it seems necessary to treat the joint venture company as a member of two groups. Indeed, that is why section 134(6) of FA 2006 overrides subsection (5) of that section.

214. ***We will consider amending the clause to meet this point.***

Clause 80: Meaning of "UK company" and "non-UK company"

The wording of subsection (2)(b) is not clear.

215. The respondent suggests a fairly lengthy addition to the paragraph to make the connection between "company" and "member".

216. ***We will consider improving the wording of the clause.***

The clause should make clear that the "law of that place" includes tax treaties.

217. We do not agree. A tax treaty may treat a company as a resident of only one, instead of both, of the contracting states, in a "tie-breaker" article. But a treaty does not treat a company as resident in a state unless the company is resident in that state in accordance with that state's domestic law. This clause is concerned only with that domestic law.

218. ***We do not propose to amend the clause to meet this point.***

Clause 81: Meaning of "entry" and "cessation"

> *The defined words apply also to a company becoming or ceasing to be a member of a group UK REIT.*

219. We do not agree. The words are expanded to include those events but only for the purposes of clauses 17 and 18 (see clauses 17(8) and 18(5)). In general the words have a more restricted meaning in this Part.

220. ***We do not propose to amend the clause.***

Clause 83: Definitions

221. Paragraphs 38 and 50 of this document consider the definitions of "group" and "group UK REIT".

APPENDIX: GENERAL POINTS RELATING TO UK REITS

222. Several respondents made suggestions that are outside the remit of the rewrite project. If the suggestion is related to a specific clause it is mentioned in the main part of this document with any other comments on the clause. In each such case we undertake to pass the suggestion to our policy colleagues for consideration.

223. Other suggestions do not relate to a specific clause. They are briefly described in this appendix. Again, they will be passed to our policy colleagues for consideration.

Compliance with REITS tests

224. These should provide more flexibility to deal with cases where, for instance:

- unexpectedly low income causes a UK REIT to fail the interest cover test (see clause 24); or
- unexpectedly high income causes a UK REIT to fail the balance of business income test (see clause 12(1)).

225. A test applied over a few years would iron out such temporary difficulties.

International accounting standards

226. Financial statements prepared in accordance with clause 14 may produce fluctuations that are beyond the control of the directors of a UK REIT. The balance of business tests could instead be based on taxable profits. And more guidance is needed on the use of consolidated accounts for the purposes of the UK REITs Part of the Bill.

Interest cover test

227. There is a particular difficulty with the need to monitor internal financing structures in the light of the transfer pricing rules. The problem may become worse if there are changes to loan relationship rules about disguised interest.

Breaches of tests

228. The rules are unnecessarily complex. In particular there seems to be no need to group the conditions (see clause 60).