EXPLANATORY MEMORANDUM TO

THE REAL ESTATE INVESTMENT TRUSTS (BREACH OF CONDITIONS) REGULATIONS 2006

2006 No. 2864

THE REAL ESTATE INVESTMENT TRUSTS (FINANCIAL STATEMENTS OF GROUP REAL ESTATE INVESTMENT TRUSTS) REGULATIONS 2006

2006 No. 2865

THE REAL ESTATE INVESTMENT TRUSTS (JOINT VENTURES) REGULATIONS 2006

2006 No. 2866

THE REAL ESTATE INVESTMENT TRUSTS (ASSESSMENT AND RECOVERY OF TAX) REGULATIONS 2006

2006 No. 2867

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty. This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 These draft Regulations set out further details of the rules relating to the taxation of Real Estate Investment Trusts and their investors in four areas.

2.2 These are: the consequences of breaching various of the conditions and tests set out in Part 4 of the Finance Act (FA) 2006, the information to be provided in the financial statements that the principal company of a group that is a Real Estate Investment Trust must supply to HMRC, how the rules in Part 4 of that Act apply to joint ventures in which the Real Estate Investment Trust is involved and the administrative provisions for the deducting and accounting for tax when property Real Estate Investment Trust pays out its tax-exempt profits as distributions to shareholders.

3. Matters of special interest to the Select Committee on Statutory Instruments

None.

4. Legislative Background

4.1 The legislation setting out a special tax regime for Real Estate Investment Trusts and their shareholders was introduced as Part 4 FA 2006. The regime exempts from tax the profits of qualifying property rental business and instead, taxes the profits in the hands of investors when they are distributed.

4.2 A Real Estate Investment Trust (UK-REIT) can be either a limited company or a group of companies. To elect to join the regime, it must meet certain conditions relating to the company (or principal company for a group Real Estate Investment Trust) that include UK residence and the requirement that shares are listed on a recognised stock exchange. For the regime to apply to exempt the profits of its property rental business from tax, the UK-REIT's business must meet certain conditions, including requirements that 75% of its activities must relate to qualifying property rental business and 90% of the income of that business must be distributed to shareholders each year.

4.3 The distributions of the profits of the tax-exempt property rental business are paid under deduction of basic rate (22%) income tax. In general, the property income distributions are taxable in the hands of shareholders in the same way as UK property income (rather than as dividends from a UK company).

4.4 Part 4 FA 2006 provides various powers under which the Treasury can make regulations covering detail and administrative arrangements for the regime. The powers that are being used for the four sets of regulations are in sections 114 to 116, 122, 129(2)(a) and (b) and 134(1) (Breaches of Condition); paragraph 31(7) of Schedule 17 (Financial Statements of Group Real Estate Investment Trusts); section 138 (Joint Ventures) and section 122 and paragraphs 4 and 19 of Schedule 17 (Assessment and Recovery of Tax). Finance (No. 2) Act 2005 added section 468A ICTA in respect of Open-ended Investment Companies and provided for the repeal of sections 468H to 468Q.

5. Extent

These Regulations apply throughout the United Kingdom.

6. European Convention on Human Rights

These Regulations are subject to annulment and do not amend primary legislation. Accordingly, no statement of compatibility with the Convention rights is required.

7. Policy Background

7.1 Government's intention to introduce a special tax regime for property investment companies was announced at the time of the Pre-Budget Report in 2005. The aim of the regime is to move the burden of taxation from the vehicle to the investor, in order to correct a number of inefficiencies in the operation of the UK property rental market. Extensive consultation has taken place since then on both the primary legislation that was enacted as part of FA 2006 and on these regulations.

7.2 It is intended that consultation with the industry will continue in the future in order to ensure that the regime is, and remains, fit for its intended purpose.

8. Impact

A regulatory impact assessment has been prepared and is available on the HMRC website at http://www.hmrc.gov.uk/ria/ria

9. Contact

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