

The future of Tax Transparent Funds & REITs



Draft Legislation published for Tax Transparent Funds and Real Estate Investment Trusts in Finance Bill 2012

Tax Transparent Funds (TTFs) to be implemented in 2012

In Budget 2011, the Government announced that they would legislate to introduce a Tax Transparent Fund (TTF) vehicle from 2012. This is part of the implementation of the fourth UCITS Directive which facilitates "master feeder" funds that allow different types of investor to invest in master structures across Europe.

The Government have responded to the risk of several billions of assets going offshore to countries that have already adopted TTFs, such as Ireland and Luxembourg.

A consultation

In May 2011 it was announced that as most of the legislation required for the implementation of TTFs was regulatory rather than tax based, a regulatory consultation would be undertaken. This has yet to begin, but will be published either at the end of 2011 or start of 2012. The Government will then engage with industry on the design of the TTF.

New Regulations

The Government, after considering the legislation required, is clear that a separate set of regulations to establish a TTF is necessary rather than full legislation being implemented through the Finance Bill 2012. Therefore, from a tax perspective the Finance Bill simply gives the Government a power to make regulations about the tax treatment of participants in TTFs for the purposes of tax.

Anticipated tax proposals

The Government announced last week that they anticipate the powers contained in the Finance Bill being used to:

- Provide, for the purposes of capital gains, that assets held by investors as part of certain tax transparent collective investment schemes will not be chargeable assets, instead it will be the investor's interest that is treated as a chargeable asset;
- Provide a relief for insurance companies that transfer assets to such transparent schemes, to ensure that no gain arises at the point of transfer;
- Enable the capital gains legislation to be adapted for use at the merger and reconstruction of new and existing collective investment scheme so that the provisions will work when applied to tax transparent funds; and

- Provide an exemption for TTFs from stamp duty and stamp duty reserve tax.

Improvement to the REIT regime

The REIT regime was introduced on 1 January 2007. This followed a consultation and review of similar regimes that had operated successfully in other jurisdictions for many years. At the time it was felt that the conditions for the UK model were too tight, and even though five years has passed the number of companies opting into the REIT regime has been disappointing.

The Government therefore launched a further consultation in 2010 to consider what modifications could be made, with a particular aim to encourage the establishment of residential REITs. As a result, it is now proposed to legislate for modifications that will reduce the barriers to entry and ensure that the regime "does not inhibit good business practice" (to quote the press release).

We set out the headline points below.

Entry charge to be abolished

Currently there is an entry charge, set at 2% of the value of the assets entering into the regime. That was set as the cost to buy into the tax benefits of the regime (recognising in particular that historic gains held by the companies would fall out of charge).

To encourage new entrants, the entry charge will be abolished. This will be a material bonus.

Relaxing diversity of ownership requirements

Currently there are rules that require the shares of the REIT not be controlled by a small group of shareholders. This was achieved by applying the "close company" test and made it difficult for REITs to be used in start-up scenarios.

To alleviate this issue, a REIT now has three years to meet the test and the terms of the test are also to be modified. This may encourage residential REITs by allowing existing portfolios to be transferred into the REIT regime.

Increasing the number of permitted stock exchanges

Currently a REIT is required to be listed on a recognised stock exchange, which in the case of the UK means the main list of the stock exchange. This restricted choice and discouraged smaller REITs who would favour the lower costs and lighter regulation of the "junior" markets.

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To give more flexibility, this is to be relaxed so that it will now be possible for the shares to be traded on AIM and Plus (or their overseas equivalents).

Other changes

In addition to these changes, there are a number of improvements to the overall conditions, for which the sector has been lobbying for some time and should be well received. These include changes to the distribution requirement, to the balance of business test and to the profit finance ratio.

Implementation

These changes are expected to be included in the Finance Bill next year, so that means that they will come into effect upon Royal Assent, so one would target July 2012.

Need advice?

If you would like any further information or advice on any of the issues raised in this note please contact your usual Osborne Clarke contact or a member of our expert team below.

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