

This note looks at the tax treatment of Real Estate Investment Trust (REIT) distributions in the hands of shareholders, with tables to illustrate the position. It also explains and illustrates the effect on shareholders of the combination of tax relief for REITs with the taxation of REIT distributions.

- A REIT is obliged to pay distributions equal to 90 percent of its exempt rental income (as calculated for tax purposes).
- Each such distribution is known as a property income distribution (PID).
- A PID will be taxed as property letting income in the hands of the shareholders.
- PIDs are taxable as property letting income for shareholders who pay tax, but this is separate from any other property letting business they may carry on.
- PIDs are paid out under deduction of tax at the basic rate (currently 22 percent (withholding tax)). Regulations provide that tax is not deducted if the PID is paid to certain classes of shareholder, in particular UK companies, charities, local authorities, UK pension schemes and managers of PEPs/ISAs/child trust funds.
- Tax deducted is credited against the shareholder's own tax liability on the PID. Shareholders whose rate of tax is less than 22 percent or who do not pay tax at all, perhaps because of personal allowances or other reliefs, can reclaim the difference from HM Revenue & Customs.
- Non-resident shareholders in countries with double tax treaties with the UK which provide for lower rates of withholding tax on dividends than 22 percent may be able to make claims for repayment of the difference from HM Revenue & Customs.
- If a REIT pays a dividend in excess of 90 percent of its exempt rental income, it will be able to choose in many cases as to whether this is an additional PID or a normal dividend. It is therefore expected that many REITs will pay both PIDs and normal dividends to their shareholders in any one year.

Tables

- The tables on the next page show how PIDs and normal dividends will be taxed on different classes of shareholder.
- For many shareholders, a higher rate is suffered on PIDs than on normal dividends. This reflects the fact that the profits distributed by PIDs are exempt from tax within the REIT.
- The tables on the third page illustrate this point by showing the combined effect of tax at company and shareholder level.
- The tables ignore the effect of foreign taxes, if any.

Taxation of different shareholder classes

UK higher rate tax payer		
	PID	Normal dividend
Profit distribution	100	100
Withholding tax	(22)	-
Additional tax to (pay)/reclaim	(18)	(25)
Net cash receipt after tax	60	75
UK basic rate tax payer		
	PID	Normal dividend
Profit distribution	100	100
Withholding tax	(22)	-
Additional tax to (pay)/reclaim	-	-
Net cash receipt after tax	78	100
UK Pension Fund		
	PID	Normal dividend
Profit distribution	100	100
Withholding tax	-	-
Additional tax to (pay)/reclaim	-	-
Net cash receipt after tax	100	100
Non resident shareholder (non-treaty)		
	PID	Normal dividend
Profit distribution	100	100
Withholding tax	(22)	-
Additional tax to (pay)/reclaim	-	-
Net cash receipt after tax	78	100
Non resident shareholder (treaty country ¹)		
	PID	Normal dividend
Profit distribution	100	100
Withholding tax	(22)	-
Additional tax to (pay)/reclaim	7	-
Net cash receipt after tax	85	100
PEPs/ISAs/CTFs		
	PID	Normal dividend
Profit distribution	100	100
Withholding tax	-	-
Additional tax to (pay)/reclaim	-	-
Net cash receipt after tax	100	100
Authorised unit trust/OEIC ²		
	PID	Normal dividend
Profit distribution	100	100
Withholding tax	-	-
Additional tax to (pay)/reclaim	(20)	-
Net cash receipt after tax	80	100
UK corporate		
	PID	Normal dividend
Profit distribution	100	100
Withholding tax	-	-
Additional tax to (pay)/reclaim	(30)	-
Net cash receipt after tax	70	100

Source: KPMG LLP (UK)

Notes

- 1 Treaty withholding rate is assumed to be 15 percent.
- 2 PIDs received by AUT/OEIC are treated as property income. They can be received gross as OEICs/AUTs are treated in the same way as a UK corporate for withholding tax purposes. A distribution of this income by the AUT/OEIC to its unit holders is treated as a normal dividend (i.e., with non repayable tax credit).

Overall tax efficiencies of a REIT: illustration

- The tables on this page illustrate how the benefit of REIT status can lead to higher shareholder returns overall.
- The tables show the position for (1) an ISA investment (2) a direct investment by a higher rate shareholder and (3) a direct investment by a basic rate shareholder.
- Each example compares investing in a REIT vs a normal company and shows the net dividend received assuming profit before tax in the company and maximum distribution.
- The amount available to distribute is significantly greater in a REIT as a result of its tax free status at corporate level.
- The position will vary for different investors, but the combined tax rate for the REIT and investor will be lower in many cases.

Investment made via ISA	
REIT	
Profit before tax	100
Tax at company level	-
Profits available to distribute	100
Dividend (PID)	100
Withholding tax	-
Additional tax to (pay)/reclaim	-
Net cash receipt for investor	100
Normal company	
Profit before tax	100
Tax at company level	(30)
Profits available to distribute	70
Dividend (normal)	70
Withholding tax	-
Additional tax to (pay)/reclaim	-
Net cash receipt for investor	70

Direct investment by higher rate shareholder	
REIT	
Profit before tax	100
Tax at company level	-
Profits available to distribute	100
Dividend (PID)	100
Withholding tax	(22)
Additional tax to (pay)/reclaim	(18)
Net cash receipt for investor	60
Normal company	
Profit before tax	100
Tax at company level	(30)
Profits available to distribute	70
Dividend (normal)	70
Withholding tax	-
Additional tax to (pay)/reclaim	(17.5)
Net cash receipt for investor	52.5

Direct investment by basic rate shareholder	
REIT	
Profit before tax	100
Tax at company level	-
Profits available to distribute	100
Dividend (PID)	100
Withholding tax	(22)
Additional tax to (pay)/reclaim	-
Net cash receipt for investor	78
Normal company	
Profit before tax	100
Tax at company level	(30)
Profits available to distribute	70
Dividend (normal)	70
Withholding tax	-
Additional tax to (pay)/reclaim	-
Net cash receipt for investor	70

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