

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 ('withholding tax': 22 percent for the tax year 07/08 and 20 percent for dividends paid from 6 April 2008 i.e the tax year 08/09).
- Regulations provide that PIDs may be paid without deduction of tax to certain classes of shareholder, in particular UK companies, charities, local authorities, UK pension schemes, Property Authorised Investment Funds and managers of ISAs/child trust funds.
- Such shareholders are generally required to make an application to the REIT to receive PIDs without deduction of tax. You can [download](#) pro forma application forms for both beneficial owners of REIT shares and intermediaries from the Reita.org library, in the Useful Forms section.
- Tax deducted is credited against the shareholder's own tax liability on the PID. Shareholders whose rate of tax is less than 22 percent (for 07/08) or 20 percent (for 08/09) or who do not pay tax at all (perhaps because of personal allowances or other reliefs), can reclaim the difference from HM Revenue and 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 (for 07/08) or 20 percent (for 08/09) may be able to make claims for repayment of the difference from HM Revenue and 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. They reflect the rates applicable for both the tax years 07/08 and 08/09.
- 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	07/08	08/09	
	PID	PID	Normal dividend
Profit distribution	100	100	100
Withholding tax	(22)	(20)	-
Additional tax to (pay)/reclaim	(18)	(20)	(25)
Net cash receipt after tax	60	60	75
UK basic rate tax payer	07/08	08/09	
	PID	PID	Normal dividend
Profit distribution	100	100	100
Withholding tax	(22)	(20)	-
Additional tax to (pay)/reclaim	-	-	-
Net cash receipt after tax	78	80	100
UK Pension Fund	07/08	08/09	
	PID	PID	Normal dividend
Profit distribution	100	100	100
Withholding tax ¹	-	-	-
Additional tax to (pay)/reclaim	-	-	-
Net cash receipt after tax	100	100	100
Non resident shareholder (non-treaty)	07/08	08/09	
	PID	PID	Normal dividend
Profit distribution	100	100	100
Withholding tax	(22)	(20)	-
Additional tax to (pay)/reclaim	-	-	-
Net cash receipt after tax	78	80	100
Non resident shareholder (treaty country ²)	07/08	08/09	
	PID	PID	Normal dividend
Profit distribution	100	100	100
Withholding tax	(22)	(20)	-
Additional tax to (pay)/reclaim	7	5	-
Net cash receipt after tax	85	85	100
ISAs/CTFs	07/08	08/09	
	PID	PID	Normal dividend
Profit distribution	100	100	100
Withholding tax ¹	-	-	-
Additional tax to (pay)/reclaim	-	-	-
Net cash receipt after tax	100	100	100
Authorised unit trust/OEIC ³ excluding (Property Authorised Investment Funds ⁴ (PAIFs))	07/08	08/09	
	PID	PID	Normal dividend
Profit distribution	100	100	100
Withholding tax ¹ on PID	-	-	-
Additional tax to (pay)/reclaim	(20)	(20)	-
Net cash receipt after tax	80	80	100
UK corporate	07/08	08/09	
	PID	PID	Normal dividend
Profit distribution	100	100	100
Withholding tax ¹	-	-	-
Additional tax to (pay)/reclaim	(30)	(28)	-
Net cash receipt after tax	70	72	100

Source: KPMG LLP (UK)

Notes

- 1 An application must be made to the relevant REIT to receive PIDs gross.
- 2 Treaty withholding rate is assumed to be 15 percent.
- 3 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/share-holders is treated as a normal dividend (i.e., with non repayable tax credit).
- 4 Property Authorised Investment Funds (PAIFs) are able to invest in REITs and PIDs received are treated as property income. PIDs can be received gross and can be distributed to PAIF shareholders as a property income distribution which may be subject to withholding tax at the basic rate depending on the tax status of the investor.

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	07/08	08/09
Profit before tax	100	100
Tax at company level	-	-
Profits available to distribute	100	100
Dividend (PID)	100	100
Withholding tax	-	-
Additional tax to (pay)/reclaim	-	-
Net cash receipt for investor	100	100
Normal company	07/08	08/09
Profit before tax	100	100
Tax at company level	(30)	(28)
Profits available to distribute	70	72
Dividend (normal)	70	72
Withholding tax	-	-
Additional tax to (pay)/reclaim	-	-
Net cash receipt for investor	70	72

Direct investment by higher rate shareholder		
REIT	07/08	08/09
Profit before tax	100	100
Tax at company level	-	-
Profits available to distribute	100	100
Dividend (PID)	100	100
Withholding tax	(22)	(20)
Additional tax to (pay)/reclaim	(18)	(20)
Net cash receipt for investor	60	60
Normal company	07/08	08/09
Profit before tax	100	100
Tax at company level	(30)	(28)
Profits available to distribute	70	72
Dividend (normal)	70	72
Withholding tax	-	-
Additional tax to (pay)/reclaim	(17.5)	(18)
Net cash receipt for investor	52.5	54

Direct investment by basic rate shareholder		
REIT	07/08	08/09
Profit before tax	100	100
Tax at company level	-	-
Profits available to distribute	100	100
Dividend (PID)	100	100
Withholding tax	(22)	(20)
Additional tax to (pay)/reclaim	-	-
Net cash receipt for investor	78	80
Normal company	07/08	08/09
Profit before tax	100	100
Tax at company level	(30)	(28)
Profits available to distribute	70	72
Dividend (normal)	70	72
Withholding tax	-	-
Additional tax to (pay)/reclaim	-	-
Net cash receipt for investor	70	72

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