

REITs – They Have Arrived

The Minister for Finance flagged in the budget in December 2012 that legislation enabling the formation of Irish real estate investment trusts (REITs) would be included in the Finance Act 2013. Details of what is proposed have now been published in the Finance Bill, which should become law in early April 2013.

What is a REIT?

Despite its name (real estate investment trust), an Irish REIT will be an Irish company incorporated under the Irish Companies Acts which will not be liable to corporation tax on certain income and capital gains flowing from a property rental business, provided certain conditions are met.

REITs are not collective investment undertakings and so will not be subject to regulatory provisions that apply to regulated funds. In particular, REITs will not be subject to the provisions of the Alternative Investment Fund Managers Directive which is causing some heartache across Europe at present.

What type of conditions are we talking about?

The Bill sets out a number of conditions relating to (i) the company itself, (ii) its property rental business, (iii) diversification, and (iv) its shareholders. They include:

- the company must be tax resident in Ireland and not resident elsewhere;
- it must be incorporated under the Irish Companies Acts;
- its shares must be listed on the main market of a recognised stock exchange in a member state of the EU;
- it must not be a close company (broadly a tax concept applying to a company controlled by a small number of people) though there are certain exceptions from this requirement where the REIT is under the control of qualifying investors, which includes collective investment undertakings.

There is a three year grace period commencing on the date that the company becomes a REIT to comply with the listing requirements and the prohibition on being a close company.

As regards the operations of a REIT, the following requirements will need to be met:

- 75% of its aggregate income must be derived from carrying on a property rental business;
- it must conduct a property rental business consisting of at least three properties, the market value of no one of which is more than 40% of the total market value of the properties constituting the property rental business;
- it must maintain a property financing cost ratio of at least 1.25:1 (being the ratio of rental income to financing costs);
- subject to having sufficient distributable reserves, the REIT must distribute at least 85% of its property income for each accounting period.

Again, there is a three year grace period regarding the requirements to hold at least three properties with no one equating to more than 40% of the total market value of the properties constituting the property rental business.

In addition, a REIT has two years to invest disposal proceeds, where it disposes of a property that constitutes part of its property rental business, or cash raised from the issue of ordinary shares.

Taxation of Shareholders

Dividends

In general shareholders, in a REIT will be subject to corporation or income tax/PRSI/USC in respect of dividends received and capital gains tax in respect of gains made in respect of its investment in a REIT. It should be noted that Irish resident corporate shareholders will be taxable on dividends received which is not the case with other dividends from non REIT Irish companies.

A REIT will be obliged to deduct 20% dividend withholding tax from dividends paid by it, including to foreign tax exempt investors, though some of these investors may be entitled to reclaim amounts withheld or claim a credit in their country of residence under the terms of double tax treaties.

Capital gains

Non resident investors will not be subject to Irish capital gains tax on a disposal of shares in a REIT but may be subject to tax on their country of residence. Taxable Irish resident investors will be subject to 33% capital gains tax on any such gains.

In addition, a REIT may be subject to tax in certain cases where a person directly or indirectly holds 10% or more of a REIT or is entitled to 10% or more of dividends. Again there is a three year grace period in respect of shareholders who hold more than 10% as a result of the company in question becoming a REIT.

What are the taxation costs of converting to a REIT?

Thankfully, no conversion charge has been included in the Bill. However a company that converts to a REIT will be deemed for CGT purposes to have sold its assets immediately before becoming a REIT and reacquired them on becoming a REIT, at market value on the day it becomes a REIT.

Additionally where an asset which was used for the property rental business of a REIT ceases to be so used, it will be treated, for CGT purposes, as having been disposed of by the REIT and reacquired by it at market value. Similar provisions apply to assets of a REIT that ceases to be a REIT.

Other Matters

Finally, the Bill includes an anti-avoidance provision and provisions enabling a parent company and wholly owned subsidiaries enjoy the benefits of the REIT legislation where the parent company and, as applicable, the subsidiaries meet the relevant requirements.

What next?

This note has been prepared on the basis of the Bill which, as with all legislation, is subject to amendment and so it is possible that some of these requirements may change. We would expect the Bill to be finalised and to become law by early April 2013.

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