

2006 No. 2864

CORPORATION TAX

**The Real Estate Investment Trusts (Breach of Conditions)
Regulations 2006**

<i>Made</i> - - - -	<i>1st November 2006</i>
<i>Laid before the House of Commons</i>	<i>1st November 2006</i>
<i>Coming into force</i> - -	<i>1st January 2007</i>

The Treasury, in exercise of the powers conferred by sections 114 to 116, 122, 129(2) (a) and (b), 134(1) and 144 of the Finance Act 2006 (a), make the following Regulations:

Citation, commencement and interpretation

1.—(1) These Regulations may be cited as the Real Estate Investment Trust (Breach of Conditions) Regulations 2006 and shall come into force on 1st January 2007.

(2) In these Regulations—

“the Commissioners” means the Commissioners for Her Majesty’s Revenue and Customs;

“the holder of excessive rights” means a person falling within section 114(1)(a), (b) or (c) being—

(a) a company as defined in section 832(1) of the Income and Corporation Taxes Act 1988(b); or

(b) an entity which is treated as a body corporate for tax purposes—

(i) in accordance with the law of a territory outside the United Kingdom with which arrangements have been entered into to provide relief from double taxation; or

(ii) in accordance with an international agreement containing such arrangements

where those arrangements have effect by virtue of an Order in Council under section 788 of the Income and Corporation Taxes Act 1988(c);

“MCT” means—

(a) in relation to a company to which Part 4 applies, the rate of tax applicable to the company under section 119(2) (rate of corporation tax: profits of C (residual)); and

(b) in relation to a group to which Part 4 applies, the rate of tax applicable to the members of the group under section 119(2) as modified by virtue of paragraph 17 of Schedule 17; and

(a) 2006 c. 25.

(b) 1988 c. 1. There are amendments to section 832, but none is relevant for present purposes.

(c) Section 788 was amended by paragraph 1 of Schedule 30 to the Finance Act 2000 (c. 17), section 88 of the Finance Act 2002 (c. 23), paragraph 321 of Schedule 1 to the Income Tax (Trading and Other Income) Act 2005 (c. 5) and section 176 of the Finance Act 2006 and partly repealed by the relevant entries in Part II(13) of Schedule 40 to the Finance Act 2000, Part 8(2) of the Finance Act 2003 and in Part 8(2) of Schedule 26 to the Finance Act 2006.

a reference (without more) to a numbered provision of the Finance Act 2006, is a reference to the provision bearing that number.

(3) The following provisions of these Regulations, other than regulations 10 and 12, apply to groups to which Part 4 applies as they apply to companies to which that Part applies, and for that purpose references in the following regulations to the company are to the principal company save that the references in regulations 6, 8 and 9 are to be read as references to the group.

Breach of conditions in section 106

Breach of conditions for company — take-overs

2.—(1) This regulation applies if a company to which Part 4 applies breaches Conditions 3 and 4 in section 106 in consequence of its becoming a member of a group (or another group) to which that Part applies.

(2) Part 4 shall continue to apply despite the breach.

Breach of condition for company — actions of others

3.—(1) This regulation applies if a company to which Part 4 applies breaches Condition 4 in section 106 where the breach is caused by someone other than the company.

(2) Part 4 shall continue to apply to the company, despite the breach, provided that the breach is remedied not later than the end of the accounting period following that in which it began.

(3) But if the breach is not remedied before the end of the accounting period following that in which it began, Part 4 shall be taken to have ceased to apply to the company at the end of the accounting period in which the breach began.

Breach of condition for company — other

4.—(1) This regulation applies if a company to which Part 4 applies breaches Condition 3 or 4 in section 106 in respect of an accounting period where the breach arises in circumstances other than those specified in regulations 2 and 3.

(2) Part 4 shall be taken to have ceased to apply to the company at the end of the previous accounting period.

Breach of conditions in section 107

Breach of requirements as to properties

5.—(1) This regulation applies in relation to breaches of Condition 1 (minimum number of properties) or Condition 2 (individual property not to represent more than 40% of the total value of the property value business) in section 107.

(2) For the purposes of section 129(2)(a) (number of breaches during a specified period which are to be disregarded)—

- (a) the number of occasions on which the company can rely on this regulation in respect of a breach of either Condition 1 or Condition 2 in an accounting period is two; and
- (b) the specified period is the ten year period beginning on the day on which the company first failed to satisfy one of those condition and ending immediately before the tenth anniversary of that day.

(3) Any breach of Condition 2 which is a necessary consequence of a contemporaneous breach of Condition 1 shall be disregarded in computing the number of breaches of—

- (a) Condition 2; and
- (b) the total number of breaches;

during any ten year period.

But the breach of Condition 1 giving rise to the breach of Condition 2 shall not be so disregarded.

This is subject to the following qualifications.

(4) If a breach of Condition 1 or 2 lasts for more than one, but not more than two, accounting periods, it constitutes only one breach for the purposes of paragraph (2).

(5) If in any three consecutive accounting periods a company fails to satisfy at least one of Conditions 1 and 2 the breach is not to be considered as minor and the company may not rely upon this regulation for the purposes of section 129(2)(a).

Breach of distribution condition

6.—(1) This regulation applies to a company which has not satisfied (to the extent required) Condition 4 in section 107 for an accounting period.

(2) Part 4 shall continue to apply to the company despite the failure.

But this is subject to the rest of this regulation.

(3) Where a company has not satisfied Condition 4 in section 107 the amount computed in accordance with paragraph (4) shall be charged to corporation tax as if it were income of C (residual) chargeable to tax under Case VI of Schedule D at *MCT*.

(4) The amount is—

$$P - D$$

Here—

P is 90% of the profits of the property rental business arising in the accounting period referred to in section 107(8); and

D is the gross amount of profits of the property rental business distributed in respect of the accounting period on or before the date set out in section 107(8)(b) or on any later date that the Commissioners may specify.

(5) No tax shall be charged if —

(a) the company declares and pays an additional dividend within 3 months following the date on which the profits of the property rental business as calculated in accordance with section 120 can no longer be altered; and

(b) the payment of the additional dividend results in the total amount of profits distributed in respect of the accounting period being 90% or more of the profits of the property rental business in that accounting period.

(6) Any additional dividend declared and paid by the company which is taken into account under this regulation must be disregarded for the purposes of determining whether or not the company has met Condition 4 in section 107 in respect of another accounting period.

(7) Profits relating to a different accounting period shall not be taken into account when calculating whether the condition in section 107(8) has been met.

(8) No loss, deficit, expense or allowance may be set off against the amount charged to tax by paragraph (3).

Breach of conditions in section 108

Breach of balance of business conditions

7.—(1) This regulation applies to a company to which Part 4 applies and which has not satisfied the requirements of Condition 1 or 2 in section 108 in respect of an accounting period.

(2) Part 4 shall continue to apply to the company, despite a breach of Condition 1 in section 108, provided that the profits arising from tax-exempt business referred to in section 108(2) are not less than 50% of the company's total profits for that accounting period.

(3) Part 4 shall continue to apply to the company, despite a breach of Condition 2 in section 108, provided that the value of the assets involved in tax-exempt business referred to in section 108(2) have not fallen below 50% of the total value of assets held by the company.

(4) But where a company fails to satisfy the requirement of Condition 1 or 2 in section 108 in any three consecutive accounting periods the breach is not to be considered as minor and the company may not rely upon this regulation for the purposes of section 129(2)(a).

(5) For the purposes of section 129(2)(a)—

- (a) the specified number of occasions on which the company can rely on this regulation is—
 - (i) two in respect of a breach of Condition 1; and
 - (ii) two in respect of a breach of Condition 2; and
- (b) the specified period is the ten year period beginning on the day on which the company first failed to satisfy the condition set out in section 108(2) or (3) and ending on the day immediately before the ten year anniversary of that period.

General provisions about breaches under sections 106 to 108

Multiple breaches of separate conditions

8.—(1) This regulation applies in relation to a company to which Part 4 applies where—

- (a) there has been a breach of at least two of the conditions in sections 106 to 108; and
- (b) at least one of the conditions breached is contained in a different section from that containing another of those breached.

(2) For the purposes of section 129(2)(a)—

- (a) the specified number of occasions on which the company can rely on regulation 2, 3, 5 or 7 of these Regulations is four;
- (b) the specified period is the ten year period beginning on the day on which the company first failed to satisfy the condition set out in section 106(5), or (6), 107 or 108 and ending on the day immediately before the ten year anniversary of that period; and
- (c) in reckoning the number of breaches of sections 106 to 108, breaches of Condition 3 or 4 in section 106 in consequence of a company to which Part 4 applies becoming part of a group (or of another group) to which that Part applies shall be disregarded.

Breach of condition — information requirements

9.—(1) This regulation applies if a company fails to satisfy a requirement set out in section 106(5) or (6), 107 or 108 (“a relevant failure”).

(2) Once a company becomes aware of a relevant failure it must provide the Commissioners as soon as reasonably practicable with the following information—

- (a) the date on which the requirement first ceased to be met and the date (if any) on which the requirement was satisfied again;
- (b) details of the requirement that was breached;
- (c) the nature of the breach; and
- (d) what (if anything) the company has done to avoid the breach recurring.

Breach of section 114: maximum shareholding

Distribution to a person with more than the maximum shareholding: charge to tax

10.—(1) If—

- (a) a company to which Part 4 applies, or the principal company of a group to which Part 4 applies, (“the distributor”) makes a distribution to, or in respect of, the holder of excessive rights, and
- (b) the distributor has not taken reasonable steps to prevent the possibility of such a distribution being made,

the distributor is to be treated as having received an amount of income computed in accordance with paragraph (2).

(2) The amount is that found by the formula—

$$\left(DO \times SO \times \left(\frac{BRT}{MCT} \right) \right) + \left(DP \times SP \times \left(\frac{BRT}{MCT} \right) \right)$$

Here—

DO is the total amount of the profits of C (tax-exempt) distributed in respect of ordinary shares;

SO is the lesser of the percentage of rights—

(a) in respect of those ordinary shares held by the holder of excessive rights; and

(b) held by the recipient of the distribution;

in respect of which a distribution is made;

BRT is the basic rate of tax in force at the time the distributor distributed the income;

DP is the total amount of profits of C (tax-exempt) distributed by the distributor in respect of preference shares; and

SP is the lesser of the percentage of rights—

(c) in respect of preference shares held by the holder of excessive rights; and

(d) held by the recipient of the distribution;

in respect of which a distribution is made;.

(3) The amount specified in paragraph (2) shall be charged to corporation tax as if it were income of C (residual) chargeable under Case VI of Schedule D arising in the accounting period in which the distributions referred to in paragraph (2) were made by the company.

(4) The rate of tax applicable to that amount is *MCT*.

(5) No loss, deficit, expense or allowance may be set off against the amount charged to tax by paragraph (3).

Distribution to holder of excessive rights: information

11.—(1) This regulation applies if a company to which Part 4 applies makes a distribution to, or in respect of, a holder of excessive rights.

(2) When the company makes its return under regulation 4 of the Real Estate Investment Trusts (Assessment and Recovery of Tax) Regulations 2006 (a) for the quarter in which the date of any distribution falls, the company must provide the Commissioners with the following information—

(a) the name and address of every person to, or in respect of, whom the distribution was made;

(b) the amount or value of the distribution;

(c) particulars of those persons' interests in the company including details of the percentages they form of the total issued share capital, ordinary share capital or any other share capital of the company;

(d) particulars of the transaction giving rise to the distribution; and

(e) what (if anything) the company has done to avoid the possibility of such a distribution being made.

(a) S.I. 2006/ 2867.

Charge to tax where profit: financing-cost ratio less than 1.25 – Real Estate Investment Trusts which are not Group Real Estate Investment Trusts

12.—(1) This regulation applies in the case of a company to which Part 4 applies, if the result of the sum specified in section 115(2) is less than 1.25 in respect of an accounting period.

(2) The amount by which—

- (a) the company's financing costs (as defined in section 115(2)(a)) exceeds
- (b) the amount of those costs which would cause the sum specified in section 115(2) to equal 1.25

shall be chargeable to tax as income of C(residual) on which corporation tax is chargeable under Case VI of Schedule D for the accounting period in which the excess arises.

(3) The amount charged to tax by paragraph (2) shall be charged at *MCT*.

(4) No loss, deficit, expense or allowance may be set off against the amount charged to tax by paragraph (2).

Charge to tax where profit: financing-cost ratio – Group Real Estate Investment Trusts

13.—(1) This regulation applies in the case of a group to which Part 4 applies if the result of the sum specified in section 115(2), as substituted by paragraph 14 of Schedule 17, is less than 1.25 in respect of an accounting period.

(2) The amount by which—

- (a) Financing Costs (External) (as defined in section 115(2)(c) as substituted by paragraph 14 of Schedule 17) exceeds
- (b) the amount of those costs which would cause the sum specified in section 115(2) to equal 1.25

shall be chargeable under Case VI of Schedule D as income of the residual part of the principal company of the group to which Part 4 applies for the accounting period in which the excess arises.

(3) The amount charged to tax by paragraph (2) shall be charged at *MCT*.

(4) No loss, deficit, expense or allowance may be set off against the amount charged to tax by paragraph (2).

Termination by notice after service of notices cancelling tax advantage

Termination by notice – specified number of section 117 notices

14. For the purposes of section 129(2)(b) (specified number of notices under section 117)—

- (a) the specified number of notices is two; and
- (b) the specified period is the period commencing with the day on which the first notice was issued and ending immediately before the tenth anniversary of that day.

*Dave Watts
Kevin Brennan*

1st November 2006

Two of the Lords Commissioners of Her Majesty's Treasury

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations make provision about the consequences flowing from a breach of the conditions in Part 4 of the Finance Act 2006 (c. 25 “the Act”), or a breach of the profit: financing costs ratio in section 115(2) of the Act, applying to a Real Estate Investment Trust.

Regulation 1 deals with the citation and commencement of the Regulations, and provides modifications for the application of the Regulations to Group Real Estate Investment Trusts.

Regulation 2 provides that, notwithstanding a breach of Conditions 3 and 4 in section 106 in consequence of a company’s becoming a member of a group or another group to which Part 4 of the Act applies, that Part is to continue to apply to the company.

Regulation 3 provides that, notwithstanding a breach of Condition 4 in section 106 caused by someone other than the company, Part 4 of the Act shall continue to apply provided that the breach is remedied no later than the end of the accounting period following that in which it began.

Regulation 4 provides that if a company breaches Condition 3 or Condition 4 in section 106 otherwise than in circumstances specified in regulation 3 or 4, Part 4 is taken to have ceased to apply to the company at the end of the previous accounting period.

Regulation 5 provides for the consequences of breaches of the property-holding conditions in section 107.

Regulation 6 provides for the consequences of the breach of the distribution condition in section 107.

Regulation 7 provides for the breach of the balance of business conditions.

Regulation 8 provides for the consequences of multiple breaches of separate conditions in different sections of Part 4.

Regulation 9 prescribes information requirements in respect of breaches of the conditions in sections 106(5) or (6), 107 or 108 of the Act.

Regulation 10 imposes a charge to tax where there is a distribution to a person holding more than the maximum permitted shareholding in a company to which Part 4 applies, and regulation 11 imposes obligations about the furnishing of information about such a distribution.

Regulation 12 imposes a charge to tax where the ratio of profit to financing costs is less than 1.25.

Regulation 13 imposes a similar charge in the case of a Group Real Estate Investment Trust.

Regulation 14 provides for the termination of the Real Estate Investment Trust régime under section 129(2)(b) where two notices under section 117 have been served within a ten year period.

A regulatory impact assessment for the introduction of the UK Real Estate Investment Trust regime was published in March 2006 and can be found at www.hmrc.gov.uk/ria.

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