

**EXPLANATORY NOTE**

**CLAUSE 65 SCHEDULE 34: REAL ESTATE INVESTMENT TRUSTS**

**AMENDMENT 47**

**SUMMARY**

1. The amendment to Schedule 34 makes changes to Section 115 of Finance Act 2006. Section 115 and the regulations made under it impose a tax charge on a REIT when the ratio of its profits to financing costs falls below 1.25. The ratio is known as the profit: financing-cost ratio.
2. The amendment allows HMRC to waive the tax charge when a REIT, which is in severe financial difficulties, breaks the limit of the profit: financing-cost ratio because of circumstances that arose unexpectedly and where the REIT could not reasonably have taken action to avoid breaching the profit: financing-cost ratio limit.

**DETAILS OF THE AMENDMENT TO SCHEDULE 34**

3. Paragraph 5A amends section 115 of Finance Act 2006 (Profit: financing-cost ratio). The amendment, which introduces new sections 3A and 3B to section 115, is retrospective and applies in respect of accounting periods that end before the amendment comes into force.
4. New section 3A will allow HMRC Commissioners to waive the charge incurred by a REIT for breaching the profit: financing-cost ratio limit in particular circumstances. The charge arises when in respect of an accounting period the ratio of profits from the property rental business, to financing costs incurred in respect of that business, falls below 1.25. The charge, which is to Corporation Tax, is on that part of the financing costs as a result of which the ratio falls below 1.25.
5. The circumstances in which the Commissioners may waive the charge are limited to where the REIT is in severe financial difficulties at a time in the accounting period, the profit: financing-cost ratio is below 1.25 due to circumstances that arose unexpectedly, and the REIT could not reasonably have taken action to avoid the breach of the profit: financing-cost ratio.
6. Section 3B provides that the regulations may specify criteria to be applied by the Commissioners in determining whether to waive a charge. However, such regulations do not have to be made for new section 3A to have effect.

**BACKGROUND NOTE**

7. The Real Estate Investment Trusts regime was introduced by Finance Act 2006 and came into effect on 1 January 2007. A REIT is exempt from UK tax on income and gains of its property rental business but pays tax on the profits and gains from other activities.
8. Companies and groups of companies whose main business is the rental of property to tenants can elect to become Real Estate Investment Trusts, subject to meeting certain conditions.
9. Once inside the regime, a REIT is limited in the amount of finance costs that it can incur as a proportion of the profits before financing costs that it makes from the property rental business. If this limit is breached then there is a charge to tax on the amount by which the limit is breached. The purpose of this tax charge is to protect the Exchequer and the investor by discouraging excessive borrowing, ensuring that profits are available for distribution to shareholders who pay the tax on them.
10. The amendment will allow the charge to tax to be waived where companies in severe financial difficulties breach the limit imposed by the profit: financing-cost ratio due to unexpected circumstances, and where the company could not reasonably have taken action to avoid breaching the limit.

Mr Chancellor of the Exchequer

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Page 290, line 24 Schedule 34, at end insert—

*Profit: financing-cost ratio*

5A (1) In section 115 (profit: financing-cost ratio), after subsection (3) insert—

“(3A) The Commissioners for Her Majesty’s Revenue and Customs may waive a charge in respect of an accounting period where they think that—

- (a) the company was in severe financial difficulties at a time in the accounting period,
- (b) the result of the sum specified in subsection (2) is less than 1.25 in respect of the accounting period because of circumstances that arose unexpectedly, and
- (c) in those circumstances, the company could not reasonably have taken action to avoid the result being less than 1.25.

(3B) The regulations may specify criteria to be applied by the Commissioners in determining whether to waive a charge.”

(2) The Commissioners may waive a charge in respect of accounting periods ending before the day on which this Act is passed.’.