Finance Bill 2009

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PRICEWATERHOUSECOOPERS

Finance Bill 2009

A number of changes affecting the real estate industry were announced when the Chancellor delivered his 2009 Budget Report on 22 April 2009. Apart from a couple of exceptions, the targeted measures were largely technical in nature.

More details of the announcements are available in the PricewaterhouseCoopers **Real Estate Budget Summary** issued on Budget day.

The publication of the draft Finance Bill 2009 on 30 April 2009 provided clarification on some areas of uncertainty, but also raised some additional concerns.

Taxation of foreign profits – debt cap

Following the release of the debt cap provisions in the Finance Bill 2009, PwC submitted representations to HMRC which, among other things, identified the following concerns:

Debits and credits arising on loan relationships of property investment partnerships (or other entities that are tax transparent for income purposes, e.g. certain property unit trusts) are reflected as loan relationship debits and credits in the tax returns of the corporate partners in the partnership. For accounts purposes however, the results of a partnership are not always reflected in a group's consolidated income statement. Where a group does not consolidate the results of the partnership, loan relationship debits relating to the partnership would be included in the 'tested amount', but would not be included in the 'available amount'.

Government amendments were introduced but it is unclear whether these amendments have dealt with the issue fully.

The Public Bill Committee debated the debt cap provisions on Tuesday 9 June 2009 and during that debate, the Financial Secretary to the Treasury accepted that the current drafting gave rise to a mismatch of tested amount and available amount in certain circumstances. He stated that the Treasury would continue to look at these problems and to consult with interested parties on the issue. He also confirmed that, if solutions could be found,

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additional rules to deal with this would be announced at the Pre-Budget Report to take effect 1 January 2010.

Real Estate Investments Trusts (REIT)

The Government tabled a Finance Bill amendment on 3 July 2009 which aims to remove tax penalties for REITs where they have breached the finance cost ratio for reasons outside their control, e.g. financial hardship. While helpful, the amendment appears to be narrow in its application. Furthermore, there may be specific criteria that need to be met for the charge to be waived, but details have not yet been provided. Removing such penalties was one of the measures raised in representations made by the property industry. The measure was raised again when the Royal Institute of Chartered Surveyors (RICS) represented by Rosalind Rowe of PwC and British Property Federation (BPF) represented by Graham Roberts of British Land recently gave evidence to the House of Lords on changes needed to support the REIT regime in the current credit crisis.

The finance cost ratio was originally designed to stop REITs reducing the amount of tax-exempt profits that are required to be distributed by generating excessive interest deductions. Under the existing legislation finance costs include not only interest costs, but all other related costs including for example, swap and debt break costs. Therefore, where a REIT was required to break an interest swap or buy in debt, the result of this penalty was to unfairly compound the REIT's costs of doing so.

Terminal loss relief

In a written Ministerial Statement on 21 May 2009, the Financial Secretary to the Treasury announced that an amendment to Finance Bill 2009 would be tabled, countering an avoidance scheme that had been disclosed to HMRC.

The scheme used a trade reorganisation to access corporation tax rules on terminal loss relief. These rules provide that losses, arising in a trade in the 12 months before cessation, can be carried back and set off against profits made in the previous three years.

These are highly targeted provisions and therefore are unlikely to be applied, except in those cases where this is a clear avoidance motive behind the reorganisation.

Temporary first-year allowances

The Budget introduced a temporary 40% first-year allowance for expenditure by businesses on certain plant and

machinery in a 12-month period beginning 1 April 2009 for corporation tax purposes, and 6 April 2009 for income tax purposes.

The relief will apply equally to the acquisition of new, unused and second-hand assets.

At the time of the Budget there was uncertainty as to which of the existing exclusions for first-year allowances would apply. Expenditure on assets provided for leasing are excluded from the enhanced relief. However, as anticipated, this exclusion will not apply

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to relevant plant and machinery installed in properties provided for leasing. This relaxation will only apply to plant and machinery of a type that might reasonably be expected to be installed in a variety of buildings. Furthermore, the enhanced relief is not available in respect of expenditure on plant and machinery that qualifies for the reduced special rate of 10%. Consequently, the expenditure affected by this new rate is likely to be limited to expenditure on certain items including (but not limited to) sprinklers, fire alarms, demountable partitions, IT/communication, sanitary ware, catering facilities, signage, intruder alarms/CCTV, fixtures & fittings and carpets.

This is still good news for landlords of core real estate assets, but may be less so for those that lease out specialist buildings, structures and infrastructure assets. It is important to note that in-house property companies are likely to be affected in the same way as external investors of real estate/infrastructure.

As expected, assets acquired from connected parties will not qualify for the first-year allowance.

Offshore funds

The long awaited new definition of an 'Offshore Fund' was published in the Finance Bill 2009. Intended to be effective from 1 December 2009 this new definition represents a move away from the current regulatory basis to a 'characteristics-based' approach in determining what constitutes an 'Offshore Fund'.

HMRC has issued draft guidance on the new definition for further consultation with the investment management industry with a response deadline of 10 July 2009. The guidance can be found at the following link http://www.hmrc.gov.uk/collective/new-offshore-funds.pdf and fund promoters should take steps now to identify the potential impact for both new and existing investors and consider making representations accordingly.

The scope of the new definition is wide-ranging and, as currently drafted, will potentially catch many real estate fund vehicles that are outside the scope of the current UK Offshore Fund rules. Examples of such funds or vehicles include, but are not limited to, the following:

1. Funds where liquidation referable to the asset values of the underlying assets is typically the only exit route for investors;
2. Offshore property holding companies may fall within the scope of the new definition when applying the proposed characteristics.

Welcome exclusions for certain types of property vehicles include, but are not limited to, single-tier arrangements such as Jersey Property Unit Trusts (JPUTs), which are investing directly in property and vehicles that are equivalent to UK REITs.

It will therefore be necessary to consider whether existing funds as well as new funds are impacted by these changes. In particular, current investments in funds made prior to 1 December 2009 will be grandfathered whereas investments made in existing funds after that date will be subject to the new rules.

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