



BECOMING A UK-REIT

PRACTICAL IMPLICATIONS
AND CONSIDERATIONS

IDEAS | PEOPLE | TRUST

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BECOMING A UK-REIT

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1. INTRODUCTION

Since its launch in 2007, the UK-REIT tax regime has become a primary approach to the structuring of collective investment in UK property.

The principal entrants to the regime in the early years were the long-established commercial property investment companies.

A steady stream of entrants have since joined and the regime has continued to go from strength to strength, so that there are now more than 80 UK-REITs.

Recent REIT entrants have focussed upon particular asset classes, such as logistics sheds, medical centres or other such assets. A new trend has been an increase in REITs specialising in residential property.

During the past few years there has been a change in the general tax environment following the OECD's focus on base erosion and profit shifting. This has led to substantial changes being made to UK domestic legislation.

With the introduction of UK tax on gains for non-residents holding UK commercial property from 5 April 2019 and the removal of certain exemptions for non-residents on residential property, we expect further new REIT entrants. This is likely to include non-resident groups looking to move onshore.

The UK-REIT regime remains an HMRC approved structure, which is attractive to a wide range of investors and has helped with the raising of funds in the capital markets for a number of groups.

This guide is intended to provide practical insights into the UK-REIT regime, the main conditions required to be met and issues a potential entrant might want to consider.



The tax environment for investment in the UK real estate has helped make the UK-REIT regime a practical and cost effective option.

2. WHAT IS A UK-REIT?

A UK-REIT is a listed company, or group of companies, whose principal activity is the ownership and management of a real estate portfolio to generate rental income and capital gains for shareholders. UK-REITs are distinguished from other UK property investment companies only by their tax status.

Companies within the UK-REIT regime are exempt from UK corporation tax on rental profits and capital gains deriving from their UK property rental business. In return, the UK-REIT must distribute, within 12 months of each accounting period, 90% of its net property rental income to investors. Such distributions are treated as property income in the hands of shareholders and are generally termed 'property income distributions' ('PIDs'). The effect of this tax treatment is that shareholders obtain broadly similar tax treatment to holding properties directly.

Conditions for becoming a UK-REIT

In addition to the distribution requirement outlined above, there are a number of other conditions that a UK-REIT must satisfy in order to join, or remain within, the UK-REIT regime. A summary of these is included in Appendix B.



A UK-REIT is distinguished from other UK property investment companies only by its tax status.

PRINCIPAL CONCEPTS

"admitted to trading"

A UK-REIT needs to be admitted to trading on a recognised stock exchange for at least part of the first day on which it enters the regime. Thereafter, shares in UK-REITs must either be listed on a recognised stock exchange throughout each accounting period or traded in each accounting period. New entrants to the UK-REIT regime have a more relaxed regime in their first three accounting periods.

An effect of this grace period is that a new UK-REIT listing on AIM has a period of up to three years to meet the share trading requirement which may otherwise be outside its control. The company could, in principle, choose to migrate to a full listing, or a dual listing on another recognised stock exchange such as The International Stock Exchange 'TISE', in order to retain UK-REIT status.

"company or group of companies"

A UK-REIT can be a single company UK-REIT or a group UK-REIT¹. A group for these purposes comprises the parent company (the 'principal' company) and its 75% subsidiaries, and their 75% subsidiaries and so on, provided that the parent company has an effective 51% beneficial interest in the lower tier subsidiaries.

"predominantly property rental business"

A property rental business is defined as 'a business that generates income from land by means of exploiting an estate, interest or right in or over land as a source of rents or other receipts'.

Income derived from a property rental business includes PIDs received from an investment in another UK-REIT.

Certain types of income are not recognised as being derived from a property rental business, including income derived from the operation of a caravan site, income derived from temporary letting of surplus space or from premises that are treated for accounting purposes as owner occupied. Rental income in respect of electric-line wayleaves, gas or oil pipelines, mobile phone masts or wind turbines is similarly not treated as property rental income for these purposes.

¹ In this guide we refer to UK-REIT groups. However, the analysis is equally applicable to a single UK-REIT company

A UK-REIT does not have to be solely a property rental group. There are no restrictions other than scale as to the type of other businesses that the UK-REIT can pursue. The scale limitations are that the UK-REIT's non-property rental business (its 'residual business') must represent no more than 25% of its total profits for each period and no more than 25% of its total assets.

"exempt from tax on rental profits and capital gains deriving from its UK property rental business"

A UK-REIT is generally exempt from UK corporation tax on income and gains of its UK property rental business. The REIT's UK property rental business comprises all property rental business undertaken by UK companies in the group (ie whether the properties are in the UK or overseas) and any rental business of non-UK companies to the extent that it relates to UK properties.

Gains on disposals of investment properties will generally be exempt from tax. There is, however, an exception to this, the so-called 'three-year development rule'. This applies where a property has been developed since acquisition; the cost of the development exceeds 30% of the fair value (as determined by International Accounting Standards) of the property at the later of the date the company acquired the property and the date the company joined the UK-REIT regime; and the company disposes of it within three years of completion of the development to a non-group company.

Where the three-year development rule applies, the gain on the property will generally be subject to UK corporation tax.

Any profits derived from the UK-REIT's 'residual businesses' are subject to corporation tax. Such profits would include, for example, interest income, property management income and any profits on sales of development property held for sale.



"90% of its net property rental income"

The amount required to be distributed is 90% of the aggregate net property rental income derived from the UK property rental businesses of every company in the group. This must be distributed by the parent company of the group to its shareholders.

Net property rental income for these purposes is calculated according to UK tax rather than accounting principles and accordingly, the amount required to be distributed to meet the distribution requirement may not equal 90% of profit before tax per the accounts. Differences may arise as a result of capital allowances (a tax measure of depreciation on expenditure on qualifying assets); fair value movements on financial instruments that are disregarded for tax purposes; revaluation movements; and expenses that are not deductible for tax purposes, eg lease inducement payments or entertainment.

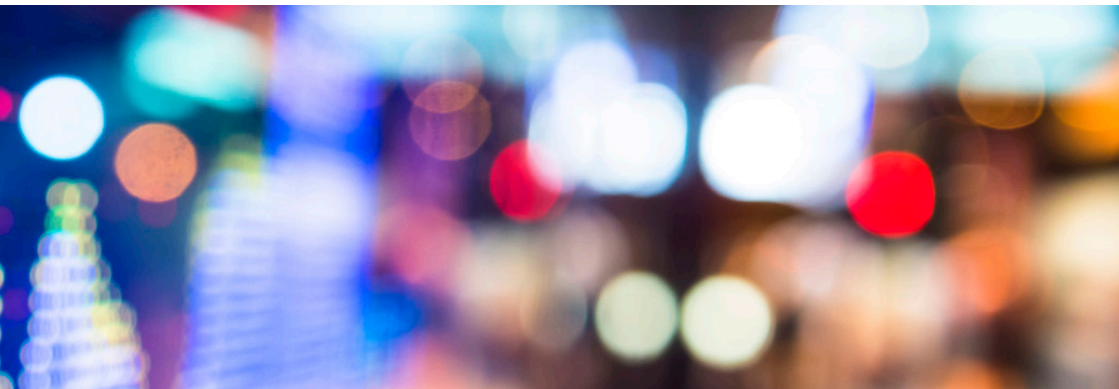
"100% of its UK-REIT investment profits"

A UK-REIT which invests in another UK-REIT is required to distribute to its shareholders 100% of the PIDs received by it.

There is no requirement to distribute any gains derived from the sale of properties or any profits derived from the residual business. To the extent that the former are distributed, they will typically be PIDs and will be treated as property income in the hands of shareholders.

Where a PID is paid, the UK-REIT must withhold tax at a rate of 20%, and pay this over to HMRC, unless the dividend is payable to a specific category of investor, such as a UK company, a registered pension scheme or a charity.

To the extent that profits and gains of the residual business, or book to tax differences of the property rental business, are distributed, these are distributed as normal dividends.



3. POTENTIAL BENEFITS OF BECOMING A UK-REIT

Conversion to UK-REIT status may enable a group to diversify its investor base, facilitate its ability to raise fresh equity and reduce overall gearing.

The key attributes of a UK-REIT which are particularly attractive from an investor perspective are:

- Rental profits and chargeable gains on disposal of investment properties are normally exempt from corporation tax in the UK-REIT. From 6 April 2019 disposals of UK property-rich companies are also exempt from corporation tax. When coupled with the fact that 90% of net property rental profits must be paid out as PIDs each year, this makes a UK-REIT attractive to many investors as it provides for regular returns whilst avoiding the double taxation that investors in property companies may otherwise suffer. Accordingly, shares in a UK-REIT have certain characteristics of a 'fixed income' product. Tax-exempt investors (eg pension funds, charities and certain institutional investors) obtain significant benefit as they will suffer no tax on their investment return.

- The UK-REIT structure is recognised as a favoured property ownership structure by many international investors, some of whom may be prevented from investing in non-REITs. Joining the UK-REIT regime therefore gives property companies access to the 'REIT' brand.
- Investors holding shares in UK-REITs have access to portfolios of properties in the office, retail, industrial and healthcare sectors for a lower capital outlay compared to direct investments and in a more liquid form.

A summary of the effective returns offered to investors by a UK-REIT in comparison to other property investment structures is set out in Section 4.

The UK-REIT regime is a stable regime that is strongly supported by both HM Treasury and HMRC, providing existing and potential UK-REITs with some certainty that the tax profile and advantages of UK-REITs should remain in place for the foreseeable future.

The April 2019 changes to the taxation of non-residents holding UK property may lead to further growth in the number of UK-REITs.

Whilst UK-REITs will remain only one of a number of structuring options available, various tax changes, implemented and mooted, provide an opportunity for all property investors to reconsider whether UK-REIT status would be of benefit to them, either now or in the future.



POTENTIAL UK-REIT CANDIDATES

UK-REIT status may be attractive to the following categories of property investment vehicle:

AIM LISTED / UNLISTED PROPERTY COMPANIES

Property companies whose shares are listed and subject to trading on AIM or equivalent markets are able to convert to UK-REIT status without incurring the cost of obtaining and maintaining a listing on the main market.

OFFSHORE PROPERTY COMPANIES

UK-REIT conversion achieves tax efficiencies for holding UK properties, without the need to maintain an offshore structure, thereby freeing up senior management time and reducing administrative costs. The widening of the taxation of UK real estate capital gains made by non-UK resident investors from April 2019 may further encourage conversion to a UK-REIT.

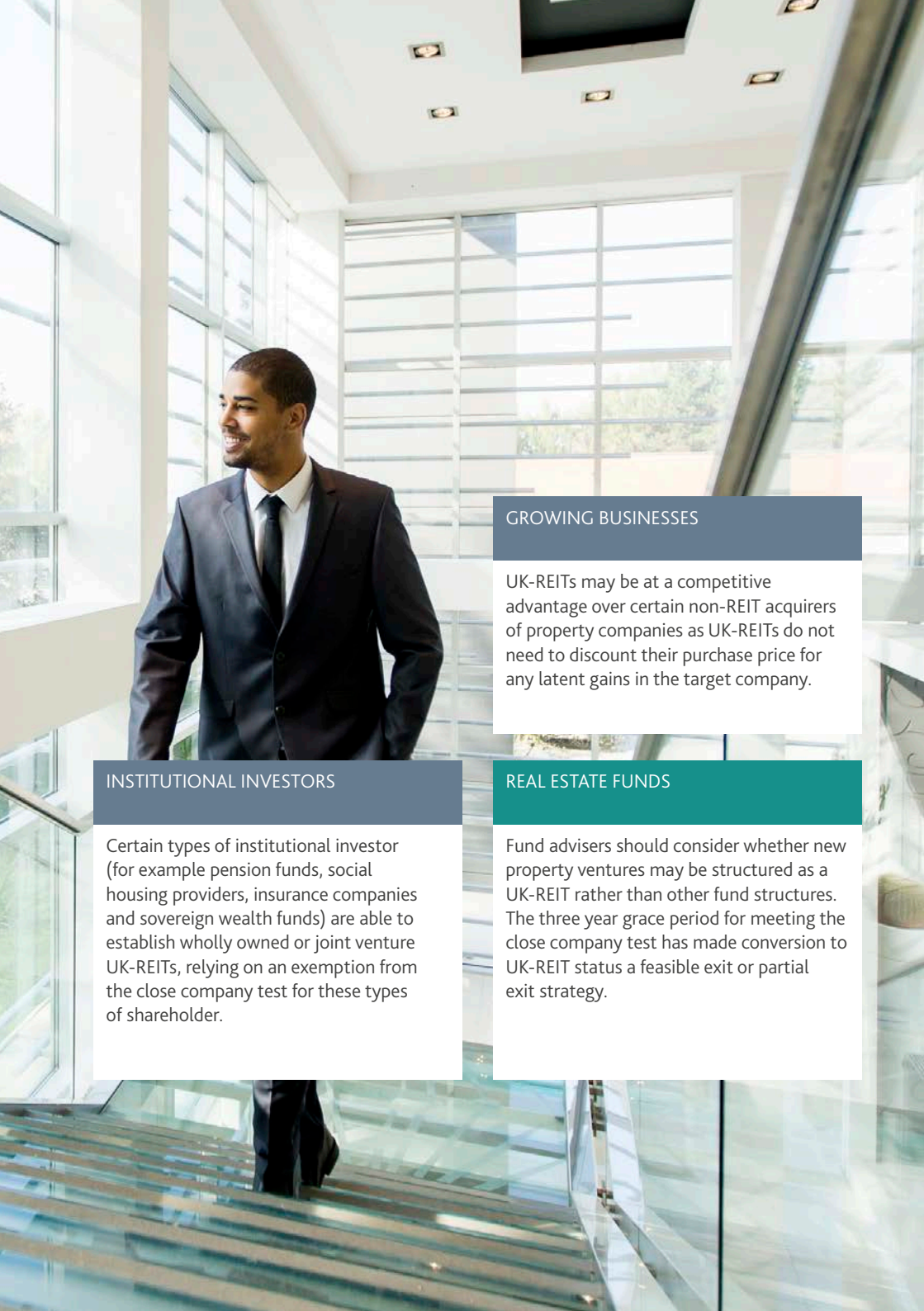
FAMILY-OWNED COMPANIES

Family companies that are considering succession planning, expansion or exit may join the regime prior to widening their shareholder base, utilising the three-year grace period to meet the close company test.

START-UP PROPERTY INVESTMENT COMPANIES

As cash is treated as a 'good' asset for the purposes of the balance of business assets test, it is easier for start-up UK-REITs to raise funds to be spent over time.





GROWING BUSINESSES

UK-REITs may be at a competitive advantage over certain non-REIT acquirers of property companies as UK-REITs do not need to discount their purchase price for any latent gains in the target company.

INSTITUTIONAL INVESTORS

Certain types of institutional investor (for example pension funds, social housing providers, insurance companies and sovereign wealth funds) are able to establish wholly owned or joint venture UK-REITs, relying on an exemption from the close company test for these types of shareholder.

REAL ESTATE FUNDS

Fund advisers should consider whether new property ventures may be structured as a UK-REIT rather than other fund structures. The three year grace period for meeting the close company test has made conversion to UK-REIT status a feasible exit or partial exit strategy.

4. TAXATION IMPLICATIONS FOR SHAREHOLDERS

The following table illustrates the effective UK tax rates suffered by investors in different property investment structures owning UK commercial real estate.

	UK-REIT			OFFSHORE COMPANY		
	INCOME	GAINS	EXIT	INCOME	GAINS	EXIT
UK resident and domiciled	45.0%	45.0%	20.0%	48.6%	48.6%	20.0%
Non-UK resident individuals	20.0%	20.0%	20.0%	17.0%	17.0%	20.0%
UK tax resident company	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%
Non-UK tax resident company	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%
Tax exempt fund	0.0%	0.0%	0.0%	17.0%	17.0%	0.0%

The table illustrates that, with regard to income receipts, investors generally receive an equivalent after tax return through investing in a UK-REIT compared with other commonly used tax efficient property investment structures and in some cases a better return.

The position is different for gains since, to the extent that gains are distributed by a UK-REIT, they are treated as property income in the hands of shareholders and property income is, generally, taxed at a higher rate than either normal corporate dividends or gains. However, in practice, this may not be a significant impediment to investing in a UK-REIT as there is no requirement for UK-REITs to distribute gains on disposals of investment properties.

UK LIMITED PARTNERSHIP			BAKER TRUST			UK COMPANY		
INCOME	GAINS	EXIT	INCOME	GAINS	EXIT	INCOME	GAINS	EXIT
45.0%	20.0%	20.0%	45.0%	20.0%	20.0%	48.6%	48.6%	20.0%
17.0%	20.0%	20.0%	20.0%	20.0%	20.0%	17.0%	17.0%	20.0%
17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%
17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%
0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	17.0%	17.0%	0.0%

The categories of investor that benefit the most from investing in a UK-REIT are the tax-exempt investor who receives the same tax treatment as investing directly in property, but without the additional cost and risk involved with direct ownership; and the UK taxable investor who realises value by selling shares in a UK-REIT that has retained capital gains that have not been subject to tax.

Notes: In compiling the table, certain assumptions have been made with regard to the tax profile of the investors and the structures they would use to hold their investment in a commercial property fund. Tax rates used incorporate the tax rate changes announced, including reduction of the corporation tax rate to 17% from April 2020 and the introduction of changes to the taxation of capital gains arising after 5 April 2019 for non-UK based investors. It has been assumed that property gains are distributed but not for the exit scenario. The position for non-domiciled investors is complex.

5. ISSUES TO CONSIDER PRIOR TO MAKING A DECISION TO JOIN THE UK-REIT REGIME

In addition to the tax implications of joining the UK-REIT regime, there are a number of non-tax issues that potential entrants will need to consider, particularly given the ongoing requirements in order to remain a UK-REIT.

SIZE OF UK PROPERTY BUSINESS

There is no minimum size requirement for a UK-REIT (indeed there are a few UK-REITs with a market capitalisation of less than £50m). However, this is a factor that should be considered when assessing the likely benefit of UK-REIT status against cost. Most established UK-REITs have a market capitalisation in excess of £200m.

UK-REIT status affects only the tax treatment of any UK property rental business undertaken by the UK-REIT. Accordingly, UK-REIT status will be of less relevance to groups with only a small UK presence.

CURRENT STRUCTURE

It may be necessary to restructure certain aspects of the corporate or financing structure of a business prior to joining the UK-REIT regime. This may be either to facilitate compliance with the UK-REIT tests or to minimise tax leakage once within the UK-REIT regime.



UK-REIT status will be of less relevance to companies or groups with only a small UK presence.

Examples of common restructuring undertaken by companies considering entry into the UK-REIT regime include:

UK-REIT REQUIREMENT / OPPORTUNITY	STRUCTURING SOLUTION
Parent company of the UK-REIT group is tax resident only in the UK.	Establishing new parent company on top of the group or transfer management and control of parent company to the UK.
A UK-REIT is required to be admitted to trading on a recognised stock exchange.	Structure of management team may need to change or expand, for example to include non-executive directors. Changes may be required to accounting policies and financial reporting and IT processes and controls to make them appropriate for a publicly listed company. The process and timetable for admission to trading will need to be considered and appropriate advisers engaged.
A UK-REIT may not need to hold properties in SPVs.	Rationalise group by reducing number of subsidiaries or property holding structures, subject to Stamp Tax implications.
Residual income received in the UK-REIT is taxable.	Restructuring of inter-company loan and guarantee arrangements to manage residual income eg internal interest.
Consider internalisation of property management function.	Restructure property management function. This may be preferable from an investor perspective and avoid unnecessary tax costs.
Ensure that any joint ventures are tax efficient once the group is in the UK-REIT regime.	Consider amendment of joint venture notices.
UK-REITs are required to undertake all transactions with related parties on arm's length terms.	Consider the group's transfer pricing policies and whether HMRC approval of the policies should be sought.

INVESTOR BASE

The decision to join the UK-REIT regime will, ultimately, only be made if it is considered to be in the best interests of the holding company's shareholders.

Entry into the UK-REIT regime will have implications for existing shareholders, as set out in Section 4. Being a UK-REIT may make the group more attractive to other types of investors, which may help it to grow.

A UK-REIT cannot be closely held (broadly, under the control of five or fewer participators, or any number of directors who are participators), although there is a grace period such that a new entrant to the UK-REIT regime has up to three years to meet the diverse ownership rule. If the company does not wish to dilute its existing shareholder base, unless there are sufficient institutional investors UK-REIT status may not be appropriate.

FUTURE COMMERCIAL PLANS

Only profits of a UK-REIT's property rental business are exempt from UK tax. As a result, UK-REIT status may not be attractive if the group's forecasts include significant non-property rental business income or assets, for example:

- Development of properties with a view to sale
- Realisation of all investments in the short to medium term
- An intention to hold portfolio investments in other property companies that are not UK-REITS.

CURRENT AND FUTURE FINANCING PLANS

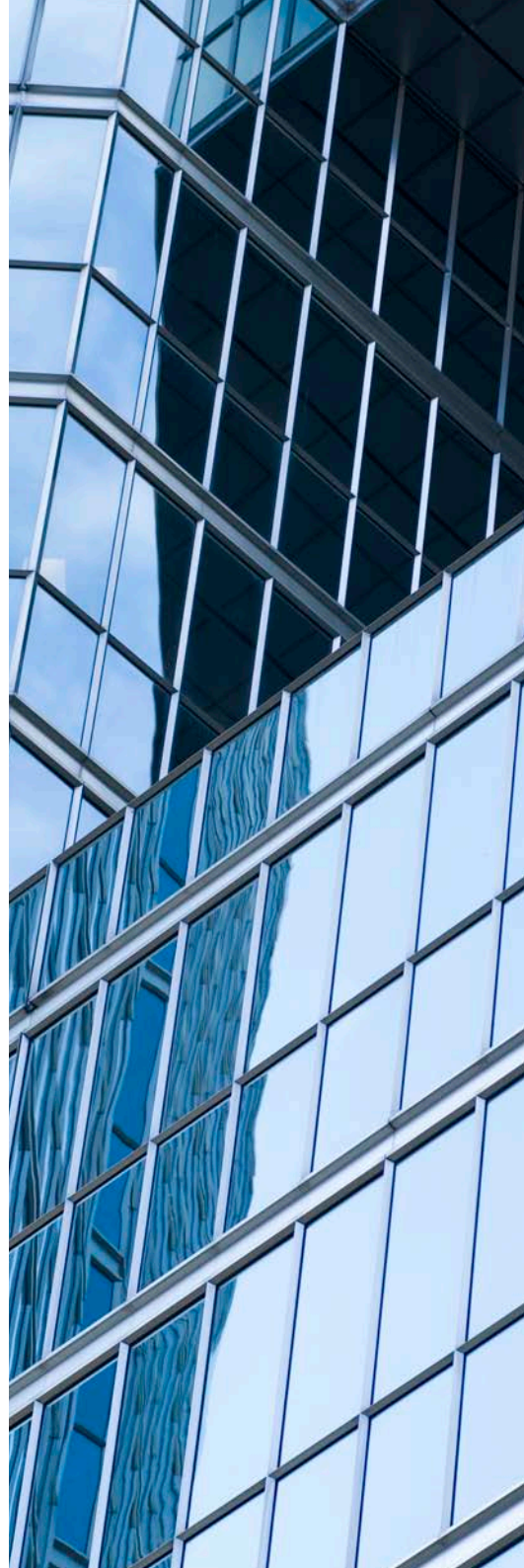
Conversion to a UK-REIT may enhance the ability of the group to access the capital markets by having its shares listed on the stock exchange. It will also benefit from the internationally recognised 'REIT' brand, which is familiar and attractive to institutional and international investors.

If the group has sufficient access to capital for its medium term plans, through existing cash surpluses, private finance or bank facilities, the additional regulation and compliance obligations of being in the UK-REIT regime may well dilute its commercial attractiveness.

UK-REITs are required to meet, on an ongoing basis, an interest cover test: the 'profit:financing cost ratio'. This test requires that profits from the UK property rental business (as calculated for tax purposes) are at least 1.25 times the interest costs incurred in relation to that business.

While failure of this test does not exclude the group from the regime; a tax charge will be imposed on the UK-REIT on any excess interest paid each year, subject to certain limitations. It will be necessary to consider the level of financing expected to be maintained by the business in future in order to determine whether any tax is an acceptable cost of joining the regime.

A general restriction on interest deductibility was introduced with effect from 1 April 2017 as part of the UK's implementation of the OECD's base erosion and profit shifting initiative. The group's financing plans will need to be considered and modelled carefully in order to ensure a cost-efficient structure and tax profile for the group once it becomes a UK-REIT.



DIVIDEND POLICY

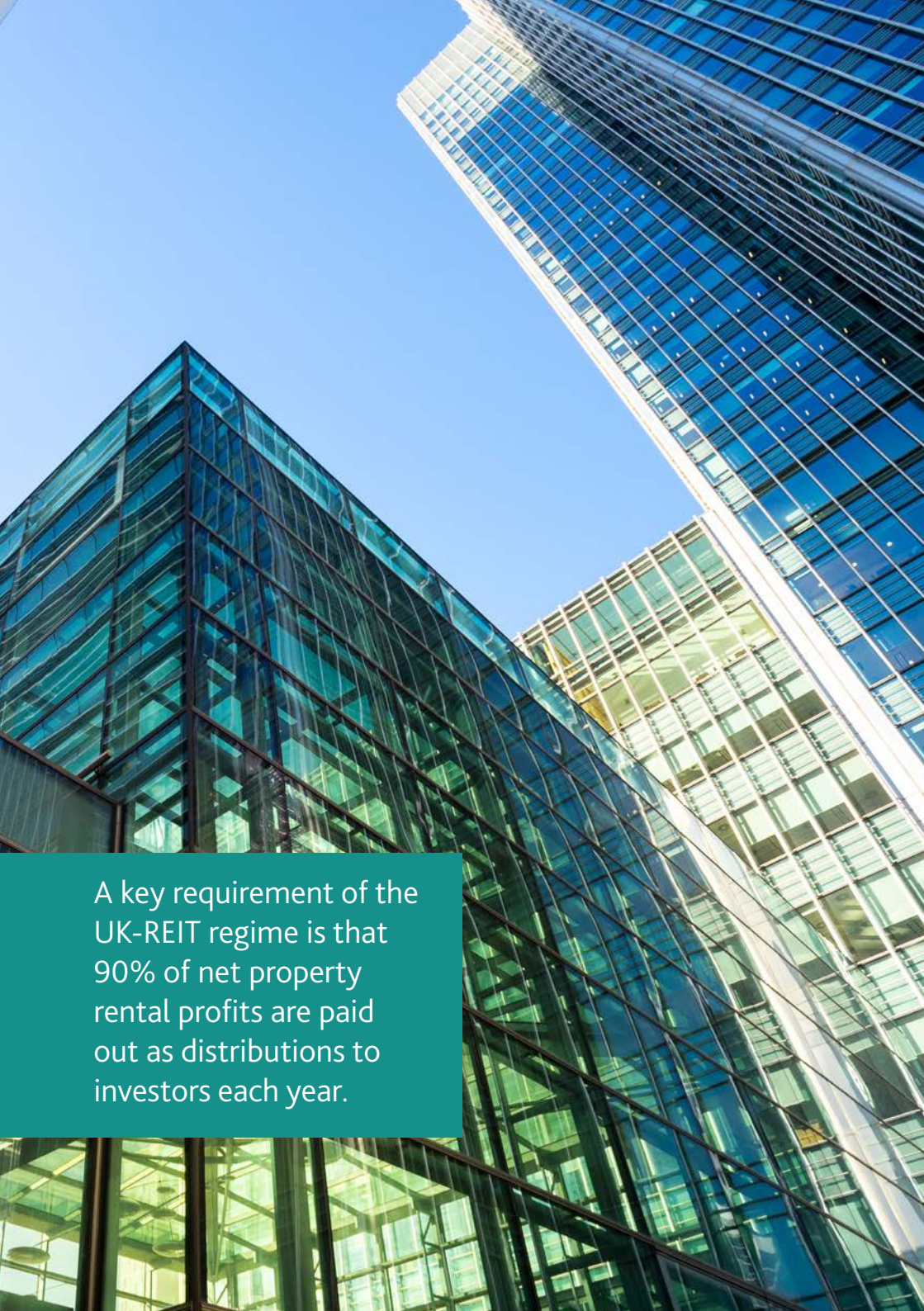
A key requirement of the UK-REIT regime is that 90% of net property rental profits must be paid out as distributions to investors each year. This could result in a different dividend policy being required, particularly if profits have previously been reinvested in the business. Care will need to be taken to ensure that there are no banking or other commercial restrictions on paying distributions. A UK-REIT is not treated as failing the distribution condition to the extent that a company within the group is prevented from paying a dividend due to a lack of distributable reserves.

If a UK-REIT has an investment in another UK-REIT, it must distribute 100% of the PIDs received.

TAX PROFILE OF THE GROUP

Consideration should be given to the current tax profile of the group. The main feature of a UK-REIT is that it is exempt from UK corporation tax on property rental business profits. Therefore, if a group is not currently paying UK tax, either as a result of brought forward tax losses or its charitable, mutual or sovereign status, there may be little tax benefit of UK-REIT status.

However, if a group has a deferred tax liability on its balance sheet in respect of unrealised gains on its property portfolio, conversion to UK-REIT status could result in a one-off profit and loss account and balance sheet benefit. The deferred tax liability can be released on entry to the UK-REIT regime as future gains on disposal of investment properties should not be subject to UK tax.



A key requirement of the UK-REIT regime is that 90% of net property rental profits are paid out as distributions to investors each year.

6. ONGOING UK TAX COMPLIANCE AND FILING OBLIGATIONS

Once within the UK-REIT regime, there are four key HMRC filing obligations in respect of each period:

1. QUARTERLY DISTRIBUTION RETURNS (FORM CT61)

The parent company of the UK-REIT is required to file a return with HMRC within 14 days of the end of any quarter in which a property income distribution is paid to shareholders. For example, if a PID is paid on 20 July 2019, the return must be filed by 14 October 2019.

The tax withheld must be paid over to HMRC by the date the return is due to be filed.

2. CORPORATION TAX RETURNS

Corporation tax returns must be filed for the principal company and any company in the UK-REIT group that has residual business. The tax returns must be filed within 12 months of the end of each period of account.

3. ANNUAL TAX FINANCIAL STATEMENTS

The main annual filing requirement for UK-REITs is the submission of tax-specific REIT Financial Statements. These statements are intended to set out in one place the information required by HMRC to determine compliance with the UK-REIT requirements including the balance of business tests, the profit: financing cost ratio and the distribution condition.

They comprise three main statements:

- An IFRS summary of the income, expenses, profits and assets of the property rental business
- An IFRS summary of the income, expenses, profits and assets of the residual business
- A summary of the profits of the UK property rental business calculated under corporation tax rules.

It is necessary to provide a reconciliation between the two IFRS statements and the audited accounts of the UK-REIT.

The first two statements are similar to consolidated accounts as intra-group transactions are ignored. They also include details of the worldwide business of the UK-REIT.

These financial statements must be in an HMRC-approved format and filed with the tax returns for the UK-REIT.

4. ANNUAL ATTRIBUTION OF RESERVES CALCULATION ('PID TRACKER')

Within fourteen days of the end of each accounting period a UK-REIT is required to provide a reconciliation showing how distributions made in the period have been allocated against the various types of income and gains that comprise the retained, distributable profit of the UK-REIT.



7. IMPLICATIONS OF BREACHING THE UK-REIT REGIME CONDITIONS

There are a number of conditions that need to be met to remain within the UK-REIT regime (see Appendix B). The extent to which the conditions may be breached without the UK-REIT being expelled from the regime will depend on a number of factors including which condition is breached, how seriously it is breached and how many times that condition has been breached since entry into the regime (or ten years if shorter).

AUTOMATIC TERMINATION FOR BREACH OF CONDITIONS

If one or more of the UK-REIT company conditions relating to tax residence, open-ended investment company status, the classes of issued share or the nature of the loans issued by the UK-REIT are not satisfied in respect of a particular accounting period, the UK-REIT will be automatically excluded from the regime from the end of the accounting period before that in which the breach took place.

The rules concerning breaching the admitted to trading rules and close company test are not so onerous (ie certain breaches are allowed). Further details of these are set out in Appendix C.



MINOR OR INADVERTENT BREACHES OF CONDITIONS

Minor or inadvertent breaches of certain conditions will not automatically result in the UK-REIT ceasing to be within the regime.

As noted in Appendix C, breaching certain conditions simply results in a tax charge being levied on the UK-REIT.

For breaches of the majority of the other conditions there will be no loss of UK-REIT status, provided the breach is quickly remedied. There is, however, a limit on how often each individual condition may be breached. If that limit is exceeded within a ten year period, the regime will no longer apply. The number of breaches allowed depends on the condition being breached. A summary of the position is set out in Appendix C.

If HMRC considers that a breach of the property rental business conditions, the distribution condition, or the balance of business conditions is sufficiently serious, it may give notice to the UK-REIT that it will be removed from the regime. There is a right of appeal to the Tax Tribunal against the issue of such a termination notice.

Newly established UK-REITs may breach a number of conditions without penalty provided they are subsequently satisfied within a certain period including:

- The '75% assets' test, provided it is satisfied by the end of the first accounting period of the UK-REIT
- The close company condition, provided it is met within 3 years of entry into the UK-REIT regime.



8. PREPARING FOR LISTING

A UK-REIT needs to be admitted to trading on a recognised stock exchange for at least part of the first day it enters the regime. Preparation work needs to be undertaken up to a year in advance of the planned listing to ensure the company is ready for the process and the added scrutiny of being a listed company.

Before undertaking an IPO, businesses should weigh up the pros and cons of listing and consider alternative options in relation to the strategic aims of the business.

The key stages in preparing for a successful IPO are summarised on the following pages. They are:

- Decide upon the most appropriate capital market for the business.
- Assess market appetite and the anticipated timing of the IPO.
- Assemble a strong, experienced team of advisors and brokers to manage and advise on the process.
- Establish an effective corporate governance and reporting structure in line with relevant regulatory requirements.
- Construct a robust investment case for future investors.
- Present a strong financial history and credible financial forecasts.



DECIDE UPON THE MOST APPROPRIATE CAPITAL MARKET FOR THE BUSINESS.

We most commonly see UK-REITS list on the Premium, Standard and Specialist Funds segment of the LSE main market, but some choose AIM.

	MAIN MARKET		AIM
	PREMIUM SEGMENT	STANDARD /SPECIALIST FUNDS SEGMENT	
Minimum trading record	3 years	None	No minimum
Minimum market capitalisation required	£700,000	None	None
Legal document	Prospectus (vetted by the FCA)	Prospectus (vetted by the FCA)	Admission document (unless public offer)
Listing and ongoing compliance costs	High cost of listing will affect returns	High cost of listing will affect returns	Usually materially lower cost of listing. Lower ongoing costs of compliance
Sponsor/Nominated Adviser required	Yes, for IPO and certain transactions	No	Yes, at all times
Broker required	N/A	N/A	Yes, at all times
Investors	Wide range of investors including institutions, private investors and overseas shareholders High liquidity but depends on the size of the company, assisted by compulsory market makers		ISA and PEP schemes are permitted holdings in AIM listed companies. An AIM listing can attract VCT funds as AIM companies retain unquoted tax status. Relatively low liquidity, no requirement for market makers.
Eligibility for inclusion in FTSE indexes	Eligible if UK incorporated	Ineligible	Ineligible
Timetable for IPO	4-5 months	4-5 months	3-4 months
Deadline for issuing financial statements after year end	4 months	4 months	6 months
Deadline for issuing interim results after half year end	3 months	3 months	3 months
Corporate governance disclosures	Yes - UK Corporate Governance Code	Yes – option as to which code	Yes – option as to which code
Shareholder approval for significant transactions	Yes, where target is more than 25% of size of listed company	No	Only where target is more than 100% of size of listed company, or where 'fundamental' disposal

ASSESS MARKET APPETITE AND THE ANTICIPATED TIMING OF THE IPO

The precise timing of an IPO depends on a number of factors, including:

- Market volatility and investor appetite for new issues
- Avoiding major competing new issues
- Availability of surplus funds for investment - investors may have pre-allocated funds for rights issues
- Macroeconomic and political matters
- Age of latest audited financial statements and related stock exchange requirements.

Brokers or the Sponsor/Nominated Advisor will be able to advise on the optimal timing.

ASSEMBLE A STRONG, EXPERIENCED TEAM OF ADVISORS AND BROKERS TO MANAGE AND ADVISE ON THE PROCESS

Consideration should be given to which advisors are best placed to act for the UK-REIT. Advisors include:

- **Sponsor/Nominated Advisor** judges whether the company is appropriate for the market and manages the listing process.
 - **Broker** will be responsible for any fundraising at flotation and ensuring a successful aftermarket in the company's shares.
 - **Reporting Accountant** will carry out financial due diligence on the company. An auditor will be required thereafter.
 - **Lawyers** oversee issues such as due diligence on behalf of the Sponsor/Nominated Advisor and verification of the statements made in the Prospectus/ Admission Document.
 - **PR** will assist in positioning and marketing the business in advance of the fundraising road show and thereafter.
 - **Investment Manager/Administrator/ Company Secretary/Asset Manager** may be involved where the day-to-day operations of a REIT are outsourced. This should be clarified ahead of listing, with agreements put in place.
-

ESTABLISH AN EFFECTIVE CORPORATE GOVERNANCE AND REPORTING STRUCTURE IN LINE WITH RELEVANT REGULATORY REQUIREMENTS

Investors and the Sponsor/Nominated Advisor will have a keen eye to the senior management team's experience and competence. For new UK-REITs with no track record, having an experienced and established executive management team (either in the business or via an external management agreement) is essential.

So too is having experienced, independent non-executives to provide robust challenge to the executives on behalf of shareholders and stakeholders.

The team should be functionally complete and suitably resourced before the IPO to deal with the governance and reporting requirements of a public company.

A prospective UK-REIT will need to consider whether its internal financial reporting systems and controls are appropriate for a public company.

Key considerations should include monthly management accounts, budgeting/forecasting, reporting timetables, IT and adherence to suggestions made in the management letter presented as part of the audit. It is common for UK-REITs to outsource significant portions of this.





The UK-REIT will require a clear, focused strategy with a detailed investment plan

CONSTRUCT A ROBUST INVESTMENT CASE FOR FUTURE INVESTORS

The UK-REIT will require a clear, focused strategy with a detailed investment plan. This will be documented for investors in the IPO Prospectus/Admission Document and will include asset/investment strategy, debt levels/limits, dividend targets, and detailed documentation of risks and risk management.

UK-REITs often choose to list using one of the following approaches:

- IPO of an existing listed investment business
- IPO of a new investment vehicle, which will use funds raised on IPO to invest in real estate, conditional on the IPO taking place and a minimum level of funds raised
- IPO of a new investment vehicle, with no committed investments on IPO. The vehicle then deploys funds raised on IPO into a defined investment strategy.

With a view to market conditions and input from the Broker or Sponsor/Nominated Advisor, businesses should undertake an IPO process with a clear view on the minimum funds needed.

Consideration should be given to ensuring the corporate structure and dividend policy will be compliant with the REIT regime.

PRESENT A STRONG FINANCIAL HISTORY AND CREDIBLE FINANCIAL FORECASTS

Although the detailed requirements differ between markets, in general financial statements covering a 3 year trading history of the business will be required for an IPO.

These financial statements should be prepared under International Financial Reporting Standards (IFRS), as this is acceptable for IPOs on all major world stock markets.

Financial projections for a period of at least 18 months from the anticipated date of the IPO will form the basis of the directors' statement on the adequacy of the UK-REITs working capital.

Longer term projections will be sought by the Sponsor/Nominated Advisor and Broker for valuation purposes and investor presentations.

These projections will therefore need to be suitably detailed and capable of being easily flexed for sensitivity analysis.

APPENDICES

APPENDIX A: DETAILS OF FURTHER KEY REQUIREMENTS AND RULES

There is no entry charge payable on admittance to the UK-REIT regime. Property assets entering the regime are rebased to market value. Shares in UK property companies are not rebased.

The admitted to trading requirement has flexibility to allow companies to be admitted to trading on AIM and its equivalents. Shares in a UK-REIT are also required to either be listed on a recognised stock exchange throughout each accounting period (which does not include AIM) or subject to trading in each accounting period. This condition does not have to be met by new entrants to the regime in the first three accounting periods in which they are within the regime.

The close company condition is relaxed to:

- Give new entrants to the UK-REIT regime a grace period of three years in which to meet the close company condition; and
- Provide that a UK-REIT that is a close company (for UK-REIT purposes) only by virtue of having one or more qualifying institutional investors as shareholders will not breach the test.

The balance of business asset condition allows cash held by the UK-REIT for the purposes of the property rental business (whether deriving from equity raises, proceeds from sales of properties or surplus bank debt) to be treated as a 'good' asset.

The definition of 'financing costs' for the purposes of the profit: financing cost test is restricted to interest (or the commercial equivalent).

A property income distribution received by a UK-REIT from another UK-REIT in which it invests is treated as income for the investing UK-REIT's tax exempt property rental business. Similarly the investment is included as an asset of the investing UK-REIT's property rental business. The investing UK-REIT must distribute 100% of the property income distributions received.

Legislation enacted in 2017 introduced a potential exemption from tax on the disposal of shares in subsidiaries where certain institutional investor conditions are met. From 6 April 2019, a disposal of a UK property rich company by a UK-REIT will not give rise to a chargeable disposal. These changes may make a disposal of a property owning subsidiary a more beneficial alternative from an overall tax perspective compared to a sale of the property held by the subsidiary.

The introduction of interest restrictions from April 2017 mean that UK-REITs need to model carefully their likely interest relief. In some circumstances it may be beneficial to make appropriate elections.

APPENDIX B: CONDITIONS REQUIRED TO BECOME AND REMAIN A UK-REIT (WITHOUT BREACHES)

PARENT COMPANY CONDITIONS	<ul style="list-style-type: none"> • Tax resident only in the UK • Not an open-ended investment company • Not a close company (although 3 year grace period and holdings by certain institutions ignored) • Shares admitted to trading on a recognised stock exchange • Only one class of ordinary shares in issue, with the only other permitted share class being non-voting restricted preference shares • No non-commercial loans.
BUSINESS CONDITIONS	<ul style="list-style-type: none"> • Worldwide group must have three properties (a property is a unit that is designed for separate letting) • No one property can exceed in value 40% of the total value of the properties involved in the property rental business • At least 75% of worldwide profits of the group must derive from the property rental business • At least 75% of the worldwide gross assets of the group must comprise assets or cash involved in the property rental business.
OTHER CONDITIONS	<ul style="list-style-type: none"> • The parent company of the UK-REIT group must distribute at least 90% of net rental profits of UK companies and non-UK companies to the extent that they derive from UK property (as calculated for tax purposes) within 12 months of the end of each period of account. Gains are not required to be distributed • A UK-REIT which invests in another UK-REIT is required to distribute 100% of the property income distributions received by the parent company of the group to its shareholders • The profit deriving from the UK property rental business (as calculated for tax purposes) must be at least 1.25 times the interest on borrowings payable in respect of that business.
TAX PENALTIES	<ul style="list-style-type: none"> • Apply if a distribution is paid to a corporate shareholder with an interest of 10% or more in the UK-REIT • May apply if distribution condition is not met • Apply if profit: financing cost ratio is not met.

APPENDIX C: BREACHING THE UK-REIT REGIME CONDITIONS

	ADMITTED TO TRADING CONDITIONS RELATING TO SHARES	CLOSE COMPANY	3 PROPERTY	40% PROPERTY VALUE	DISTRIBUTION	75% ASSET TEST	75% PROFIT TEST
Breach does not result in exit from regime	Takeover of one UK-REIT by another***	1. Takeover of one UK-REIT by another*** 2. Actions of someone other than company	A single breach should not result in exit from regime (see below)	Only if not a necessary consequence of breaching '3 property' rule	Any breach*	Up to 2 breaches in a 10 year period provided ratio remains above 50%	Up to 2 breaches in a 10 year period provided ratio remains above 50%
Time allowed to rectify breach to avoid penalty	n/a	1. n/a 2. End of next accounting period	By end of next accounting period	By end of next accounting period	3 months after tax liability finally determined **	End of next accounting period after start of initial breach	End of next accounting period after start of initial breach
Length of a 'single breach'	n/a	n/a	Up to end of next accounting period after start of initial breach	Up to end of next accounting period after start of initial breach	Measured by reference to accounting period	Measured by reference to accounting periods	Measured by reference to accounting periods
Number allowed in a ten year period	n/a	1. n/a 2. No limit	2	2	Any number	2	2

Source: Based on HMRC guidance as amended for changes enacted since guidance published.

* Tax charge is levied on UK-REIT on deemed income equal to shortfall in distribution.

** Applies only where the shortfall is the result of an increase in the finally agreed profits of the property rental business compared with the amounts shown on the tax return.

*** If a breach occurs as the result of being taken over by another UK-REIT, the group can remain in the regime despite breaching either of these conditions.

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