Briefing

BURGES SALMON

Investment Funds

October 2014

PAIF tension between property funds and platforms

As Property Authorised Investment Funds ("**PAIFs**") become increasingly popular, the Tax Incentivised Savings Association has reported on what it describes as a growing tension between industry bodies that are keen to take advantage of the available tax advantages of the PAIF structure, and platforms' failure to support these funds.

PAIFs generally

Where an open-ended investment company ("**OEIC**") invests in a portfolio that comprises predominantly real property or shares in UK Real Estate Investment Trusts (UK-REITS) and certain similar entities it can, subject to satisfying a number of other conditions, elect to be authorised as a PAIF.

The main benefits to funds and their investors of the PAIF regime are tax related. Generally, investors are taxed as if they had invested directly in the underlying assets and therefore receive benefits not otherwise available to most other collective investment schemes that invest in rental property. These tax benefits are achieved by ring fencing income received from the fund's property investment business, (e.g. rentals) and then splitting the remaining types of income between "other taxable income" (e.g. interest and taxable dividends) and exempt dividend income. Investors, therefore, receive three different types of income, each of which is taxed differently – a structure that is designed to separate retail investors from corporate holders. The net result of this, however, is that platforms struggle to cope with the administrative burden of accounting for each type of income received and distributed by the funds.

Taxation of PAIF distributions

The three different types of PAIF distributions are as follows:

Property income distributions ("**PIDs**") are taxable as the income of a UK property business. These PIDs are paid to income tax paying investors net of tax at the basic rate (thereby creating an extra liability for higher rate taxpayers). PIDs are also chargeable to corporation tax in the hands of a corporation tax payer, though the taxpayer in this instance will receive the PID in gross form.

Other taxable income, the second category of income distributions, is treated for tax purposes as if the distribution were a payment of yearly interest. This is generally paid to corporation tax payers without any deduction for tax, but for income tax payers is paid net of tax at the basic rate.

Finally, dividend income distributions are exempt from corporation tax and, for income tax, carry a one-ninth non-repayable tax credit which satisfies basic rate tax liabilities, but which requires payment of an additional amount by higher rate taxpayers.

Other tax benefits include no capital gains tax for investors and an exemption from stamp duty land tax ("**SDLT**") on the conversion of an existing authorised fund into a PAIF. The government is consulting on extending the SDLT exemption to the conversion of an unauthorised fund into a PAIF.

As a result of this beneficial tax regime, PAIFs have fast become the preferred structure for property portfolios. Recent notable conversions to the PAIF structure have been the £3.4bn M&G Property Portfolio, the £986m Standard Life Investments UK Property fund and the £1.4bn L&G UK Property trust.

However, the perceived lack of interest from platforms to introduce support for PAIFs has proved frustrating for the industry, the Treasury and HMRC, with the Chief Executive of the Association of Real Estate Funds, John Cartwright, recently calling for platforms to take up the interest in PAIFs and to properly implement them into their systems.

The timing would seem to be right, with PAIFs poised to become increasingly popular as real estate investment continues to increase with net retail sales of £242m in August 2014.

Burges Salmon advised on the incorporation of the first authorised PAIF and our Funds team regularly advises on the authorisation and ongoing management of regulated funds. **If you would like advice on the above or with regards to PAIFs generally please contact Nigel Popplewell, Tom Dunn, Nicola Manclark or Victor Ondoro.**

continued overleaf

Contacts

For further information, please contact:

Nigel Popplewell
Partner, Tax

+44(0)117 902 2782
nigel.popplewell@burges-salmon.com

Tom Dunn
Partner, Funds

+44(0)117 902 7796
tom.dunn@burges-salmon.com

Nicola Manclark
Senior Associate, Tax

+44(0)117 902 2743
nicola.manclark@burges-salmon.com

Victor Ondoro
Consultant, Funds

+44(0)117 307 6051
victor.ondoro@burges-salmon.com

BRM0829 10 14