HMRC - CFM97740 - Reits: Disallowance To Residual Business

TIOPA10/S452

As noted, REITs have flexibility with how they allocate disallowances between the property rental business (PRB) and the residual businesses.

To accommodate this there are special rules which apply where a group have allocated less than the full amount of a disallowance to the PRB. This allows groups to avoid allocating restrictions to a PRB by allocating a higher amount to the residual business.

This is achieved by treating the residual business as bringing in matching amounts of tax-interest expense and tax-interest income in certain circumstances.

The steps

The following steps apply for determining how to give effect to disallowances allocated to the PRB and residual business of a REIT company in respect of a particular accounting period.

Preliminary calculations

As an initial step it is necessary to calculate the aggregate net tax-interest expense and the interest capacity of the group for the period of account. This then determines the total disallowed amount of the group for the period in the normal way.

In calculating these amounts no special provisions for REITs apply, except:

The “property rental business company” and the “residual business company” are treated as separate members of the same worldwide group; and

The property rental business income and gains are not treated as exempt from Corporation Tax.

Step 1

Determine the maximum amount that could be the allocated disallowance for the PRB and the maximum amount that could be the allocated disallowance for the residual business. The sum of those maximum amounts is referred to as “the total REIT expenses”.

These are the net amounts of tax-interest for the respective businesses. The effects of the limit on the property rental business disallowance on this step is ignored.

Step 2

Determine the amount (if any) that is the allocated disallowance for the PRB for the accounting period. This amount is referred to in this subsection as “the actual disallowed amount”.

This is the actual amount of disallowance allocated to the PRB, and so take accounts of the limit on the property rental business disallowance.

Step 3

Deduct from the total REIT expenses (from step 1) the actual disallowed amount (from step 2).

This gives the amount of the total REIT expenses that remain after taking account of the actual disallowed amount allocated to the PRB.

Step 4

Determine whether so much of the total REIT expenses as remain after step 3 exceeds the net tax-interest expense of the residual business.

This determines if, ignoring these steps, there is insufficient tax-interest expense in the residual business to absorb any disallowance.

Step 5

Where the application of step 4 produces an excess it means that, ignoring these steps, there is insufficient tax-interest in the residual business. In this scenario the residual business is required to bring into account in the accounting period matching tax-interest expense and income amounts equal to the amount of the excess.

By bringing in these equal and opposite amounts, this ensures that the residual business has sufficient amounts to absorb any disallowed interest not allocated to the PRB.

Example

The REIT group has an interest disallowance of £100,000.

The following steps are undertaken to calculate the maximum amount that can be allocated to the residual business.

The total REIT expenses for the company is £15,000 (£10,000 plus £5,000).

Step 2: Ascertain the actual disallowed amount

The actual disallowed amount allocated to the PRB is £500.

Step 3: Calculate the remaining total REIT expenses

The remaining total REIT expenses after the actual disallowed amount allocated to the PRB is £14,500.

Step 4: Determine if this exceeds the net tax-interest expense of RB

The remaining total REIT expenses of £14,500 exceeds the net tax-interest expense of the residual business of £5,000. The amount of the excess is £9,500.

Step 5

The amount of excess calculated in the previous step, £9,500, is now brought into the accounts of the residual part of the business as both deemed interest expense and deemed interest income.

This increases the amount of disallowance.

Notes

The combined effect of these rules is to permit the whole, a part or no amount of the allocated disallowance to be treated as arising in the PRB company up to that business’ net tax-interest expense, subject to the limit on the property rental business disallowance.

To the extent that the allocated disallowance is not fully treated as arising in the PRB company, the balance can be allocated to be arising in the residual business company. This is given effect by treating the residual business company as bringing into account a tax interest expense and tax interest income equal as required (to the extent that there is not already sufficient net tax-interest expense in the residual business company). In some cases this may create a residual business where there was none before.

It should be noted, however, that a consequence of these provisions is that the amount of the disallowance allocated to the PRB and the residual business of the company cannot exceed the sum of the tax-interest expense in the residual business and the PRB.

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