UK Infrastructure Investment Trusts

A UK infrastructure investment trust (UK IIT) would be an infrastructure investment company which, very broadly, simulates (from a tax perspective) direct investment in UK infrastructure. Many of the characteristics build on those already in place in the REIT regime, adapting for the existing tax treatment of infrastructure activities.

The IIT removes the application double taxation that can arise when investing through a corporate structure and enables UK tax exempt investors and other overseas investors (e.g. sovereigns and pension funds) to benefit from their own tax status so that they can receive gross of tax returns from indirect investment.

As for REITs, IITs could be publicly traded (e.g. listed and traded on the LSE), be institutionally owned (e.g. listed on The International Stock Exchange), or have 70% ownership by institutional investors.

Purpose of the IIT regime

The IIT regime would seek to provide a number of commercial and tax benefits, including:

- Leveraging and extending the existing global REIT "brand" and adapting it for infrastructure (building on the growing international regimes with similar characteristics which attract infrastructure investment)
- Attracting international capital seeking long-term sustainable investment in emerging infrastructure (digital and energy transition)
- A liquid and publicly available source of investment
- The ability to make commercial decisions in a tax-exempt environment based on the commercial performance of individual assets

Design objectives

- Flexibility: given the life of the infrastructure projects, infrastructure investments must be capable of being bought and sold by the IIT to non-IIT investors
- Efficiency: be exempt from UK corporation tax at the asset / operational level, with the tax obligations shifted up to investors who are taxable on their returns under UK and/or overseas tax rules
- Oversight and certainty: a formal approval regime to raise the status of such vehicles and give greater confidence in marketing such vehicles to investors who tend to prefer familiar structures and those that have been pre-approved by tax authorities

What is an IIT?

- An IIT is a company (or group of companies) undertaking the construction, operation, ownership and management of infrastructure projects which meet certain conditions.
- The IIT would take the form of an incorporated company which meets the necessary conditions (see below). Entry into the regime could be through election and notification to HMRC, or clearance application / acceptance from HMRC (greater certainty to taxpayers and investors).

Infrastructure business

- The IIT must have an infrastructure business. This can be designed taking into account the Public Benefit Infrastructure Exemption under the Corporate Interest Restriction rules, with potential expansion to capture new business models and activities supporting the digitisation of the UK economy, not necessarily subject to a formal UK regulatory regime.

Tax status of a IIT

- A UK IIT is exempt from corporation tax on both trading directly arising on infrastructure activity, on chargeable gains arising on sales of infrastructure asset (and shares in infrastructure investment companies) carried on in the UK.

- Tax is effectively levied at the investor level (subject to the tax status of investors) on their share of infrastructure income which is distributed to them by the IIT as a new infrastructure dividend distribution subject to [20]% withholding tax, with exemptions available to certain categories of investor who would receive gross, see below..

- Shareholders are generally treated as receiving dividend income which is subject to corporation tax/income tax at the investor's marginal tax rate (with the corporation tax exemption for UK corporate shareholders switched off).

- UK investors who are exempt from UK tax, can reclaim any withholding tax to put them into a position equivalent to investing directly in the UK infrastructure.

- Non-UK investors who are not within the charge to corporation tax, including non-resident companies not carrying on a UK business, or otherwise within the scope of UK corporation tax, will be subject to income tax on the distribution from the UK IIT.

- In general, the mechanism of tax collection for non-UK shareholders is by the levying of a [20]% withholding tax imposed on the distributions of exempt income and gains so that non-UK shareholders shouldn't then have an obligation to file UK tax returns (same as the REIT regime).

- Non-UK investors may benefit from a favourable treaty rate under their respective double tax treaty.

- Profits on activities of the IIT other than the infrastructure business (any 'residual business'), such as interest income or other management services, will be subject to corporation tax in the normal way.

Withholding tax on distributions

- A UK IIT distribute [90][1]% of profits from its infrastructure.

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[1] The reference to 90% distribution of profits is a placeholder, replicating the existing equivalent requirement for REITs

- Dividend distributions out of exempt trading income and gains by the UK IIT are subject to a new special rate of withholding tax of [20]%; however, payments can be made gross to UK corporates, UK pension funds, UK charities [and others as appropriate].

- In general, the IIT must withhold 20% on relevant distributions to overseas investors who may then be entitled to claim a partial or full refund from HMRC where a treaty rate applies.

- It is necessary to distinguish the special rate of withholding tax on dividends from an IIT, from dividends made by other types of UK company, where no withholding tax would continue to apply. As such, this new withholding tax is in effect a new category of withholding tax and only applicable to IIT.

- Distributions out of other income or gains from the residual business (i.e. outside the IIT ringfence) are treated as ordinary dividends which are not subject to any UK withholding.

Recycling of capital

- One aspect of IITs is the potential for the recycling of capital whereby returns generated by the IIT could be used to re-invest in new infrastructure projects, rather than remitting returns back to investors.

- Where such recycling is undertaken, one option is to exempt the proportion of profits that are reinvested from the [90]% dividend requirement. Where funds are remitted, the dividend remittance and associated withholding tax obligation could be deferred.

- There could be two ways through which this could be monitored by the IITs / HMRC:

    - A principles approach where HMT/HMRC could outline ‘good’ categories of new investment where realised profits / cash could be allocated.

    - An application approach whereby the IIT could apply for a deferral, provide details of the investment being incurred and the deferral amounts through a clearance procedure with HMRC.

Tax status of investors

- In the case of a non-UK tax resident investor, the distribution is treated as a dividend for the purposes of any relevant double tax treaty and it may therefore be possible for the investor to reclaim withholding tax suffered.

- However, the “holders of excessive rights” rules seek to prevent a corporate investor from holding 10% or more of the IIT and this may limit the possibility of accessing the lower treaty rates which generally only apply where the investor holds 10% or more of the company.

IIT Conditions

There are a number of conditions to satisfy on the set-up (or conversion) and on an ongoing basis to preserve IIT status.

- the infrastructure activity must represent at least [80]% of the IIT’s income, profits, assets and activities[2]

[2] This 20% test is a placeholder and could be adjusted – rationale for 20% is that it aligns with existing HMRC guidance around trading tests for SSE

- parent must be UK resident
- [90]% of infrastructure income profits must be distributed within 12 months (distribution requirement) unless reinvestment relief claimed
- Parent company must:
    - Satisfy the listing requirements or be at least [xx]% owned by institutional investors; and
    - be diversely owned (although certain institutional investors are automatically treated as diversely held)
    - Cannot have excessive gearing and debt finance must be broadly on ordinary commercial terms
- Corporate shareholders holding 10% or more ("holders of excessive rights") can cause the IIT to suffer a tax charge (anti avoidance measure to prevent use of tax treaties to eliminate all UK tax altogether)

IIT company requirements

- An IIT can be either a single company IIT or a group IIT. To be a single company IIT, the company would have to be a trading infrastructure company; to be a group IIT, the qualifying infrastructure activities must be carried on by members of the group.
- The principal company of a group IIT or a single company IIT must be a UK resident company, which is not resident in another jurisdiction at the same time.
- A group IIT consists of a parent company plus all of its 75% subsidiaries, regardless of their tax residence, where the ultimate parent has an economic benefit of more than 50% in each subsidiary.
- An IIT can only issue one class of ordinary shares. These would have a certain designation for UK corporation tax purposes (linked to the tax status of the IIT), allowing HMRC to apply the special IIT withholding tax rate, distinguishing them from other dividends.
- Requirements from REIT regime around IITs being widely held and non-close could also be implemented.

Distribution requirement

- 90% of the (tax-exempt) income from the infrastructure business must typically be distributed within 12 months of the end of the accounting period. As above this can be deferred through reinvestment of returns in new qualifying projects.

Financing requirements

- IITs cannot be excessively geared by debt. The intention would be to incorporate the range of existing restrictions and anti-avoidance provisions governing loan relationship deductions (e.g. TP, CIR, anti-hybrid, unallowable purpose etc) with a tax charge borne at the IIT level where such debt financing is taken out.
- A tax charge would be levied on the IIT where there is excess financing.

Holders of excessive rights

- To protect the ability of the UK to levy withholding tax on dividends from the IIT, a 'Holder of Excessive Rights' protection is applied.
- In the event that a corporate shareholder were to hold 10% or more of the IIT, they may be entitled to claim beneficial treaty rates that would undermine the IIT regime by negating HMRC's ability to collect tax through the withholding tax mechanism.
- Therefore, the regime has been designed to discourage the IIT from allowing its shareholders to aggregate 10% or more of their ownership of the IIT through a corporate vehicle.
- A corporate shareholder (or a shareholder treated as a company for treaty purposes), wherever tax resident, who holds 10% or more of the shares or voting rights in a UK IIT, is regarded as a holder of excessive rights.
- Where the IIT pays a dividend to a HoER, a penalty tax charge can arise on the IIT. The charge can only be mitigated where the IIT has taken "reasonable steps" to prevent the payment of such a dividend.
- The HoER charge is removed where distributions are paid to investors entitled to gross payment e.g. UK registered pension schemes..