

## Benefits of PAIF structure for property investing

Introduced in April 2008, the property authorised investment fund (PAIF) is a new type of vehicle resulting from a collaboration between the Financial Services Authority and HM Revenue & Customs (HMRC). The aim was simple: to make investment in property funds more attractive to a wider range of investors. However, given the downturn in the property market which coincided with the introduction of this structure, it was not until 2010 that such funds really began to appear. Since then interest has been steadily growing due largely to the beneficial tax status which PAIFs offer.

PAIFs are a type of open ended investment company (OEIC) which can invest in a wide range of property assets including physical property (both commercial and residential), as well as shares in UK real estate investment trusts (UK REITs), exchange traded funds and other collective investment vehicles. The flexibility of the PAIF structure enables better management of short term liquidity and offers the potential for greater diversity through access to specialist assets, such as shopping centres, indirectly via collective investments.

The attractiveness of the PAIF structure lies largely in the benefits offered by their tax treatment, as they allow both taxable and tax exempt investors to participate in the same fund on a tax efficient basis. They are designed to be tax transparent vehicles, thereby creating no tax liability in respect of investment income. Income from direct property and from shares held within a PAIF is taxed as though the investment was held in the underlying assets directly. PAIFs are not liable to a withholding tax on investment income.

Before the introduction of PAIFs, tax exempt investors, such as pension schemes, charities and ISA investors investing in property via traditional authorised funds faced a number of problems. This was because although these investors were exempt from tax on rental income received directly, the exemption did not apply to income received from authorised funds. Importantly, under the new PAIF structure the point of taxation is moved from the fund to the investor, meaning that the investor is taxed on the property income as if the property was held directly. As a result of this, investment is now open to a much wider range of investors, without any tax disadvantage to existing investors.

The PAIF structure allows for the delivery of three streams of income: property income (derived from rental income paid on properties held directly in the fund), interest income (paid out from any bank interest or income into the fund) and dividend income (arising from dividends paid by shares held in the fund). Investors pay tax at their own rate on each of these three types of income and at each distribution they receive a tax voucher describing the types of income received. The required 20% tax on the property and interest streams is then deducted automatically for taxpaying investors and submitted to HMRC on behalf of investors. For tax-exempt investors, the income will be paid or re-invested into the PAIF gross of taxes.

As a result of these changes the universe of potential property investors is greatly expanded. While to date they have been primarily aimed at institutional investors, they also provide specific benefits to retail tax-exempt investors such as ISA holders. According to the IMA, investors using their full ISA allowance to invest in a traditional property fund pay £80 a year in unnecessary tax, which they would avoid in a PAIF. Other tax exempt investors such as SIPP holders, pension funds and charities will enjoy similar benefits.

The property sector was not immune from the market turmoil which hit most asset classes in 2008, although investors are returning in good numbers, recognising the important role property investment can play in a diversified portfolio. The introduction of PAIFs facilitates investment from a broader range of individuals, which in turn should strengthen the sector as a whole. The PAIF market is relatively restricted at the moment, with just a handful of funds currently available. However, we look forward to PAIFs becoming more widespread over the next couple of years as the property sector continues to improve and a growing number of fund providers convert existing funds or launch new ones in order to take advantage of the beneficial tax treatment that this structure offers.

Source: rlam as at 25 January 2011 unless otherwise stated.

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Our reference: 032-PRESS-01/2011-SS