PROPERTY AUTHORISED INVESTMENT FUND (PAIF) EXPLAINED

What is a PAIF?

A Property Authorised Investment Fund (PAIF) is an open-ended investment company (OEIC), authorised by the Financial Conduct Authority, that specialises in holding property, and where taxation on the profits of its property investment business lies with its investors.

The PAIF regime was first introduced to the UK in 2008, and was received as a welcome addition to the UK fund landscape. However, in the wake of the economic downturn, initial take up was lower than expected, leading to further reforms to the regime being made in 2012. Since then the regime has proved increasingly popular, with a number of PAIFs subsequently being launched.

The principal attraction of the PAIF structure is that eligible investors within a PAIF can receive gross income from their investment. Eligible investors include tax-exempt investors – individuals investing through an Individual Savings Account (ISA) or Self-Invested Personal Pension (SIPP) – as well as tax-exempt institutional investors such as pension funds.

Key requirements

In order for a property fund to be PAIF compliant, it must adhere to the following:

- Operate Property Investment Business;
- Report income in three “streams”; and
- Not permit Body Corporates to hold more than 10% of Net Asset Value of the fund.

What is Property Investment Business?

To qualify as a PAIF, Property Investment Business must be undertaken. This means carrying on a property rental business which generates income from land and/or to carry on a business consisting of owning shares in UK real estate investment trusts (REITs) and/or their foreign equivalents.

What are the three income streams?

Typically, a property fund will derive its income from various sources, including rental income and interest. An authorised property unit trust will suffer 20% corporation tax on property rental income, distributing income onward to investors as a single “dividend” payment. As a result, the 20% tax paid cannot be reclaimed.

In contrast, a PAIF separates its distribution in to three different “streams” for UK tax purposes (reflected in the associated tax voucher):

- Property income;
- Interest income; and
- Other income (dividends)

Splitting the income payment in this way allows each stream to be treated differently for tax purposes. Since income is no longer subject to 20% tax within the fund, both property income and interest income can be paid gross to eligible investors.

INCOME STREAM	COMPRISING OF		TAX TREATMENT
		ELIGIBLE INVESTORS*	INELIGIBLE INVESTORS*
Property	Mainly rental income	Paid gross without tax deducted	Paid with 20% income tax deducted
Interest	Any interest earned on property bonds or cash deposits	Paid gross without tax deducted**	
Other	Any dividends (and some non-taxable rental income)	Paid as a dividend distribution***	

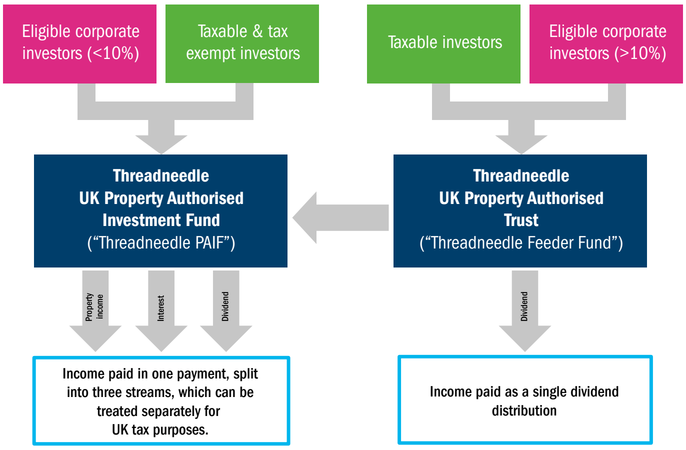
*Eligible investors are those able to receive or reclaim the tax deducted at source.

**From 6 April 2016, a tax-free Personal Savings Allowance of £1,000 (or £500 for higher rate taxpayers) was introduced so that the basic rate payers will not have to pay tax on the first £1,000 of interest they receive from PAIF distributions (interest). From 6 April 2017, all interest distributions are made gross, so no tax will be deducted from any interest distributions.

***From 6 April 2016, the 10% dividend tax credit will be abolished. Instead a new dividend tax allowance of £5,000 a year will be introduced where Shareholders will receive the first £5,000 of dividend income free from income tax.

Why do PAIFs often have an associated feeder fund?

A feeder fund linked to a PAIF, whilst not subject to the same tax rules, can provide investors with an efficient means to obtain exposure to the performance of the PAIF. Feeder funds are often established for PAIFs because certain investors are either ineligible, or unable to invest in the PAIF. For example, HMRC rules prevent any Body Corporate from owning 10% or more of a PAIF directly, whilst many Platforms are still operationally unable to process streamed income payments for their clients.



Who benefits from the PAIF structure?

Tax exempt investors, including individuals holding their investment in an ISA or in a SIPP, will benefit from the PAIF structure. This is because both property income and interest income can be paid gross of tax. All things being equal, tax exempt investors can expect to receive an uplift of 25% in investment income compared to an authorised property unit trust.

Higher and additional rate taxpayers who currently hold units in an authorised property unit trust outside of a tax wrapper such as an ISA or SIPP may benefit from holding units in the Feeder Fund rather than shares in the PAIF structure, from 6 April 2016, if their dividend income, including the dividend income from the Feeder Fund, received in a tax year is less than the £5,000 dividend allowance.

Threadneedle PAIF

Columbia Threadneedle Investments converted the Threadneedle UK Property Trust (the Trust) into the Threadneedle UK Property Authorised Investment Fund (the ‘Threadneedle PAIF’), a newly-formed Open-Ended Investment Company on 14 May 2016.

To find out more visit columbiathreadneedle.com

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