

# bulletin

National Association of Real Estate Investment Trusts®

## **U.S.-UK. Tax Treaty is Ratified and the Senate Approves Protocols to Tax Treaties with Mexico and Australia**

On March 31, 2003, the U.S.-U.K. Tax Treaty entered into force. Protocols to tax treaties with Mexico and Australia were approved by the U.S.

Senate on March 13, 2003, and are expected to enter into force when certain documents are exchanged between the U.S. government and those countries' governments. As described below, the treaties are important because they incorporate the 1997 U.S. Treasury Department's treaty policy with respect to REIT dividends and the U.K. and Mexico treaties allow pension funds in those countries to invest in REIT stock without paying U.S. taxes on ordinary dividends.

### **General Summary of Applicable Ordinary Dividend Withholding Rates and Effective Dates of the Treaties**

Treaty	Individuals and Institutional Investors	Pension Investors	Effective Date
U.S.-U.K.	15%, for (a) individuals who own not more than 10% or (b) others that own not more than 5% of a publicly traded REIT or not more than 10% of a "diversified" REIT	0% for pension plans that own not more than 5% of a publicly traded REIT or not more than 10% of a "diversified" REIT	Dividends paid or credited after May 1, 2003
U.S.-Mexico	10%, for (a) individuals who own not more than 10% or (b) others that own not more than 5% of a publicly traded REIT or not more than 10% of a "diversified" REIT	0% for pension plans that own not more than 5% of a publicly traded REIT or not more than 10% of a "diversified" REIT	Dividends paid/credited on or after the first date of the second month following the date on which U.S. and Mexico notify each other that their respective treaty requirements have been satisfied
U.S.-Australia	15%, for (a) individuals who own not more than 10%, (b) others that own less than 5% of a publicly traded REIT or less than 10% of a "diversified" REIT or publicly traded "Australian property trusts"	15% for pension plans that own not more than 5% of a publicly traded REIT or not more than 10% of a "diversified" REIT	Dividends derived on or after later of July 1, 2003, or the first date of the second month following the date on which "Instruments of Ratification" are exchanged by the U.S. and Australia

## Background

Under the Internal Revenue Code, a U.S. corporation must withhold and remit to the IRS 30% of its ordinary dividends paid to non-U.S. shareholders. Since World War II, the United States has entered into many bilateral treaties that reciprocally lower withholding taxes to encourage cross-border investments.

In 1996 and 1997, NAREIT conducted a dialogue with Congress and the Treasury Department regarding the U.S. tax treaty negotiating position for REIT dividends. The pre-1997 position had sought a 15% rate on dividends to foreign individuals owning less than 10% of a REIT, with 30% withholding imposed on other distributions. In 1997, the Treasury Department agreed to amend its negotiating position to obtain in tax treaties a 15% withholding rate on REIT dividends to non-U.S. institutions as long as the institution owns less than (1) 5% of a publicly traded REIT; or (2) 10% of any REIT, the properties of which are sufficiently diversified.

On July 24, 2001, the United States and the United Kingdom executed a new income tax treaty that incorporates the 1997 REIT policy described above. In addition, under the new treaty, U.S. corporations will withhold no tax on their ordinary dividends paid to shareholders that are U.K. pension plans. Essentially, the two countries have decided to respect the tax-exempt status of their pension plans when they make passive corporate investments.

The exemption of dividends to pension plans follows similar provisions in the U.S. tax treaties with Canada, the Netherlands, Switzerland, and Venezuela. This exemption in the U.S.-U.K. Treaty initially did not apply to dividends paid by REITs or mutual funds to

U.K. pension plans. Following a dialogue between NAREIT and the Treasury Department, the U.S. and U.K. signed a Protocol dated July 24, 2002 that extended the exemption to REIT dividends as long as the U.K. pension plan follows the 1997 tax treaty guidelines for REITs, *i.e.*, the pension plan owns 5% or less of a publicly traded REIT or 10% or less of any REIT the assets of which are diversified (*i.e.*, no single asset comprised more than 10% of its assets).

## SUMMARY OF THE TREATIES

### U.S.-U.K. Tax Treaty

The U.S.-U.K. Tax Treaty replaces a treaty that was in effect since 1980. It contains the following relevant provisions for REITs. First, REIT ordinary dividends are eligible for a reduced withholding rate of 15% if the U.K. shareholder complies with the 1997 Treasury Department treaty guidelines applicable to REITs. Thus, a 15% withholding rate is applicable to REIT dividends to: (a) individuals who own less than 10% of the REIT's stock and (b) institutional investors that either (i) own less than 5% of a publicly traded REIT or (ii) own less than 10% of a diversified REIT (that is, a REIT that has no single asset that comprises more than 10% of its holdings).

Second, REIT dividends to U.K. pension funds are eligible for zero withholding if the U.K. pension fund complies with the 1997 treaty guidelines, *i.e.*, owns less than 5% of a publicly traded REIT or less than 10% of a diversified REIT. Reduced withholding under the U.S.-U.K. Tax Treaty begins with dividends paid on or after May 1, 2003. The treaty does not appear to affect 35% withholding on REIT capital gains distributions. See Treas. Reg. § 1.1445-8.

For a detailed description of the U.S.-U.K. treaty [CLICK HERE](#).

## U.S.-Mexico Tax Treaty Protocol

The Protocol to the U.S.-Mexico Tax Treaty amends the existing income tax treaty with Mexico, which was concluded in 1992. This Protocol also reduces the withholding rate on REIT ordinary dividends (in this case, to 10%) for Mexican shareholders that comply with the 1997 treaty guidelines applicable to REITs discussed above, *i.e.*, are individuals who own less than 10% of the REIT or institutional investors who own less than 5% of a publicly traded REIT or less than 10% of a diversified REIT. As with the U.S.-U.K. Treaty, REIT dividends to Mexican pension funds now also are eligible for a zero withholding rate (down from 30% under the prior treaty) for Mexican pension funds that comply with the treaty guidelines, *i.e.*, hold less than 5% of a publicly traded REIT or 10% of a diversified REIT.

This treaty enters into force once the U.S. and Mexican governments notify one another, through diplomatic channels, when their respective constitutional and statutory requirements for the entry into force of the Protocol are satisfied. The treaty-reduced withholding rates will be effective for dividends paid on or after the first day of the second month following the date on which the Protocol enters into force. For example, if the Protocol enters into force on June 30, 2003, the reduced dividends withholding rates will apply for dividends paid after August 1, 2003. The treaty does not appear to affect 35% withholding on REIT capital gains distributions. See Treas. Reg. § 1.1445-8.

For a detailed description of the U.S.-Mexico Treaty [CLICK HERE](#).

## U.S.-Australia Tax Treaty Protocol

The U.S.-Australia Protocol amends the existing income tax treaty with Australia, which concluded in 1982. The Protocol to the U.S.-

Australia Tax Treaty also reduces the withholding rate on REIT ordinary dividends (in this case, to 15%) for Australian shareholders that comply with the 1997 treaty guidelines applicable to REITs discussed above, *i.e.*, are individuals who own less than 10% of the REIT or institutional investors who own less than 5% of a publicly traded REIT or less than 10% of a diversified REIT.

The Protocol also permits the reduced 15% withholding rate to apply to REIT dividends paid to “listed Australian property trusts” (“LAPTs”), which are publicly traded pooled investment entities, much like mutual funds or REITs, that are not taxable in Australia to the extent that they distribute all of their income. NAREIT advocated this change in a letter to the U.S. Treasury Department. For LAPTs with known shareholders of 5% or more, such shareholders will be viewed as owning their proportionate interest in the U.S. REIT, and will have to satisfy the 1997 treaty guidelines themselves in order to be eligible for the 15% withholding rate. The U.S.-Australia Tax Treaty Protocol does not provide for a zero withholding rate for dividends to Australian pension funds.

Reduced withholding under the U.S.-Australia Tax Treaty will apply to ordinary dividends paid on or after the later of July 1, 2003, or the first date of the second month following the date on which the Protocol enters into force. The treaty does not appear to affect 35% withholding on REIT capital gains distributions. See Treas. Reg. § 1.1445-8.

For a detailed description of the U.S.-Australia Treaty [CLICK HERE](#).

If you would like to discuss this in greater detail, please contact

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