INREV PROFESSIONAL STANDARDS

PENSION FUND SURVEY 2012

INFORMATION ON THE LEGAL, REGULATORY AND TAX TREATMENT OF PENSION FUNDS

INREV

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INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. Our aim is to improve the accessibility of non-listed real estate funds for institutional investors by promoting greater transparency, accessibility, professionalism and standards of best practice.

As a pan European body, INREV represents an excellent platform for the sharing and dissemination of knowledge on the non-listed real estate funds market.

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1 INTRODUCTION

We are pleased to present the first edition of the INREV Pension Fund Survey, which has been initiated and supported by the INREV Tax Committee.

Pension funds form an important group of institutional investors in the non-listed real estate funds industry. Therefore, a basic level of knowledge about their legal, tax and regulatory regimes is important for all the key players in this industry.

The purpose of this paper is to provide INREV members with a brief introduction to the legal, regulatory and tax regime of pension funds in countries where there is a significant pension fund sector. This comprises the UK, Germany, Denmark, the Netherlands, Switzerland, the United States and Canada. The focus is on real estate investments of pension funds.

This publication does not provide an exhaustive overview of all the relevant aspects. It is merely an overview of the general legal, tax and regulatory framework in the mentioned jurisdictions.

We would like to thank all the members who have contributed to this first edition.

We hope this paper will serve as a practical guide for INREV members and we invite you to provide us with feedback any suggestions you may have to improve the next edition of this paper.

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Chairman INREV Tax Committee

Amsterdam, July 2012

2 CANADA

2.1 General / legal form

Pension plan funds can be held in any legal title arrangement that is acceptable to the Minister of Finance. This generally allows funds to be held:

– under a contract for insurance;

– under a trust agreement;

– by a pension corporation;

– under an arrangement administered by the government of Canada, or by the government of a province of Canada, or an agent of either one; or

– through any combination of the above.

2.2 Regulatory overview

A registered pension plan is a pension plan that has been registered by the Minister for the purposes of the Income Tax Act (the "Act").

It is a definite arrangement established as a continuing contract by an employer, a group of employers or by a union with employers with a primary purpose to "provide periodic payments to individuals after retirement and until death in respect of their service as employees."

In order to sponsor a pension plan an employer must have employees. Partners in a partnership, for example, cannot sponsor a pension plan as they are not employees of the partnership.

All registered pension plans must have an administrator, which is the person or body of persons with the ultimate responsibility for administering the plan. The administrator is responsible for ensuring that returns required by the Act or the regulations are properly filed. In many cases, the plan administrator will be the employer or a board of trustees. The administrator or the majority of the persons in the group that constitutes the administrator, must in principle be resident in Canada.

A registered pension plan is subject to investment restrictions the Act, which prohibits certain investments from being held as property by a plan. It also requires the plan to comply with the investment restrictions of the federal Pension Benefits Standards Act, 1985, or a similar provincial law. If the plan is not subject to any such provincial law, it must comply with the Pension Benefits Standards Act, 1985.

Pension plan funds cannot hold property that is a share of the capital stock of, an interest in, or a debt of:

a) an employer who participates in the plan;

b) a person who is connected with an employer who participates in the plan;

c) a person or partnership that controls, directly or indirectly, in any way, a person or partnership referred to in (a) and (b);

d) a member of the plan; or

e) a person or partnership that does not deal at arm's length with a person or partnership referred to in (a), (b), (c), or (d).

An interest in, or a right to acquire, a share, interest, or debt described above is also prohibited.

However, prohibited investments do not include:

– a bond, debenture, note, mortgage, hypothec, or similar obligation described in the definition of "fully exempt interest" in the Act;

– a share listed on a stock exchange designated by the Minister of Finance, or an interest in or a right to acquire such a share;

– a bond, debenture, note or similar obligation of a corporation for which any shares are listed on a stock exchange designated by the Minister of Finance, or an interest in or a right to acquire such a property; or

– a mortgage in respect of real property in Canada that meets all the following conditions:

  - Where the amount paid for the mortgage (together with the amount of any indebtedness outstanding at the time the mortgage was acquired under any mortgage or hypothec that ranks equally with or superior to the mortgage) exceeds 75% of the fair market value at that time, of the real property that is subject to the mortgage and that the mortgage is insured under the National Housing Act or by a corporation that offers its services to the public in Canada as an insurer of mortgages (unless this condition is waived by the Minister).

  - Where the registered pension plan holding the mortgage would be considered a designated pension plan only because of specified member participation, and not because of their remuneration, the plan is administered by an approved lender under the National Housing Act.

  - The mortgage bears an interest rate that would be considered reasonable if the mortgagor dealt with the mortgagee at arm's length.

2.3 Taxation

Canadian pension funds are generally exempt from tax. With respect to Canadian funds investing in foreign tax jurisdictions, the tax implications typically result from the specific foreign jurisdiction and the taxes generated from that jurisdiction.

The taxation of foreign pension funds that carry on a business in Canada or hold property in Canada will depend on the classification of the entity either as a corporation, trust or partnership for Canadian tax purposes. Canada's tax treaties with other countries may provide relief to foreign investors who invest in Canada. The type of relief is dependent on the classification of the fund and the particular foreign jurisdictions involved.

3 DENMARK

3.1 General / legal form

Danish pension funds (*pensionskasser*) are organised as separate legal entities under the laws of Denmark and are governed by the Danish Financial Business Act (Danish FBA), consolidated Act no. 885 of 8 August 2011 (*Lov om finansiel virksomhed*) as well as its own constitutional documents.

3.2 Regulatory overview

Danish pension funds are regulated by the Danish FSA (*Finanstilsynet*), which is the official government body established to supervise financial undertakings, including pension funds in Denmark.

Under the Danish FBA, Danish lateral pension funds (nationwide occupational pension funds) are associations or affiliations (1) where the members of which have either received training or education within specific fields of training or education or are employed by undertakings of a specific nature, and which have as their object to provide a pension in accordance with uniform rules for all the members as part of their conditions of employment or as part of some other form of attachment to an undertaking, or (2) the members are self-employed persons within the same industry, and which have as their object to provide a pension in accordance with uniform rules for all their members.

Pension funds have both a right and a duty to use the word *pensionskasse* in their name. Other undertakings may not use names or descriptions for their activities that may create the impression that they are pension funds. Licensed pension funds are registered in the Danish Commerce and Companies Agency.

The income is derived from a combination of member contributions and income from investments. All pensions must be fully funded and the assets covering the insurance provisions are subject to extensive regulations regarding their investments. Generally, the assets are required to be invested in a responsible manner and for the beneficiaries' advantage in line with the Danish FBA. Also, the investments need to ensure that there is adequate security for the pension fund to meet its obligations at all times.

To comply with the Danish FBA, the pension funds must therefore have a group of "registered assets", the value of which corresponds at least to the value of the total insurance provisions of the pension fund. When investing the registered assets there may not be a disproportionate dependence on any specific category of assets, investment market or investment. The currency risk must also be limited in a similar manner. Danish resident pension funds may invest in domestic or foreign real estate assets, directly or indirectly through real estate funds.

3.3 Taxation

For Danish tax purposes, providers of pensions and pension benefits may generally be divided into two groups; life insurance companies and pension funds. The following information deals with taxation for the latter group only.

Danish resident pension funds are separate legal entities, and would therefore be subject to corporate tax under the Danish Corporate Income Tax Act. However, they are exempt from corporate tax under a general exemption clause. The yields on investments are subject to separate taxation under the Danish Pension Investment Return Tax Act (PAL). It is noted that non-resident pension funds have no special tax treatment when they invest in Denmark, except for special treaty provisions if applicable.

The taxation under PAL for pension funds is primarily aimed at the part of the increase in insurance provisions that derives from the yield on the investments – including investments in real estate funds – made by the pension fund and which are subject to a mark-to-market taxation at a rate of 15.3%. The PAL tax is collected on both yields ascribed to the individual insurance provisions and on yields ascribed to the net equity of the pension fund. As Danish pension funds are subject to tax on their income, they may under certain conditions credit foreign taxes in their Danish tax. This may be relevant if investing in foreign real estate funds or assets.

As the tax base in which foreign taxes can be credited may be relatively small compared to the total investment income, many Danish pension funds anticipate not being able to credit the full amount of taxes withheld. This varies individually by pension fund. Any taxes withheld, which cannot be credited in the Danish tax, may be carried forward to be credited in future taxes. However, if the tax base continuously remains too small to match the creditable amount, the taxes withheld are effectively lost.

It is common practice to reclaim taxes withheld in foreign jurisdictions down to the level of treaty rates. The Danish tax authorities take the view that Danish pension funds should be considered Danish residents for the purposes of tax treaties. Some treaties such as the US/Denmark treaty has beneficial rates for pension funds.

4 GERMANY

4.1 General / legal form

In Germany there are various types of retirement schemes established despite real pension funds only being introduced some years ago. First, *Pensionskassen* exist to insure the loss of income at retirement age. Second, there are *Versorgungswerke* which are superannuation funds for liberal professions, again covering retirement schemes for these groups of persons. Finally, there are occupational and personal schemes known as *Pensionsfonds*. All are typically considered as pension funds.

The *Pensionskassen*, *Versorgungswerke* and *Pensionsfonds* are organised as entities with legal persona. *Versorgungswerke* are set-up in the form of corporations under public laws (*Körperschaft des öffentlichen Rechts*), governed by the different state laws while *Pensionskassen* and *Pensionsfonds* may be set-up in the form of a public company (*Aktiengesellschaft*, *European Company* [SE]) or a mutual insurance association (*Versicherungsverein auf Gegenseitigkeit*). Finally, *Pensionskassen* may also be set-up as corporations under public laws (*Körperschaft des öffentlichen Rechts*) or as institutions under public laws (*Anstalt des öffentlichen Rechts*).

4.2 Regulatory overview

German *Pensionsfonds* are regulated by the German Insurance Supervisory Authority, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin). BaFin is the official government body established to supervise insurance undertakings, including *Pensionskassen* and *Pensionsfonds* in Germany.

It is not mandatory for *Pensionskassen* to be regulated in Germany. However, most typically prefer to subject themselves voluntarily under the regulation of BaFin. Only in unusual cases does federal law require *Pensionskassen* to be regulated.

Both *Pensionskassen* and *Pensionsfonds* are governed by Supervision of Insurance Undertakings Act, *Versicherungsaufsichtsgesetz* (VAG). According to these provisions and the provisions of the Investment Ordinance for Insurance Companies or *Anlageverordnung* (AnlV), these undertakings can invest in real estate directly or through real estate holding entities if the properties are located in either a state of the European Economic Area (EEA) or in a state with full Organisation for Economic Co-operation and Development (OECD) membership. Additionally, investments in partnership-type closed end funds are possible under the same conditions and are comparable to a German limited partnership (GmbH & Co. KG).

Investments in REITs are also possible provided that the REIT is comparable to a German REIT and is located in either a state of the EEA or in one with full OECD membership. Additionally, these investors can invest in regulated closed end and regulated open end funds, where the fund entity is located within the EEA and the funds provide for a set-up comparable to German funds according to the German Investment Act or *Investmentgesetz* (InvG). These rules are highly complex especially due to their interpretation by BaFin and each investment needs to be analysed on a case by case basis.

Versorgungswerke are regulated by the federal state regulators and are very similar to the federal regulation under the VAG provisions.

4.2.1 GENERAL

All German *Pensionskassen* (regulated or deregulated) and *Pensionsfonds* require a license for start up of the business and for ongoing business.

German *Pensionskassen* and *Pensionsfonds* may only undertake pension and pension-related activities and the scope of allowed services is clearly defined. The products of both types of pension forms have to provide services as a fully-funded system (*Kapitaldeckungsverfahren*) and are not allowed to use a circulation procedure (*Umlageverfahren*). This means that the system has to be independent from demographic developments and that payments to policyholders are supported by their directly paid premiums.

4.2.2 PENSIONSKASSEN

Unregulated *Pensionskassen* have to follow specific reporting requirements by submitting certain information to the regulator such as business plans and declarations of investment policy.

Regulated *Pensionskassen* have to observe all requirements of the supervision of life insurance companies. In particular, this means requirements on risk-monitoring, investments and the formation of actuarial provisions. An insurer's own funds or solvency position must be adequate to cover individual solvency capital requirements.

There is a framework to set out several own funds components. In cases where a single insurance undertaking is not in the position to fulfill this requirement, the insurer has to submit a solvency or funding plan to the supervisory authority, which has to approve the plan.

In line with insurance companies, *Pensionskassen* have to ensure that their liabilities under the insurance contracts can be fulfilled at all times by means of the type, scope and quality of the coverage assets. Therefore the coverage assets must take due account of risk. For example, the required guarantee assets and other restricted assets must be covered by investments which meet the statutory eligibility requirements, especially in terms of safety, liquidity and profitability. In addition, all items enclosed in the portfolio should be diversified.

4.2.3 PENSIONSFONDS

Generally, *Pensionfonds* are in principal subject to provisions also governing life insurance companies. This includes being obligated to maintain a sufficient capitalisation base and to observe special investment principles and requirements for coverage assets, in particular. In addition, there are reporting requirements and minimum standards of risk-monitoring. These are the same requirements as for regulated *Pensionskassen* as set out in 4.2.2.

4.3 Taxation

Pensionskassen and *Versorgungswerke* are exempt from corporate income and trade tax. *Pensionsfonds* are generally taxable entities and therefore subject to corporate income tax at a rate of 15% (plus a 5.5% solidarity surcharge) and to trade tax at rates ranging between approximately 7% and 17%, depending on the municipality where the investor is located. However, they are allowed to build up accruals for their liabilities towards their policyholders which they can deduct from their tax basis. This will result in a very low effective taxation.

As all these investors are either tax exempt or subject to low taxation in Germany, they tend to prefer investments either directly or through fund or holding structures which provide for a low foreign tax loss, which means that the income will be subject predominantly to tax in Germany.

Foreign pension funds and comparable schemes would be compared to German entities for tax purposes. Depending on the outcome of such comparison, the foreign pension scheme would generally be treated in the same manner, especially if the foreign pension fund is located in a EU state. However, it cannot be guaranteed that the tax authorities will not take a different view.

The German tax authorities take the view that German pension funds should be considered residents of Germany for purposes of tax treaties and therefore entitled to the benefits such as the reduction of source state withholding tax even to the extent they are tax exempt. Under some tax treaties, for example, with the United States, pension funds there are subjected to additional requirements in order to get treaty access.

5 THE NETHERLANDS

5.1 General / legal form

The Netherlands have a long standing tradition of pension funds. The majority of company or industry pension funds have the form of a Dutch foundation or *stichting*. A pension fund may also be structured as a limited liability company (*besloten vennootschap*) or a public liability company (*naamloze vennootschap*).

5.2 Regulatory framework

Under the Dutch Pension Act, pension funds may only perform activities in connection with pension and pension-related activities. However, the scope of these permitted activities is not completely clear. The core activity of pension funds is investing received pension contributions but the Dutch Pension Act does not contain specific investment regulations or limitations.

As a general rule, pension funds should make their investments on the basis of the "prudent person rule". This means that, in principle, pension funds are free to choose their investments – including real estate investments, investments in domestic and foreign real estate funds, etc. – but these should always be made in the best interest of the persons entitled to pensions. Pension funds should therefore consider the impact of an investment on their overall portfolio, also taking into account their obligations for the short- and long-term.

The management board of a pension fund is required to draw up a declaration which gives a concise overview of the investment policy of the pension fund and its related risks.

Finally, secondary activities should be exercised in an entirely separate legal entity. The pension fund is allowed to participate in that legal entity, but a situation where the management board of the pension fund and the separate legal entity consists mainly of the same persons should be avoided.

5.3 Taxation

5.3.1 CORPORATE INCOME TAX

Dutch resident pension funds are generally exempt from Dutch corporate income tax (CIT) on their income, including any income derived from real estate held directly or indirectly through a tax transparent entity. Based on a Ministerial Decree, non-Dutch resident pension funds deriving income from the Netherlands may also be exempt from CIT on request provided their core activity is to manage pension schemes or early retirement schemes comparable to the Dutch schemes.

For pension funds to qualify for the CIT exemption, 90% of their core activities should be directly related to managing qualifying pension schemes or early retirement schemes which provide for the care of (former) employees and, in some cases, their relatives. In addition, the profit of the pension fund should only be applied for the benefit of the insured persons, certain exempt entities or the public interest, except for a distribution of a maximum 5% per year on the paid-up capital or contributions. Pension funds with the legal form of a limited liability company, public liability company or another entity with capital divided into shares are not exempt from CIT if the (former) employees or eligible close relatives, jointly or separately, directly or indirectly, hold an interest of at least 10% of the nominal paid up capital of that entity.

In line with this, the secondary activities of pension funds may retain their CIT exemption as long as non-core activities make up no more than 10% of activities. However, since January 2004, profits obtained by pension funds from certain designated commercial activities may be fully subject to CIT. The pension funds should however retain the full exemption regarding profits from their core activities.

The Dutch Under-Minister of Finance has not yet published the implementing regulation designating those commercial activities so the partial CIT liability is therefore not yet effective. It is noted that if a pension fund has a substantial stake in a real estate investment fund with an active investment strategy, the question may arise as to whether the investment falls into these certain designated commercial activities as it may not be considered a passive investment.

Furthermore, it is interesting to note that the shareholder's requirements applicable to Dutch REITs imply that pension funds are allowed to hold 100% of the shares in a Dutch REIT.

If the secondary activities of pension funds make up more than 10% of total activities, pension funds will be fully subject to CIT at the statutory rate of 25% in 2012. The first €200,000 of profits are subject to a 20% CIT rate.

The Dutch tax authorities take the view that Dutch pension funds, although exempt from CIT, should be considered residents of the Netherlands for purposes of tax treaties and therefore entitled to the benefits of such treaties with the reduction of source state withholding tax.

Under some Dutch tax treaties, for example the tax treaty with the United States, pension funds are explicitly considered a tax resident. The Dutch tax authorities further take the view that foreign pension funds are to be considered tax resident under a tax treaty if the other State considers a Dutch pension fund as a tax resident.

5.3.2 DIVIDEND WITHHOLDING TAX

In addition to the CIT exemption, Dutch pension funds can claim a full refund of Dutch dividend withholding tax which was withheld by a Dutch company on a dividend payment. This refund is also applicable to pension funds established within the European Union and in other states with which the Netherlands has a bilateral or multilateral agreement with exchange of information provisions and which are comparable to a Dutch pension fund (for example, not subject to tax in the country of establishment).

6 SWITZERLAND

6.1 General / legal form

The Swiss pension system is split into three pillars. The first pillar is the mandatory Old-Age and Survivors' Insurance where payments are continuously financed by current contributions while the second pillar comprises the actual pension funds.

The second is mandatory for employees with an annual salary of more than CHF24,360, whereas the first pillar only covers income between this minimum amount and a maximum of CHF83,520. In this case, the insured person can voluntarily insure up to the ten times the maximum amount in pillar two. The third pillar is optional and focuses on special savings accounts with banks as well as life insurance.

Pension funds (pillar two) are separate legal entities in the legal form of a foundation, a cooperative or a facility of the public law. The following information focuses only on the regulatory and tax environment of pillar two pension funds and cannot be applied to life insurances or savings accounts (pillar three).

6.2 Regulatory overview

Pension funds must register with the respective cantonal or federal supervising authority. They are free to organise, administrate and finance themselves within the framework of the applicable law, and therefore required to issue provisions on their organisation, administration, financing, control, benefits and how that relates to the employers, the insured and those who are entitled to benefits. The highest board of the pension fund is made up of representatives of employers and employees in equal parts.

The investments of the assets must be diversified and structured in line with an appropriate risk allocation. The risk assumed must be related to the structure of future obligations in the short-, medium- and long-term. The target return on investments must be in line with returns in the money, capital and real estate markets.

Pension funds are also restricted in the classes of assets they are allowed to invest in as well as in the quantity they may hold in relation to total assets. Pension funds may invest directly or indirectly in cash, bonds and certain other debt instruments, real estate, and participations in listed companies. Alternative investments are not permitted if they are combined with an obligation to make an additional contribution. If there is no such liability, pension funds may only invest in such alternative investments by means of diversified collective assets, diversified certificates or diversified structured products.

Investments in one debtor also may not make up more than 10% of the pension fund's total assets, with the exception of certain debtors such as the Swiss Federation. Participations in companies as well as real estate may not make up more than 5% of the pension fund's total assets. The investments of pension funds are further limited by investment allocation and may not make up more than 50% of the pension fund's total assets. Investment restrictions apply to collective capital investments as well as to derivative financial instruments. The latter, particularly, may not have a leverage effect on the overall assets of the pension fund.

Investments in mortgage titles may make up to 50% of the pension fund's overall assets. However, mortgage titles can only be granted up to a share of 80% of the respective real estate's fair market value.

As well as an individual real estate asset making up not more than 5% of the pension fund's total assets, total investments in real estate may also not make up more than 30% of the overall assets of the pension fund. In addition, only up to one third of such real estate investments may be allotted to foreign real estate investments. Any mortgages secured on the real estate may not exceed 30% of the fair market value of the respective real estate.

6.3 Taxation

Swiss pension funds are exempt from income and capital taxes. Foreign pension funds which are subject to Swiss income and capital taxes (for example, due to owning real estate in Switzerland) are generally not exempt from income and capital taxes. An exemption is only granted if the foreign pension fund provides financial security for employees of a Swiss domiciled company or a company with a permanent establishment in Switzerland. In practice, the tax administrations request that in order to grant a tax exemption to foreign pension funds at least one third of the respective foreign company's employees to whom the pension fund provides financial security are either working in Switzerland or are of Swiss nationality, even though there is no legal basis for this practice.

Domestic pension funds are subject to securities transfer taxes, whereas foreign pension funds are exempt from such duty. The securities transfer tax amounts up to 3% for foreign taxable securities, whereas the generally applicable rate for Swiss securities is 1.5%.

For Swiss withholding taxes, pension funds can fully reclaim any taxes withheld by domestic companies on their dividend distributions or interest payments on debt instruments. In an international context, a refund of foreign withholding taxes is subject to the respective double tax treaty. Since pension funds are generally tax exempt with regard to Swiss corporate income taxes, any residual withholding taxes of another state cannot be credited in Switzerland and constitutes a final tax burden. Therefore, many tax treaties Switzerland has agreed provide for a full exemption of withholding tax for pension funds in the other state, allocating the right of taxation (or exemption) to the state where the respective pension fund is domiciled.

7 UNITED KINGDOM

7.1 General / legal form

7.1.1 OCCUPATIONAL PENSION SCHEMES

Occupational pension schemes are almost always established under trust. Assets are held and benefits are administered by a board of trustees on behalf of the beneficiaries, in other words the members who participate in the scheme. Occupational pension schemes fall into two main categories:

(A) DEFINED BENEFIT "FINAL SALARY" SCHEMES

Members of a defined benefit scheme are promised a pension at retirement, usually based on a percentage of final pay. Employees may be required to contribute a percentage of pay in order to accrue benefits under the scheme but the employer is responsible for meeting the balance of the cost of providing the benefit.

(B) DEFINED CONTRIBUTION "MONEY PURCHASE" SCHEMES

Under a defined contribution or "money purchase" pension scheme, the level of benefit at retirement is not guaranteed. Instead, a member is entitled to whatever level of benefits can be purchased at retirement from a notional account established on his behalf, which consists of contributions paid by him and his employer together with the investment return on those contributions up to the date he draws his benefit.

7.1.2 PERSONAL PENSION SCHEMES

Personal pension schemes are established by insurance companies or others authorised to operate such schemes and offer pensions on a defined contribution basis. The member's benefit at retirement will be based on the contributions made to that account and the investment return.

Group personal pensions (GPPs) are an increasingly popular choice for employers who wish to offer some form of pension provision but who do not want the responsibility of an occupational pension scheme. An employer who offers a GPP chooses a provider and may choose a range of investment funds that the provider will offer its employees. Employers are often able to negotiate better terms for their staff on a group basis than individual employees would be able to access in the retail market.

7.2 Regulatory framework

7.2.1 OCCUPATIONAL PENSION SCHEMES

Occupational pension schemes are regulated by the Department for Work and Pensions and The Pensions Regulator. The Pensions Regulator's statutory objectives include: (a) promoting the good administration of work-based pension schemes by providing practical guidance for trustees and employers; and (b) protecting members' benefits and reducing the risk of calls upon the Pension Protection Fund (PPF) (see page 15) – by monitoring and regulating schemes' funding position.

Legislation requires defined benefit schemes to target a level of funding which is likely to be sufficient to provide the benefits promised to members. Since 2005, the PPF, a public body, has provided compensation for members of insolvent schemes. The PPF is financed by a levy on defined benefit pension schemes.

The rules of most occupational pension schemes give trustees a power to invest the scheme's assets as if they were "absolutely or beneficially entitled" to them. In principle, they are free to choose to invest in domestic or foreign real estate funds but when deciding on an investment strategy, they must consider:

- any investment restrictions contained in the scheme's governing documents;
- legislative provisions, notably the Occupational Pension Schemes (Investment) Regulations 2005;
- how suitable different asset classes are to meet the scheme's needs;
- the risk and returns involved with different types of investment;
- diversifying scheme investments; and
- cash flow requirements.

7.2.2 PERSONAL PENSION SCHEMES

Personal pension schemes are mainly regulated by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000. The Pensions Regulator also oversees these schemes to some extent and provides best practice guidance to employers who sponsor such schemes. The Financial Services Compensation Scheme provides compensation in the event of the failure of the provider.

7.3 Taxation

Registered pension schemes qualify for certain reliefs and exemptions from UK tax so as to encourage saving for retirement. In particular, income from the investments and deposits held by the pension scheme is exempt from income tax and any gains on the disposal/realisation of investments held for the purposes of the scheme are exempt from capital gains tax. The exemption extends to withholding taxes on dividends from UK REITs and distributions from unauthorised unit trusts with UK resident trustees. In addition, contributions by both members of the scheme and employers attract tax relief (subject to certain limits). Non-registered pension schemes do not benefit from this favourable tax treatment.

A registered pension scheme, which can be either an occupational pension scheme or a personal pension scheme, is one which has applied for registration with the UK tax authority, HM Revenue & Customs (HMRC) and satisfies certain conditions. In particular, in the case of an occupational pension scheme, the scheme must have been established by an employer or employers and, in respect of a personal pension scheme, it must have been established by a person with permission from the FSA. A pension scheme is not prevented from registering with HMRC even if it has been set up outside the UK; the same conditions apply provided the scheme administrator is resident in the UK or another EU member state. In the event that the pension scheme's registration is withdrawn by HMRC (for example as a result of the scheme failing to provide information to HMRC) this will result in an income tax charge; it is advisable to agree in advance with HMRC in the case of a non-UK pension scheme.

There are few restrictions on the activity of a registered pension scheme which prevent it from qualifying for the exemption from income tax and capital gains tax. However, tax charges do arise in relation to certain types of activity.

Income from trading activity undertaken by a registered pension scheme will be assessed for tax in the normal way and will not qualify for the particular tax exemptions that apply to income from investments held by the scheme. The distinction as to whether a person is trading or making investments depends on the facts of each case (for example, where assets are held for a short time period, this will support classification of an activity as a trade rather than as an investment). In addition, the exemptions from UK tax do not apply to income or capital gains arising from investments held by the pension scheme as a member of a property investment limited liability partnership (LLP). In other words, they do not apply to an LLP whose main business consists of investing in land where the principal part of its income is derived from the land. In practice, a pension scheme may undertake trading activity through an unauthorised unit trust to enjoy an effective exemption from UK tax on such activity.

Where a member is able to direct or influence the manner of investments the registered pension scheme makes, then, subject to certain exceptions, tax charges may arise if the scheme holds investments that are taxable property such as residential property and tangible moveable assets. A tax charge may also arise if an unauthorised payment is made to a member or employer by the registered pension scheme on the value of the payment.

As an alternative to direct investment in particular assets, a pension scheme may use its funds to pay premiums to an insurance company which will then use those premiums to acquire assets, the income and growth in value of which provide the benefits the insurance company has contracted to pay the pension scheme. To ensure a registered pension scheme using insurance policies is not at a disadvantage, the insurance company is entitled to exemption from UK corporation tax for income and gains on assets of its long-term insurance fund which are referable to pension business (in other words, business which is referable to contracts entered into for the purposes of registered pension schemes). The pension scheme would itself be exempt from tax on the receipts under the policy from the insurance company. This exemption does not apply to assets held by an insurance company as a member of a property investment LLP.

Some of the UK's double tax treaties, for example, the UK/US double tax treaty, expressly include pension schemes as being resident in a contracting state for the purposes of the treaty. In any event, however, HMRC take the view that UK pension schemes should be considered resident in the UK for the purposes of claiming the benefit of the provisions of the UK's double tax treaties.

8 UNITED STATES

8.1 General / legal form

Generally speaking, there are two types of pension plans: defined benefit plans and defined contribution plans. A defined benefit plan promises participants a specified monthly benefit at retirement. The plan may state this promised benefit as an exact dollar amount, such as $100 per month at retirement or, more commonly, it may calculate a benefit through a plan formula that considers such factors as salary and service (for example, 1% of average salary for the last five years of employment for every year of service with an employer).

A defined contribution plan, on the other hand, does not promise a specific amount of benefits at retirement. Rather, the participant or the employer (or both) contribute to the participant's individual account under the plan. Contributions are sometimes made at a set rate, such as 5% of their earnings annually. These contributions generally are invested on the participant's behalf, and the participants ultimately receive the balance, which is based on contributions plus or minus investment gains or losses, in their account. The value of the account will fluctuate due to changes in the value of investments. Examples of defined contribution plans include 401(k) plans, 403(b) plans, employee stock ownership plans, and profit-sharing plans.

A money purchase pension plan is a plan that requires fixed annual contributions from an employer to a participant's individual account. Because a money purchase pension plan requires these regular contributions, the plan is subject to certain funding and other rules.

8.2 Regulatory overview

The general rules of Employee Retirement Income Security Act (ERISA) apply to each of these types of plans, but some special rules also apply. ERISA protects plans from mismanagement and misuse of assets through its fiduciary provisions. ERISA defines a fiduciary as anyone who exercises discretionary control or authority over plan management or plan assets, anyone with discretionary authority or responsibility for the administration of a plan, or anyone who provides investment advice to a plan for compensation or has any authority or responsibility to do so. Plan fiduciaries include, for example, plan trustees, plan administrators, and members of a plan's investment committee.

The primary responsibility of fiduciaries is to run a plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries must act prudently and must diversify the plan's investments in order to minimise the risk of large losses. In addition, they must follow the terms of plan documents to the extent that the plan terms are consistent with ERISA. They also must avoid conflicts on behalf of the plan that benefit parties related to the plan, such as other fiduciaries, service providers, or the plan sponsor. Fiduciaries that do not follow these principles of conduct may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of plan assets. Courts may take whatever action is appropriate against fiduciaries that breach their duties under ERISA, including removal of fiduciaries.

The US Department of Labor's Employee Benefits Security Administration is the agency charged with enforcing the rules governing the conduct of plan managers, investment of plan assets, reporting and disclosure of plan information, enforcement of the fiduciary provisions of the law, and workers' benefit rights.

8.3 Taxation

US qualified pension plans are generally exempt from US taxation on passive income related to the organisation's exempt purpose. The general exemption from taxation does not apply to unrelated business taxable income (UBTI), whether realised by the tax exempt organisation directly or indirectly through a partnership or limited liability company. UBTI is generally defined as any gross income derived by a tax-exempt entity from an unrelated trade or business that it regularly carries on and that is not related to its exempt purpose minus deductions directly connected with that trade or business. Under Internal Revenue Code and Income Tax Regulations, most types of passive income, related to the organisation's exempts purpose, are not treated as UBTI. These exclusions include dividends, interest, capital gains, and certain rents from real property.

Most governmental plans take the position that, as governmental entities, they are not subject to tax on UBTI. Nevertheless, some governmental plans seek to avoid or minimise UBTI, especially if UBTI can be avoided or minimised at little expense.

To qualify for tax-exempt status, pension plans must comply with an array of legal requirements specified in the Code and Regulations. For example, plan sponsors are required to establish and maintain an updated, legally compliant, written pension plan document that is communicated to employees and describes the specific terms and benefits provided under the plan. Failure to maintain compliance with qualification requirements may ultimately lead to revocation of a plan's qualified status, including the loss of tax benefits, which could potentially harm innocent pension plan participants.

Foreign pension plans are generally taxed like other foreign investors, which mean that they are subject to US income tax on income that is effectively connected with a US trade or business (ECI) or otherwise qualifies as US source income. Under section 892 income through certain investments in the US (for example, stocks, bonds and other financial instruments) earned by foreign pension plans that are controlled by a foreign government is exempt. In addition to US income tax, foreign pension plans qualifying as a foreign corporation may also be subject to a 30% branch profits tax when earnings and profits that are derived from ECI are withdrawn from the corporation's US trade or business ("branch").

Non-ECI income which qualifies as Fixed, Determinable, Annual, Periodical (FDAP) income such as received dividend and interest payments is subject to a 30% income tax rate. In many cases foreign pension plans may benefit from double tax treaty protection as in principle the US strives to grant access to foreign pension plans in their double tax treaties. As such, the effective tax burden of foreign pension plans with real estate investments in the US may be lowered.

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