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Insights

UK BUDGET 2021: TAX IMPACT ON REAL ESTATE SECTOR

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SUMMARY

The Chancellor trailed a number of the tax announcements for real estate well before today. However, it was noticeable that there were nuances in the Budget announcements. Previously unannounced measures will ease the impact of pre-announced changes for taxpayers.

SO WHAT'S NEW?

The rate of corporation tax is jumping up to 25% from April 2023 for larger businesses

Relevant to onshore and offshore corporate landlords of UK real estate, the Chancellor announced that the corporation tax rate will jump up from 19% to 25% from April 2023 for larger businesses. The much quoted prediction of an incremental increase in rates starting from the autumn was missing.

However, to soften the blow for small businesses, the Chancellor has taken small companies with profits of less than £50k out of this increase and tapered the rate for profits up to £250k.

We are therefore reverting to an earlier situation of a main rate of corporation tax for larger businesses and a small profits rate for smaller businesses.

For larger non-resident corporate landlords used to paying 20% income tax on rents up until April 2020, the switch to a 25% corporation tax on a broader tax base may come as a sting in the tail. However, funds investing in UK real estate can take some comfort that a separate work stream is underway to improve the attractiveness of UK REITs, which are exempt from UK tax on their property rental business. For more information, please see our blog on REITs.

A £25bn giveaway on plant and machinery allowances – the super-deduction

The Chancellor's biggest giveaway (projected cost to the exchequer of c. £25bn) will introduce enhanced capital allowances on expenditure on plant and machinery incurred between 1 April 2021 and 31 March 2023.

What items?

The enhanced allowances are for “plant & machinery”. From the perspective of the property industry, this is one of the two main categories of expenditure already attracting capital allowances. The other category, structures and building allowances, do not benefit from today’s announcement.

Certain items are excluded (for example, expenditure on vehicles or on the provision of plant and machinery for leasing). Accordingly landlords would not benefit from the enhanced rates for any plant and machinery located in any tenant’s demise. However, it is likely that expenditure incurred by a landlord on the common parts (such as escalators) is capable of falling outside of this exclusion.

What conditions?

In order to benefit from enhanced allowances, there are a number of conditions, the principal ones being:

- The assets must be unused and not second hand.
- The expenditure must be “incurred” on or after 1 April 2021 but on or before 31 March 2023. “Incurred” has its usual capital allowance meaning, namely generally when the payment obligation becomes unconditional (even if payment is to be in the future) – this is subject to special rules, notably for payments left outstanding for 4 months or more, and for staged payments under long-term contracts. Businesses with substantial capital expenditure on plant and machinery should have regard to these rules, so as to maximise the amount of plant and machinery expenditure that will be incurred within the 1 April 2021 to 31 March 2023 window.
- The expenditure must not be incurred pursuant to a contract entered into prior to 3 March 2021. For the avoidance of doubt, expenditure under a contract entered into before today but “incurred” in the 1 April 2021 and 31 March 2023 period, will not benefit from the enhanced allowances.
- The expenditure should be incurred by a company, as opposed to a partnership or an LLP.

How much?

For items that currently attract plant and machinery allowances at the regular rate of 18% per year, a one-off first year allowance of 130% is given (called a “super-deduction”). Expenditure of £100 in a year will result in a deemed expense of £130, fully deductible against profits of the business in that year (and to the extent unused, it can be carried forward to be deductible against profits of future years subject to the usual rules). If a business's accounting period straddles 1 April 2023, the rate of super-deduction for expenditure incurred before 1 April 2023 will be between 100% and 130%, depending on what proportion of the accounting period occurs before 1 April 2023. Again, businesses may wish to consider taking care as to which accounting period expenditure falls into.

For items that currently attract allowances at the lower rate of 6% per year (long life assets, integral features), a one-off first year allowance of 50% will be given (called a “special rate deduction”). Expenditure of £100 in a year results in (a) tax deductible expense of £50 fully deductible against profits of the business in that year (and to the extent unused, it can be carried forward to be deductible against profits of future years subject to the usual rules) and (b) capital allowances on the remaining £50 written down at 6% per annum from the following year.

Other points

Other rules include those relating to the calculation of balancing charges on disposals and to counteract “contrived, abnormal or lacking genuine commercial purpose” arrangements to increase availability of enhanced allowances.

More flexible loss relief for businesses badly hit by COVID-19

The Chancellor has responded to calls to make loss relief rules more flexible by allowing a three-year carry back of trading losses arising during tax years 2020/21 and 2021/22 to be set against profits of earlier years. This is available to companies and individuals, but is subject to a £2m cap of unused losses. This measure should allow affected businesses to get a tax refund, and thereby a cash flow benefit, for up to two additional years of loss carry back. Currently, trading losses can only be carried back for 12 months.

As this measure is targeted at trading losses, it will not help landlords that have made losses due to rent arrears.

There is an extended stamp duty land tax holiday with a tapering of the relief to ease transition back to pre-holiday rates

The Chancellor officially confirmed an extension of the £500k stamp duty holiday until the end of June 2021, but went further by providing a further holiday for the first £250k from July 2021 until the end of September 2021.

There will be a huge sigh of relief for those already on track to buy their property as this should avoid a difficult conversation about who was otherwise going to bear the stamp duty cost if they had missed the completion deadline of 31 March 2021.

The stamp duty holiday, coupled with the government offering to guarantee 95% mortgages for property purchases up to £600k, is clearly aimed to stimulate the residential housing market.

The non-resident surcharge for acquiring residential property

This is not new, but by way of reminder, non-residents (and certain UK tax resident companies with material non-resident investors) will be paying an additional 2% stamp duty land tax surcharge on the purchase of residential property from 1 April 2021. The non-resident surcharge should not apply to transactions where 6-or-more dwellings are acquired; the commercial SDLT rates should apply instead.

The reduced rate of VAT for the hospitality industry will be extended with a further discount until normal rates resume

The Chancellor announced a further extension to the reduced 5% VAT rate for the hospitality industry (including food, hotels, restaurants and cinemas) until the end of September 2021 and went further by allowing a 12.5% VAT rate for the following six months until 31 March 2022. From 1 April 2022 it will revert to the standard rate.

The Freeports have been announced

The Chancellor has announced the location of eight new English Freeports. These will be based in East Midlands Airport, Felixstowe & Harwich, Humber, Liverpool City Region, Plymouth, Solent, Thames and Teesside. Once tax sites within these Freeports have been designated, businesses in those tax sites will be able to benefit from a number of tax reliefs, such as enhanced capital allowances, a stamp duty land tax exemption and business rates relief. The Freeport itself will offer customs and VAT advantages for business operating through it.

A tax deduction is available for business rates relief handed back to government

Not strictly a new announcement, but as trailed in December 2020, businesses that have handed back business rates relief to government will be interested to see this relief. It applies where a business makes a payment to a public authority to repay coronavirus support or relief.

SO WHAT WASN’T MENTIONED?

A new tax on larger residential developers

Large residential developers are still waiting for the details of a new developer tax to help fund cladding remediation costs. This is to be introduced alongside a levy on developing certain high-rise buildings in England. Will the new tax for developers be a corporation tax surcharge on profits so that only profitable companies pay? The consultation is expected to be launched on 23 March 2021.

Plans to reform business rates longer term

Although hospitality, leisure and retailer operators will be pleased that the business rates holiday is being extended (as discussed in our blog 'UK Budget 2021: Business Rates Update'), they will need to wait longer for any more radical reform of this outdated tax. The final report on the business rates review has now been delayed until the autumn, with just an interim response expected on 23 March 2021. This means that retailers will need to wait even longer to see if the Chancellor takes the more radical step of introducing an online sales tax to do more to level the playing field between bricks and mortar and online retailers.

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