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Insights

SPRING BUDGET 2023 – TAX IMPACT ON THE REAL ESTATE SECTOR

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SUMMARY

Underneath the headline points, the Budget contained a number of measures designed to fulfil the Chancellor's objective of encouraging growth and investment. There was broadly good news for those investing in UK real estate. We look at some of the key announcements relevant to real estate below.

Capital Allowances

After the Chancellor confirmed that the corporation tax rate would be increased to 25%, one question in the minds of business was about changes to the tax system to incentivise capital investment. We now have the answer.

Capital allowances (the tax equivalent of accounting depreciation for capital expenditure) are being made more generous than expected (though less generous than the "super-deductions" given during COVID).

The headline point is that for expenditure from April 2023 until the end of March 2026 (and potentially beyond), companies incurring expenditure and which are subject to corporation tax can claim:

- 100% capital allowances (ie, full tax deduction for the expense in the year of expense) on investment in **new** (ie, not second-hand) general plant and machinery; and
- 50% first year allowances (ie, tax deduction for half the expense in the year of expense) on investment on special rate plant and machinery (including long-life assets and integral features). The remainder of the expense (50%) will be deductible in subsequent years in accordance with the usual rules, ie 6% annual allowances on a reducing balance basis.

These new rates compare with 130% “super allowances” for general plant and machinery and 50% first year allowances for special rate plant and machinery given in 2021, which apply until the end of this month. However, these new rates are noticeably more generous that the 18% annual allowances on a reducing balance basis for general plant and machinery, and 6% annual allowances on the same basis for special rate plant and machinery given before 2021.

The availability of both the 100% rate and the 50% rate is subject to the usual restrictions on first year allowances. In particular, these rates are only available on the acquisition of **new** assets. These is also a restriction on “assets acquired for leasing”, but as this restriction does not apply to fixtures generally included in buildings (“background fixtures”), this latter restriction should not materially affect landlords.

If a taxpayer disposes of an asset that has attracted the new allowances, the taxpayer is subject to an immediate balancing charge equal to 100% of its disposal value (general assets)/ 50% of the disposal value (special rate assets).

Investment zones

The Chancellor hopes to catalyse growth clusters across the UK by creating up to 12 new investment zones in the UK. Possible areas for investment zones in England have already been identified. A package of measures are intended to make investment in those areas more attractive, including tax relief. Special tax reliefs similar to those available to freeports (except for customs) will be on offer for a time limited period. Special tax sites will be approved by the government within the investment zones. The government is looking for growth in these zones in one of five key areas: technology, creative industries, life sciences, advanced manufacturing and “the green sector”.

The investment zone proposal was first announced by Kwasi Kwarteng. Hunt’s version is scaled back and more focused.

Sovereign wealth

The Chancellor has decided not to change the current exemptions from UK tax for sovereign investors. He has listened to feedback given in the consultation to reform the current exemptions from UK tax for sovereign investors (see our blog).   Initially, the government was considering reducing the existing immunity from UK tax for sovereign investors from April 2024 in a way which would have withdrawn the exemption from UK tax on income and capital profits from investing in UK real estate.

Interest deductibility

The Chancellor announced a number of technical changes to the corporate interest restriction rules, which can limit tax deductions for interest on a group basis. The changes are intended to protect the Exchequer, remove unfair outcomes and reduce administrative burdens for businesses. In most cases, these will take effect for periods of account commencing on or after 1 April 2023.

REIT

The Chancellor confirmed three changes in relation to UK real estate investment trusts ("REITs") to take effect from 1 April 2023:

1. As trailed in December 2022, the requirement for a REIT to hold at least three properties has been removed for a REIT holding a single commercial property worth at least £20m. In our experience, because a "single property" was interpreted widely, relatively few REITs found this rule caused an obstacle to participating in the regime. However, this change should reduce uncertainty for some REITs and may allow the prospect of single asset REITs in a wider range of sectors.

2. We now have a glimpse of the proposed changes to the "three year rule", which provides that property developed by the REIT and sold within three years following practical completion will be treated as a disposal outside the REIT's tax exempt ring-fenced business, if the cost of development exceeded 30% of the fair value of the property on acquisition or entry into the REIT regime. Although the exact changes will only be known when the draft legislation is published, the policy paper suggests that the change is intended to prevent properties being caught by these rules simply because of increases in capital value before development commences.

3. A final proposed change will be to permit a REIT to pay property income dividends to a partnership partly subject to withholding and, to the extent partners in the REIT would be entitled to gross payment, partly gross.

These changes follow a theme of moderate but welcome changes to the UK REIT regime over recent years, which should continue to enhance its attractiveness to investors in UK real estate.

Other fund measures

The PIF - there was no announcement on the tax treatment of a new tax transparent unauthorised vehicle, the unauthorised co-ownership AIF (or "PIF", as it has become known in the market), so we will have to wait longer to see if the Government is able to deliver an onshore version of a JPUT.

Genuine diversity of ownership test (or "GDO") – the Chancellor has announced a change to this test (used to assess widely held ownership) as it is used for the purposes of qualifying asset holding companies, REITs and non-resident capital gains rules. The amendments provide that where an individual investment entity forms part of a wider fund arrangement, that entity can satisfy the GDO condition by reference to the arrangements as a whole (even if the individual entity would not satisfy the GDO condition when considered in isolation).

VAT and fund management fees – HMRC will publish its response to the consultation on reforming VAT and fund management fees "in the coming months". In the consultation, the government looks to improve legal clarity and certainty around the VAT treatment of fund management fees.

Carried interest - This measure will allow UK resident investment managers to make an election to accelerate their tax liabilities in order to align their timing with the position in other jurisdictions, where they may obtain double taxation relief. Amendments made under this measure will have effect for the tax year 2022 to 2023 and subsequent tax years.

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