Real Estate Tax Checklist

What should be on your radar?

December 2022

Introduction

As anticipated in our previous briefing, April saw the introduction of residential property developer tax and the qualifying asset holding company (QAHC) regime, as well as significant changes to the REIT rules. Unsurprisingly, that has not been followed by a pause in new developments to allow a time of quiet reflection for those interested in real estate taxation.

There is plenty going on of interest to those in the real estate sector, both domestically (e.g. the recent "mini-Budget" and Autumn Statement announcements) and internationally (e.g. the signing of a new UK/Luxembourg double tax treaty), and with so many tax developments progressing it can be difficult to stay on top of things. This briefing provides a checklist of the key tax issues to be aware of (including future developments) and sets out the actions you should be undertaking now in preparation.

How we can help

As one of largest teams of tax lawyers in the City, we advise on all tax issues relating to real estate, and are delighted to have recently further strengthened our practice with the arrival of Kyle Rainsford, who specialises in real estate taxation and real estate M&A.

We are currently advising clients on many of the matters identified in this briefing, and, through our membership of industry bodies and government working parties, are also involved in several of the new developments referred to here.

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Real Estate Vehicle Tax

Tax development	Introduction	What does this mean for the real estate sector?
New Luxembourg/UK double tax treaty	On 7 June 2022, the UK and Luxembourg signed a new double tax treaty (DTT) which could come into force as early as next year. The most significant change from the current DTT for real estate investors is the introduction of a rule which allows the UK to tax Luxembourg residents on gains arising on indirect disposals of UK real estate (and vice versa for indirect disposals by UK residents of Luxembourg real estate). Until now, the absence of this rule had made Luxembourg a popular choice for holding structures to invest into UK land. However, this change does not mean that sales by Luxembourg residents of all shares (or comparable interests) that derive over 50% of their value from UK land will, in fact, be taxed in the UK. This is because, broadly, disposals of interests in tax opaque property-owning entities are currently only within the scope of the UK's domestic non-resident CGT rules where the relevant interest derives 75% or more of its value from UK land. For more detail please see our briefing.	If Luxembourg ratifies the treaty by the end of 2022, these changes will come into force (i) from 6 April 2023 (for capital gains tax payers) or (ii) for financial years beginning on or after 1 April 2023 (for corporation tax payers). Real estate investors should therefore (if they have not already done so) start considering the impact on their current and future structures. In doing so, they should bear in mind that there is no grandfathering, meaning that the entire gain from the disposal of an interest in a UK property-rich vehicle by a Luxembourg resident would be subject to UK tax, including any part that has accrued before the changes to the treaty came into effect. However, a base cost uplift is available to 5 April 2019.
Proposed amendments to the QAHC Regime	The QAHC regime was only introduced in April, but the government has already published further draft legislation, primarily designed to make it more accessible for certain fund structures. In particular, the government envisages introducing special rules to facilitate access to the regime for parallel funds and aggregator funds. An aggregator fund is, essentially, a fund through which different associated funds hold their interests in the same underlying asset and a parallel fund is essentially, a fund that takes the form of a number of associated vehicles investing together in the same underlying assets. For more information about the QAHC regime, please see our full QAHC briefing.	The QAHC is a potentially attractive vehicle through which to hold real estate. This is particularly the case for overseas property due to the simplicity and breadth of the exemptions of tax on profits and gains from such property. These exemptions do not apply in relation to UK real estate, but the availability of other UK tax benefits, such as an exemption from having to withhold tax on interest, may make it a useful part of the toolkit when structuring the holding of such real estate. Aggregator and parallel funds are common fund arrangements, and amendments to the QAHC rules to facilitate their use of that vehicle would be welcome.
Potential introduction of unauthorised onshore contractual fund	As discussed in our last briefing, in February, the government confirmed that it will explore options for a new form of unauthorised fund in the form of a contractual scheme aimed at professional investors, envisaging that this will be an attractive vehicle for the real estate sector.	As discussed in our last briefing, the new form of UK unauthorised fund is an exciting development although much will turn on the extent of the tax privileges from which it benefits. If they mirror those that apply to the co-ownership authorised contractual scheme (CoACS), then the new vehicle may present a viable alternative for commonly used offshore structures (in particular, the JPUT).

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Changes to the REIT regime	As discussed in our last briefing, in February, the government announced that it is considering further changes to the REIT regime (e.g. allowing a REIT to hold a single property and amending the 3-year development rule) and said that it would explore whether some of them could be delivered in the next Finance Bill. Whilst there is no reason to think that further changes to the REIT regime are not still on the government's agenda, we have seen no draft legislation, and no announcements on the issue were made in the Autumn Statement. This does not preclude the possibility of changes being made in the Finance Act 2023, but may indicate a slower timescale.	The fact that the government looks set to introduce further reforms to make the REIT regime more attractive is welcome news for the real estate sector. We still do not yet know which reforms will be taken forward, and at what speed. We will know more about the likelihood of any making it into the Finance Act 2023 when the bill for it is formally introduced into Parliament, most probably in the spring.
Implementation of OECD Pillar Two (global minimum corporate tax rate) from 31 December 2023	As mentioned in previous briefings, the main plank of Pillar Two is the Global anti-Base Erosion rules (GloBE rules) that introduce a minimum global corporate tax rate for multinational enterprises (MNEs) that meet a €750m turnover threshold. There will be various exclusions, including for investment funds that are ultimate parent entities of an MNE group and pension funds (and any holding vehicles used by such funds). The GloBE rules will impose top-up taxes where the effective rate of tax of an MNE in a jurisdiction is below 15% and will also allow source taxation (for example, withholding taxes) on certain cross-border related-party payments that are taxed less than a minimum rate of 9%. The UK government has published draft implementation legislation and intends the first part of the rules to come into force on 31 December 2023. For further information on the UK implementation timetable please see our Autumn Statement briefing.	As GloBE focuses on an MNE's "effective tax rate" in a jurisdiction (and not that jurisdiction's headline rate), real estate businesses may need to carefully consider whether they may be affected by these rules, as tax benefits like certain allowances and deductions may reduce the effective tax rate. The GloBE Model Rules include an exclusion for "Real Estate Investment Vehicles". The scope of this exclusion is not entirely clear, particularly in relation to REITs. Helpfully, the draft UK rules specifically exempt UK REITs and overseas REIT equivalents, side-stepping this issue, although, given the international scope of the rules, REITs may need to consider whether other relevant jurisdictions in which they operate have taken a similar approach. For further information, see our article on the UK implementation of the regime, first published in the Tax Journal.

Bricks and mortar tax

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Government announces creation of investment zones	In September's mini-Budget the government announced a package of measures, (including planning liberalisation and generous tax reliefs) to create new investment zones, and, in the Autumn Statement, refocussed the proposal to catalyse a limited number of the "highest potential knowledge-intensive growth clusters". The proposed tax reliefs go beyond those currently available for freeports, with headline enhanced incentives including, (i) 0% employer NICs on new employee earnings of up to £50,270, and (ii) a 20% rate of structures and buildings allowances, relieving the cost of investment in just 5 years (assuming sufficient taxable profits). The tax incentives will be time-limited for 10 years. The start date for this 10-year period has not been confirmed. For more detail, please see our briefing.	The reliefs will only apply within designated investment zones, with the government saying in the Autumn Statement that the first clusters would be announced "in the coming months". Eight freeports were announced in March 2021, and the first of these became operational from November 2021. Similar timeframes might apply for setting up investment zones. It will be interesting to see whether the enhanced tax reliefs attract businesses to the new investment zones and what the impact will be on the surrounding area.
Increase in lower stamp duty land tax (SDLT) bands for residential transactions until 31 March 2025	In the mini-Budget on 23 September, the then Chancellor announced an increase in the SDLT 0% rate threshold of £125,000, so that it now applies to the first £250,000 of consideration. Consequentially, the 3% rate threshold for corporate purchasers and those purchasing a second property has increased by the same amount (so, now applying to the first £250,000 of consideration), as has the nil rate band for first time buyers (so, from £300,000 to £425,000) and the value up to which first time buyers' relief can be claimed (so, from £500,000 to £625,000). In addition, the 0% rate threshold which applies in calculating the SDLT due on rent payable under residential leases has been increased from £125,000 to £250,000. In the Autumn Statement the government announced that these threshold increases would end on 31 March 2025.	This will be welcome news for those involve in affected property transactions. The recent insertion of a time limit is intended to encourage transactions during what its expected to be a tough time for the UK economy. It will be interesting to see how the property market responds given the current economic climate.
HMRC nudge letters for non-resident landlords	HMRC has told the Chartered Institute of Taxation that it will be sending so-called 'nudge letters' to offshore corporates owning (or who have owned) UK property which HMRC's data analysis indicates may not have paid all their tax. The idea is that the letters will prompt compliance. There are two letters, one focussing on tax on rental income and annual tax on enveloped dwellings (ATED) liabilities and the other on gains made on disposals between 6 April 2015 and 5 April 2019 in relation to which no non-resident capital gains tax return was made.	This is another example of HMRC using data to identify possible non-compliance. As well as "nudging" corporate landlords, both letters also ask them to ask UK-resident individuals who have an interest in the corporate to make sure their related tax affairs are up to date. Although the letters are not formal enquiries, they should be taken seriously, with professional advice likely to be appropriate.

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End of super-deductions on 31 March 2023	Since 1 April 2021 companies have been able to claim (i) a 130% super deduction on expenditure on new plant and machinery which would otherwise qualify for the 18% main rate of capital allowances, and (ii) a special rate first year allowance at 50% for expenditure that would otherwise have qualified for the special rate writing down allowance, such as integral features or long life assets. These generous reliefs were always time-limited, with an end date of 31 March 2023.	Companies planning significant capital expenditure over the coming months may wish to consider bringing it forward to benefit from the super-deductions allowance. If a company's accounting period ends before 1 April 2023, qualifying expenditure incurred in that period will benefit from the 130% super deduction. Expenditure incurred before 1 April 2023 in accounting periods which straddle that date will benefit from a tapered rate of relief pro rata to how much of that accounting period falls before 1 April 2023. No relief is available for any expenditure incurred after 1 April 2023.
100% annual investment allowance (AIA) to be made permanent	The AIA enables businesses to claim a 100% deduction for capital expenditure on qualifying plant and machinery up to a specified limit. The AIA was set at £200,000 with effect from 1 January 2016 and was increased to £1 million on a temporary basis from 1 January 2019. This temporary increase has been subject to several extensions since it was first announced with the latest extension due to run out on 31 March 2023. Rather than yet another extension the government announced in the September mini-Budget that the AIA will be permanently set at £1 million.	The permanent rate will be welcome as it provides a greater level of certainty to businesses and removes the complexity of changing amounts. The government are hoping this permanent change will encourage further business investment and expect that that the new permanent allowance will cover the investment needs of 99% of the UK's businesses. Nevertheless the overall UK regime for deduction of capital expenditure remains less generous than those of our European neighbours and capital-intensive businesses will still be watching with interest at potential reforms to the capital allowances regime.
Online sales tax (OST) not to be introduced	In the Autumn Statement the government confirmed that it will not be introducing an OST. This follows on from a consultation which it ran earlier this year exploring the potential for such a tax as a means of funding a cut in business rates and rebalancing the taxation of the retail sector between online and in-store retail. The government has said that its decision not to introduce an OST reflects concerns raised about its complexity and the risk of creating unintended distortion or unfair outcomes between different business models.	The concerns identified in relation to introducing an OST are certainly valid ones, with the consultation document identifying various difficult distinctions (e.g. would "click and collect" be within scope and how would services be dealt with?). However, it remains to be seen if the government has any other proposals to address the underlying issues for in-store retailers that had led to the OST being considered.
HMRC consults on digitalising business rates	Last year the government committed to modernise and digitalise business rates by matching rates data with central HMRC tax data and enabling businesses to view rates information in one place alongside other tax information in a standardised way. Between 20 July and 30 September HMRC ran a follow up consultation seeking views on how to deliver that commitment.	If implemented, the proposals may be of some benefit to those holding multiple properties, with information about all properties owned by them potentially accessible in one place, in a standard format.

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Business rates support package	Various measures were announced in the Autumn Statement to reduce the burden of business rates, including, (I) freezing the business rate multiplier in 2023–24, (ii) ensuring that transitional relief relating to next year's revaluations does not come at the expense of those whose property's rateable value decreases, and (iii) extending and increasing Retail, Hospitality and Leisure Relief. In addition, the government has confirmed that the previously announced Improvement Relief (to ensure ratepayers do not see an increase in their rates for 12 months as a result of making qualifying improvements) will be introduced from April 2024 and will be available until 2028, at which point the government will review the measure.	This package, which the government says will provide targeted support worth £13.6 billion over the next 5 years, will be welcomed by businesses, especially in the current economic client. It will be interesting to see whether the government has any plans for more general reform of business rates, particularly, given the fact that the mooted online sales tax, which would have funded a reduction in business rates, is not going ahead (see above).
Court of Appeal holds that 12-month time limit applies to refunds of SDLT for contract not carried into effect	SDLT is usually due when the land interest is actually acquired, but it can be accelerated where there is "substantial performance" of the sale contract. This can occur when access is taken early or a "substantial" amount of the consideration is paid. Where SDLT is accelerated in this way if the contract is later not carried into effect or is annulled or cancelled the legislation provides for an ability for the SDLT to be repaid. In *Candy v HMRC* the Court of Appeal held that the fact that the SDLT could only be repaid by way of amendment to the original SDLT return meant that there was a 12-month time limit (running from when the SDLT return was required to be filed) to claim the refund. This time limit applied even if the taxpayer could never claim in time because the contract was cancelled more than 12 months after substantial performance.	Businesses which "substantially perform" contracts and accelerate SDLT should understand that the consequence of this decision is that if the contract is cancelled more than 12 months after the SDLT is due, no refund of the SDLT that is paid may be possible. If early access is to be taken for works more than 12 months before the anticipated completion date, it may be worth considering other potential structures.
Upper Tribunal (UT) holds that physical manifestation of a building required for construction to have begun for multiple dwelling relief (MDR) purposes	Last year we discussed the first tier tribunal (FTT) decision in the joint cases of *Ladson Preston Ltd* and *AKA Developments Greenfield v HMRC*. In both cases land with planning permission to construct multiple dwellings had been acquired, but in one bore holes had been dug by the purchaser whilst the other involved bare land. The FTT held that in neither case were there "multiple dwellings" for MDR purposes. The UT has upheld the FTT decision (but with slightly different reasoning) and shed some further light as to when a building has started to be constructed for MDR purposes, confirming that there must be a "physical manifestation" of the building. This is important because the MDR definition of "dwelling" includes a building that is "in the process of being constructed for use" as a dwelling.	The definition of dwelling for MDR purposes is very similar to the main SDLT definition of "residential property" and so this decision is likely to have wider SDLT relevance. Last year we commented that it would have been helpful if the FTT had given clearer guidance as to when construction has started, and the UT has provided a little more certainty. The confirmation that some form of physical manifestation is required is useful, as is the ruling that it must be of the building itself (which is why the UT held, using different reasoning to the FTT, that investigative bore holes did not suffice). Unfortunately, the UT declined to set out further guidance on what precise physical manifestation of a building is required, leaving purchasers unclear about precisely when after development has commenced MDR is available.

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