TRAVERS SMITH

Real Estate Tax Changes

What should be on your radar?

Autumn 2021

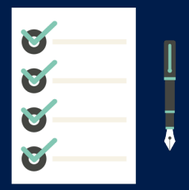
Introduction

The last few months have seen several significant developments in relation to tax. Whilst perhaps the most headlines were generated by the OECD's announcement that agreement has been reached on the introduction of important changes to global corporate tax rules, there have been several noteworthy developments from a domestic tax perspective, including the provision by the UK government of more details of the new tax on residential property developers and the new tax privileged regime for asset holding companies, both of which are due to come into force next April.

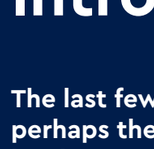
This briefing includes an overview of the key tax changes for the sector that have recently been implemented or are coming down the track in the next few months, plus a summary of some potentially significant future developments for both direct and indirect real estate investments. We also comment on what these developments might mean for the real estate sector.

How we can help

As one of the largest teams of tax lawyers in the City, we advise on all tax issues relating to real estate. We are currently advising clients on the matters identified in this briefing, and, through our membership of industry bodies and government working parties, are also involved in many of the new developments referred to here.



Key contacts



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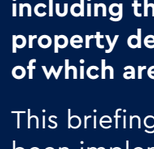

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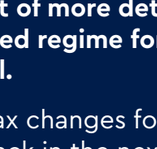

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Follow us on LinkedIn for updates from Travers Smith Tax.

Real Estate ("Bricks and Mortar") Tax

Tax Change	Introduction	What does this mean for the real estate sector?
Introduction of residential property developer tax (RPDT) from 1 April 2022	RPDT is part of a package of measures to help pay for the remediation works as a result of the cladding crisis, following the Grenfell Tower tragedy. The government is still working on its final design and has published draft legislation. The rate of tax is yet to be decided but the idea is to raise at least £2bn over a decade. RPDT will come into force from 1 April 2022. It is expected that RPDT will apply to corporation taxpayers in respect of their profits, exceeding an annual allowance, from residential property development activities relating to UK land in which they (or a related company) have (or have had) an interest. Importantly, it only applies to land held as trading stock by the developer (or related company) so, investors, including build-to-rent (BTR) operators, should not be within scope. Profits are calculated in the same way as for corporation trading profits but with important differences, for example, there are no deductions for finance costs. In addition, the regime contains various special rules for joint ventures. For more information on RPDT please click here.	RPDT will be another cost for residential property developers to take into account, impacting on profitability and, potentially, viability of projects. It is also possible that those subject to RPDT will be subject to the new Building Safety Levy – for more on which see below. It is interesting to note that the scope of the tax has been significantly modified as a result of government discussions with industry. For example, in the initial consultation on the design of the tax, the government had envisaged it applying to BTR activities and was considering its application to purpose-build student accommodation (PBSA), but both those asset classes should now be out of scope (in the case of PBSA, provided it is reasonable to expect that the building will be occupied by students on at least 165 days a year). Developers will want to keep an eye out for the Autumn Budget on 27 October, when the final design of the tax, including the rate, is expected to be announced.
Introduction of Building Safety Levy (sometimes called the "Gateway 2 Levy")	Like RPDT, the Building Safety Levy (the Levy) is to help fund remediation of defective cladding. The government is currently consulting on its design and calculation. Unlike the RPDT, there is no mention of any fixed sum to be raised or any time limit for the period the Levy would be imposed. There is also no mention yet of any rate, though two options have been proposed in respect of what it would be based on (i) a charge per square metre of the entire internal floor area, subject to certain exclusions, or (ii) a fee per residential unit in scope. The Levy will apply to new residential buildings which are 18 metres or more in height, or at least seven storeys tall, and will be payable (subject to exclusions such as for affordable housing) during the pre-construction stage at Gateway 2 (with potentially some ability to pay by instalments for smaller businesses). The definition of "residential" may differ from that used for RPDT and operate differently to SDLT generally. It is proposed that the Levy will be payable by any person or organisation for whom a construction project is carried out, including as part of their business.	The government expects the Levy to come into force alongside the new Gateway 2 planning process in 2023. Eventually, it will form part of a reform of the planning system by which Section 106 and CIL are replaced by a more formulaic approach, including this and the new Infrastructure Levy. Helpfully, all affordable housing looks like it should be out of scope of this Levy, but otherwise much remains uncertain, albeit it is clear that there could be potential overlap with the RPDT (see above). Given the potential impact of the Levy (and RPDT) on the sector, those potentially impacted will want to monitor developments closely. For more information please see our detailed briefing on the Levy.

Tax Change	Introduction	What does this mean for the real estate sector?
Introduction of various tax reliefs for businesses operating in tax sites in freeports	Eight "freeports" are to be introduced in England. These are 'zones' based around one or more transport hubs (such as a seaport, an airport or a rail hub), which offer certain customs, tax and planning benefits to businesses operating there. There are four main categories of tax relief that are potentially available (subject to meeting the relevant conditions) to businesses located in freeport "tax sites" (i.e. relatively small designated areas within a freeport) in England: • full or partial relief from stamp duty land tax (SDLT); • enhanced capital allowances, in the form of (a) enhanced structures and buildings allowances and (b) enhanced plant and machinery allowances; • relief from secondary Class 1 national insurance contributions (employer NICs); and • business rates relief. The rules relating to the reliefs (including the conditions and the circumstances in which they can be withdrawn) are quite complex. For further information, please see our briefing here.	The reliefs are fairly generous and, in many cases, will benefit landlords. For example, land used in the course of a (non-residential) property rental business is used in a "qualifying manner" for the purposes of the SDLT relief. So commercial landlords acquiring land contained entirely within a freeport tax site should be able to claim a complete exemption from SDLT on the purchase (partial relief is available where some of the transaction land is in a freeport tax site and some is not). On the other hand, landlords will not (at least as the legislation is currently drafted) be able to claim the enhanced plant and machinery allowances, which is disappointing and not in line with the position (eventually) adopted on the 130% so-called "super-deduction" (see below). And there are a number of other limitations/ downsides to the package of tax reliefs – they are time limited, the conditions are quite onerous in a number of respects and some of them are subject to clawback (notably SDLT) such that ongoing monitoring by taxpayers of the use of the property will be required. But considered in the round, this is a fairly generous package of reliefs that appears to have the potential to go a long way in incentivising businesses to set up or relocate to tax freeport sites.
HMRC change of policy on VAT self-supply charge relating to construction of care homes etc in light of *Balhousie*	Following the case of *Balhousie Holdings Limited*, HMRC have changed their policy about what constitutes the disposal of an "entire interest" in land for the purposes of the self-supply VAT charge relating to zero-rated acquisitions or construction of buildings certified as intended for use for a relevant residential purpose (RRP) or relevant charitable purpose (RCP). One of the scenarios in which a self-supply charge can arise is on a disposal (within 10 years of the acquisition/construction) of the "entire interest" in the RRP/RCP land. In *Balhousie*, the taxpayer had bought a care home under a zero-rated purchase and subsequently entered into a (simultaneous) sale and leaseback of the property, while continuing to run the care home throughout. The Supreme Court ruled that there was no disposal of the taxpayer's "entire interest" in the land since it had always had an interest in the property either as owner or lessee without interruption. The lower courts had accepted HMRC's argument that there were two separate transactions.	On 6 October 2021, HMRC published Revenue and Customs Brief 13 (2021), in which they accept that there will not be a disposal of an "entire interest" in land for the purposes of the VAT self-supply charge where certain conditions are met. In particular: • when the RCP/RRP property is sold, "there must be an immediate lease in place, which is a seamless transaction with no time lapse"; • the lease must be for the remaining term of the 10 years from the original purchase date (or longer); and • the property must be continually used or operated for a qualifying purpose, such that the business suffers no break in trade as a consequence of the sale and leaseback transaction. Taxpayers looking to enter into a sale and leaseback transaction of a property which they acquired under a VAT zero-rated transaction in reliance on the RRP/RCP provisions may draw some comfort from this change in HMRC policy. Having said that, HMRC seemingly had little alternative in light of the *Balhousie* judgment, and the conditions set out in the Brief arguably suggest that HMRC is looking to interpret the decision narrowly. Other recent case law (e.g, *A Blue UK Limited*) suggests that there could be developments in the VAT treatment of sale and leaseback transactions more generally – this is something that taxpayers entering into such transactions should monitor closely.

Tax Change	Introduction	What does this mean for the real estate sector?
Introduction of temporary super deductions and special rate allowance	For expenditure incurred from 1 April 2021 to 31 March 2023 (other than as a resulf of a contract entered into before 3 March 2021) companies will be 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. Importantly for the real estate investment sector, after industry lobbying, the original proposals were modified so that expenditure on so-called background plant and machinery in let property will also qualify. For more detail please read our Budget 2021 briefing on the topic and our later briefing on the extension of the allowances to background plant and machinery.	The increased allowances are aimed at encouraging investment and are likely to be helpful, at least in the short term. As the enhanced allowances only apply to expenditure incurred before the date on which the main rate of corporation tax is due to increase to 25% (1 April 2023), it may be that companies bring forward, to periods with a lower tax rate, investment that would otherwise have benefited from allowances when the tax rate is higher.
Court holds that planning permission (PP) not enough to make property "dwelling" for multiple dwelling relief (MDR)	In the recent joint cases of *Ladson Preston Ltd and AKA Developments Greenfield v HMRC*, the first tier tax tribunal (FTT) considered the meaning of "dwelling" for MDR purposes. Both cases concerned land over which PP had been granted for the construction of multiple dwellings. In one case, the land was bare land and in the other there were commercial buildings on the land but bore holes had been dug by the purchaser. The FTT considered that for MDR to apply the main subject matter of the transaction had to be multiple dwellings, and held that as the PP and activity of digging the bore holes could not be transferred (and the bore holes were anyway not the main subject matter of the transaction), this requirement was not satisfied.	The definition of dwelling for MDR purposes is very similar to the main SDLT definition of that term and includes a building (or part) that is in the process of being constructed or adapted for use as a single dwelling. The FTT considered this concept and, ideally, would have given clear guidance as to when it considered the construction process had started. However, although the FTT indicated that PP would not be enough, it seemed to shy away from being definitive on the point, instead basing its decision on the meaning of "dwelling" in the context of the wider MDR rules. Therefore, the extent of the "being constructed" limb of the general SDLT definition is still uncertain, although the judgment seems to indicate that some form of physical works is needed. Interestingly, it is currently proposed that express drafting is used so that in relation to RPDT, PP is enough to make a property "residential" and so potentially within scope of the new tax.
VAT option to tax notification time limit extension not renewed	Under the normal rules, HMRC must generally be notified of an option to tax within 30 days of the decision to opt being made. However, as a result of the Covid pandemic, HMRC temporarily extended the period to 90 days and allowed the notification to be made with electronic signatures. HMRC has now confirmed the end of the extension, so that the 90 day period is limited to decisions made between 15 February 2020 and 1 July 2021. HMRC has also confirmed that the ability to make notification with electronic signatures has been made permanent.	The time limit extension has been a helpful concession. As various Covid related measures are rolled back, the return to the statutory 30 day period is unsurprising. Businesses should take note that this shorter period now applies. Making the ability to use electronic signatures permanent is a sensible move by HMRC, but businesses looking to use this route should take care to comply with the evidentiary conditions relating to it.

Real Estate Vehicles Tax

Tax Change	Introduction	What does this mean for the real estate sector?
UK Funds Review	As discussed in our February briefing, the government has launched a review of the UK funds regime, covering tax and relevant areas of regulation, with the aim of ensuring that the UK asset management sector remains strong and competitive. The review includes a wide-ranging call for input which has now closed and in relation to which we are awaiting the government's response. More advanced are the introduction of a new tax privileged regime for asset holding companies (AHCs) (see below) and certain amendments to the REIT regime (see below). There is also to be a review of the VAT treatment of fund management fees, but that is yet to start.	The proposals to fill in the gaps in the UK funds offering and do more to assist the growth of related businesses across, and retention of asset management in, the UK are very welcome. The swift progress being made on AHCs and REITs is welcome news and and it is good to see that the government has taken on board industry feedback. It is hoped that the same approach will be taken in relation to proposals resulting from the call for input. The lack of progress on the VAT review of fund management fees is a little disappointing, as these can be a significant issue in fund structuring. Ideally, we will not have to wait much longer for the review to start.
New tax privileged regime for qualifying asset holding companies ("QAHCs") from April 2022	Draft legislation on several key aspects of the new regime for "QAHCs" has been published. A QAHC must satisfy several eligibility criteria, including that (broadly) it is an investment company 70% owned by "good investors" (including, diversely owned funds, pension funds, UK REITs (and certain similar overseas companies) and sovereign wealth funds). The generous tax benefits available to QAHCs do not apply to all their activities, in particular, UK real estate income and gains are subject to corporation tax in the normal way. However, QAHCs are exempt from gains on non-UK real estate and shares (provided the investee company is not UK property rich) and, provided it is subject to local taxation, non-UK real estate income. In addition, a QAHC is exempt from tax on profits from loans and derivative contracts relating to its overseas property business, does not have to withhold tax from interest paid to investors and can more easily make share repurchases that are treated as capital (rather than income) transactions for shareholders (with share repurchases also benefitting from an exemption from stamp duty).	The introduction of the QAHC should significantly enhance the UK's attractiveness as a jurisdiction through which to hold overseas property, with the simplicity and breadth of the exemptions of tax on profits and gains from such property being especially welcome. However, while the QAHC offers competitive tax advantages as a vehicle for the holding of non-UK real estate, following the principle of local taxation of real estate income and gains, it does not contain any special benefits for the holding of UK real estate, so income and gains on this would be subject to corporation tax in the usual way. Much fine tuning of the draft legislation is needed, with some significant areas under consideration. For more details of what the QAHC regime means for REITs please see our Finance Bill 2022 briefing.
Long-term asset fund (LTAF)	The LTAF is a proposed new FCA regulated open-ended fund, aimed at assisting with investment in long-term assets. For more detail, please see our February briefing.	The new fund is welcome, particularly as a vehicle through which defined contribution pension schemes (DC schemes) should be able to access long-term assets. Although the timing appears to be have slipped, with the prospect of having an LTAF up and running by this November now looking remote, progress is being made. In particular, the Productive Finance Working Group has recently published "a roadmap for increasing productive finance investment" containing recommendations focussing on supporting DC Scheme investment in illiquid assets, a key element of which was development of the LTAF. The FCA's final policy position on the LTAF is expected this Autumn.

Tax Change	Introduction	What does this mean for the real estate sector?
Amendments to the REIT regime	Draft legislation has been published containing changes to the REIT regime (effective from 1 April 2022) that are designed to make it more attractive. These include allowing REITs to be unlisted where one or more "institutional investors" hold at least 99% of the REIT's ordinary share capital and disapplying the "holders of excessive rights charge" in respect of property income distributions (PIDs) paid to investors who are entitled, under relevant UK domestic REIT withholding tax rules, to gross payment (but not those entitled to be paid gross by virtue of provisions outside the REIT code, such as by making a treaty relief claim).	These changes are very welcome and should facilitate the use of the UK REITs. In particular, the ability to have unlisted REITs should facilitate their use for suitable single investors or as an onshore joint venture vehicle for such investors, albeit the proposal does not go as far as many hoped, due to its restriction, effectively, to institutional investors. For more of our thoughts on the proposals please see our Finance Bill 2022 briefing. Further changes will also be made to the REIT regime as part of the wider funds review – though it seems on a later time scale – and we expect other detail to emerge as we find out more about the QAHC regime.
Professional Investor Fund (PIF)	The PIF, as proposed by AREF, would be a closed-ended or a hybrid (but not an open-ended/FCA authorised) fund and would have the form and tax treatment of the authorised contractual scheme (ACS). For more detail, please see our February briefing.	HM Treasury called for views on the PIF as part of the wide-ranging call for input forming part of the UK funds review (see above). However, we do not yet have any further detail, so must wait and see.
OECD Pillar One and Pillar Two	Widespread international agreement has been reached on a two pillar solution to address the tax challenges arising from the digitalisation of the economy (often called "BEPS 2.0"). The complex proposals, which will significantly reform the taxation of large multinational enterprises (MNEs), are yet to be finalised, but, in high level terms, it is expected that: • 'Pillar One' will re-allocate some taxing rights over MNEs from their home countries to the markets from which they derive revenue of at least €1m (or, for smaller jurisdictions with GDP lower than €40 billion, at least €250,000), regardless of whether they have a physical presence there. It will only apply to very large MNEs (global turnover above €20 billion (reducing to €10 billion in no earlier than seven years) and profitability above 10%) that do not fall within an exclusion; and • 'Pillar Two' will include Global anti-Base Erosion Rules (GloBE) under which a global minimum tax rate of 15% is to be introduced for MNEs that meet the €750m threshold for country-by-country reporting, subject to various exclusions. In addition to the GloBE proposals, Pillar Two will introduce new rules allowing jurisdictions to impose limited source taxation (e.g. withholding tax) on certain related party payments that will be subject to a tax rate below 9%. For more information on the proposals please see our briefing here.	The BEPS 2.0 proposals will be of interest to large MNEs but, given the high turnover threshold for the application of Pillar One, real estate focussed MNEs are more likely to be interested in how Pillar Two may impact on their business. Given that local jurisdictions normally retain local taxing rights and many popular investee jurisdictions have rates above 15%, at first sight, it may seem that the GloBE may not be relevant for most real estate businesses. However, as GloBE focuses on an MNE's "effective tax rate" in a jurisdiction (and not that jurisdiction's headline rate), that is likely to be too simplistic a view, and many real estate businesses may need to carefully consider their position. There is to be an exclusion from Pillar Two for investment funds that are ultimate parent entities of an MNE group. Back in October last year, the OECD produced a detailed blueprint for both pillars which included a definition of "investment fund", but there were some concerns as to whether it would extend to all REITs. Representations were made on the point, and, in any event, the proposals have moved on a lot in the last year, but this is something to look out for when the new rules are finalised. For those in the real estate sector with multi-national tax affairs, this is certainly an issue to watch.