CADWALADER

The UK's Autumn Budget 2021: Implications for Real Estate

November 30, 2021

By **Adam Blakemore**
Partner | Tax

By **Catherine Richardson**
Partner | Tax

By **Hugo Chan**
Associate | Tax

As we draw close to the end of the year, we take a moment to revisit some of the taxation changes announced in the Autumn budget, with some of these being implemented in the upcoming tax year in April 2022. Set out below are items which we think are of most interest to Cadwalader's clients in the real estate industry. Readers can also refer to our **memo** published on 28 October 2021 for discussions on other tax measures.

New Tax Regime for Asset Holding Companies

As part of the Government's wider review of the UK funds regime to boost the UK's competitiveness as a location for asset management, the Government will legislate to introduce a bespoke tax regime for qualifying asset holding companies ("QAHC"). This regime targets UK resident intermediate holding companies interposed between investors and underlying assets. The taxation in the new regime is based on existing UK tax rules but with some targeted modifications to address specific tax barriers which are considered to have discouraged the market from establishing asset holding companies in the UK.

The Government has conducted two consultations on this regime, and published on 20 July 2021 its response to the second-stage consultation, accompanied by some of the draft legislation which will be required for the operation of the new regime. The draft legislation prescribed a robust set of eligibility criteria to limit accessing the new regime's benefits to the intended users only, requiring a QAHC to be at least 70 percent owned by diversely owned funds or certain institutional investors, and to carry out investment activity with no more than insubstantial ancillary trading. Also, the benefits of the proposed regime will be applicable to the QAHC's investment activity only in respect of certain asset classes, such as non-UK land, certain shares and loans, and any derivative contract in relation to any asset previously mentioned.

Under the draft legislation and the accompanying policy paper, these benefits will include certain modifications to the corporation tax rules (such as allowing deductions for interest payments on certain profit-participating and results-dependent loans, exempting gains on disposal of certain shares and non-UK property, and exempting profits of a QAHC's non-UK property business, where those profits are subject to tax in a non-UK jurisdiction), withholding tax rules (by exempting withholding in relation to interest in respect of securities held by investors in that QAHC), and stamp taxes rules (by exempting repurchases by a QAHC of share and loan capital which it previously issued from stamp duty and stamp duty reserve tax).

The Budget confirms that this regime is intended to be legislated in Finance Bill 2021-22, and refers to the two consultations and the draft legislation. The policy paper in the Budget sets out further benefits that a QAHC will enjoy

under the regime (in addition to those mentioned in the policy paper published on 20 July 2021). These additional benefits include exempting the associated profits that arise from loan relationships and derivative contracts and allowing certain amounts paid to certain “non-domiciled” residents by a QAHC to be treated as non-UK source when such individuals claim the remittance basis for the purposes of UK income tax and capital gains tax.

The publications accompanying the Autumn Budget do not include a full suite of revised draft legislation for the QAHC regime. It therefore remains to be seen what further legislative changes will be made in respect of the points still being considered by the Government in accordance with its response to the second-stage consultation in July 2021 and the additional modifications mentioned in the Budget. In relation to the value added tax (“VAT”) treatment of fund management fees, the Government has announced in the Autumn Budget that it will consult on options to simplify the VAT treatment of fund management fees, a critical remaining piece in the regime before a successful launch can be achieved.

Real Estate Investment Trusts (“REITs”)

Responses to the asset holding company consultation in relation to investments in real estate led to proposals for changes to the REIT regime. With effect from 1 April 2022, the Government has announced that amendments will be made to the rules applying to REITs, including by relaxing or removing some of the conditions which determine whether a company qualifies to be a UK REIT.

Among other things, the proposed changes remove the requirement for REIT shares to be admitted to trading on a recognised stock exchange where institutional investors hold at least 70 percent of the ordinary share capital in the REIT, remove the “holders of excessive rights” charge where property income distributions are paid to investors entitled to gross payment, and introduce a new simplified “balance of business” test so that a REIT may not be required to prepare the additional statements required where the full test is otherwise met.

These amendments will no doubt be welcomed by the real estate investment sector, and will alleviate certain constraints and administrative burdens, thus further enhancing the attractiveness of the UK REIT regime.

Residential Property Developer Tax (“RPDT”)

The Government consulted on the policy design of the new Residential Property Developer Tax (“RPDT”) and conducted a technical consultation on the draft legislation during 2021. In Budget 2021, the Government confirmed the introduction of the RPDT with effect from 1 April 2022 for companies or groups of companies undertaking UK residential property development with annual profits in excess of £25 million. The Government announced in Budget 2021 that the rate of the RPDT would be 4 percent. The £25 million allowance can be allocated by the group between its companies.

Whilst hypothecated taxes are not a common feature of the UK tax system, revenues raised from the RPDT are intended to be used to fund cladding remediation and, thus, the RPDT is expected to be a time-limited tax. However, the draft legislation does not include a sunset clause, and respondents to the consultations noted that the expected revenues raised (expected to be £2 billion over a 10-year period) may be insufficient.

Non-profit housing developers and build-to-rent developers have been excluded from the scope of the RPDT.

Companies and groups engaging in residential property development will need to give careful consideration to the activities within scope and any reliefs (such as in respect of loss relief or group relief) which may be available.