Clients&FriendsAlert

UK Budget 2023 – Key Tax Measures

16 March 2023

The Chancellor of the Exchequer delivered the United Kingdom ("**UK**") Budget for 2023 on 15 March 2023.

The Budget was delivered against a backdrop of some familiar political headwinds, caused by the lengthy shockwaves of the Covid-19 pandemic, the war in Ukraine and high interest rates. The stated intention of the Chancellor was to restore economic stability, support UK public services, and lay the foundation for long-term growth. The tax developments announced in the Budget reinforce these objectives. Some of the technical taxation proposals in the Budget were published in draft legislative form by the UK Government in July 2022, but bear the signs of extensive consultation and development since their original announcement.

In this Client and Friends Alert we have outlined the key tax measures that we expect to be of interest to Cadwalader's clients and friends.

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Qualifying Asset Holding Companies

Since its introduction in April 2022, the UK's qualifying asset holding company ("**QAHC**") has been successful in terms of take-up and investor interest. The purpose of the regime is to deliver a proportionate and internationally competitive tax regime for asset holding companies which are resident in the UK, by means of a simplified set of tax rules applicable to QAHCs that are intended to tax investors as if they had invested directly in the QAHC's underlying assets.

One of the focus points of the QAHC regime has been facilitating investment by funds. In this context, the QAHC regime contains certain limitations on how an asset holding company owned by a private fund can qualify as a QAHC. One key condition is that the asset holding company must be owned as to at least 70 per cent. by "category A investors" which (relevantly for a private fund) includes a "qualifying fund". A "qualifying

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fund" is a collective investment scheme which meets a "genuine diversity of ownership" threshold.

Proposals were made by the UK Government in July 2022 for amendments to the QAHC regime, and those proposals have largely been confirmed in the Budget. Some additional provisions have also been announced.

The changes to the QAHC regime include the following provisions:

- The QAHC legislation shall be amended to confirm that a company which is within the tax-favoured regime for UK "securitisation companies" cannot also, simultaneously, be a QAHC. There has been some discussion of this point in the taxation press and HMRC consultation groups, but the statement by the UK Government in the Budget press releases, and any proposed legislative changes, will put the point beyond doubt.

- An amendment will be included in the QAHC legislation to allow an investment fund to be treated as meeting the genuine diversity of ownership threshold when that investment fund is closely associated with another investment fund that satisfies that threshold. The policy rationale is to facilitate investment by multi-vehicle, associated and parallel investment funds whose management is substantially coordinated such that they act together in relation to their investments as if they were a single fund.

- Changes will be made to the QAHC regime to facilitate participation in a QAHC by certain fund entities. When the QAHC regime was introduced, the definition of a "qualifying fund" required a fund vehicle to be a collective investment scheme ("**CIS**"), following the definition which is used UK tax purposes. Certain non-UK entities, that would be a CIS from a general perspective, might not fall within the precise UK tax definition if they were established as a body corporate under their local law. The UK Government has announced that amendments will be made to the QAHC legislation to ensure that fund vehicles which would be a CIS if they were not a body corporate shall be treated as if they were a CIS; such fund entities can therefore satisfy the requirement of being "qualifying funds", subject to other conditions being met.

- The existing anti-fragmentation rule in the QAHC legislation will be extended to exclude from the regime structures involving more than one QAHC in which the combined percentage of relevant interests that are not held by eligible "category A investors" exceed 30 per cent..

- Amendments will also be made to allow an election which treats listed securities as unlisted. The eligibility criteria for entrance into the QAHC regime includes an ownership, activity, and investment strategy condition, requiring

that the QAHC does not have a strategy of investing in listed equities or interests which derive their value from listed equity positions. The proposed change will allow a QAHC to hold listed securities and still meet the investment strategy condition, but the QAHC will be taxable on the dividend income receivable from such securities. Various protections will be included to prevent companies entering into arrangements to avoid the dividend income being taxable.

Most of the changes will have effect on and after the date of Royal Assent of Finance (No 2) Bill 2023 ("Finance Bill"). However, (i) the clarification that a securitisation company cannot also be a QAHC has effect from 15 March 2023 (the date of the Budget); (ii) the extension of the anti-fragmentation rule has effect from 20 July 2022 (when draft provisions were published); and (iii) the amendment to the definition of a collective investment scheme, and certain other changes, have effect from 1 April 2022 (the commencement of the QAHC regime).

UK Real Estate Investment Trusts ("REITs")

As part of a speech announcing the Edinburgh Reforms in December 2022, the UK Chancellor of the Exchequer announced that changes would be made to the UK REIT regime in the Finance Bill. These changes are motivated by the UK Government's intention to further increase the attractiveness of the REIT regime.

The changes will remove the requirement for a REIT to own at least three properties in its property rental business if the REIT holds a single commercial property worth at least £20 million.

The UK Government will also amend the rule that deems a disposal of property within three years of being significantly developed as being outside the property rental business of the UK REIT, so that the valuation used when calculating what constitutes a significant development better reflects increases in property values and is not distorted by inflation.

Changes will also be made to amend the rules for deduction of tax from property income distributions paid to partnerships to allow a property income distribution to be paid partly gross and partly with tax withheld. The distribution will be permitted to be paid gross to the extent that it is the income of partners that would be entitled to gross payment if they held an interest in the REIT directly.

These changes were welcomed by the UK property investment sector when announced in December 2022, and broaden the scope and flexibility of the UK REIT sector. The changes announced to the disposal of property will be introduced on 1 April 2023. The UK Government appears to intend that the other changes mentioned above related to REITs will be made with effect from Royal Asset to the Finance Bill

(although there is a slight conflict in the Budget documentation in respect of confirming that date as being the relevant one, as opposed to 1 April 2023).

Amendments to the Genuine Diversity of Ownership ("GDO") condition

The GDO condition is used as a condition in the QAHC, UK REIT and Non-Resident Capital Gains ("**NRCG**") rules. Under current law, the GDO condition must be applied to each entity within a fund structure in isolation. Therefore, a particular entity can fail to satisfy the GDO condition, even though it forms part of a wider arrangement which, taken as a whole, would meet the relevant requirements.

As noted above in the context of QAHCs, to address this problem, an amendment will be made to the GDO condition for the purposes of the QAHC regime, and comparable changes will be made to the REIT and NRCG rules. The legislative amendments will ensure that where an entity forms part of "multi-vehicle arrangements", the GDO condition can be treated as satisfied by the entity if the GDO condition is met in relation to "multi-vehicle arrangements".

The definition of "multi-vehicle arrangements" encompasses a group of entities which form part of a wider fund structure where an investor would reasonably regard their investment to be in the structure as a whole.

This measure will have effect on and after the date of Royal Asset to the Finance Bill.

Deeming certain non-UK shares acquired in a share exchange as UK shares

Under the UK's legislation for taxing chargeable gains, shareholders who exchange their shares under a "share-for-share" exchange will not generally be treated as having made a disposal of their original shares for the purposes of the taxation of chargeable gains. Instead, the shareholder is treated as having acquired the new shares at the same time, and for the same consideration, as the old shares.

Under current law, it is possible for UK resident non-domiciled individuals ("**non-doms**") to rely on the share-for-share exchange relief to exchange securities in a UK company for securities in a non-UK company. As the new securities do not have UK situs, the non-dom can then access the remittance basis of taxation on the gains realised on the disposal of the non-UK securities or distributions received in respect of those non-UK securities.

In order to ensure that non-doms are taxed on gains and distributions received where value has been built up in a UK business, proposals have been published in the Budget to deem any securities in a non-UK company which are acquired in exchange for securities in a UK company to be located in the UK for the purposes of capital gains tax and income tax. As such, non-doms will no longer be able to access the

remittance basis of taxation on gains or dividend and distribution income received in respect of those securities which will (after such changes are made) be deemed to be located in the UK. If securities deemed to be located in the UK by this measure are later exchanged for securities in another non-UK company, the newly acquired securities are also deemed to be located in the UK, regardless of the number of subsequent exchanges of such securities that take place.

This measure will apply if (i) an individual obtains non-UK securities in exchange for UK securities and either of sections 135 or 136 of the Taxation of Chargeable Gains Act 1992 applies; and (ii) the companies involved are close (or would be if it was a UK company) and the individual holds at least 5 per cent. of the securities in the UK company before exchange and in the non-UK company after exchange.

This measure will have effect for share exchanges or scheme of reconstruction carried out on or after 17 November 2022.

Technical Amendments to the Corporate Interest Restriction ("CIR") rules

This measure will make various technical revisions to the CIR rules to address a number of issues to protect the Exchequer and reduce unfair outcomes or high administrative burdens. Subject to certain exceptions, these revisions are to have effect for periods commencing on or after 1 April 2023.

Consolidation of the UK Government's powers to implement Automatic Exchange of Information ("AEOI") regimes

There are currently four international AEOI regimes: (i) the Common Reporting Standard ("**CRS**")/Foreign Account Tax Compliance Act ("**FATCA**"); (ii) Country by Country Reporting ("**CbCR**"); (iii) Mandatory Disclosure Rules ("**MDR**")/DAC6; and (iv) Reporting Rules for Digital Platforms.

These existing international AEOI regimes have been implemented under regulation-making powers. These are currently spread across four pieces of primary legislation that enable the regulations to be laid.

To simplify the tax code, this measure will consolidate these regulation-making powers into one piece of legislation. The previous primary legislations in relation to these powers will be repealed. The power to lay the MDR regulations will be amended so that it works as intended.

Capital Gains – Completion of Unconditional Contracts

The UK Government has announced changes to ensure that HMRC has time to assess tax due and that taxpayers can claim allowable losses, where there is a delay between

an unconditional contract being entered into and the asset being conveyed or transferred. Specifically the period for assessments in relation to chargeable gains and for claiming allowable losses will be modified from operating by reference to the tax year or accounting period in which the asset is conveyed or transferred rather than the tax year or accounting period in which the contract for disposal was made.

Whilst this measure has the potential to benefit taxpayers by protecting the period in which allowable losses are claimed, the policy objective is also targeted at removing avoidance opportunities by enabling HMRC to assess tax due where more than four years has passed between an unconditional contract being entered into and the asset being conveyed or transferred.

These changes will have effect in relation to assets disposed of, and acquired under, an unconditional contract entered into on or after 1 April 2023 for companies and 6 April 2023 for individuals (amongst others).

Carried Interest – Elective Accruals Basis

Whilst the taxation of carried interest is often mooted as a possible target of Budget announcements, the Budget has proposed only a minor (albeit meaningful) change. The UK Government has announced that changes will be made to ensure that effective double taxation relief can be claimed by UK tax resident individuals in receipt of carried interest.

At present, carried interest that is taxable under the capital gains tax regime is taxable when the carried interest arises to the individual. This position is not necessarily consistent with the taxation of carried interest in other jurisdictions and thus relief under a double taxation treaty may be precluded owing to timing differences in the recognition of such amounts. This has recently been a friction point between the respective UK and United States timing of the taxation of carried interest.

As such, the changes will permit an individual who expects to receive carried interest to make a voluntary but irrevocable election for that carried interest to be taxed on an accruals basis. This is intended to remedy the situation in which individuals cannot claim double taxation relief from other countries, owing to such amounts being taxed at different times in two jurisdictions.

This measure will take effect from the date on which the Finance Bill receives Royal Assent.

OECD BEPS Pillar 2 – Multinational Top-Up Tax and Domestic Top-Up Tax

Following a consultation on the UK implementation of the OECD Pillar Two, which closed in early 2022, the UK Government has confirmed its intention to introduce of both a multinational top-up tax and a domestic top-up tax.

The OECD Inclusive Framework's agreement on a two-pillar solution has been the scope of much discussion and is now moving towards implementation. As such, this announcement is not wholly unexpected. The changes address profit shifting and aggressive tax planning by imposing a floor on tax competition between jurisdictions by providing for minimum levels of corporation tax.

The multinational tax top-up will be charged on a "responsible member" of a qualifying multinational group, being a consolidated group where at least one of the members is not in the same territory as the others and the global annual revenues of the group exceed €750 million in at least two of the previous four accounting periods.

The domestic tax top-up will be charged on a "qualifying entity", being a UK member of a domestic or multinational enterprise group and that entity either has revenues, or is part of a group that has revenues, that exceed €750 million in at least two of the previous four accounting periods. The tax will apply when the group's profits arising in the UK are taxed below the minimum rate of 15 per cent.

Entities that are typically exempt from corporation tax (such as governmental entities, international organisations, non-profit organisations and pension funds) will be excluded from the rules. Entities that are the ultimate parent of a group and have a tax neutral investment status (such as investment funds and real estate investment vehicles) will also be excluded.

These measures will have effect in respect of in-scope groups' accounting periods beginning on or after 31 December 2023.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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