Budget summary
UK Spring Budget 2023
Key changes for real estate investment management

The UK Chancellor of the Exchequer, Jeremy Hunt, delivered his Budget on 15th March, disappointingly like other recent holders of the post opting to be sustained during his effort only with water, eschewing the historical tradition of a Budget tipple. Ken Clarke was the last to partake in alcohol, a large tumbler of Glenfarclas single malt whisky, a fine choice. William Gladstone fortified himself with sherry with a beaten egg in it.

On to more weighty matters, we are not covering everything, but picking out things that are, at least in our view, particularly interesting for real estate investment.

- Matters with a direct impact, being changes to:
  - REIT rules;
  - Qualifying Asset Holding Companies (QAHC) rules;
  - the Genuine Diversity of Ownership (GDO) condition.
- Slightly less direct:
  - A change to the carried interest rules.
- Changes (or not) that affect potential investors:
  - Sovereign immunity rules;
  - Charity provisions;
  - Local Government Pension Scheme
  - Technical changes for collective money purchase pension schemes.
- Some other stuff:
  - Capital allowances;
  - Interest deductions;
  - A couple of things that only affect massive companies;
  - Investment zones

REIT rules

As has been announced twice already, and of course covered in our newsletter, the government will legislate in the Spring Finance Bill 2023 to amend the REIT regime. Three changes have been announced, to:

- remove the requirement for a REIT to hold a minimum of three properties where it holds a single commercial property worth £20m or more;

- amend the rule that deems a disposal of property within 3 years of being significantly developed to be outside the property rental business; and

- amend the rules for deduction of tax from property income distributions paid to partnerships.

For those who want it, the technical detail is here.

There has been a lot of interest in setting up listed and unlisted REITs. This will be accelerated by the increase in the corporation tax rate from 19% to 25% from 1st April.

Qualifying Asset Holding Companies (QAHC) rules

Again a topic that we have been covering in our newsletter.

The need for tweaking of the QAHC regime that came into force on 1st April 2022 has been recognised for some time. Draft legislation was published in July last year. The amendments are proposed to:

- allow an investment fund to be treated as meeting the genuine diversity of ownership (GDO) condition when it is closely associated with another investment fund that meets that condition (more on this subject below);

- facilitate the entry into the QAHC regime of certain types of fund that are regarded as corporate entities;

- extend the existing anti-fragmentation rule, a slightly geeky change to exclude certain structures with more than one QAHC.

Again, for those who want it, the technical detail is here.

The Genuine Diversity of Ownership (GDO) condition

The GDO condition is used across a range of tax regimes with the purpose of preventing investment funds that are only open to a small number of predetermined investors from benefitting from those regimes. HMRC has been conducting a dialogue with the industry with a view to reforming the rules. The current proposal is to amend the GDO condition in the QAHC, REIT and Non-Resident Chargeable Gains (NRCG) rules. The changes will improve the operation of the GDO condition for fund structures involving multiple pooling vehicles.

More information can be found here.

A change to the carried interest rules

The proposal introduces an elective accruals basis for the carried interest rules. Although it may sound counter-intuitive to elect to be taxed earlier on carried interest, this allows the UK tax paid to be offset against overseas tax (e.g. US) to be paid on the same carried interest, so paying UK tax earlier to reduce tax overall.

More information can be found here.

Sovereign immunity rules

On 4th July last year, HM Treasury published a consultation on sovereign immunity from direct taxation which ran until 12th September. This proposed a significant change for investment in real estate by sovereign wealth funds. The proposal was that income and gains from trading and property would no longer be covered by sovereign immunity from direct taxation. This change would also cover distributions from REITs and PAIFs. The Spring Budget included an announcement that this is being knocked on the head:

The government has carefully considered the responses to the consultation on sovereign immunity from direct taxation. It has decided that there will be no change to the current exemption, and that it will continue to operate as it does now. The government welcomes the constructive engagement with sovereign investors during the consultation, and over the longer term.

Charity provisions

This proposal changes the tax definition of a charity to limit it to UK charities this excluding certain EU / EEA charities who previously qualified. The amendments do not have effect in respect of interests held prior to 15 March 2023 in determining whether or not a person is:

- An 'institutional investor' for the purposes of UK Real Estate Investment Trust rules;
- An 'eligible investor' for the purposes of the Exempt Unauthorised Unit Trust rules; or
- A 'relevant qualifying investor' for the purposes of the Qualifying Asset Holding Companies regime.

We have never come across this in practice, so have no idea how many investors this might affect.

More information can be found here.

Local Government Pension Scheme (LGPS)

The Budget included a statement on LGPS investment, which we reproduce below.

The government is challenging the Local Government Pension Scheme in England and Wales to move further and faster on consolidating assets – a forthcoming consultation will propose LGPS funds transfer all listed assets into their pools by March 2025, and Spring Budget 2023 set direction for the future. This may include moving towards a smaller number of pools in excess of £50 billion to optimise benefits of scale. While pooling has delivered substantial benefits so far, progress needs to accelerate to deliver and the government stands ready to take further action if needed. The Government will also consult on requiring LGPS funds to consider investment opportunities in illiquid assets such as venture and growth capital, thereby seeking to unlock some of the £364 billion of LGPS assets into long-term productive assets.

It is worth noting:

- The LGPS are already major investors in real estate as an asset class, and indeed in illiquid assets more broadly. In many ways they are the last bastion of defined benefit pension provision;

- Although the LGPS have put a lot of work into pooling their direct property, this is not straight-forward;

- For the first time, the LGPS are now in net outflow. Major reductions in council headcount since its heyday means that there is less money going into the top of the hopper than coming out at the bottom.

The government's aspirations need to be seen in context. We await the forthcoming consultation with interest.

Collective money purchase (CMP) pension schemes

John continues to be the only person in the real estate industry excited by this topic. The Pension Schemes Act 2021 introduced legislation to allow CMP pension schemes to operate in the UK. There is an ongoing consultation on extending this to multi-employer schemes, covered in our recent newsletter.

The Budget tax changes, which were originally announced in July last year, will clarify the tax treatment on transfers, periodic income and the valuation of dependant pension benefits during the winding-up phase of a CMP scheme. Whilst it is slightly odd to be thinking about the winding up arrangements before the schemes have been launched, it is always good to think about the destination before getting on the bus.

The actual changes are not of particular interest, but hopefully a point of detail to be crossed off for those looking to establish schemes.

For anyone sad enough to want to read it, the technical detail is here.

Capital allowances

This measure will temporarily increase the relief available for companies for capital expenditure on plant and machinery in the year the expenditure is incurred for qualifying expenditure incurred on or after 1 April 2023 but before 1 April 2026.

Companies can claim:

- a 100% first-year allowance for main rate expenditure – known as full expensing; and

- a 50% first-year allowance for special rate expenditure.

Key things to note are:

- “Special rate expenditure”, which is probably more of interest for real estate investors includes:
  - Integral features such as:
    - lifts, escalators and moving walkways
    - space and water heating systems
    - air-conditioning and air cooling systems
    - hot and cold water systems
    - electrical systems, including lighting systems
    - external solar shading
  - Fixtures and fittings
  - thermal insulation added to existing buildings
  - solar panels
  - certain “long life assets” with a useful life of at least 25 years

- The relief applies only to companies within the charge to corporation tax.

There are businesses whose sole purpose is to help people make capital allowances claims. We are sure that they are all over this.

Interest deductions

A veritable smörgåsbord of very technical changes to the Corporate Interest Restriction (CIR) rules, to correct perceived anomalies identified by a working group set up in July last year.

These are all set in the relevant policy paper, which you can find here.

A couple of things that only affect massive companies

There are two announcements that implement OECD tax proposals for multinational enterprises with global revenues of €750 million or more, both of which were announced last year:

- G20-OECD Pillar 2 multinational top-up tax and domestic top-up tax;

- Enhanced transfer pricing documentation

If anyone falling into this category would like to use our services, we should be delighted to partake in the crumbs from your table,

Investment zones

Following the demise of the "Freeports" initiative, the government has announced something similar as a successor, with the proposed establishment of twelve investment zones, eight in England and four, as yet unidentified in, Scotland, Wales and Northern Ireland.

The eight locations in England that have been shortlisted are:

- The proposed East Midlands Mayoral Combined County Authority
- Greater Manchester Mayoral Combined Authority
- Liverpool City Region Mayoral Combined Authority
- The proposed North East Mayoral Combined Authority
- South Yorkshire Mayoral Combined Authority
- Tees Valley Mayoral Combined Authority
- West Midlands Mayoral Combined Authority
- West Yorkshire Mayoral Combined Authority

The proposal is:

Investment Zones will have access to a single 5 year tax offer matching that in Freeports, consisting of enhanced rates of Capital Allowance, Structures and Buildings Allowance, and relief from Stamp Duty Land Tax, Business Rates and Employer National Insurance Contributions. Alongside this, Investment Zones will have access to flexible grant funding to support skills and incentivise apprenticeships, provide specialist business support and improve local infrastructure, dependent on local requirements. Local partners will be able to choose the number and size of tax sites, within the £80 million envelope, up to a maximum of 3 sites totalling 600 hectares. The amount of grant funding will depend on the number and size of tax sites.

HM Treasury and the Department for Levelling Up, Housing & Communities (DLUHC) has published an *Investment Zones Policy Offer,* which you can find here.

The areas listed above have been invited to begin discussions with the DLUHC and HM Treasury and commence the development of an Investment Zone proposal, working in partnership with Government. While specific timelines for submission are to be finalised, the Government has said that it wants to make rapid progress and intends to have the first proposals from areas with mature proposals agreed by the summer so planning and preparation for delivery can begin. Ultimately, they want to have all Investment Zone proposals agreed by the end of the financial year and expect funding to commence in the financial year 2024/2025.

More on this will follow as details become available.

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