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Section 35 and Schedule 4: investment vehicles

The heading “miscellaneous corporation tax matters” is particularly apt for section 35 of the Finance (No.2) Act 2023 (F(No.2)A2023) given the miscellany of amendments, affecting three separate fund-related tax regimes, it enacts.[1] Further, although some of those amendments, particularly those relating to real estate investment trusts (REITs),[2] are substantive, others (mainly those that amend the recently enacted qualifying asset holding company (QAHC) regime) are better described as tinkering—though, in this context, tinkering should not be read pejoratively. Although several of the changes to the QAHC regime are basically corrections (picking up things that appear to have been overlooked in the rush to deliver the QAHC regime in the Finance Act

[1] Amendments are made to each of the real estate investment trust (REIT) regime in the Corporation Tax Act 2010 (CTA 2010) Pt 12, the qualifying asset holding company (QAHC) regime in the Finance Act 2022 (FA 2022) Sch.2 and the rules in the Taxation of Chargeable Gains Act 1992 (TCGA) Sch.5AAA that apply to certain UK property rich collective investment vehicles.

[2] The REIT regime is contained in CTA 2010 Pt 12.

2022 (FA 2022)[3]), others evidence the government's continuing commitment to ensuring that the QAHC regime works for funds in the real world.[4] Hence, according to the Explanatory Notes:

> "The amendments make the regime more widely available to investment fund structures which fall within its intended scope while enhancing the operation of the regime."[5]

Section 35 F(No.2)A2023 is in many ways therefore a further stage in the Wider Funds Review[6]—with the promise of more to come.[7]

The amendments are set out in Schedule 4 F(No.2)A2023, which is subdivided into three Parts—one for each of the three regimes subject to amendment. This note considers each Part separately—but in reverse order to that of the Schedule (reflecting not only the timing of when the changes were first revealed, but also the respective lengths of each Part).

QAHCs: Part 3, Schedule 4 F(No.2)A2023

In the Summary of Responses to the Wider Funds Review, the government confirmed that it would be continuing to engage with the QAHC working group[8] as a means of allowing for "real-time feedback" on the regime's effectiveness and the "identification of further opportunities to enhance it".[9] Only a few months later, in July 2022, draft legislation, making "limited changes" to the QAHC regime, was published[10] as part of the so-called "L-day" legislation drop. Events—in the form of a change or two in prime minister—then intervened. The draft QAHC changes were

[3] Sarah Squires, "Finance Act 2022 Notes: Section 14 and Schedule 2: qualifying asset holding companies" [2022] B.T.R. 354.

[4] HM Treasury, Policy Paper, *Review of the UK funds regime: a call for input - Summary of responses* (February 2022), *https://www.gov.uk/government/publications/review-of-the-uk-funds-regime-a-call-for-input* [Accessed 14 September 2023], Ch.1, fn.2.

[5] HM Treasury, *Finance (No. 2) Bill Explanatory Notes*, *https://publications.parliament.uk/pa/bills/cbill/58-03/0276/en/220276en.pdf* [Accessed 14 September 2023], Clause 35 and Schedule 4: Investment Vehicles at para.35. See also HMRC, Policy Paper, *Amendments to the Qualifying Asset Holding Companies regime* (20 July 2022), *https://www.gov.uk/government/publications/amendments-to-the-qualifying-asset-holding-companies-regime/amendments-to-the-qualifying-asset-holding-companies-qahc-regime* [Accessed 14 September 2023].

[6] HM Treasury, *Review of the UK funds regime: a call for input - Summary of responses* (2022), paras 2.45 and 2.57 (REITs) and para.3.2 (genuine diversity of ownership condition).

[7] HM Treasury, *Review of the UK funds regime: a call for input - Summary of responses* (2022), para.3.2 listed ongoing work streams—one of which (relating to a new unauthorised contractual fund structure) has recently been the subject of a stand-alone consultation: see HM Treasury and HMRC, *Reserved Investor Fund Consultation* (April 2023), *https://www.gov.uk/government/consultations/reserved-investor-fund-consultation* [Accessed 14 September 2023].

[8] This working group was established in July 2021 to enable the government to engage with stakeholders on both policy design and draft legislation ahead of the Finance Bill 2022–23 (see HM Treasury, *The Tax Treatment of Asset Holding Companies in Alternative Fund Structures: government response to second stage consultation* (July 2021), *https://www.gov.uk/government/consultations/taxation-of-asset-holding-companies-in-alternative-fund-structures-second-stage-consultation* [Accessed 14 September 2023], Ch.4).

[9] HM Treasury, *Review of the UK funds regime: a call for input - Summary of responses* (2022), Ch.1, fn.2.

[10] Written statement by Lucy Frazer, the Financial Secretary to the Treasury (20 July 2022), *https://questions-statements.parliament.uk/written-statements/detail/2022-07-20/hcws256* [Accessed 14 September 2023] and also HMRC, *Amendments to the Qualifying Asset Holding Companies regime* (2022), *https://www.gov.uk/government/publications/amendments-to-the-qualifying-asset-holding-companies-regime* [Accessed 14 September 2023].

effectively put on hold until the Finance (No.2) Bill 2022–23—though this seems to have given the government extra time to both fine-tune and add to the proposed changes.[11]

Further, the disruption to the normal Finance Bill timetable caused by those events means that the various changes to the QAHC rules contained in Part 1 of Schedule 4 F(No.2)A2023 have different commencement dates. Although most of the amendments had to wait for Royal Assent before taking effect, some are retrospective—depending on the provision, to any of 1 April 2022[12] (when the QAHC regime came into force), 20 July 2022[13] (when draft legislation amending Schedule 2 FA 2022 was first published) and 15 March 2023[14] (the date of the 2023 Spring Budget). If that was not confusing enough, some changes also include (bespoke) transitional rules, intended to ensure that existing QAHC structures are not disadvantaged by something which, when all is said and done, represents a change in law.[15]

Meaning of "qualifying fund"

The most significant change made by F(No.2)A2023 is to extend the definition of "qualifying fund" in paragraph 9 of Schedule 2 FA 2022 to include what the legislation calls "multi-vehicle arrangements".[16] This definitely is an example of the government making the regime more widely available by broadening the categories of funds that can be qualifying investors[17] within the QAHC rules. By way of reminder, for a company to be potentially eligible to be a QAHC, at least 70 per cent of its investors must be qualifying investors.[18]

Under the original QAHC legislation, a collective investment scheme generally had to satisfy a genuine diversity of ownership (GDO) test to be a qualifying fund.[19] The application of the GDO test created issues in practice for some types of common fund structure—including so-called "parallel funds", the specific target of the proposed July 2022 amendments to the definition of qualifying fund.[20] By way of (simple) illustration, assume a manager sets up a fund to invest in European green tech start-ups. Some investors will invest directly in the fund, but others may need to invest indirectly, through a specially formed intermediate vehicle or another fund (for regulatory or other reasons). The manager therefore provides potential investors with options for investing in the fund, each option influenced by the requirements of particular investors.

Under the original FA 2022 provisions, the GDO test would have to be applied to each intermediate vehicle individually—and, in many cases, would be failed given that each such vehicle would be targeted at a limited number of investors. The changes made by paragraph 12

[11] The July 2022 draft legislation was limited to three amendments only: by the time that Finance (No.2) Bill 2022–23 was ordered to be printed in March 2023, two of these had been re-crafted and several other changes to the QAHC regime incorporated in the Bill.
[12] Finance (No.2) Act 2023 (F(No.2)A2023) Sch.4 paras 11 and 14.
[13] F(No.2)A2023 Sch.4 para.9.
[14] F(No.2)A2023 Sch.4 para.8.
[15] F(No.2)A2023 Sch.4 paras 8(4) and 9(4).
[16] F(No.2)A2023 Sch.4 para.12, amending FA 2022 Sch.2 para.9.
[17] FA 2022 Sch.2 paras 8(1)(b) and 9.
[18] FA 2022 Sch.2 para.3 (although note that the statutory test is written as a negative, i.e. no more than 30% of a company's investors can be non-qualifying investors).
[19] FA 2022 Sch.2 para.2(b). For completeness, a collective investment scheme can also be a qualifying fund if it is not close (determined with reference to the close company rules in CTA 2010 Pt 10): see FA 2022 Sch.2 para.9(2)(b).
[20] HMRC, *Amendments to the Qualifying Asset Holding Companies regime* (2022).

of Schedule 4 F(No.2)A2023 mean that the GDO test can now also be applied by reference (effectively) to the totality of the fund arrangements: basically, as long as the "multi-vehicle arrangements"[21] themselves meet the GDO test, then each entity comprised in those arrangements will (assuming it is itself a collective investment scheme) be capable of being a "qualifying fund" within the regime even it fails the GDO test on a stand-alone basis.[22]

Whereas the July 2022 draft legislation was pretty prescriptive in terms of the type of arrangements that could benefit from this broader GDO test (by including both a rather detailed definition of "parallel fund" and a targeted anti-avoidance rule),[23] the amendments made in the final legislation appear more flexible, with guidance likely to play an important role in explaining what constitutes "multi-vehicle arrangements".[24]

Schedule 4 F(No.2)A2023 contains a further important change to the definition of qualifying fund. In the original legislation, only a collective investment scheme can rely on the GDO test to determine if it can be a qualifying fund: other entities must be non-close or 70 per cent controlled by qualifying investors to be a qualifying investor.[25] However, paragraph 11 of Schedule 4 F(No.2)A2023 allows certain alternative investment funds (AIFs) to access the GDO test even though they are not themselves a collective investment scheme: however, only an AIF in corporate form that would, but for the fact it is a company, be a collective investment scheme, can rely on this new provision to access the GDO test.[26] But for such an AIF, the ability to use the GDO test (rather than undertaking the rather technical (and painful) exercise of establishing either non-closeness or who controls you) can only be of benefit—particularly as the GDO test is basically a one-off test (directed at how the fund is marketed[27]) whilst the non-close/control tests are continuing ones.

HMRC say that this change is aimed at certain limited partnerships that, as a legal matter, are body corporates, for example, Delaware Limited Partnerships.[28]

Who can(not) be a QAHC?

Whilst the changes to the definition of qualifying fund should broaden access to the QAHC regime, the amendment made by paragraph 8 of Schedule 4 F(No.2)A2023 to paragraph 2 of

[21] F(No.2)A2023 Sch.4, para.12(5) inserts a definition of "multi-vehicle arrangement" into FA 2022 Sch.2 para.9(10).
[22] HMRC, Policy Paper, *Amendments to the Genuine Diversity of Ownership (GDO) condition* (15 March 2023), *https://www.gov.uk/government/publications/amendments-to-the-genuine-diversity-of-ownership-condition/amendments-to-the-genuine-diversity-of-ownership-gdo-condition* [Accessed 14 September 2023].
[23] HMRC, Policy Paper, *Amendments to the Qualifying Asset Holding Companies regime: draft clauses* (20 July 2022), *https://www.gov.uk/government/publications/amendments-to-the-qualifying-asset-holding-companies-regime* [Accessed 14 September 2023], cl.1(5).
[24] F(No.2)A2023 Sch.4 para.12 and see HMRC, Internal Manual, *Investment Funds Manual* (published 5 July 2019; updated 19 July 2023), IFM17360, "Fund structures involving multiple entities", *https://www.gov.uk/hmrc-internal-manuals/investment-funds/ifm17360* [Accessed 14 September 2023].
[25] FA 2022 Sch.2 para.9(2)(b) and (c) and HMRC, *Investment Funds Manual* (2019; updated 2023), IFM40240, "Eligibility criteria: category A investors: meaning", *https://www.gov.uk/hmrc-internal-manuals/investment-funds/ifm40240* [Accessed 14 September 2023].
[26] The definition of "collective investment scheme" is taken from the Financial Services and Markets Act 2000 s.235: see FA 2022 Sch.2 para.58(1).
[27] HMRC, *Investment Funds Manual* (2019; updated 2023), IFM17100, "Genuine Diversity of Ownership (GDO): Introduction", *https://www.gov.uk/hmrc-internal-manuals/investment-funds/ifm17100* [Accessed 14 September 2023].
[28] HM Treasury, *Finance (No. 2) Bill Explanatory Notes*, Clause 35 and Schedule 4: Investment Vehicles, para.24.

Schedule 2 FA 2022 will have the opposite effect as it excludes certain companies from being able to be a QAHC.

When the QAHC regime was introduced, only REITs were expressly excluded from being a QAHC.[29] With effect from 15 March 2023, a company that qualifies as a securitisation company for UK tax purposes (and so benefits from the effective "switching off" of normal corporation tax rules under the UK's securitisation tax regime)[30] is also excluded from accessing QAHC benefits.[31] This is understandable: the government was clear that, as far as credit funds were concerned (that is, funds set up to invest in debt securities and loans), the regime required the QAHC to earn an appropriate level of (taxable) profit, to be established applying arm's length principles.[32] Even though the government accepted that the nature of a QAHC's activities should mean that its profit may not necessarily be significant,[33] it seems likely that it envisaged something more than the very low level of retained profit earned by securitisation companies.[34]

This change takes effect from 15 March 2023, and is generally prospective—so any securitisation company that had validly made an entry notification before then should continue to benefit from the QAHC regime provided it "continuously remains a QAHC"[35]—but if such a company subsequently leaves the QAHC regime, there is no way back in.

Investment strategy condition

The investment strategy condition in paragraph 13 of Schedule 2 FA 2022 benefitted from being relatively straightforward (particularly when compared to the ownership condition). All it required was that the relevant QAHC's investment strategy did not involve investing in listed equities (with an exception to allow public-to-private deals by private equity funds).

However, it seems that this condition may have proved problematic in practice for some funds. The condition has therefore been amended: seven new subparagraphs have been added, almost quadrupling the size of paragraph 13 of Schedule 2 FA 2022. The changes may allow more funds to benefit from the regime, but this is definitely at the cost of simplicity.

The effect of the changes[36] is that a QAHC is able to invest in listed equities (and still qualify for the regime) provided it agrees (by making an election[37]) to pay corporation tax on any dividends

[29] Note that, although a REIT cannot be a QAHC, the government has said that it is looking further at interaction between the two regimes: see HM Treasury, *Review of the UK funds regime: a call for input - Summary of responses* (2022), para.2.56.
[30] Instead, a securitisation company's profits for tax purposes are determined as per the Taxation of Securitisation Companies Regulations 2006 (SI 2006/3296) reg.14.
[31] F(No.2)A2023 Sch.4 para.8(1) amending FA 2022 Sch.2 para.2(1).
[32] HMRC, *Investment Funds Manual* (2019; updated 2023), IFM40120, "Overview: Policy Background", *https://www.gov.uk/hmrc-internal-manuals/investment-funds/ifm40120* [Accessed 14 September 2023].
[33] HMRC, *Investment Funds Manual* (2019; updated 2023), IFM40670, "Other tax issues; transfer pricing: pricing", *https://www.gov.uk/hmrc-internal-manuals/investment-funds/ifm40670* [Accessed 14 September 2023].
[34] HMRC, Internal Manual, *Corporate Finance Manual* (published 16 April 2019; updated 4 September 2023), CFM72580, "Other tax rules on corporate finance: securitisation: periods beginning on or after 1 January 2007: the regulations: the corporation tax charge: the formula: 'RP' and 'DS'" and CFM72680 "Other tax rules on corporate finance: securitisation: periods beginning on or after 1 January 2007: the regulations: modifications to other tax rules: other points".
[35] F(No.2)A2023 Sch.4 para.8(4).
[36] F(No.2)A2023 Sch.4 para.13.
[37] The election must also be notified to HMRC: see FA 2022 Sch.2 (new) para.13(5).

received from those listed equities, regardless of whether they would otherwise be exempt under Part 9A of the Corporation Tax Act 2009.[38] Where an election is made, the legislation states that listed securities held by the QAHC are treated as if they were not listed: a sort of (tax) Schrödinger's cat (with something both listed and unlisted at the same time).[39]

But this is not the only statutory fiction provided for in paragraph 13 of Schedule 4 F(No.2)A2023. A second fiction applies to counter possible "equity washing" (that is, a QAHC that makes such an election then taking steps to escape (that is, avoid) a dividend tax charge). If a QAHC sells listed equities just before a dividend date, and then, within 30 days, buys the same type of listed equities back once the dividend has been paid, the QAHC is to be taxed on the dividend that it would have received had it not made the sale.[40] Here, the legislation adopts a concept of "dispossession"—the equities that are sold by the QAHC are defined as "dispossessed securities" and the period before they are bought back as the "dispossession period". Given that "dispossession" generally applies to the situation where a person has something taken away from them, this seems rather an odd drafting choice given that any sale by the QAHC would presumably have been voluntary—unless of course the draftsperson was thinking about HMRC as a person potentially "dispossessed" of tax revenues because of the QAHC's (attempt at a) cunning plan.

An election under paragraph 13(3) of Schedule 4 F(No.2)A2023 remains in place unless and until the company ceases to be a QAHC.[41] So any fund considering making such an election will need to weigh up whether overall QAHC benefits are worth the cost of losing out on the dividend exemption on its holdings of listed equities.

Ownership condition

The various changes to the ownership condition (contained in paragraphs 9, 10 and 15 of Schedule 4 F(No.2)A2023) definitely seem to represent things that were overlooked last year.

The first change, in paragraph 9 of Schedule 4 F(No.2)A2023 amends the anti-fragmentation rule contained in paragraph 4 of Schedule 2 FA 2022. This change was included in the draft legislation published in July 2022[42] and so takes effect from 20 July 2022, just a few months after the QAHC regime was enacted: so the need for this appears to have been picked up by the government pretty quickly, but not quickly enough to be included as an amendment to FA 2022 during its parliamentary journey.

The anti-fragmentation rule is intended to prevent non-qualifying investors getting round the ownership condition by routing their investment in a putative QAHC through an entity that is itself a qualifying investor (for example, another QAHC). The rule sets out a number of circumstances in which, when applying the ownership condition, indirect interests of investors

[38] FA 2022 Sch.2 paras 13(3) and (6), inserted by F(No.2)A2023 Sch.4 para.13(1). Although the effect of an election is to switch off the exemptions in CTA 2010 Pt 9A, the government does not (it seems) intend to make any (corresponding) amendments to CTA 2010 ss.931 and 931A.
[39] FA 2022 Sch.2 para.13(3) and see HMRC, *Investment Funds Manual* (2019; updated 2023), IFM40266, "Eligibility criteria: election to treat listed securities as unlisted", *https://www.gov.uk/hmrc-internal-manuals/investment-funds/ifm40266* [Accessed 14 September 2023].
[40] FA 2022 Sch.2, para.13(7), and (8), inserted by F(No.2)A2023 Sch.4 para.13(1).
[41] FA 2022 Sch.2 para.13(5)(c) and (d).
[42] HMRC, Policy Paper, *Amendments to the Qualifying Asset Holding Companies regime: draft clauses* (2022), cl.1(2)–(4), Issue date of consultation 20 July 2022.

are to be taken into account—and is one of the most complex areas of the QAHC regime. The change made by paragraph 9 of Schedule 4 F(No.2)A2023 just adds to its complexity.

In contrast, paragraph 10 of Schedule 4 F(No.2)A2023 is simply about making sure that the use of the grouping rules to determine the extent of a person's (equity) interest in a QAHC for the purposes of the ownership condition works in the right way.

The FA 2022 provisions simply incorporate various group equity holder tests wholesale: again, a few months later, the government seems to have identified that this was a mistake. This is because, for group relief purposes, the equity holder rules focus on identifying the *lowest* possible percentage interest a person has (that is, so that group relief is only available where the parent genuinely has the specified percentage of equity rights in its subsidiary). However, the ownership condition, which is concerned with the level of ownership of non-qualifying investors, is about identifying the *highest* possible interest of such persons. Hence, paragraph 10 of Schedule 4 F(No.2)A2023 involves a sort of tax "through the looking glass" (as it were)[43]: so, for QAHC purposes, "less" becomes "more", and "highest" is "lowest".

The final change is to address the possibility of a QAHC raising funds through certain Sharia-compliant financings and identifies when, for the purposes of the ownership condition, a provider of alternative finance is to be treated as an equity holder (and as having a relevant interest in the QAHC), and when it is simply treated as a lender under a normal commercial loan.[44]

A missed definition

Again in the category of amendments needed so the rules "work as intended"[45] (and accordingly not picked up when finalising the original legislation), paragraph 14 of Schedule 4 F(No.2)A2023 adds a definition of "derivative contract" to paragraph 53 of Schedule 2 FA 2022, ensuring that the scope of the capital gains exemption as it applies to derivatives over shares is appropriately delineated. This change may appear minor, but is important enough to be made retrospective to 1 April 2022.

This, and the changes to the ownership condition discussed above, highlight the challenges for officials in producing complex legislation in a very short timetable—and, taking account of experience (for example) in relation to the corporate interest restriction,[46] the possibility of a series of further corrections across future Finance Acts cannot be ruled out as HMRC (and taxpayers) experience the rules in practice (rather than just in principle).

[43] In contrast with *Jabberwocky*, however, although Alice would find these provisions equally hard to understand, the writer doubts she would consider them pretty.

[44] F(No.2)A2023 Sch.4 para.15.

[45] HM Treasury, *Finance (No. 2) Bill Explanatory Notes*, Clause 35 and Schedule 4: Investment Vehicles, para.30.

[46] Originally enacted in Finance (No.2) Act 2017, the rules have been tweaked in most of the subsequent Finance Acts, including F(No.2)A2023: Julian Feiner and Ross Windell, "Section 34 and Schedule 3: corporate interest restriction" [2023] B.T.R 433.

REITs: Part 2, Schedule 4 F(No.2)A2023

Responses to the various consultations on the QAHC regime provided the government with a wish-list of reforms to the REIT regime.[47] In February 2022, the government said it would explore whether any of these reforms "can be delivered in the next Finance Bill".[48] For two of them—amendments to the "minimum 3 properties condition" in section 529 CTA 2010 and the three year development rule in section 556 CTA 2010—it is the next-but-one Finance Bill that delivers.[49]

They are joined in Schedule 4 F(No.2)A2023 by two other changes, neither of which were foreshadowed in the earlier consultations.[50] But of the one change the government specifically referenced as a candidate for the next Finance Bill (the interaction between REITs and QAHCs),[51] there is no sign. This suggests that the government felt that this required a longer consultation period than F(No.2)A2023 allowed.

The changes made by F(No.2)A2023, like those made in FA 2022,[52] are directed at simplifying the regime (and as a result increasing its attractiveness).

Changes to the REIT conditions

Part 2 of Schedule 4 F(No.2)A2023 contains two changes to the REIT conditions.

The main change is to section 529 CTA 2010 (the so-called property business condition—which is actually two conditions (A and B)).[53]Section 529 CTA 2010 requires the REIT's property business to consist of at least three properties,[54] with no single property representing more than 40 per cent of the total value of all properties involved in that business[55]: an approach which the government said was consistent with that of other jurisdictions that had REIT rules.[56]

But, in light of representations made as part of the asset holding company consultations,[57] going forward a REIT can hold just one property (that it lets out) provided that single property

[47] See HM Treasury, *Review of the UK funds regime: a call for input - Summary of responses* (2022), para.2.45.
[48] HM Treasury, *Review of the UK funds regime: a call for input - Summary of responses* (2022), para.2.57.
[49] These two reforms were confirmed as part of the Edinburgh Reforms in December 2022: see HM Treasury, *Financial Services: The Edinburgh Reforms* (9 December 2022), *https://www.gov.uk/government/collections/financial-services-the-edinburgh-reforms* [Accessed 14 September 2023].
[50] F(No.2)A2023 Sch.4 paras 5 and 6.
[51] HM Treasury, *Review of the UK funds regime: a call for input - Summary of responses* (2022), para.2.57.
[52] Sarah Squires, "Finance Act 2022 Notes: Section 15 and Schedule 23: real estate investment trusts" [2022] B.T.R. 367.
[53] CTA 2010 s.527(2)(b) and (3)(b).
[54] This is Condition A. Note that, as confirmed in HMRC's Internal Manual, the three property condition could be met by a single property if there are at least three distinct rental units comprised in it: see HMRC, *Investment Funds Manual* (2019; updated 2023), IFM22030, "Real Estate Investment Trust: Conditions And Tests: Property Rental Business Conditions: Condition A: Single Property".
[55] CTA 2010 s.529 (Conditions A and B).
[56] HM Treasury and Inland Revenue, *UK Real Estate Investment Trusts: a discussion paper* (TSO, March 2005), *https://webarchive.nationalarchives.gov.uk/ukgwa/20090609020118/http://www.hm-treasury.gov.uk/uk_real_estate_investment_trusts.htm* [Accessed 20 August2023], para.3.6.
[57] HM Treasury, Policy Paper, *Review of the UK funds regime: a call for input* (January 2021), *https://www.gov.uk/government/publications/review-of-the-uk-funds-regime-a-call-for-input* [Accessed 14 September 2023], para.2.16 and HMRC, *Investment Funds Manual* (2019; updated 2023), IFM22030, "Real Estate Investment Trust: Conditions And Tests: Property Rental Business Conditions: Condition A: Single Property".

is valued at at least £20 million when the REIT enters the regime.[58] The ability to hold a single (but sizeable) property and still qualify as a REIT is likely to be of particular benefit to those wanting to invest in large, single tenant, logistics "sheds", for example.

In common with the approach taken to the non-close and listing conditions (in 2012 and 2022 respectively), the property business condition now operates as an "either/or" condition.[59] This means that you can be a REIT if you hold (for letting) at least three properties—provided no one property exceeds 40 per cent by value of all such properties—or, if you hold less than three properties, at least one property that you hold (and let out) is valued at at least £20 million.[60] Plus, as an "either/or" condition, it now provides an effective safe harbour for those REITs that, either through accident or design,[61] find themselves at risk of breaching the three property condition (and so paragraph 3 of Schedule 4 F(No.2)A2023 makes consequential changes to the provisions that deal with breaches of the REIT conditions).[62] So if a REIT starts off with three properties and then sells one, it will still meet this particular condition provided that, at the time of the sale, one of the remaining properties has a value of at least £20 million.[63]

The other change concerns the application of the GDO test to multi-vehicle arrangements (the same change as brought in for QAHCs).[64] For REITs, however, the relevance of this change is limited: it only applies where the REIT is working out whether its investor base means that it does not have to list its shares.[65] This is because, as HMRC state, "The GDO condition was introduced for particular purposes into the REIT rules in Finance Act 2022".[66]

The three year development rule

The three year development rule in section 556 CTA 2010 applies where a REIT develops a property which it then sells within three years of finishing the development activity.[67] If, when the property is sold, the costs of carrying out the development work represent more than 30 per cent of the property's value at a particular (historic) date, any profit is treated as arising in the REIT's residual business (and so taxable under normal corporation tax rules).[68] This may mean that the profit is taxable as a capital gain, or potentially, depending on the relevant facts, as a trading profit.[69] If the former, then this begs the question as to why (as if the activity is respected

[58] F(No.2)A2023 Sch.4 para.3(2) which inserts a new condition C at CTA 2010 s.529(2A).
[59] The "either/or" approach means that s.529 CTA 2010 is now defined as the "property rental business condition" (see new s.516(3A) CTA 2010)—even though the original condition itself requires two conditions to be met to meet it!
[60] F(No.2)A2023 Sch.4 para.3(1) which amends CTA 2010 s.527(2)(b) and (3)(b).
[61] Here, "accident" could be a change in property values: "design" includes a property sale.
[62] F(No.2)A2023 Sch.4 para.3(3)–(5).
[63] F(No.2)A2023 Sch.4 paras 3(2) and (3), inserting new CTA 2010 ss.529(2A), 529(2B)(a) and 561(3A). Note that the draft Finance Bill 2023–2024 clauses published on 20 July 2024 contain an extension of this safe harbour to REITs that sell the single property that met the new Condition C but immediately replace it with another of the required value.
[64] HMRC, Policy Paper, *Amendments to the Genuine Diversity of Ownership (GDO) condition* (March 2023).
[65] F(No.2)A2023 Sch.4 para.5 amending CTA 2010 s.528ZB.
[66] HMRC, Policy Paper, *Amendments to the Genuine Diversity of Ownership (GDO) condition* (2023).
[67] Or, where the property is owned by a UK property rich company, that company is sold.
[68] CTA 2010 s.556(2)–(3B).
[69] See also HMRC, *Investment Funds Manual* (2019; updated 2023), IFM24520, "Real Estate Investment Trust: Residual income: treatment of disposals: three year development rule: CTA2010/S556".

as investment, what is the policy reason for removing the REIT exemption that would otherwise apply?)—after all, in the latter case, trading activity would be residual business in any event.[70]

But, according to the government, this rule is needed—and apparently "respondents [to the AHC consultations] generally supported the principle behind the 3-year development rule".[71] However even those that supported it felt that there was room for improvement, suggesting amendments to limit its scope.[72]

The government took note and so paragraph 4 of Schedule 4 F(No.2)A2023 contains a helpful amendment to section 556 CTA 2010, providing REITs with an ability to use a more recent (rather than historic) property valuation—namely from when development activity started[73]—when working out if development costs exceed 30 per cent rule of the relevant property's value (but only if that more recent value is greater than the property's historic value).[74] Although the other changes to the REIT rules in Part 2 of Schedule 4 F(No.2)A2023 only take effect from Royal Assent, REITs can benefit from the modified section 556 CTA 2010 in relation to disposals made on or after 1 April 2023.[75]

Property income distribution (PID) withholding

There is one further change to the REIT regime in Part 2 Schedule 4 F(No.2)A2023: almost a bonus amendment as, unlike the others, it was not pre-announced as part of the Edinburgh Reforms.[76] Paragraph 6 of Schedule 4 F(No.2)A2023 inserts a new regulation into The Real Estate Investment Trusts (Assessment and Recovery of Tax) Regulations 2006,[77] extending the circumstances in which a REIT can pay a PID free of withholding. This new regulation (regulation (7A)) allows a REIT to look through a partnership to its individual partners, and withhold (or not withhold) tax on paying a PID depending on the identity (and proportionate interest) of a particular partner.[78] As the new regulation only applies where the REIT has a reasonable belief as to a particular partner's status (and profit share), in practice only a limited number of (closely-held) REITs may know enough about their investors to be comfortable using this new regulation to pay PIDs free of withholding tax.

[70] CTA 2010 s.522.
[71] HM Treasury, *Review of the UK funds regime: a call for input - Summary of responses* (2022), para.2.48: although "generally" suggests not all. For example, the British Property Federation (BPF) suggested that the three year development rule be repealed in its response to the call for input: see BPF, *Review of the UK Funds regime* (April 2021), *https://bpf.org.uk/media/4003/uk-funds-review-bpf-response-20-april-2021.pdf* [Accessed 14 September 2023].
[72] HM Treasury, *Review of the UK funds regime: a call for input - Summary of responses* (2022), para.2.48.
[73] In the legislation, the beginning of the accounting period in which development started—recognising that pinpointing a specific date for the start of works can be challenging.
[74] F(No.2)A2023 Sch.4 para.4(3) and (5) inserting new CTA 2010 s.556(3ZA) and (3AAA).
[75] F(No.2)A2023 Sch.4 para.4(6).
[76] HM Treasury, *Financial Services: The Edinburgh Reforms* (2022).
[77] The Real Estate Investment Trusts (Assessment and Recovery of Tax) Regulations 2006 (SI 2006/2867).
[78] F(No.2)A2023 Sch.4 para.6.

Schedule 5AAA of the Taxation of Chargeable Gains Act 1992 (TCGA): Part 1, Schedule 4 F(No.2)A2023

Last, but, within the context of Schedule 4 F(No.2)A2023, first, are various amendments to Schedule 5AAA TCGA: or rather, the same amendment applied to various paragraphs of Schedule 5AAA to which it is relevant.[79] That amendment concerns the application of the GDO condition in the context of a multi-vehicle arrangements, that is, the same change made in relation to QAHCs (in Part 3) and REITs (in Part 2).[80]

The fact the same change is being made across three different tax regimes highlights the increasing reliance placed on the GDO condition as evidence that a fund is widely held (and so, from a policy perspective, eligible for particular UK tax benefits). It also emphasises the potential cross-overs between the three regimes that are the subject of Schedule 4 F(No.2)A2023. "No man is an island" said John Donne[81]—and, when it comes to funds taxation, neither (it seems) is any particular regime.

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[79] F(No.2)A2023 Sch.4 Pt 3 amends TCGA Sch.5AAA paras 7, 13, 46, 46A, 47 and 51.
[80] HMRC, Policy Paper, *Amendments to the Genuine Diversity of Ownership (GDO) condition* (15 March 2023).
[81] John Donne, *Meditation XVII, Devotions upon Emergent Occasions*.
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