NORTON ROSE FULBRIGHT

Asset holding companies

The UK is open for business

A new regime for qualifying asset holding companies (**QAHCs**) has been introduced as part of the Finance Act 2022 which became law on 24 February 2022. The aim of the new regime is to encourage the use of UK tax resident holding companies for investments made by fund and institutional investors. Such holding companies allow investors to ring fence risk, streamline administration and group related investments while giving greater control over the distribution and reinvestment of profits.

The new regime modifies the UK tax rules for QAHCs with the aim of broadly treating investors as if they were invested directly in the underlying assets. Rather than a blanket exemption, the regime introduces a range of measures to tackle various issues with the UK tax treatment of intermediate holding companies.

The regime is elective and will apply from 1 April 2022 (for corporation tax, stamp duty and SDRT purposes) and 6 April 2022 (for income tax and capital gains tax purposes).

Taxation of QAHCs

The new regime is targeted primarily at holdings in unlisted equity and debt and in non-UK real estate. Whilst a QAHC cannot undertake trading activities or invest in listed securities (save in limited circumstances), the regime does not prevent a QAHC from investing in other assets such as UK real estate or intangible assets, although these assets will not attract the same beneficial tax treatment.

Equity

A key benefit for a QAHC is that gains on any disposal of shares (other than shares in UK property rich entities) should be exempt. This means that, unlike under the existing UK substantial shareholding exemption, there is no minimum requirement as to the size of the stake or the duration of the holding. Dividend receipts on the equity investments meanwhile would likely already be exempt for the QAHC under existing rules.

Debt

Whilst interest payments on any debt assets would be subject to tax in the QAHC, the new regime ensures that deductions are allowed for interest paid by the QAHC under profit participating or results-dependent debt that would usually be disallowed as distributions (subject to usual transfer pricing rules). The UK hybrid rules have also been relaxed, as well as rules which restrict interest deductions on accrued interest. The intention is that the QAHC would only be taxable on a small transfer priced margin.

Real estate

For non-UK real estate holdings QAHCs benefit from an exemption from gains on disposal in the same way as for shares and also an exemption from tax on rental receipts where those rents are subject to tax in a non-UK jurisdiction. Whilst UK real estate is not subject to the special tax rules under the QAHC regime, there is no prohibition on a QAHC holding UK real estate (or indeed other assets which are not covered by the special tax rules). Given the lack of special treatment though it may be that a UK REIT remains a preferable structure for investment in UK real estate – with the Government recently introducing a number of relaxations to improve the attractiveness of REITs for qualifying investors.

Other changes

The regime also means that withholding tax should not apply on interest payments from the QAHC to investors. This removes the need for the QAHC to rely on double tax treaties, the qualifying private placement rules or other domestic exemptions such as the quoted Eurobond.

Relaxations have also been introduced on the repatriation of capital through buy-backs – removing the stamp duty charge and allowing investors capital treatment. Stamp duty will still apply on transfers of interests in the QAHC (or arrangements which are economically equivalent to transfers).

Significantly, QAHCs should still be able to avail themselves of any applicable treaty benefits vis-à-vis the underlying jurisdictions of the assets.

A QAHC's qualifying investments will be ring-fenced so that losses from these activities cannot be set against profits of any non-qualifying activities. Group relief will be available within a QAHC qualifying group and within a non-qualifying group, but not between such groups.

The tax changes that have been made do not touch on VAT as there is an ongoing VAT consultation around the management of fund structure.

Requirements to be "Qualifying"

In order to elect into the regime there are a number of conditions to be met by the company, namely that:

- It is tax resident in the UK.
- The sum of relevant interests held by investors who are not Category A investors (see below) does not exceed 30%. If a QAHC issues different classes of shares, this condition is applied to each class of share.
- The main activity of the company is carrying on an investment business.
- Its investment strategy does not involve the acquisition of listed or traded securities (or interests deriving their value from such securities) unless the acquisition is made for the purposes of facilitating a change in control of the issuer with the result that the securities cease to be listed or traded.
- It is not a UK REIT.
- No equity securities of the company are listed or traded on a recognised stock exchange, or any other public market or exchange.

These conditions operate on an ongoing basis, although the ownership condition is deemed to be met in the two-year period starting with the date on which the company becomes a QAHC provided there is a reasonable expectation that the condition will be met at the end of that period.

Category A investors

As noted above, the QAHC regime is only open to entities which are substantially held by so-called "Category A" investors. These include:

- Funds that are a collective investment scheme or alternative investment fund that meets a diversity of ownership condition.
- Entities benefiting from sovereign immunity from UK tax.
- Trustees or managers of a pension scheme (other than an investment-regulated pension scheme).
- Public authorities.
- Charities.
- REITs, their non-UK equivalents and certain other property related collective investment vehicles.
- Long-term insurance businesses.
- Entities that are QAHCs or are intermediate entities that are themselves at least 99% owned by Category A investors.

The rules for calculating the percentage held by investors who do not fall within these categories require close attention as they are complicated and can trace through indirect holdings and incorporate a wide definition of what constitutes a relevant interest

Electing into the regime

An election into the regime must to be made to HMRC prior to entry. HMRC have published guidance on the notification requirements and also on the information to be provided on an annual basis which includes the market value of assets within the qualifying ring fence, the gross proceeds from disposals and the amounts paid to investors by way of redemptions.

HMRC have flagged that they are willing to discuss the new regime with potential QAHCs or their investors and there is the scope for making a non-statutory clearance application to get comfort on the application of the regime to particular structures.

On entry into the regime, a QAHC will be deemed to have sold and repurchased the assets relating to its qualifying activities. Any tax charge that arises

on the deemed disposal cannot be deferred but losses, group relief or the substantial shareholding exemption may apply. On exit from the regime, any ring-fenced assets will be rebased to market value. New accounting periods will commence on entry to, and exit from, the regime.

Conclusion

The new regime is a significant move towards removing the UK tax barriers that might prevent the establishment of UK tax resident asset holding companies and together with the other benefits of establishing a company in the UK, this will be of considerable interest to managers and investors particularly in the context of private equity, infrastructure and debt funds.

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