QAHCs explained:

A quick guide to the UK Asset Holding Company Regime

The Bright Alternative

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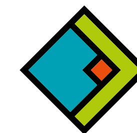

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QAHCs explained

As part of its wide-ranging review of the UK funds regime, the UK Government consulted the funds industry on a raft of measures, including the tax treatment of asset holding companies ("AHCs"). In response to various consultations on the issue, the UK Government confirmed that it would introduce a new tax regime for AHCs, the final form of which was revealed with the publication of the Finance Bill 2022 on 4 November 2021.

The new regime comes into effect on 1 April 2022 and introduces the concept of the Qualifying Asset Holding Company ("**QAHC**"). QAHCs stand to benefit from a number of attractive tax advantages which, when coupled with the strength and depth of the UK's fund and corporate services industry and extensive double tax treaty network, could well see the UK re-position itself as a genuinely attractive alternative to European fund centres such as Luxembourg and Ireland for managers looking to set up asset holding structures in a tax efficient manner.

In this article, we take a look at the QAHC regime, what entities will qualify as QAHCs, the tax advantages that QAHCs will benefit from and the potential impact that the regime will have on the UK funds industry.

QAHCs will, subject to satisfying certain conditions, stand to benefit from a number of attractive tax advantages.

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Introducing Qualifying Asset Holding Companies ("QAHCs")

The broad aim of the new regime is to ensure that where funds hold assets through underlying UK tax resident companies, UK investors are taxed as if they invested in the underlying assets directly and that asset holding companies pay no more tax than is proportionate to the activities they perform.

To qualify as a QAHC, a company must satisfy each of the criteria below:

- It has made (and not rescinded) a decision to be treated as a QAHC.
- It must be resident in the UK.
- It must not be a UK REIT.
- None of its equity securities are publicly listed or traded.
- Its main activity is the carrying on of investment business. Any other activities of the company must be both ancillary to the carrying on of that business and not carried on to a substantial extent (the "**Activity Condition**").
- Its investment strategy does not involve the acquisition of listed or traded securities (or interests deriving their value from them), unless the acquisition is made for the purposes of facilitating a change of control which will result in the securities ceasing to be listed or traded.
- The sum of 'relevant interests' in the QAHC held by investors who are not 'Category A' investors does not exceed 30%. Put another way, at least 70% of the QAHC must be owned by 'Category A investors' (the "**Ownership Condition**").

Ownership Condition

Category A investors include a range of institutional investors such as most pension funds, charities and authorised long-term insurance businesses. Investment funds that are "qualifying funds" are also Category A investors. Broadly, these are (i) "collective investment schemes" (CISs) or "alternative investment funds" (AIFs) for regulatory purposes that either are not close or are 70% controlled by Category A investors, and (ii) CISs that meet certain requirements as to diverse ownership (such as UK and non-UK REITs).

A person will be considered to have a 'relevant interest' in a QAHC if, due to a direct or indirect interest, they are:

- beneficially entitled to a proportion of the profits available for distribution to equity holders of the QAHC;
- beneficially entitled to a proportion of the assets of the QAHC available for distribution to its equity holders on a winding up; or
- have a proportion of the voting power of the QAHC.

Where there are different classes of securities tracking specific profits or assets, a similar test will be applied to those classes of interest, but excluding the voting power test.

Election into the QAHC regime

A company that wishes to be classified as a QAHC must submit a notification to HMRC. Obviously a holdco established while a fund remains in capital raising mode may struggle to satisfy the Ownership Condition, but a special rule allows a company to be classified as a QAHC if it meets all of the other conditions and declares that there is a reasonable expectation that the Ownership Condition will be met within two years.

The tax position

A QAHC that has met the ownership conditions and other eligibility criteria and elected into the regime will benefit from generous tax advantages, including:

1

Capital gains on disposals of overseas property or of shares which do not derive at least 75% of their market value from UK land (irrespective of the size of the stake or the length of time it was held) are exempt from corporation tax on chargeable gains.

2

QAHCs are exempt from tax on profits of an overseas property businesses to the extent that those profits are chargeable to foreign tax on income which corresponds to income tax or corporation tax.

3

Payments of interest by a QAHC on securities held by its investors will not be subject to withholding tax.

4

Subject to transfer pricing (which will be more stringently applied to QAHCs to deter tax avoidance):

- deductions for interest payments that would usually be disallowed on the basis that they are paid under profit participating loans and results-dependent debt are permitted; and
- the late paid interest rules will not apply in certain situations, resulting in interest payments being relieved for a QAHC when accrued rather than paid.

It is also worth noting that QAHCs will be deemed to be 'close companies' for the purpose of the loans to participators rules.

5

Premiums paid by a QAHC when it repurchases its share capital from an investor will be treated as a capital rather than income distribution if, generally speaking, the premium derives from capital gains realised on underlying investments. Note that this will not apply to shares held by a person where the right or opportunity to acquire the shares arose by reason of their employment.

6

There will be an exemption from stamp duty and stamp duty reserve tax (SDRT) for repurchases by a QAHC of its share and loan capital. There will not however be a stamp duty or SDRT exemption for transfers of shares in a QAHC.

7

Non-UK domiciled investment managers (i) who have invested in the QAHC; (ii) who provided investment management services to the QAHC; and (iii) who are subject to the remittance basis of taxation, will benefit from rules ensuring that the remittance basis will apply to any income and gains arising from foreign assets held through the QAHC. Note that, absent these rules, holding assets via a QAHC would convert offshore income and gains (which

would otherwise be taxed on the remittance basis) into UK income and gains taxed on an arising basis.

8

Interestingly, a company can undertake both QAHC qualifying and non-QAHC qualifying business. The effect of this bifurcation is that a QAHC can essentially be split into two theoretical sub-entities, one part qualifying as a QAHC and the other part not. One notable impact of this is that losses arising from non-qualifying activities are not permitted to be set off against profits of qualifying activities and vice versa. Assuming there are multiple QAHCs within a consolidated accounting group, the impact from a group relief perspective is that two sub-groups are deemed to exist, one qualifying and the other not, with group relief only available within the qualifying group and non-qualifying 'groups' respectively and the sharing of losses as between the qualifying and non-qualifying parts of the group prohibited.

9

On entering into the QAHC regime, a company will be deemed to have made a disposal and reacquisition at market value of investments held by it in overseas land, loan relationships and derivative contracts relating to overseas property business and shares. Although tax charges will not be deferred, group relief or the substantial shareholding exemption could apply to deemed share disposals. Even if the 12-month holding requirement under the substantial shareholding exemption is not met at the time of the deemed disposal, the disposal could still benefit from the exemption provided that the QAHC continues to hold the shares after it enters into the regime.

10

A new accounting period will also begin on the date a company ceases to be a QAHC, with overseas land, loan relationships and derivative contracts related to overseas property business and shares again treated as being sold and reacquired at market value immediately before the company ceases to be a QAHC.

QAHCs are exempt from tax on profits of an overseas property businesses.

Election into the QAHC regime

A company that wishes to be classified as a QAHC must submit a notification to HMRC. Obviously a holdco established while a fund remains in capital raising mode may struggle to satisfy the Ownership Condition, but a special rule allows a company to be classified as a QAHC if it meets all of the other conditions and declares that there is a reasonable expectation that the Ownership Condition will be met within two years.

Ongoing monitoring and exit from the QAHC regime

A QAHC is required to take reasonable steps to monitor its ongoing compliance with the Ownership Condition and to notify HMRC if it ceases to satisfy any of the conditions to becoming a QAHC, or if it intends to voluntarily exit the QAHC regime. Generally speaking, a company will cease to be a QAHC immediately after beaching any of the QAHC conditions (save in respect of the Ownership Condition and the Activity Condition, discussed in more detail below) or on the date specified by it in an exit notification.

“Non-deliberate” breaches of the Activity Restriction will not be treated as a breach of the QAHC conditions, subject to the QAHC notifying HMRC and to the QAHC satisfying the condition again as soon as reasonably practicable. “Non-deliberate” breaches of the Ownership Condition will also not be treated as a breach of the conditions, subject to:

A. no more than 50% of the relevant interests in the QAHC being owned by non-category A investors;

B. the QAHC notifying HMRC;

C. the QAHC taking reasonable steps to monitor compliance with the Ownership Condition; and

D. the Ownership Condition being satisfied again within 90 days of the day on which the QAHC became aware of the breach.

Breaches will be considered “deliberate” if they occurred as a result of the action of a specific person (including the QAHC, its directors and/or its managers) if that person knew that a consequence of the action in question would be a breach of the relevant condition and that person could reasonably have avoided taking the action in question.

The legislation also provides for a two-year wind-down period in certain circumstances for a company which intended to cease its QAHC qualifying business at the time a breach of the Ownership Condition occurred. The effect of this is that the company will cease to be a QAHC at the end of the two year period, rather than immediately following the breach.

A genuine alternative to Luxembourg?

The overhaul of the UK asset holding company regime is an extremely welcome move by the UK Government, allowing the UK to offer a genuinely competitive product to rival the holding company regime available in Luxembourg. The attractiveness of the product itself will no doubt be enhanced by the depth of experience and talent in the domestic funds and corporate services space.

The QAHC regime is not perfect, however. The qualifying conditions have been criticised for their complexity and, whilst QAHCs can hold UK real assets, the broad tax exemption enjoyed by QAHCs with regard to gains and income from overseas real assets will not extend to income or gains arising from UK real assets (although existing exemptions will remain available, of course). Whilst this leaves a QAHC in no worse a tax position than any other non-UK holding company in this respect, the QAHC looks less appealing to funds investing in UK real estate when compared to the UK REIT, which enable funds to flow to investors without the risk of double taxation.

With regard to UK REITs, it is worth noting that the REIT regime has also been the subject an overhaul as part of the UK Government's fund industry review, with a number of changes proposed which enhance the attractiveness of the REIT regime, including a relaxation of the listing requirement and excluding penalties for REITS with corporate shareholders which have a shareholding of more than 10%. It seems likely then that the QAHC will not be a 'one size fits all' structuring solution, and that for certain structures and deals other vehicles and/or jurisdictions will be favoured.

Whilst some may feel that the QAHC regime (and the UK's review of fund industry taxation generally) does not go as far as they had hoped, ultimately the net result of the new legislation is that, from 1 April 2022, the UK will be in a position to offer fund managers genuine optionality both with regard to their jurisdiction and holding vehicle of choice, enabling managers to choose the most advantageous domicile and vehicle when designing their asset holding structures and to tailor their holding structure to suit their fund's particular investment strategy.

The broad tax exemption enjoyed by QAHCs with regard to gains and income from overseas real assets will not extend to income or gains arising from UK real assets.

Get in touch

If you would like to discuss any of the topics in this guide, as well as how the Aztec Group can support you, please talk to either your usual contact or get in touch with:

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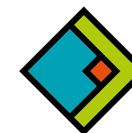

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