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Qualifying Asset Holding Companies (QAHCs): A new UK tax regime for alternative fund structures

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Overview

On 20 July 2021, the UK government published further details of, and draft legislation for, a new elective tax regime for alternative fund structures. Although certain aspects have yet to be clarified, the proposals have been widely welcomed, and demonstrate that the government is serious about increasing the global appeal of the UK funds industry.

The draft legislation creates a competitive UK tax regime for alternative fund structures, making it more tax efficient to hold fund investments through UK companies satisfying certain criteria. The new regime, which applies to qualifying asset holding companies (QAHCs), is part of a wider reform of the funds industry, and will come into force in April 2022.

However, the draft legislation currently published is not complete, and provides a framework only; further legislation will follow and is expected to be subject to further consultation. A separate project analysing the VAT treatment of services provided in an alternative funds context is also expected to be undertaken.

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Tax consequences of the new regime

Where the new regime applies, the overall intention is to tax investors as though they had invested in the underlying assets, rather than through the (holding) company.

In particular, there will be no corporation tax on gains on disposals by the QAHC of overseas land and relevant shares, nor will there be any corporation tax on overseas property income if that income is taxable in another jurisdiction. Broadly, "relevant shares" are shares and stock other than those in property-rich companies. Further, there are carve-outs from rules otherwise restricting deductibility under loan relationship rules for amounts treated as distributions, and from rules restricting relief on late paid interest. This is expected to allow QAHC's to be funded by way of profit participating loans, with the expectation that they should ultimately be subject to corporation tax on a relatively small arm's length profit margin, calculated in accordance with transfer pricing principles.

Investments in overseas land, relevant shares, creditor relationships and certain derivative contracts will be ring-fenced so that losses cannot be set against profits of other activities. Group relief will be available within a QAHC qualifying group and within a non-qualifying group, but not between the groups.

The draft legislation also provides for an exemption from obligation to withhold on interest paid by QAHC to an investor, removing the complexity of needing to rely on another exemption from withholding tax, such as treaty relief or the Quoted Eurobond exemption. However, withholding will still apply in respect of interest on a normal commercial loan where the lender has no other interest in the QAHC.

Although currently not included in the existing draft legislation, the government has said that further legislation will provide for:

– Premiums paid on the buy-back of shares to be taxed as capital, rather than income.

– Exemption from stamp duty and SDRT on the repurchase of shares and loan capital (but not in relation to the transfer of QAHC shares).

On entry into the regime, the QAHC will be deemed to have sold and repurchased the assets relating to its qualifying activities. There will be no deferral of a tax charge on disposal, but losses, group relief or the substantial shareholding exemption may apply. On exit from the regime, any assets that were ring-fenced will be rebased to market value.

The government is also continuing to deliberate on certain outstanding issues. In particular, whether there should be provision for a minimum amount of investment capital, and the scope of any targeted anti-avoidance rules. There is also the question of how the new regime will interact with other tax specific rules, including the corporate interest tax restriction, the taxation of derivatives, transfer pricing and hybrid mismatches.

What are the conditions for QAHC status?

In order to be treated as a QAHC, a company must satisfy a series of conditions.

- First, the company must be UK resident, not a REIT and not otherwise listed on a recognised or public market or exchange.
- At least 70% of the company must be owned by "Category A investors".

  Broadly, Category A investors comprise other QAHCs, qualifying funds (collective investment schemes or alternative investment funds that meet a diversity of ownership condition), relevant qualifying investors (persons acting in the course of long-term insurance business, UK REITs, certain collective investment vehicles, trustees and managers of a pension scheme and charities) and Ministers of the Crown.
- As its main activity, the company must invest its funds with the aim of spreading investment risk and giving investors the benefit of its fund management. Other activities must not be carried on to a substantial extent.

The regime will be elective. As a result, the relevant company must have made, and not rescinded, a decision to be a QAHC.

What now?

The government is clearly committed to its policy to increase the competitiveness of the UK. However, the inevitable tension remains between the desire for competition in the private equity and funds industries and the concern that a new advantageous regime should not be misused. As ever, the devil will be in the detail, and not all of that detail has yet been revealed. Nonetheless, there is evidence of robust dialogue between stakeholders, and commentators are optimistic that a useful, balanced and workable regime will be achieved.

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