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A New UK Tax Regime for Asset Holding Companies

by James Spencer, Emma Rigby, Rob Davidson

On 27 October 2021, as part of its wider review of the UK funds regime, the UK government published its long-awaited final policy paper, 'New taxation regime for asset holding companies (AHCs)'. The proposals form part of the UK government's drive to promote the attractiveness of the UK as a hub for investment within the funds sector and to advocate for the UK to become a jurisdiction of choice for holding assets within fund structures by introducing a new tax regime which rivals that of fund-friendly Luxembourg.

Scope and Application

AHCs are companies through which institutional investors and funds acquire and hold investment assets, such as real estate. The regime will apply to any unlisted, UK-resident AHC which elects to become a 'qualifying asset holding company' (QAHC) and satisfies the complex ownership and activity requirements detailed below.

An electing AHC must (1) be owned by 70% of 'good' or 'category A' investors, which is a wide-ranging definition including diversely owned funds, certain institutional investors (such as some pensions funds, long-term life insurance companies, and sovereign entities), and UK real estate investment trusts (UK REITs); and (2) mainly carry out investment activity, with no more than insubstantial (i.e., less than 20%) ancillary trading permitted. As with entry into the regime, QAHCs must also elect to exit the regime.

Under the regime, a QAHC will benefit from a number of preferential tax treatments for the taxation of the QAHC itself and certain payments which can be made by a QAHC.

Some of the most beneficial advantages of the QAHC regime include:

- A corporation tax exemption on gains on disposals of certain shares, including shares in companies which do not derive at least 75% of their value from UK real estate (i.e., companies that are not 'UK-property rich').
- A corporation tax exemption on gains on disposals of non-UK real estate.
- A corporation tax exemption on profits of a non-UK real estate business (including rental income) and the associated profits that arise from loan relationships and derivative contracts to which the QAHC is a party for the purposes of its non-UK real estate business (but only to the extent that these profits are subject to overseas tax).

- The treatment of premiums paid on a repurchase by the QAHC of its own share capital as capital rather than income distributions.
- A stamp duty and stamp duty reserve tax exemption on repurchases by a QAHC of its own share capital and loan capital which it previously issued.
- Exemption from UK withholding tax on interest payments to investors in the QAHC.

The regime will be introduced with effect from 1 April 2022.

What Does This Mean for the UK Investment Funds Industry?

The presence of AHCs in investment fund structures has been a perpetual feature for a number of tax and non-tax purposes. Whilst AHCs serve as liability blockers for the main fund vehicle and provide a practical platform through which the underlying asset can be managed, investment funds also use AHCs to prevent double taxation at both the AHC level and investment fund level. The reforms, therefore, seek to maintain the purpose served by establishing AHCs in fund structures, whilst providing fund managers with the opportunity to establish tax-friendly AHCs in the UK.

The regime recognises that AHCs are used by investment funds to facilitate the flow of investment proceeds and capital commitments between investors and underlying fund assets, whilst simultaneously ensuring tax neutrality at the investment fund level and mitigating tax leakage arising at the AHC level. The aim of the regime is to ensure that the investment fund suffers no more tax than if it had invested in the underlying investment assets directly. The AHC only pays tax to an extent proportionate to its (limited) intermediary role within the fund structure.

The introduction of the new regime seeks to enhance the UK's competitiveness as a location for investment funds and their investment vehicles by uniting the UK's broad double tax treaty network and strong financial services infrastructure with a tax system as favourable as Luxembourg.

What Does This Mean for Real Estate Investment?

For investment funds which operate in the real estate sector, the introduction of the QAHC regime brings into play some interesting new factors to consider when determining how to structure their real estate investment.

The regime will introduce corporation tax exemptions for QAHCs for gains on disposals of non-UK real estate (whether or not they are taxed overseas) and on profits, including rental income, of a QAHC's non-UK real estate business (to the extent that the profits are taxed overseas). Therefore, there are evident tax benefits in establishing a QAHC within a multijurisdictional fund structure that invests in non-UK real estate.

However, whilst a QAHC is permitted to invest in and hold UK real estate, if it does so, it will not benefit from the preferential corporation tax exemptions which apply to non-UK real estate and will still be subject to usual UK corporation tax rules. Therefore, rental income from UK real estate and gains on disposals of UK real estate or shares in 'UK property-rich' companies will still be chargeable (except where an existing exemption applies), and this could result in tax leakage at the QAHC level.

For investment funds investing in UK real estate, investing via a UK REIT may remain the preferable structure. UK REITs enable rental income and gains arising from UK real estate to flow to the UK REIT's investors without being subject to double taxation and therefore offer a tax-friendly way of investing in UK real estate.

In tandem with the review on the tax treatment of AHCs, the UK government has also been conducting an extensive review of the UK REIT regime. A number of reforms are proposed, including a relaxation of the listing condition and the exclusion of a penalty for UK REITs with corporate shareholders which have a shareholding of more than 10%. These changes will also take effect from April 2022 and will strengthen the appeal of the UK REIT regime by minimising related costs and administrative burdens.

Whilst the limits of the QAHC regime are apparent when considering UK real estate, the QAHC regime has been formulated to enable it to operate efficiently alongside, and complement, the existing (and soon-to-be enhanced) UK REIT regime. From April 2022, the UK will offer tax-friendly investment structures for investment funds looking to invest in either UK or non-UK real estate; however, the preferred investment vehicle in question (a QAHC or a UK REIT) will vary in each case.

Conclusion

The introduction of the QAHC regime appears to be a promising step towards addressing the obstacles faced by fund managers when building UK AHCs into their fund structure and looks to boost the UK's reputation as an attractive location for establishing AHCs.

Notwithstanding the fact that the QAHC regime has its limits, by not extending its application to UK real estate and requiring complex election conditions to be met, QAHCs provide an attractive new structure through which investment funds may choose to invest in certain asset classes, such as non-UK real estate.

Accordingly, investment funds should begin to consider the tax and commercial benefits of establishing UK-based AHCs as part of their fund structure and repatriating any existing offshore AHC operations to the UK.

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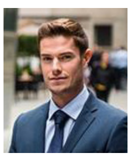
If you have any questions or would like additional information, please contact your Alston & Bird attorney or the following:

James Spencer
+44.0.20.3823.2231
james.spencer@alston.com

Emma Rigby
+44.0.20.3907.1289
emma.rigby@alston.com



Robert J. Davidson
+44.0.20.3823.2189
rob.davidson@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ▪ 1201 West Peachtree Street ▪ Atlanta, Georgia, USA, 30309-3424 ▪ 404.881.7000 ▪ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ▪ Suite 21B2 ▪ No. 7 Guanghua Road ▪ Chaoyang District ▪ Beijing, 100004 CN ▪ +86.10.85927500
BRUSSELS: Rue Guimard 9 et Rue du Commerce 87 ▪ 3rd Floor ▪ 1000 Brussels ▪ Brussels, 1000, BE ▪ +32.2.550.3700 ▪ Fax: +32.2.550.3719
CHARLOTTE: One South at The Plaza ▪ 101 South Tryon Street ▪ Suite 4000 ▪ Charlotte, North Carolina, USA, 28280-4000 ▪ 704.444.1000 ▪ Fax: 704.444.1111
DALLAS: Chase Tower ▪ 2200 Ross Avenue ▪ Suite 2300 ▪ Dallas, Texas, USA, 75201 ▪ 214.922.3400 ▪ Fax: 214.922.3899
FORT WORTH: Bank of America Tower ▪ 301 Commerce ▪ Suite 3635 ▪ Fort Worth, Texas, USA, 76102 ▪ 214.922.3400 ▪ Fax: 214.922.3899
LONDON: 5th Floor ▪ Octagon Point, St. Paul's ▪ 5 Cheapside ▪ London, EC2V 6AA, UK ▪ +44.0.20.3823.2225
LOS ANGELES: 333 South Hope Street ▪ 16th Floor ▪ Los Angeles, California, USA, 90071-3004 ▪ 213.576.1000 ▪ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ▪ 15th Floor ▪ New York, New York, USA, 10016-1387 ▪ 212.210.9400 ▪ Fax: 212.210.9444
RALEIGH: 555 Fayetteville Street ▪ Suite 600 ▪ Raleigh, North Carolina, USA, 27601-3034 ▪ 919.862.2200 ▪ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ▪ Suite 2100 ▪ San Francisco, California, USA, 94105-0912 ▪ 415.243.1000 ▪ Fax: 415.243.1001
SILICON VALLEY: 1950 University Avenue ▪ Suite 430 ▪ East Palo Alto, California, USA 94303 ▪ 650.838.2000 ▪ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ▪ 950 F Street, NW ▪ Washington, DC, USA, 20004-1404 ▪ 202.239.3300 ▪ Fax: 202.239.3333