

Insights

PROMOTING UK FUNDS – IMPROVING THE TAX TREATMENT OF ASSET HOLDING COMPANIES IN THE UK

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As part of an initiative to promote UK funds the government is proposing a beneficial new tax regime for asset holding companies (**AHC**) in investment fund structures. This is intended to make the UK a more competitive location for holding companies, recognising that increasingly there are reasons to locate these entities in the same jurisdictions as the funds themselves. It is just one aspect of a wider review of the UK funds tax and regulatory regime aimed at bolstering the UK's asset management industry.

The goal is to find an AHC regime that will work as an intermediate investment vehicle in a range of different investment funds, e.g. private equity funds, credit funds, infrastructure funds, and potentially multi-jurisdictional real estate funds.

One challenge the government faces is creating a regime which is sufficiently simple and certain to compete with established regimes, such as in Luxembourg. Another is for the regime to switch off a series of existing tax rules which would otherwise create a barrier to an attractive AHC regime.

The consultation on AHCs is wide-ranging at this stage. Many ideas are being considered, with scope for fine-tuning down the line. In terms of timing, we are expecting the regime to be introduced in Finance Act 2022 with draft legislation being provided this year.

What structures will be eligible?

The base case is that an AHC should be wholly owned by a widely held qualifying fund or funds. These could be a collective investment scheme (CIS) or an alternative investment fund (AIF), or maybe even a REIT.

Helpfully, the government is also considering allowing more diverse investors to invest directly in the AHC without setting up a fund vehicle. It is considering allowing an AHC that is not 'close' (i.e. not owned by five or fewer shareholders/participants) or close only because it has an owner that meets criteria, such as being a 'qualifying institutional investor'. This would, for example, allow

direct investment by asset managers and ownership by one or more institutional investors pooling capital at the AHC level.

The government proposes that the AHC's assets are managed by an independent asset manager, rather than the owners, and for a fee. This asset manager would in turn need to prove its credentials by being authorised or registered for the purposes of asset management and be regulated. The condition that the manager be independent from the investors may prove a stumbling block for some, e.g. an AHC wholly owned by one or more institutional investors. But there may be a special exception to allow asset managers to hold a carried interest, subject to a cap.

There will be a limit to the activities the AHC can undertake. Its role is what is says on the tin – it's there to hold assets and also facilitate flows of capital, income and gains between investors and investment assets. The government is thinking of prohibiting any form of trading.

What will the benefits of the regime be?

The aim is for any UK tax leakage in the AHC to be limited. The ultimate goal is to ensure no significantly worse outcome than if the investors had invested directly in the underlying assets.

Income profits in the AHC will be taxable, but only taxable proportionate to the AHC's limited role of facilitating income and capital flows between investors and the assets.

In relation to capital gains, relief would be given so that the AHC does not generally pay tax on capital gains provided they are either returned to investors (where tax may be paid instead, depending upon the nature of the investors) or reinvested. Significantly, an absolute exemption is not being considered, so there could be an exit charge on leaving the AHC regime. This could be in the form of an immediate tax charge on capital gains that have not been returned to investors or reinvested and a subsequent tax charge on cumulative gains when the AHC's assets are sold after leaving the regime. The risk of an exit charge is an unattractive aspect of the proposals in contrast to other jurisdictions. This is particularly the case given limits on the investor eligibility criteria conferring AHC status; it may narrow the category of buyer an investor could sell an AHC on to.

The government is thinking of allowing returns to investors to be streamed so that a capital receipt in the AHC is treated as capital when returned to investors, however that return is structured. So a capital profit paid up to the investor by way of dividend would be capital, not income. Whilst welcome, this streaming is likely to create complexity.

Other benefits being considered to save administrative costs and tax for investors are:

- an exemption from withholding tax on interest paid by AHCs – this would avoid the need to claim tax treaty benefits or alternatively list a quoted Eurobond; and
- an exemption from stamp duties on selling equity and debt interests in the AHC.

Will there be much compliance?

Some reporting is envisaged. The degree of compliance is likely to depend upon the degree of the regime's complexity. It is proposed the AHC will elect into the regime rather than enter it unintentionally.

How will this impact on real estate funds?

This is an uncertain aspect of the consultation. The government wants to protect the UK tax base in relation to profits from UK property and is considering how to do this. One alternative is that the AHC is simply prohibited from owning UK property or UK property rich assets. Another route is to allow ownership, but restrict the regime's benefits in relation to such interests, so the AHC would, for example, pay tax on selling UK property.

The government asks whether there is interest in the AHC being used in multi-jurisdictional real estate funds. If the AHC were to own non-UK real estate, the general relief on gains for AHCs should apply, but the taxation of income from non-UK real estate is not clear. Alternatives are an exemption from UK tax on the rent or subjecting the rent to UK tax and giving a credit for any overseas tax paid.

However, there is more positive news for real estate funds. Several REIT measures were put forward for consultation alongside the AHC to make the UK's REIT regime more competitive. These are intended to stop some barriers to entry to the regime and improve the operation of it. They will be introduced at the same time that the AHC regime goes live and [are the subject of a separate blog](#).

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