MAPLES GROUP

UK OUTLINES BENEFICIAL TAX TREATMENT FOR ASSET HOLDING COMPANIES

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Indicative of the potential for greater flexibility in its post-Brexit economic policy, a new initiative is underway in the UK to increase its attractiveness as a fund and asset holding company ("AHC") jurisdiction for alternative investment funds.

Following a two stage UK Treasury consultation process, with significant input from the financial sector, the government has affirmed its commitment to implementing a competitive new regime for asset holding companies. The framework addresses the domestic tax challenges faced by managers forming intermediate entities through which alternative investment funds hold assets. Closed-ended private equity funds, which tend to invest in target companies through multiple asset holding companies, were a primary focus of this exercise, particularly in regards to difficulties returning capital gains to the fund from disposals of shares in such companies. The enhancements to the UK fiscal framework will aim to capitalise on the jurisdiction's strengths as a leading fund and asset holding jurisdiction, notably at a time of corporate tax changes elsewhere in Europe, while maintaining the country's relevance in the alternative investment fund management sphere, following its withdrawal from the European Union.

Legislative Outline

The Government has set out its intention for the final shape of the AHC regime which is to be in place for the 2022 / 23 tax year. In order to qualify for the new regime, UK resident companies will need to meet a set of conditions and elect to become a Qualifying Asset Holding Company ("QAHC"). The eligibility criteria to elect to become a QAHC are focused around the ownership, structure and types of investors into a QAHC, as well as the activities undertaken by a QAHC.

Eligible (Category A) investors will generally be either diversely owned funds with regulated managers, or institutional investors already regulated by the authorities, including pension funds, life assurance businesses and REITs. Ownership rules will require a minimum 70% holding by category A investors, through direct investment or indirectly via another QAHC, allowing a chain of QAHCs to be established as necessary. Other investors (Category B) may hold up to 30% of a QAHC, so as not to exert undue influence over the vehicle, while the rules generally will concur with the variety of funding mechanisms that may be employed and the implications of carried interest arrangements.

It is the intention of the Government that a QAHC's activity should be investment related and not trading. A test for the QAHC's purpose will potentially be introduced in the future, in order to include companies set up for the holding of eligible investments to generate returns for eligible investors. In addition, the investment activity will be limited to certain assets, including shares, overseas real estate and lending.

Direct or indirect investments in UK real estate will not benefit from the new tax treatment, however investments in overseas real estate will. Additionally, it is being considered that a minimum level of capital, in the region of £50 million to £100 million, will be required for a QAHC.

Under the new regime, it is intended that for tax purposes a QAHC will be treated as a flow-through vehicle. The taxation of a QAHC will be based on existing corporation tax rules, amended to allow income and gains to be returned to investors with little or no tax paid by the QAHC, with investors taxed on these amounts in their jurisdiction of residence as appropriate. Furthermore, the tax paid by the QAHC is not proposed to be disproportionate to the value of the activity it undertakes. While there will not be a general relaxation of the duty to deduct withholding tax from interest, the government said it recognises that obtaining relevant exemptions on withholding tax are less burdensome in other jurisdictions where asset holding companies are commonplace. Therefore, it intends to remove the obligation to withhold a sum representing income tax related to payments made regarding securities held by investors in a QAHC. Chargeable gains on assets typically held by AHCs, such as shares, and interests in shares or overseas real estate will be exempted under the new proposals. Losses from disposals will not be allowable. While a broad exemption had been considered for all chargeable gains, the government said that will not be implemented. In addition, there will be various modifications to how certain loan relationships and derivatives are treated from a tax perspective, including turning off certain distribution rules in respect of profit participating loans and results-dependent debt, effectively giving the QAHC an allowable deduction under the loan relationship rules.

Some details are still yet to be fleshed out in certain areas, including the application of rules regarding transfer pricing and hybrids to the new QAHC regime, as the UK government continues the consultation exercise. Among other measures aimed at removing barriers for investment in UK real estate through the REITs regime, where REITs are wholly, or at least 99% owned by institutional investors, the requirement that the REIT must be listed on a recognised stock exchange will be removed.

Active Markets

For some time ahead of this exercise, which was initiated in March 2020, the Maples Group had seen consistently strong growth in the use of UK holding companies, as well as the formation of more UK domiciled alternative investment funds. Much of this activity has been private equity related, with managers holding record levels of 'dry powder' finance globally. The theme of specific assets utilising UK holding companies has also been a notable feature, going back to the onset of the COVID-19 pandemic, along with the use of UK companies in both fund and corporate structures. Where foreign entities have been redomiciled to the UK we have also been engaged in the appointment of UK resident independent directors as part of a comprehensive best-practice suite of corporate governance policies.

From our interactions and work with clients in this space, it is well understood that much of the attraction of UK-domiciled holding companies is entwined with the breadth of double taxation treaties that the UK already has in place. Other factors behind the UK's prevalence in this area are the quality of service providers and the depth of its financial sector and markets. With over £9 trillion of assets under management, the UK's asset management sector is the second largest globally and the largest in Europe. As the headquarters for many leading financial institutions, there has always been a strong familiarity with London as one of the world's pre-eminent international financial hubs.

With the UK re-examining its own role in international financial services in the wake of Brexit and potential for further growth in the area of alternative investments, it would suggest that beneficial tax changes will encourage greater use of UK holding companies going forward. The Treasury said that any changes will need to be consistent with the UK's continued commitment to fully adhere to international tax standards, including

the OECD's Base Erosion and Profit Shifting (BEPS) minimum standards and global standards on fair tax competition as governed by the OECD's Forum on Harmful Tax Practices (FHTP). It was also confirmed that no changes will be made to the UK's Controlled Foreign Corporation (CFC) rules, with respect to QAHCs, which will remain in accordance with the BEPS recommendations. The Maples Group has been able to support our clients in enabling them to adhere to these standards, by assisting with the implementation of best practice corporate governance, including the appointment of appropriately qualified and experienced independent directors.

The proposed new framework for the tax treatment of holding companies comes at a time of heightened activity around the convergence of alternative investment funds and corporate deal making. From our perspective, such activity is taking place across asset classes and across regions, with inbound capital reaching the UK from North America, Asia and the Middle East. Notably we are seeing corporate vehicles established in the UK to hold assets located in the Middle East and South America, including in the energy sector. In the UK there has been significant activity in the renewables space for a number of years in addition to social housing projects and care homes. Another interesting segment bisecting the technology and infrastructure sectors has been investment in data centres, while there has also been significant activity more generally in technology, consistent with global trends and the UK's specialist expertise in this area. In concert with increased demand for UK holding companies we expect to see more demand for the various fiduciary services the Maples Group provides in this regard, such as incorporation, registered office, company secretarial and corporate governance, including the appointment of professional independent directors. With a well-established presence in London, the Maples Group's fiduciary team plays a key role for our clients in ensuring that companies are fulfilling their statutory requirements in the UK. This has been important for a number of our clients who have not historically used the UK and may be less familiar with the requirements of this jurisdiction. We have been able to assist them implementing these requirements into their multi-jurisdictional operations through our presence in other key locations combined with our knowledge of the UK regulatory environment.

Overall, UK requirements are not especially onerous including the maintenance of statutory books and records, the ability to file IFRS accounts and the filing of annual confirmation statements. The Maples Group has robust systems in place to ensure client companies are fully compliant with all relevant obligations. With a long-standing history of promoting good governance, the Maples Group offers a professional and well-established route to providing certainty and comfort to the users of funds, investment vehicles and other corporate structures.

About the Authors

Sam Ellis

Sam serves as an independent director on a wide range of alternative investment funds including hedge funds, funds of funds, segregated portfolio companies, private equity vehicles and related structures. Sam joined the Maples Group in 2011 and carries over 15 years' experience in the legal and financial services industry. Prior to his transition to the firm's London office in 2014, Sam was a Senior Vice President in the fiduciary services team in the Cayman Islands, providing director and advisory committee services to a variety of complex alternative investment structures domiciled in the Cayman Islands.

From 2003 to 2011 Sam was a Vice President at Macquarie Group in the London and Melbourne offices working on equity capital markets and merger and acquisition transactions across a variety of sectors and regions. Sam began his professional career in law with Freshfields Bruckhaus Deringer in Brussels, Belgium focusing on EU merger clearances and antitrust cases. Sam has a Bachelor of Commerce degree and a Bachelor Law degree (1st Class Honours) from the University of Melbourne. He is a chartered accountant and member of the Institute of Chartered Accountants in Australia and the Institute of Directors in the UK. Sam also holds the Accredited Director designation from the

Institute of Chartered Secretaries and Administrators Canada and is fluent in German.

Tina Westwood

Tina has extensive knowledge of the full spectrum of corporate and administration services for funds, companies, LLPs and trusts, gained through extensive experience in various roles within fund administrators and trust and company service providers in the UK and in Jersey.

Previously, Tina was Director of Minerva Fiduciary Services (UK) Limited in London where she was responsible for administering UK companies and assisting the global group with its onshore and offshore service offering. Prior to that, Tina worked for Minerva Trust & Corporate Services Limited. She was previously employed by Nautilus Trust Company Limited, following the sale of its business by Atlas Trust Company (Jersey) Limited. Tina has also worked for Quorum Trust (Jersey) Limited and Barclays International Funds Limited.