

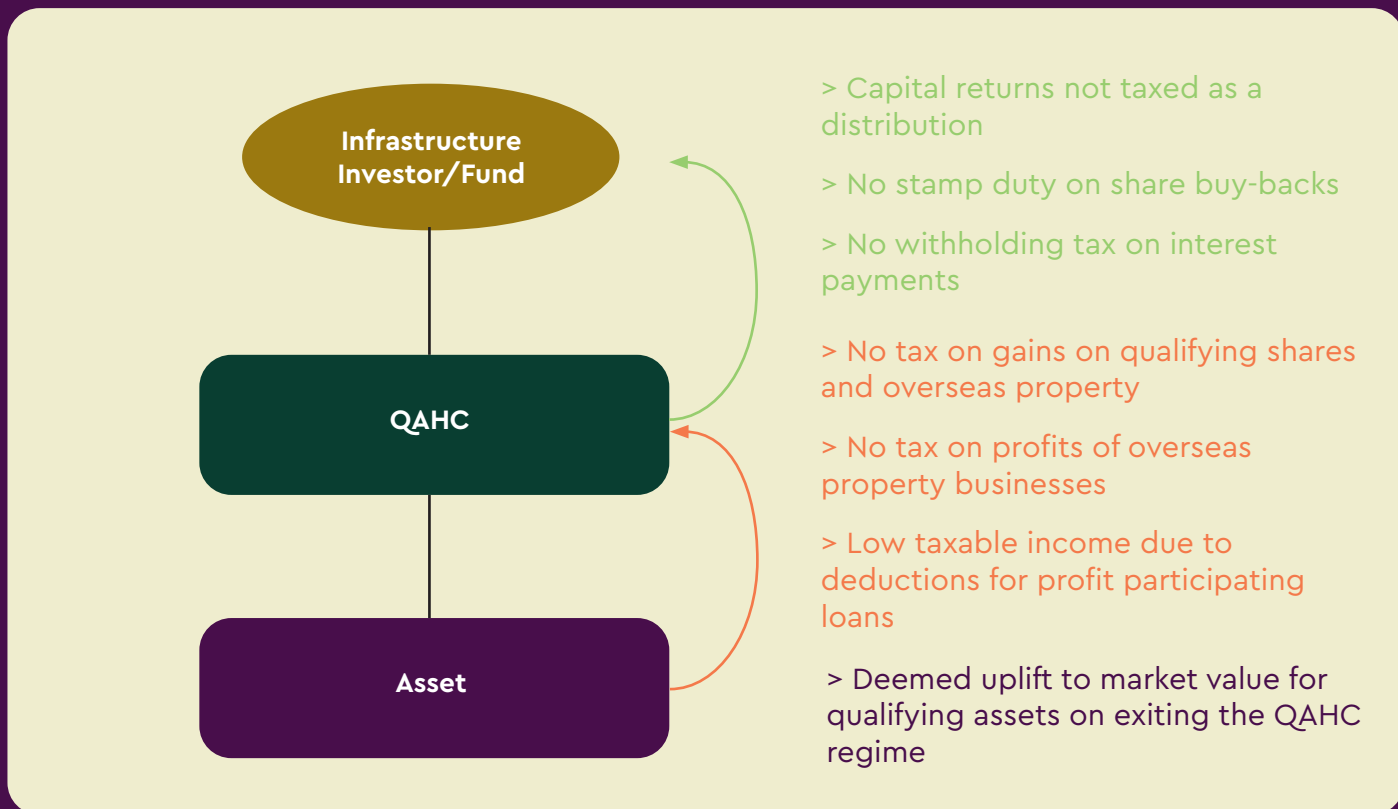
# Qualifying asset holding company regime and infrastructure investors

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In a bid to bolster its attractiveness to the asset management sector, the UK is introducing a new tax efficient vehicle: the qualifying asset holding company ("QAHC", pronounced "quack"). The elective regime will be introduced in April 2022 and, by providing a simplified basis of taxation and a host of generous tax benefits, should allow the UK to compete with Luxembourg and other competitor jurisdictions.

## Simplified overview of QAHC tax benefits



The QAHC regime looks promising for infrastructure investors and funds, particularly those with a lack of natural substance in other commonly used European jurisdictions for asset holding companies ("AHCs"), such as Luxembourg, Ireland and the Netherlands. This briefing is intended to provide a high-level overview of the tax benefits and eligibility criteria of the QAHC regime, as well as a summary of how it compares with rival offerings (particularly Luxembourg).

If you would like to know more about how QAHCs could be used when structuring your future investments, please contact any of the individuals listed at the end of this briefing.



# How will QAHCs benefit infrastructure funds and investors?

AHC stacks are the go-to for many funds and investors as it creates a platform for investments to be held and managed in addition to providing liability protection. Notwithstanding the benefits, AHC structures bring with them the risk that the ultimate investor may be liable to more tax than they would have had they made a direct investment in the underlying asset.

Currently, the most popular way to circumvent this risk is to make use of Luxembourg's (or, in some cases, Ireland and the Netherlands') tax reliefs and wide-ranging double tax treaties. However, with ATAD III fast-approaching, which will introduce additional substance requirements for EU member states, it may become more challenging to utilise AHCs in these jurisdictions.

The goal of the UK QAHC regime is to firmly establish the UK as the go-to for asset managers, as opposed to EU member states, by offering a regime with the following tax benefits:

## Low taxable income

QAHCs will be able to use profit participating loans to reduce taxable income such that QAHCs are only taxed on amounts proportionate to the value of its "ring fence" activities (broadly, investment activities in relation to qualifying shares, non-UK land, debt and related derivative contracts).

## Capital returns to investors

To facilitate capital returns, QAHCs will be able to switch off the UK tax rules that treat premiums on share buy-backs as distributions, facilitating capital returns to investors (save in certain circumstances).

## Exemption for gains on shares and non-UK land

QAHCs are exempt from tax on gains on non-UK property and "qualifying shares" (broadly, all shares apart from those deriving at least 75% of their value from UK land). This exemption is free of conditions and caveats, so will afford more certainty and flexibility than the existing UK 'substantial shareholding exemption' rules.

## No withholding tax on interest or dividends

QAHCs will not have to pay withholding tax on interest. And the UK does not have withholding tax on dividends.

## Stamp duty on buybacks

Exemption from stamp duty and stamp duty reserve tax on buybacks of shares or loan capital.

## Exemption for non-UK property business income

QAHCs are exempt from tax on profits of non-UK property business to the extent that those profits are chargeable to a non-UK tax.

## Exit market value uplift

Deemed uplift to market value for QAHC's qualifying assets on exiting the QAHC regime.

Although the regime will not be appropriate for all infrastructure assets (for example, an asset deriving the majority of its value from UK land), it will eliminate many of the major 'red flags' associated with the current UK framework and help to reduce tax leakage at the QAHC level. Indeed, there is already market interest in the use of QAHCs as a fund feeder or master holding company.

Of notable mention to infrastructure investors is the blanket interest withholding tax exemption and switching-off of the deemed distribution rules, as they will facilitate the use of profit participating loans to circumvent the 'cash-trap' problem caused by many infrastructure assets held via existing UK structures. The QAHC regime's simplicity should also not be underestimated, which, given the fast-paced and transactional nature of infrastructure investing, will be of great benefit and provide certainty when implementing highly complex structures.

Whilst the regime looks promising, there are some areas where it falls short. For example, the regime does not offer a blanket stamp duty exemption and fails to address potential UK company law impediments to accessing capital returns. This may cause some to consider using entities incorporated in more flexible jurisdictions outside the UK (but which are still UK tax resident) as QAHCs.

## Other tax consequences of being a QAHC

In addition to the above benefits, there are other tax consequences that investors and funds should be cognisant of when considering the use of QAHCs:

- **Restrictions on benefiting from non-ring fence activities:** examples include restrictions on tax neutral intra-group transfers of ring fence assets from a non-QAHC to a QAHC and the surrender of ring fence losses from a QAHC to a non-QAHC. This latter point may mean that QAHCs are not commonly used in leveraged acquisition stacks, as a QAHC's losses from financing costs cannot be used to relieve trading profits in the underlying companies. That being said, the position is no worse than the current UK position and indeed the Lux position.
- **Deemed disposal of ring fence assets:** if an existing company elects to become a QAHC it will be deemed to have disposed of certain ring fence assets for market value on joining the regime. In existing structures, we commonly see 'investment-specific' AHCs being incorporated to facilitate infrastructure investments, rather than the use of existing vehicles, so this feature of the regime should not be of much concern. In any event, the QAHC regime also offers an extended version of the substantial shareholders exemption which, in many cases, will prevent any tax charge arising on the deemed disposal.
- **More stringent application of the UK transfer pricing rules ("TP"):** the exemption for small and medium-sized entities is disapplied for all investors (irrespective of the size of their holding) under the QAHC regime.
- **Reporting requirements:** there are additional reporting requirements with which QAHCs have to comply, such as the need to provide an estimate of the market value of the QAHC's ring fence assets at the end of each accounting period.

## Eligibility criteria

There are seven eligibility requirements. **Four** of these are very straightforward but the other **three** contain a little more complexity and are discussed further on the following page.

UK tax resident

Not a UK REIT

None of its equity securities listed or traded on a public market or exchange

An entry notification is in force

Meets investment strategy condition

Meets ownership condition

Meets activity condition

### The investment strategy condition

The company's investment strategy must not involve the acquisition of equity securities listed or traded on any public market or exchange (or interests whose value derives from such securities), otherwise than in certain specified circumstances.

### The ownership condition

The ownership condition limits the size of "relevant interests" that "non-Category A investors" can have in the QAHC or in any enhanced class of the QAHC's securities (i.e. securities that entitle holders to a greater proportion of the company profits or assets of a particular class) to 30%.

### The activity condition

The main activity of the company must be the carrying on of an investment business, and the other activities of the company must be ancillary and not carried on to any substantial extent.

### Relevant interests

A person has a "relevant interest" if they are, broadly, beneficially entitled to a company's profits of its ring fence business available for distribution or assets of that business available for distribution on winding up, or if they have voting power in the company in relation to "standard resolutions".

Generally, when calculating relevant interests, you do not look through transparent "qualifying funds" (see Category A investors for more information on "qualifying funds").

### Category A investors

Broadly, category A investors include a range of institutional investors, including pension funds, charities and long-term insurance businesses. Most importantly, investment funds that are "qualifying funds" (broadly speaking, CISs and AIFs that are not close) are also category A investors

QAHCs are Category A investors, meaning that QAHCs can be stacked.

Whether a proposed structure will meet the above criteria, especially the ownership condition, will need to be assessed on a case-by-case basis, not only at the initial investment stage but also before any exits and new investments. However, we do not see it acting as a barrier to infrastructure investments utilising QAHCs in most circumstances.

## How do QAHCs compare with the alternatives?

For those with existing infrastructure and AHCs in Luxembourg (or elsewhere), it may be unrealistic to expect the QAHC regime to be a sufficient incentive for them to down tools in Luxembourg and relocate to the UK. However, that could change, especially if the government continues to improve the attractiveness of the UK's fund offering as it has promised, and if maintaining adequate substance in Luxembourg becomes more challenging in the future (particularly in the context of ATAD III).

As shown in the comparison table on the next page, the QAHC regime puts the UK on a relatively level playing field with Luxembourg in terms of tax treatment. For many managers and investors going forward, we suspect that decision making will instead focus on administrative ease and substance (especially in light of ATAD III). Given the significant amount of capital infrastructure investors have in UK 'inbound' infrastructure (and their associated presence in the UK), it is reasonable to assume that in many cases the new UK regime will have the upper hand.

# QAHC regime: comparison with Luxembourg

	Luxembourg	UK QAHC regime	Winner
<b>Eligibility criteria</b>	No specific holding company eligibility criteria	Eligibility criteria must be met but should not be cause for concern	<b>Luxembourg due to simplicity, but not a concern in the UK if you meet the eligibility criteria</b>
<b>Taxation of gains</b>	Participation exemption subject to simple conditions	Simple and wide-ranging exemption from capital gains on most shares and overseas land	<b>UK</b>
<b>Taxation of dividends</b>	Participation exemption subject to simple conditions	At least as beneficial as current UK position (i.e. a wide-ranging exemption)	<b>Draw – attractive position in both jurisdictions</b>
<b>Taxation of income</b>	Taxed at full rates, but only on transfer priced margin. Hybrid rules apply in principle, but effective carve out for funds	Taxed at full rates, but only on transfer priced margin for ring fence activities with deductions for profit related interest. Hybrid financial instrument rules and late paid interest rules disapplied	<b>Draw – though the group relief switch off is problematic for AHC use in leveraged acquisition stack</b>
<b>Withholding tax on interest</b>	Generally no interest withholding tax	Exemption for payments of interest by QAHC	<b>Draw – attractive position in both jurisdictions</b>
<b>Withholding tax on dividends</b>	Withholding generally applies but typically returns can be structured not to be dividends	None (i.e. same position as for most UK companies)	<b>UK</b>
<b>Capital returns for UK investors</b>	Easy process – e.g. redemption of alphabet shares for partial liquidation	Usual tax treatment of share repurchases as distributions switched off for QAHCs, so capital treatment potentially available	<b>Luxembourg due to simplicity, but position in both jurisdictions is attractive</b>
<b>Use of cross-border AHC</b>	Good treaty network and access to EU directives, but see substance concerns below	Good treaty access. No access to directives.	<b>Draw – Luxembourg directive access is balanced out by substance concerns</b>
<b>Substance</b>	Investee jurisdictions are increasingly questioning Luxembourg AHC entitlement to treaty / directive benefits. In addition, the introduction of ATAD III, which will take effect from 1 January 2024, could introduce significant challenges for Lux structures	In principle it should be easier for human and technical resources to reside in UK	<b>UK (in principle)</b>

## Key contacts

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