

## FB 2021-22 – Qualifying asset holding companies

### Lecture B1294 – 22.41 minutes

From 1 April 2022 a new tax regime for qualifying asset holding companies (QAHCs) and some of the payments they make will be introduced. The regime will apply to certain QAHCs that are used in a range of collective and institutional investment structures to hold investment assets.

It will also apply to investment funds, institutions and individuals that invest in these structures. A qualifying AHC will have to be at least 70% owned by diversely-owned funds or certain institutional investors and carry out mainly investment activity with no more than insubstantial ancillary trading.

The broad intention behind this regime is to ensure UK competitiveness as a location for asset management and investment funds.

It operates so that investors are taxed broadly as if they had invested in the underlying assets and the intermediate holding companies pay no more tax than is proportionate to the activities they perform.

#### *Conditions for being a QAHC (Para 2, Schedule 2)*

The company must:

- a) be UK resident;
- b) meet the 'ownership condition' (see below);
- c) meet the 'activity condition' (see below);
- d) meet the investment strategy condition;
- e) not be a REIT;
- f) not have equity securities listed or traded on any recognised stock exchange, or any other public market or exchange; and
- g) have an entry notification in force (see below).

#### *Ownership condition (Para 3, Schedule 2)*

A company is deemed to meet the ownership condition in its first two years as long as it will meet the ownership condition thereafter.

The condition is met if:

- a) the sum of 'relevant interests' held by persons who are not Category A investors does not exceed 30%; and
- b) where securities have been issued that entitle holders to a greater proportion of assets or profits of a particular class ('an enhanced class'), than to the other profits or assets of the company, the sum of the relevant interests in that class of profits or assets held by non-Category A investors must be no more than 30%.

Category A investors are a:

- a) QAHC;
- b) a qualifying fund– i.e. a non-close fund with genuine diversity of ownership;
- c) a relevant qualifying investor– e.g. long-term insurance businesses, UK REITs, persons not liable for tax on grounds of sovereign immunity, a non-UK equivalent of a UK REIT, collective investment vehicles, trustees or managers of pension schemes, charities unless controlled by their main donors;
- d) an intermediate company; and
- e) a public authority – UK government ministries or departments, local authorities, any health authority, public transport bodies (e.g. TfL).

Relevant interests include direct or indirect interests in the QAHC, being profit available for distribution to equity holders, the assets used wholly or partially for the QAHC business available for distribution to equity holders in a winding up, or the voting power and is take as the highest of these percentage interests.

For enhanced classes, a person has a relevant interest of the higher of its direct or indirect interest in the profits of that class distributable to equity holders, or the assets of that class available for distribution to equity holders in a winding up.

The interests of connected persons (as defined in ss1122-1123 CTA 2010) are aggregated with the person unless the connected person is a Category A investor.

The definition of securities includes ordinary shares and non-commercial loans.

Where a person has a beneficial entitlement to profits that arises under investment management profit-sharing arrangements (i.e. a variable profit share related to the services provided), it is necessary to use the maximum proportional entitlement that could arise over the life of the arrangements, instead of the actual proportion at any particular time.

#### *Notification (Paras 14 - 16)*

A company must notify HMRC that it intends to be a QAHC, specifying the date and that it meets all the conditions, or all but the ownership conditions. As noted above, it is deemed to meet the ownership condition for the first two years as long as it reasonably expects this condition to be met within the next two years.

The date specified must be no earlier than 1 April 2022 and is normally the day after the notification date after this but can be later than this.

If the company is non-resident, the notification must state where it is resident, its registration number in that territory and the date on which it will become UK resident (presumably by moving central control and management to the UK).

#### *Corporation tax consequences of becoming a QAHC (para 17 et seq.)*

An accounting period ends the day before the company becomes a QAHC and a new one begins.

Where the assets below enter the QAHC ring fence business (see below), there is a deemed disposal (at market value) outside the ring fence business, and reacquisition inside it, of

- a) any overseas land the company owns;
- b) any loan relationship or derivative contract the company is party to for the purposes of an overseas property business; and
- c) any qualifying shares.

Similarly, when one of the above assets leaves the ring fence business, there is a deemed disposal at market value within the ring fence and a deemed acquisition outside it.

If the QAHC holds a substantial shareholding in c) above, but at the date of the deemed sale, the 12 months ownership condition was not met for the purposes of SSE, but subsequently they are held for at least 12 months and, at that time, a disposal would qualify for SSE, no gain is deemed to arise on becoming a QAHC on those shares.

If the company was non-resident and became UK resident in the 30 days before it became a QAHC, no deemed disposals arise.

#### *QAHC ring fence business (Para 20)*

Once the company has become a QAHC, its qualifying activities are treated as separate and distinct from all other activities it carries on now, any activity it carried on before becoming a QAHC and any activity it will carry on after it has ceased to be a QAHC.

This means that:

1. the ring fence business is treated as a separate company distinct from any other activity it carries on for the purpose of calculating corporation tax (though it only files a single CT600 for all its activities);
2. no loss arising outside the ring fence business can be set off against the profits of that business; and
3. no loss arising within the ring fence business can be set off against any profits of any other activity outside the ring fence (including before it became a QAHC and after it has ceased to be one), although they can be group relieved against QAHC ring fence profits of other 75% group companies.

Just and reasonable apportionments are needed for assets, receipts, losses and gains which relate to both the QAHC ring fence business and the other activities.

Transfers of chargeable gains and allowable losses between a 75% group company and a QAHC are treated as arising outside of the QAHC ring fence business.

A distribution received by a QAHC received from a REIT that is treated as a profit from a UK property business is received outside the QAHC ring fence business (and is therefore taxable on the QAHC).

Part 7ZA CTA 2010 (limiting deduction of losses brought forward) does not apply to a QAHC ring fence business.

### *Extra return required*

A QAHC must send a return to HMRC for each accounting period (separate to its CT600) with:

1. its name and UTR;
2. the name, UTR (if any) and address of any person (if a partnership, the details of the partnership not the particular partner who provided the services) who has provided investment management services to the QAHC;
3. an estimate of the market value of the assets within the QAHC ring fence business as at the end of the accounting period;
4. the gross proceeds from disposals of assets from ring fence business in the accounting period;
5. payments made by the QAHC to redeem, repay or purchase its own shares.

This return must be provided to HMRC before the end of the filing date for the CT600 for the accounting period. Failure to meet this deadline will mean a £300 penalty which is appealable and subject to a reasonable excuse defence.

### *Ceasing to be a QAHC*

A company can notify HMRC that it wishes to leave the QAHC regime by serving it with an 'exit notification', stating its name, UTR and the date on which its entry notification no longer has effect (but cannot be retrospective).

A QAHC must notify HMRC if it ceases to meet a relevant condition as soon as is reasonably practicable after becoming aware of it. It must set out:

1. a description of the breach;
2. the date on which it occurred;
3. the date on which the QAHC first became aware of it; and
4. where the breach is a breach of the ownership condition to which a 'cure period' (see below) could apply and whether it intends to rely on this cure period (and if so, what steps it intends to take to meet the ownership condition by the end of the cure period).

### *Cure periods*

If the breach of the ownership period is not deliberate, the company has notified HMRC of it as above and the breach has ceased as soon as reasonably practicable, the breach is treated as not having occurred.

A breach is deliberate if the QAHC, a director or manager of the QAHC, an owner with a relevant interest of at least 25% (or a person who directs or manages the owner) does anything that they knew would lead to a breach of the ownership condition and it would have been reasonable for the person to avoid doing that thing.

A cure period of 90 days from when the QAHC became aware of the breach applies to the breach of ownership condition if:

1. the breach was not deliberate;
2. Category A investors still hold more than 50% relevant interest in the QAHC;
3. the company took reasonable steps to monitor compliance; and
4. the QAHC has notified HMRC that it intends to rely on the cure period.

HMRC can extend the 90-day period at its discretion.

Where a cure period applies, no breach is treated as having occurred.

#### *Wind-down period*

If the breach of the ownership condition was as a result of an investor ceasing to be Category A, or because the QAHC purchased or redeemed a relevant interest and at the time it intends to cease the ring fence business soon as practicable, it can notify HMRC that it is entering a 'wind-down period' (i.e. that it expects to have sold all the ring fence assets within two years of the QAHC becoming aware of the breach).

During this period, its ring fence business will still fall within the QAHC regime, despite being in breach of the ownership condition.

The wind-down period is generally two years from the company becoming aware of the breach but it can be extended by HMRC, but if the QAHC acquires assets or raises capital in that period (which must be notified to HMRC), the wind-down period ceases immediately unless these actions were connected with the wind-down or to prevent the insolvency of the QAHC during the wind-down period.

#### *Ceasing to be a QAHC (Para 29 et seq.)*

Generally, a company ceases to be a QAHC immediately after a condition ceases to be met, unless the breach can be cured or it enters a winding-down period as set out above.

If a breach of the ownership condition is not cured, the company ceases to be a QAHC at the end of the cure period, unless the cure period ceases to apply because Category A investors' relevant interest falls to 50% or less, in which case the company loses its QAHC status immediately after this occurs.

If the company has entered a wind-down period, it ceases to be a QAHC at the end of that period.

When a company ceases to be a QAHC a chargeable accounting period ends and a new one begins the following day.

The QAHC is treated as disposing of (at market value) the relevant assets discussed above (land, certain loan relationships and derivatives and qualifying shares) within the QAHC ring fence and then reacquiring them outside the ring fence.

Any interest payable on securities issued by the company, which is in connection with the transfer of relevant interests as a result of which the company ceased to be a QAHC, is treated as made while it was a QAHC if it was paid on the same date it ceased to be one, but after this cessation occurred.

#### *Group aspects (Part 4)*

If overseas land, relevant loan relations or derivative contracts, qualifying shares or any other asset that will be within the QAHC ring fence business are sold to the QAHC by other 75% capital gains group companies, or vice-versa, the normal intra-group rules on tax-neutral transfers are disapplied.

As the companies are connected, the disposals will be treated as taking place at market value.

Ownership periods of shares transferred to a QAHC by a group company are aggregated for the purposes of establishing if a later disposal by the QAHC qualifies for substantial shareholding exemption (Schedule 7AC TCGA 1992). This applies even if the recipient company has ceased to be a QAHC by the time it disposes of the shares. However, for the purposes of this law, any shareholdings owned by other group companies are ignored in determining whether the QAHC owns at least 10% of the share capital and voting power.

There are provisions relating to de-grouping gains where a QAHC disposes of shares which are exempt as a result of it being a QAHC. Normally, where a gain or loss would have been adjusted as a result of s179(3D) or (3E) TCGA 1992 for the transferor of the asset previously transferred to the QAHC, the gain or loss accruing is treated as accruing to the QAHC outside of its ring fence business.

#### *Loans to participators*

If a QAHC lends to a participator, it is deemed to be a close company for the purposes of s455 tax.

#### *Exchange gains and losses*

If a QAHC has a loan relationship asset or liability, which it either fair values or uses in a designated fair value hedge of foreign currency risk, and it is denominated in a foreign currency, the exchange gain or loss for the accounting period is the change in the fair value attributable only to changes in:

1. the spot rate between the currency of the instrument or another currency relevant to the value of the asset or liability; and
2. the base currency of the QAHC.

This flexibility will be used typically where a QAHC borrows in one currency and then uses this money to make a number of investments which are denominated in different currencies.

#### *Connected company loan relationships*

The normal rule in s349 CTA 2009 that amortised cost must be used for connected company loan relationships is disapplied if the QAHC lends the money as part of its investment activities and accounts for the loan using fair value accounting.

#### *Transfer pricing*

The participation condition in s148 TIOPA 2010 is extended so that the transfer pricing rules in Part 4 TIOPA 2010 apply to arrangement between a QAHC and

1. investors with a relevant interest in the QAHC; or
2. any person for whom the participation condition would be met in relation to their relationship with those investors.

The small and medium-sized enterprise exemptions do not apply to transactions involving a QAHC.

#### *Corporate interest restriction*

If a QAHC owns a subsidiary and chooses to account for it at market value under the 'investment company exemption' in IFRS 10, the subsidiary and any of its subsidiaries do not form part of the worldwide group in which the QAHC sits.

Instead, the subsidiary and any of its own subsidiaries form their own worldwide group for CIR purposes.

If a QAHC has a wholly owned subsidiary which is itself a QAHC and is not accounted for as a market value investment, the two companies are included in the same worldwide group for CIR purposes.

#### *Treatment of certain amounts payable by a QAHC*

The loan relationship rules treat certain amounts of interest payable as distributions, where they are payable on 'special securities' in certain cases.

Para 44 prevents such amount being treated as distributions where the securities fall within Conditions B, C and D of s1015 CTA 2010 (convertible securities, interest linked to the results of the company, securities connected with shares in the company) and a QAHC is party to the security for the purpose of its ring fence business.

If the security is used partly for the ring fence business and partly for other purposes, a just and reasonable apportionment of the amount payable must be made.

#### *Application of hybrid mismatch rules*

Where the payer treats an instrument as debt (giving rise to interest payable) but in the recipient jurisdiction, the corresponding amount receivable is treated as a distribution, this can give rise to a hybrid financial instrument deduction/non-inclusion mismatch (Chapter 3 Part 6A TIOPA 2010) in which it is possible for the interest payable to be disallowed.

Para 45 ensures that the amount payable in Para 44 above remains deductible, notwithstanding how it is treated in the recipient's jurisdiction.

Where a QAHC receives a payment and is obliged to make a relevant distribution which is not treated as distribution for tax purposes in accordance with Para 44, the amount received used to make the distribution is treated as ordinary income for the purpose of Chapter 3 Part 6A TIOPA 2010.

#### *Payments of distributions etc. to individuals taxed on remittance basis*

If the QAHC pays interest or makes a distribution to an individual who is taxed on a remittance basis, or the individual disposes of shares in the QAHC, the foreign portion of these amounts is treated as relevant foreign income or a foreign chargeable gain if the individual has provided investment management services to the QAHC.

The foreign proportion is the proportion of the QAHC profits derived from foreign sources (on a just and reasonable basis) in the relevant period. For this purpose, the QAHC includes any profits that would have arisen had it disposed of all of its assets at market value immediately before the end of the period (i.e. it includes mark-to-market gains and losses on its assets in its profits).

Profits are 'foreign source' based on the underlying income or assets to which the profits relate, not just the direct source. For example, if the income and gain in value of an investment in another UK company derive from the investee's profits arising outside the UK, this is foreign source income for the QAHC.

If the company has been a QAHC for at least three accounting periods, the relevant period is the three most recent complete accounting periods. If not, it is the period from when the company became a QAHC to when the income or chargeable gain arose on the individual.

#### *Purchase of own shares*

If a QAHC makes a payment on the redemption, repayment or purchase of its own shares, this is not generally treated as a distribution for tax purposes.

There is an exception for 'qualifying' employment-related securities. These are securities acquired by an employee who is not a fund manager in relation to the QAHC which were made available as a result of employment either by the QAHC or a company in which the QAHC has at least a 25% interest.

If the payment, redemption, repayment or purchase of own shares takes place in a cure period, Para 47 will not apply (so the receipt will be generally taxed on the recipient as a distribution) if the payment is made to a non-Category A investor where the relevant interests of non-Category A investors total more than 30% (or 30% of an enhanced class) and the person increased their relevant interest in the QAHC on or after the date this limit was exceeded.

This rule applies even if the breach leading to the cure period is rectified such that it is not treated as a breach of the ownership condition.

#### *Transactions in securities rules*

Para 49 largely disapplies the T-i-S rules in relation to holdings in a QAHC. It would be inappropriate to introduce uncertainty for individuals where the QAHC rules clearly state that buy-backs of shares are not treated as distributions.

The rules continue to apply in full to qualifying employment-related securities, reflecting the non-availability of capital treatment on buybacks of such securities.

#### *Late paid interest*

The late paid interest rules in s373(1) CTA 2009 does not apply where interest is payable by a QAHC on a loan relationship to which it is a party for the purpose of its QAHC ring fence business.

Interest payable must be apportioned where the loan relationship is partly for the purpose of the QAHC ring fence business (on a just and reasonable basis).

#### *Deeply discounted securities*

S409 CTA 2009 (postponement until redemption of debits of close companies' deeply discounted securities) does not apply to a qualifying debit (where the debit relates to the amount of the discount and the security for the purpose of its QAHC ring fence business).

Again, apportionment is made where the QAHC is party to the deeply discounted security partly for the purpose of the ring fence trade on a just and reasonable basis.

#### *Overseas property income*

There is no liability to corporation tax on overseas property profits to the extent that these profits are taxable (at a rate greater than 0%) in a foreign jurisdiction.

This exemption extends to profits arising from loan relationship and derivative contracts held by a QAHC for the purposes of an overseas property business which is itself exempt.

#### *Disposals of overseas land and certain shares*

A gain on disposal of overseas land by a QAHC is exempt for corporation tax purposes.

Similarly, gains on shares are exempt unless the shares derive at least at least 75% of their value from UK land.

Shares for this purpose includes stock, other membership interests in a company, an interest as a co-owner of shares, right of a unit holder in a unit trust, units in transparent funds treated as assets under s103D(3) TCGA 1992 and derivatives where the underlying asset is shares (such as share options, share warrants etc.).

#### *Stamp Duty and Stamp Duty Reserve Tax*

The transfer to a QAHC of its own shares or loan capital is exempt from all stamp duties if:

- a) the transfer does not form part of disqualifying arrangements (i.e. the QAHC buys back, then issues new shares or loan capital to a different person where this was the main or one of the main purposes of the arrangement to avoid stamp duties on an effective transfer from one party to another of the shares or loan capital);
- b) it does not take place when arrangements for a substantial sale (at least 90% of the relevant interests) of the QAHC exist; and
- c) the QAHC delivers a return to the registrar of the purchase of its own shares (as required by s707 CA 2006).

This exemption includes where the company ceases to be a QAHC as a result of the purchase of its own shares or loan capital.

#### *Exemption from withholding tax*

A QAHC does not need to deduct withholding tax from payments of interest, however this interest arises.