Joint AREF/ IPF Member Discussion

Industry Consultation 'Tax treatment of asset holding companies in alternative fund structures'

Thursday 16th April 2020 – 11:15hrs

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IPF Investment Property Forum

Agenda

- Introduction – John Forbes
- Tax treatment of Asset Holding Companies in alternative fund structures – Matthew Roach
- Discussion & Q&A’s on the Consultation

Speakers

John Forbes
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years supporting the UK

Tax treatment of Asset Holding Companies in alternative fund structures

- KPMG discussion pack on HM Treasury consultation
- April 2020

Introduction

- At Budget 2020, HM Treasury published a consultation into the tax treatment of Asset Holding Companies (“AHCs”) in alternative fund structures.
- The consultation is part of a proposed broader review of UK funds, including tax and regulatory regimes.
- As part of this review a consultation into the VAT treatment of investment management fees was also launched in March 2020.
- The consultation comes off the back of the Government’s Investment Management Strategy II which resulted in the creation of an Asset Management Taskforce, which was launched to enhance dialogue between the Government, regulator, and industry.
- The consultation has also been launched as a consequence of the 2019 UK Funds Regime Working Group Report produced by the IA at the request of the Taskforce. This report included many recommendations including (i) the establishment of new UK fund types, including a Long Term Asset Fund and Onshore Professional Fund, (ii) changes to tax and regulatory rules, and (iii) enhanced promotion of UK funds. This consultation arises as part of the changes to the tax regime. We expect further consultations to cover other areas.
- While not mentioned in the documents, Brexit serves as a catalyst for these proposed reforms.
- The consultation document explains (i) policy concerns, (ii) key features and challenges with the current regime, and (iii) possible changes. Respondents are asked to answer a number of questions. This document provides an overview and commentary.
- Responses to the consultation are due by 20 May 2020.

Understanding the policy concern

Framework

- The government is prepared to make changes where there is a clear rationale.
- However, changes must not be inconsistent with BEPS and other international commitments, should not significantly reduce the UK tax base, and not create opportunities for avoidance/abuse.
- The UK has a competitive tax regime but the Government has been made aware of barriers to AHCs being established in the UK. These are explored in this summary,

Which funds?

- The Government would like to understand which type of funds are facing these barriers.
- The consultation specifically mentions real estate, credit, and private equity funds and also references the OECD definition of non-CIV fund.

Why SPVs?

- As part of the consultation, the Government would like to better understand the reasons for funds using SPVs.
- Known reasons included within the paper include (i) giving the fund greater control over distributions and reinvestment policies, (ii) limitation of liability, (iii) to allow for co-investing and borrowing, and (iv) administrative benefits, including tax.

Benefits?

- The Government would like to be convinced of the benefits of introducing new rules for AHCs.
- Benefits may be directly as a consequence of increased taxation or indirect benefits such as fees generated and the employment of service providers.
- As part of the consultation, the government has asked respondents to quantify the potential benefits.

Key features of the current UK tax regime

UK Tax Regime

Treaty network

- The UK has double tax treaties with more than 130 countries, making it one of the world's largest networks.
- In many cases, asset managers already have substantial activities, operations, and personnel in the UK.

Withholding tax

- The UK does not impose any withholding tax on dividend distributions.
- There are broad exemptions and widely available treaty relief in respect of the 20% withholding tax applied to payments of yearly interest.

Substantial shareholding exemption

- The UK has a wide corporate tax exemption for gains on disposal of 10%+ shareholdings.
- The regime relaxes certain requirements where there is a ownership by Qualifying Institutional Investors ("QII").

Corporation tax rate

- The UK has a competitive rate of corporation tax at 19%.
- The UK has a special taxation regime that applies to Securitisation companies.

Regardless, the Government is aware of barriers to the creation of AHCs in the UK.

Challenges to the UK as a domicile

The Government have identified the specific barriers which apply to specific funds and generally.

Credit Funds

Current rules mean that it is difficult to structure arrangements in the UK intended as financing vehicles, which in line with their activities, earn a simple financing margin.

The UK Securitisation regime is complex and there are barriers to using in a fund context compared to alternative options in other jurisdictions.

The Government have concerns over amending the existing securitisation regime, in order to maintain stability for existing arrangements falling within the rules.

The Government is seeking responses on how these barriers could be addressed.

Real asset funds

The consultation describes the Government's understanding that real estate funds require AHCs which have a good treaty network and allow the repatriation of profits through a structure without suffering withholding tax.

In general, the UK scores well against these criteria but it is recognised that despite reform to the SSE, the application of SSE to real estate structures remains a barrier.

The SSE currently requires more than 80% ownership by QIIs in order for the "trading" requirement to be waived.

It is proposed that (i) the QII rules could be expanded, or (ii) a new exemption introduced.

Reform may be required to the non-resident capital gains tax rules.

The Government is also interested how changes to the REIT regime (such as removing the listing requirement) may achieve the objectives of the consultation.

Private equity funds

The consultation notes AHCs in private equity fund structures have similar requirements as for real estate structures.

The consultation again notes the reforms to SSE and states that despite the UK scoring well against the criteria, there continue to be barriers to UK AHCs.

The Government recognises that a key point is the ability to retain the nature of capital gains when investment returns are returned to the fund. The Government understands the importance of this to participators and carried interest holders.

The Government would like to understand if this matter is also relevant to other types of fund, and the challenges with other jurisdictions.

General

The Government is keen to understand to what extent withholding tax on UK source yearly interest is a deterrent to UK AHCs (despite the Quoted Eurobond and broad treaty exemptions).

The Government are committed to the hybrid mismatch rules introduced in 2017. However, they have been made aware of unintended consequences impacting fund structures. In particular, they are aware of concerns around the "acting together" provisions operate in deduction/non-inclusion mismatch outcomes.

The Government have also asked for examples of how challenges have been overcome in other jurisdictions. (For example, Luxembourg have introduced certain de minimis provisions).

The Government also notes broader BEPS concerns.

There is no mention of other taxes (e.g. Stamp / VAT).

The Government have identified certain barriers and initial possible solutions. Respondents are asked to comment.

Giving effect to change

The Government notes that if change is merited to address these barriers, this could be through a series of isolated measures, or, a more comprehensive regime could be considered.

Isolated

This is anticipated to involve:

- Further reform to SSE (e.g. expanding categories of QII).
- Changes to distribution or corporate law rules
- Possible amendments to the Securitisation rules
- Reform of the REIT rules (e.g. removing the listing requirement).
- Further domestic exemptions for interest WHT
- Exclusions or adaptions of anti-hybrid provisions

Comprehensive

- The Government do not provide a framework for what a comprehensive regime may look like.
- However, it is noted that this could involve a regime which ensures AHCs are subject to tax on a basis proportionate to their activities.
- It is also noted that the regime could operate by the disapplication of certain provisions within the corporation tax framework.
- However, a comprehensive framework could also involve a different basis for tax (e.g. in a similar manner to Securitisations which are subject to tax on their retained profit).

Designing a regime which balances fund requirements with not disturbing the wider corporate tax framework or presenting avoidance opportunities is complicated. Respondents invited to comment.

Talking points

Commercial considerations for lenders etc

Investor concerns?

How to define non-CIV funds?

How to quantify possible benefits of UK AHCs?

Are Luxembourg / Ireland too far ahead?

Interaction of changes with other taxes (VAT, Stamp etc)

Compliance and filing requirements, and how these compare with other jurisdictions.

Treaty access for new type of structure?

How to implement / design changes or a new regime?

Requirement to locate fund and AHC in same jurisdiction?

Impact of Brexit

Consistent approach for all types of alternative funds?

How could a securitisation style regime work? Suitable for credit or more broadly?

Interaction / concerns connected to NR CGT?

Specific considerations for Infrastructure?

Is the public infrastructure exemption for CIR working?

Consultation questions

1. What role do AHCs perform within alternative fund structures? What are the commercial and tax benefits to using AHCs in alternative fund structures, and what advantage do they offer versus direct investment?
2. To what extent are AHCs prevalent in other funds or pooled investment structures?
3. What do you consider to be the main fiscal and economic benefits to the UK – both direct and indirect – of greater AHC domicile? Can you support with any quantitative evidence?
4. For each of the fund classes identified in Chapter 3 [Credit Funds, Real Asset Funds, and Private Equity Funds] what are the different challenges that the UK tax rules create for the establishment of AHCs in the UK? Are there any other fund classes for which similar challenges arise?
5. How are the challenges to locating an AHC in the UK, to the extent they exist, currently overcome? How do tax rules in other countries address these challenges?
6. What impacts have recent developments in the international tax landscape had on determining where to locate an AHC? How have asset management firms so far responded to these developments?
7. To what extent are there non-tax barriers to AHCs being located in the UK? If so, how might these dilute the impact of reform to existing tax rules intended to improve the UK's attractiveness as an AHC location?
8. How could the challenges identified as part of Question Four best be overcome?
9. Do you consider that there is a case for the government to develop specific rules concerning the tax treatment of asset holding vehicles in alternative fund structures? What could these rules look like? How should eligibility be defined for qualifying fund structures and the AHCs within them?

Thank you

Discussion on the Consultation

We encourage participation in this discussion.

Please ‘unmute’ your microphone to contribute.

You can also use the ‘chat’ (look for the speech-bubble icon) to indicate you would like to make a comment and/or ask a question for John, the moderator, to raise.

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