WTS Global Financial Services Infoletter

Editorial

Tax developments affecting the international Financial Services industry

Dear Madam/Sir,

We hope you may find interesting the latest version of the WTS Global Financial Services Newsletter presenting taxation related news from seven countries with a focus on the international Financial Services industry[1].

The following participants in the WTS Global network are contributing with a diverse range of FS tax topics, e.g. the WHT treatment of manufactured dividends in France, the establishment of the first International Financial Services Centre in India or the decision of the Spanish Supreme Court that declares the existence of discrimination in the taxation of non-resident hedge funds when receiving dividends from Spanish companies:

- Finland – Castrén & Snellman
- France – FIDAL
- Germany – WTS Germany
- India – WTS Dhruva Advisors
- Indonesia – Consulthink
- Spain – ARCO Abogados y Asesores Tributarios
- United Kingdom – Hansuke
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Thank you very much for your interest.

Frankfurt, 27 June 2023

With best regards,

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For details on WTS Global Financial Services:
https://wts.com/global/services/financial-services

1 The editors would very much like to thank their WTS colleague Sergi Meseguer for his valuable support.

Contents

Please find the complete list of contact details at the end of the newsletter.

Finland

CASTRÉN & SNELLMAN

German AIF – Special investment fund (real estate) with one direct unitholder deemed tax exempt for income tax purposes in Finland

The case at hand concerned a German investment management firm in a tax dispute regarding the tax treatment of a German investment fund (AIF) investing mainly in real estate.

The Helsinki Administrative Court issued a ruling in April 2023 stating that the fund must be considered as tax exempt for income tax purposes in Finland. The tax dispute concerned the taxation of the income that a German special investment fund investing in Finnish real estate received from Finland. The fund had only one direct unitholder, but it was part of a larger investment structure. The investment structure effectively involved the co-investment of assets of a large number of individuals. The investment structure's investments were diversified for example to Finnish real estate.

The fund qualified as a German special open-ended real estate investment fund within the meaning of § 284 KAGB. The fund was not a legal person, but a pool of assets based on a contractual agreement between the management company and the unitholders. The assets of the Fund were managed by the fund's management company. The fund had only direct investor, which was a fund-of-fund, whose only investor was a German institutional investor. The fund distributed annually at least three quarters of its profits, excluding unrealized capital gains.

The tax dispute concerned the Finnish Income Tax Act's provision on the tax exemption of investment funds. The Finnish Income Tax Act includes a tax exemption provision (Section 20a of the Income Tax Act) that, under certain conditions, exempts domestic and foreign investment funds and special investment funds from income tax in Finland at the fund level. Said tax exemption provision became effective in tax year 2020 and has since caused challenging interpretation differences with the tax authorities as well as several tax disputes. The domestic provisions and their application with respect to foreign investors have proven to be problematic from the perspective of the EU fundamental freedoms. The CJEU has issued a preliminary ruling on one aspect of the Finnish tax exemption provision, and the Finnish Supreme Administrative Court has recently issued rulings on the tax treatment of investment funds.

The Administrative Court assessed whether the fund fulfilled the tax exemption conditions laid down in Section 20a Income Tax Act event though it had only one direct unitholder. The Court ruled that taking into account the wording of the tax exemption provision, the principle of legality in taxation and the preparatory work concerning the provision, the tax exemption for all special investment funds investing mainly in real estate and real estate securities within the meaning of Chapter 16a Section 4 of the Finnish Act on Alternative Investment Fund Managers, is subject to the condition that the fund distributes annually at least three quarters of its profits, excluding unrealized capital gains. In other words, the Court ruled that the only tax exemption condition set for foreign real estate investment funds is that the fund fulfils the annual profit distribution requirement.

The fund fulfilled the annual profit distribution requirement, and therefore the Administrative Court ruled that the fund was tax exempt for income tax purposes in Finland.

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France

WHT treatment of manufactured dividends

Following recent attention on the *"Cum/Cum"* and *"cum-Ex"* arrangements, the French tax authorities (FTA) issued on 15 February 2023 two public tax rulings on the WHT treatment of manufactured dividends paid by French banks to non-residents.

Context

It is recalled that under French domestic rules and subject to the provisions of applicable double tax treaties, French-source dividends are subject to a WHT levied at a rate equal to that of the French corporate income tax (25%) when distributed out to non-individuals that are not tax residents of France. Moreover, as from 1st July 2019, an anti-arbitrage provision provides that any related manufactured dividends payments in the frame of stock loans (and assimilated trades) of less than 45 days, between a French resident borrower and a non-French resident lender, are in scope of the French dividend WHT which may be refunded if it is evidenced that the transaction was not principally tax motivated. The two commented rulings considerably extend the scope of the WHT and raise significant questions on their future application by the FTA.

First ruling (BOI-RES-RPPM-000122)

The FTA were requested to opine on whether the WHT should be levied by a bank on payments made to non-residents other than payments related to dividends attached to French equities.

The FTA state that the WHT is not limited to situations where a bank pays actual dividends attached to French equities and can also apply to situations where the bank passes-on 'dividend equivalent' payments to a non-resident in cases where the actual dividend has not been paid directly to the bank.

The tax ruling defines a "dividend equivalent" as any transfer of value that is subordinated or determined, explicitly or implicitly, by reference to a dividend.

Second ruling (boi-res-rppm-000123)

Under the second ruling the FTA were requested to opine on whether banks should levy the dividend WHT on temporary transfers of French equities and certain derivatives transactions performed with non-resident taxpayers.

1. Temporary acquisition of French equities involving non-residents

The FTA opine on banks' intermediation transactions in which they receive, as an intermediary, a dividend equivalent payment from a third party, such payment being passed-on to a non-resident for the same amount. They consider that these transactions are neutral for the bank's result (since the dividend is retroceded) and therefore do not give rise to WHT provided that the bank demonstrates that the borrower is not a related party and the transaction does not involve any benefit for the bank.

On the contrary, payments made by the bank in the context of temporary acquisitions of French equities from non-residents which are linked notably to transactions aimed at hedging short selling positions, scrip dividends transactions or transactions intended to ensure the settlement and delivery of equities are likely to give rise to the WHT even when the lender or seller of the French equities does not exclusively seek a tax benefit.

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2. Derivatives transactions with non-residents

The FTA define derivatives as financial instruments whose price depends on another variable, which may be the price of an asset, then called the 'underlying'. The FTA distinguishes non-delta-one transactions which are generally not subject to WHT with delta-one transactions which may give rise to such WHT where there is a dividend equivalent payment.

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Good news for non-resident real estate (and securities) investment funds (CJEU dated 27 April 2023, *"L-Fund"*)

In its important judgement of 27 April 2023 (C-537/20), the Court of Justice of the European Union ("CJEU") rules that the free movement of capital (Art. 63 TFEU) precludes the German legislation related to the taxation of non-resident special real estate funds. Such investment funds were liable to corporate income tax on German real estate income, whereas resident special real estate investment funds were exempt from taxation. This question had been referred to the CJEU by the Federal Finance Court of Germany (BFH) in its decision of 18 December 2019 (I R 33/17) in connection with fund taxation rules applicable from 2004 – 2017.

The recent judgement indicates that the CJEU continues on the path of enforcing the Free Movement of Capital in the EU.

The L-Fund case dated 27 April 2023

The background to the CJEU proceedings is that, from 2004 to 2017, domestic investment funds were exempt from corporate income tax under Section 11 (1) sentence 2 InvStG 2004 and income was taxed at the fund investor level, whereas in the case of foreign real estate funds, German real estate income was subject to tax already at the fund level. Specifically, the German income of the fund at issue consisted of rental income and capital gains from the sale of German real estate. The reclaiming investment fund was a Luxembourg AIF. It had two non-German institutional investors.

The CJEU considers this unequal taxation of resident and non-resident special real estate funds to be an inadmissible restriction on the free movement of capital within the meaning of Article 63 TFEU, which cannot be justified either by the need to ensure the coherence of the domestic tax system or by the need for a balanced allocation of taxation rights between the Member States. The CJEU states that it would have been possible to maintain the internal coherence of the tax system if a non-resident specialized property fund could benefit from the exemption from corporate income tax; provided that the German tax authorities ensure, with the full cooperation of such investment fund, that the investors in this fund pay a tax equivalent to that to which the investors in a resident specialized property fund were liable.

Transfer to securities funds

In the view of WTS, the main points of this CJEU judgement can also be applied to the German WHT on dividend income suffered by foreign securities funds in the years 2004 to 2017.

This view derives from the fact that domestic securities funds were not subject to withholding tax on their German dividends, while foreign securities funds suffered a tax deduction of 26.375% on their dividends (WHT of 15% after double tax treaty reduction, if applicable). Tax-legally, the transferability of the CJEU judgement at hand to securities funds results from the fact that the central norm of Section 11 (1) Sentence 2 InvStG 2004 does not refer to real estate investment funds alone, but was directed at investment funds as such. It is precisely this provision that the CJEU declares to be incompatible with European law in its recent judgement. Therefore, it is our view that also foreign securities funds were discriminated against.

Although the further development remains to evolve, it can be expected that the German tax authority will have to approve applications for tax refunds from the aforementioned funds eventually; provided, that the securities funds submitted a corresponding refund application to the tax authority for the relevant years 2004 – 2017 in a timely manner.

What's next?

We believe that the German tax authority will not "simply" pay out to the respective (real estate and securities) investment funds the WHT reclaim amounts subsequent to the upcoming final decision of the German national court.

It is likely a combination of two approaches by the German tax authority should be expected. On the one hand, there will be an increase of the administrative enforcement burden (e.g. dividend WHT documentation) and, on the other hand, an increase of the burden of proof regarding the beneficial ownership of the claimant fund (e.g. holding periods, hedging, securities lending).

With a view to securities funds, in preparing for the enforcement procedure to be expected, WTS would like to propose the following steps:

- Health check of existing German WHT reclaim filings (tool-based);
- Holding periods of German equity assets;
- Hedging of German equity assets (within the fund's portfolio);
- Securities lending with German equity assets over the ex-date of the dividend (the fund acting as the lender or as the borrower).

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India

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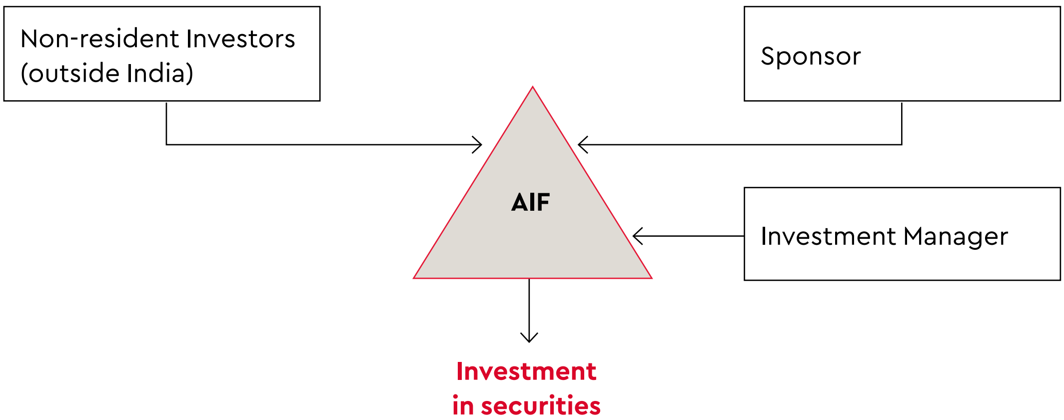
Establishment of the first International Financial Services Centre ("IFSC")

Gujarat International Finance Tech-city ('GIFT City') is India's first IFSC established with a vision to make India a hub for international financial activities. GIFT City aims to bring the financial services transactions that are currently carried on outside India by overseas financial institutions and overseas branches/subsidiaries of Indian financial institutions back to Indian shores. 'Units' and entities in GIFT City are treated as 'people resident outside India' for the purposes of the exchange control laws of India. However, for the purpose of tax, the entities in GIFT City shall be residents.

In the following paragraphs, we have discussed below the tax and regulatory aspects pertaining to having an Alternative Investment Fund ('AIF') and family office in GIFT City for people outside India.

AIF in GIFT City
An AIF is a privately pooled investment fund (whether from Indian or foreign sources) in the form of a trust, a company, or a limited liability partnership which collects funds from investors (whether Indian or foreign) for investing in accordance with a defined investment policy. Further, the regulations in India provide for three categories of AIFs (which *inter alia* depends on the underlying investments proposed to be made).

Given that there are certain income-tax advantages for setting up a Category III AIF in GIFT City (as compared to AIF Category-I and II), we have discussed below the regulatory and tax framework relevant to the case of Category III AIF in GIFT City. The GIFT City AIF structure is depicted below:



Broad regulatory framework

- AIF in the GIFT City is permitted to inter alia invest in securities listed in GIFT City, securities issued by companies incorporated in GIFT City/ India/ foreign jurisdictions, units of another AIF.
- Substance requirements for the manager of the AIF in GIFT City will be required such as minimum staffing, education qualifications, relevant financial experience.

Broad Income-tax framework/ incentives

In the hands of Category III AIF in GIFT City:

› Following income earned by Category III AIF in GIFT City shall be exempt in its hands [subject to the condition that all units of Category III AIF are held by non-residents (other than units held by its sponsor or manager)]:

i. income from transfer of foreign securities;
ii. Income from foreign securities and where such income otherwise does not accrue or arise in India; and
iii. Income from a securitization trust in India which is chargeable under the head 'profits and gains of business or profession'.

In the hands of the non-resident unit holders of Category III AIF in GIFT City:

› Any income from Category III AIF in GIFT City will be exempt for investors.

Family office in Gift city

Family offices are set up by wealthy individuals to invest and manage personal wealth. They work like any asset management company or money manager —the only difference is family offices have the family members as its investors.

GIFT City has introduced the Fund regulations last year to enable set-up of Family Investment Fund ('FIF'). The broad tax and regulatory contours of FIF are as under:

› It is a self-managed fund pooling money only from a single family (being Indian resident or non-residents);
› Definition of single family- A group of individuals who are the lineal descendants of a common ancestor and includes their spouses (including widows and widowers, whether remarried or not) and children (including stepchildren, adopted children, ex nuptial children);
› It can be set-up in the form of a Company, Trust (Contributory Trust only), limited liability partnership;
› It should have minimum corpus of USD 10 million within a period of 3 years from the date of obtaining certificate of registration and should maintain the same;
› FIF could be open ended or close ended;
› FIF can invest in all types of overseas, Indian securities as well as securities listed in GIFT City;
› Income earned by such FIF can potentially be considered to be exempt from Indian income-tax.

Given the above, FIF in GIFT City should be considered for the following reasons:

i. Ability to invest and hold overseas assets
ii. Feasibility to leverage in GIFT City or overseas to make investments
iii. Tax holidays

Ease of succession planning for non-resident Indians having family in India.

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VAT on sale of seized collateral

During tax audits, banks and financial institutions often receive VAT assessment on sale of seized collaterals. VAT assessment on sale of seized collateral has become one of major tax controversy in financial service sector for many years. Dispute resolution of this VAT assessment could take 3–5 years up to the Supreme Court, yet with inconsistent verdicts. With no precedent law in Indonesia, verdicts of Tax Court or Supreme Court varies, depends various factors, including supporting documents underlying the sale of collateral.

Financial service companies, where their core income is non-VAT able, expect to minimize VAT impact in various transactions of their business cycle. Financial service companies expect the sale of seized collateral to be considered as sale of asset by borrower, from which borrower uses the proceedings to settle outstanding loan. Therefore VAT, if any, shall be collected and be responsibility of the borrower being the seller of asset. Tax office, during tax audits, does not have same view with financial service companies on this VAT issue, and often assesses VAT on sale of collateral.

Government Regulation No 44/2022 and Minister of Finance Regulation no 41/2023 provide clarity on VAT treatment on sale of seized collateral. According to those regulations, financial service institutions shall collect VAT on a sale of seized collateral at reduced tax imposition base of 10%, which result in net VAT amount of 1.1% on sale price of seized collateral.

VAT is liable on the following basis:

- VAT-able delivery: Delivery of collateral by creditor (bank and financial company) to purchaser of collateral falls under definition "transfer of right" that is subject to VAT.
- Collateral and Seized Collateral: Collateral that is delivered by creditor to purchaser is collateral that is seized by creditor for settlement of Loan, Syariah Financing, Fiduciaries Loan, where the confiscation is made based on applicable regulation in financial sector

VAT mechanism

When asset is delivered by borrower to creditor (bank and finance company) being collateral, it is not considered as VAT-able delivery. If the borrower is default, creditor seizes the collateral, VAT invoice is not issued at this event. Only if the seized collateral is sold by creditor to a purchaser, VAT is liable. Creditor to collect VAT and issue VAT invoice to the purchaser, once it receives payment from purchaser.

VAT is calculated at [VAT base] x [VAT rate] x [Sales Proceed] = 10% x 11% x sales proceed = 1.1% of sale price of the seized collateral.

Creditor to issue VAT invoice or certain documents that are considered as VAT invoice which at least contains information of:

- Number and date of documents
- Name and tax ID number of Creditors
- Name and tax ID number or ID number of Borrower
- Name and tax ID number or ID number of Purchaser
- Detail of seized collateral
- VAT imposition base
- Amount of VAT collected

Input VAT of creditor that relates to delivery of seized collateral, if any, cannot be credited by creditor. Purchaser who is registered as VAT Entrepreneur, can claim VAT collected by creditor as input VAT.

The implementing regulation, Minister of Finance Decree PMK 41/2023 is effective from 1 May 2023.

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Spain

The Supreme Court declares the existence of discrimination in the taxation of non-resident hedge funds when receiving dividends from Spanish companies

The Supreme Court recently published its decision of 5 April 2023, in which it ruled for the first time on the taxation of dividends obtained from companies resident in Spain by non-resident alternative investment funds (AIFs) and the possible discriminatory tax treatment with respect to resident alternative investment funds (AIFs). The current decision concerns a French hedge fund.

Previously, the Court, in rulings on 27 March 2019 and 13 November 2019, had concluded the existence of discriminatory tax treatment, although those cases involved a non-resident UCIT fund and a fund resident in the US, and prior to the amendment of the legal regime by Law 2/2010 of 1 March, which from that point onwards equalized the taxation of non-resident and resident UCITs by establishing a legal mechanism that currently allows non-resident investment funds to obtain a refund of the excess withholding tax (general or resulting from the DTT), up to the effective taxation of 1% enjoyed by resident harmonized funds, by simply providing a certificate proving compliance with the requirements of Directive 2009/65/EEC.

However, this legislative reform left out non-harmonized investment funds, meaning that in recent years there have been numerous legal claims from this type of funds in order to obtain equalization of the effective taxation of 1% with their resident counterparts, alleging unjustified discriminatory tax treatment which is restrictive of the freedom of movement of capital. In this context, the Supreme Court has ruled for the first time on this issue, the claimant being an alternative investment fund (AIF) resident in France.

The questions submitted to the Supreme Court in order to establish jurisprudential doctrine were:

› To determine whether the comparability analysis should be carried out under the domestic law applicable to resident AIFs, under Directive 2009/65/EC or under the legislation applicable to such AIFs in their country of residence.

› To specify the parameters to be taken into account in the comparability test, in particular whether the following should be taken into account: prior authorization of the non-resident AIF, number of investors and minimum capital, open nature of the fund allowing access to any investor, the investment objective, risk diversification and deferral of taxation to the investor.

› To determine who bears the burden of proof of the comparability requirements and, in particular, of any eventual neutralization of discriminatory treatment in application of the DTT.

The Court, referring to its previous rulings in 2019 and carrying out an analysis and assessment of CJEU Case-law, with continuous reference to the most recent; 30/01/2020, Köln-Aktienfonds Deka, C-156/17, 07/04/2022, A SCPI, C-342/20, 17/03/2022, Allianz GI-Fonds AEVN, C-545/19, concludes as follows, establishing its jurisprudential doctrine in the following terms:

1. Firstly, it claims that Spanish legislation on the matter infringes EU law, violating the principle of free movement of capital guaranteed in Article 63 TFEU, as there is no express regulation on the conditions of comparability for receiving the same tax treatment and there is no procedure for refunding the excess withholding tax borne at source, for a non-resident AIF that is in a comparable situation to a resident AIF that enjoys the more beneficial tax regime.

   It reasons that it is inherent to the principle of legal certainty to expressly regulate the documentation and information that must be provided in order to enjoy the tax advantage, meaning that, in this case, the absence of regulation by the national legislator cannot be an obstacle which prevents non-resident funds in a comparable situation from enjoying the tax advantage granted to the resident.

2. In order to carry out the comparability analysis, the requirements demanded of resident AIFs under the domestic legislation do not have to be fulfilled identically, but rather the objective and the content and aim of the domestic legislation must be taken into account. Therefore, it must be carried out taking into account the essential elements considered by the domestic legislator to grant favorable tax treatment to resident AIFs, interpreted in the light of the Directive regulating the management of AIFs, 2011/61/EU, as well as the legislation applicable to this type of AIF in their state of residence.

   It rules out that the requirements on the minimum number of investors, minimum capital or a certain investment, risk and diversification policy required under Spanish law to grant resident AIFs the favorable tax treatment have to be applied identically to non-resident AIFs.

3. Therefore, the elements to be taken into account for the purposes of the comparability test are as follows.

- The AIF shall be open in nature, in the sense that it attracts capital contributions from the general public, including professional investors, but excluding AIFs that limit access to family or personal wealth, or by membership of a particular group.

- The AIF must prove that it is authorized and supervised by the supervisory authority in its country of residence.

- The AIF must prove that it is managed by an entity authorized in its country of residence as an Alternative Investment Fund Manager within the meaning of Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD), by means of a certificate issued by the supervisory body.

4. The burden of proof of compliance with the comparability requirements must be made more flexible for the non-resident AIF, due to the absence of a domestic regulation that specifies the means of proof to be provided, without being able to demand disproportionate or difficult documentary evidence. In case of doubt or insufficient evidence, use should be made of the information exchange mechanisms under the DTT and Directive 2011/61/EU AIFMD.

5. The neutralization of the unjustified discrimination can only be achieved by the provisions of the DTT if it allows the AIF to deduct in full the withholding tax borne in excess in Spain, confirming that this recovery is at the fund level, not the investor.

   The Supreme Court has established this jurisprudential doctrine and sets a very important precedent. The ruling has two separate dissenting opinions, demonstrating the controversy sparked. These opinions argue that the majority view is too lax; non-resident AIFs should have to comply with the same requirements as resident AIFs under domestic law. This doctrine has been reiterated by the Court in other rulings issued in subsequent days (between 5 and 25 April) with similar dissenting opinions. It remains to be seen whether the Spanish Tax Authorities or the Central Economic and Administrative Court will adopt this Supreme Court doctrine when resolving open claims or will stick to the arguments of the dissenting opinions, but there is no doubt that an interesting horizon is opening up for future claims from this type of funds. Furthermore, as this, doctrine is based on the violation of article 63 of the TFEU which refers to the free movement of capital both between EU Member States and other countries, we believe that the arguments should apply not only to EU AIFs but also to non-EU AIFs.

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Initiatives arising from the *"Tax Administration and Maintenance Day"* and the Spring Budget

On 27 April 2023, as part of 'Tax Administration and Maintenance Day', HM Government published a series of tax policy and consultation documents to deliver a modern, simple and fairer tax system, these included a series of measures impacting the financial services sector, including:

Reserved Investor Fund consultation

HM Government launched a consultation on the introduction of a Reserved Investor Fund (RIF) regime. RIFs would take the form of a contractual scheme that may be marketed only to professional investors and certain other sophisticated investors. A RIF is expected to be a suitable vehicle to hold UK real property and much of the consultation focuses on tax matters relevant to real estate investments, including non-resident capital gains tax, capital allowances and stamp taxes. However, the RIF is also expected to be relevant to other asset classes across private and public markets in the creation of a broader tax exemption regime for onshore UK fund vehicles. The consultation seeks feedback on a range of issues concerning the design of the proposed new fund, in particular the design of the tax regime for such a fund.

Modernisation of Stamp Taxes on Share Transfers

The consultation is for the anachronistic, and sometimes overlapping stamp duty and stamp duty reserve tax (SDRT), to be replaced with a single tax on securities. Much of the features of this tax would be based on the current SDRT for electronic transfers. Theoretically, stamp duty applies to any instrument of transfer executed in the UK irrespective of the location of the company and its share register. Whereas, SDRT applies to UK securities irrespective of where they are traded or where the transaction counterparts are based.

Decentralised Finance – HMRC's new consultation on Lending and Staking

As new forms of cryptoassets and related services continue to evolve, so too does the Government's approach to the taxation of them. HMRC's formal consultation proposing to introduce legislation to disregard transactions for relevant tax purposes that arise through the lending or staking of cryptoassets, in line with the economic substance of the activity, is a welcome step in the right direction. In addition, the potential introduction of a new miscellaneous income charge specifically for cryptoassets should provide some certainty to taxpayers when completing their tax returns.

Decentralised Finance – Lending and Staking

HM Government is seeking views on modifying the tax treatment of decentralised finance (DeFi) lending and staking. The consultation intends to create a regime that better aligns the taxation of cryptoassets used in DeFi lending and staking transactions (DeFi transactions) with the underlying economic substance, whilst reducing the administrative burden on users.

The current tax rules, CRYPTO6000, can result in transactions being treated as disposals by the lender or liquidity provider even though the effective economic ownership of the cryptoassets is retained. Such tax outcomes do not reflect the underlying economic substance and give rise to a tax liability from DeFi transactions where no gain has been realised. The new consultation is seeking views on the implementation of a taxation option for DeFi lending and staking that is intended to disregard from CGT any disposal of beneficial ownership. Instead, a charge to CGT will arise when the cryptoassets are economically disposed of (such as an outright sale or when they are exchanged for goods and services).

On 15 March 2023, the Chancellor of the Exchequer delivered the widely anticipated Spring Budget, which contained several measures of interest to the financial services sector:

Carried Interest
HM Government plans to introduce legislation that will enable individuals in receipt of carried interest to elect to have it taxed in the UK on an accruals basis.

Pillar Two (global minimum tax) legislation
HM Government has confirmed that it will implement Pillar Two and certain exemptions are expected for investment funds that serve as the ultimate parent of the group, but the specific details are yet to be clarified. Asset managers need to consider the potential impact on the tax profile of portfolio companies.

Sovereign Immunity Exemption
Contrary to the previously announced amendments to the sovereign immunity exemption process, HM Government has for now decided not to make any changes to the exemption from UK direct taxation. This means that the entitlement to sovereign immunity from UK tax, which was previously based on case law and common practice, will continue to operate as it does now. The previously proposed legislation to comprehensively establish robust statute based principles and conditions for sovereign immunity exemption from UK tax have been eschewed for now.

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The Qualifying Asset Holding Company ("QAHC") regime

Introduction
The QAHC regime was introduced to increase the UK's attractiveness as an asset-holding jurisdiction. As many European funds have deal and management functions in the UK, the regime allows them to align their holding structures with their existing operational substance. This is of particular importance considering the increased focus on economic substance as a result of BEPS Action 6, the Danish cases on beneficial ownership and ATAD III.

Although the UK is no longer within the EU, such that certain directives are not available, it currently has the largest treaty network.

Key benefits

- Broad exemption from corporate tax ("CT") on gains on disposal of overseas property and qualifying shares (no conditions, unlike most participation exemptions);
- CT exemption on overseas property business profits (including loan relationships), provided that such income is subject to tax elsewhere;
- Disapplication of the late-paid interest provisions, such that a tax deduction arises on an accrual basis rather than a paid basis;
- Interest on PPLs is tax-deductible and the anti-hybrid rules are disapplied;
- Separate corporate interest restriction groups for certain subsidiaries (subject to conditions);
- Disapplication of loss restriction rules;
- WHT exemption on interest (note that there is no UK WHT on dividends);
- Capital treatment for the redemption/repurchase of shares (subject to exceptions) along with an exemption from UK stamp duty;
- For non-UK domiciled individuals who (i) are taxed on a remittance basis; (ii) provide investment management services in connection with arrangements to which the QAHC applies; and (iii) receive income and gains from the QAHC's non-UK assets, these will not be subject to UK tax unless remitted to the UK.

Eligibility

The following conditions must be met to qualify for the regime:

Ownership condition

At least 70% of the company's relevant interests (profits, assets or voting power) must be held by "Category A" investors (e.g. qualifying funds, QAHCs, UK REITs (or overseas equivalent), UK public authorities, pension schemes, charities or sovereign immune entities).

There are provisions that allow a company a grace period of up to two years (can be extended via HMRC agreement) to meet this condition.

Activity condition

The main activity of the company is the carrying on of an investment business and any other activity is ancillary to that business.

Investment strategy condition

The company's investment strategy should not involve the acquisition of listed equity securities or interests deriving value from such securities, although such securities can be acquired with a view to completing a delisting.

The company must also be UK tax resident, cannot be either a UK REIT or a securitisation company and must opt into the regime.

If a QAHC unintentionally breaches either the activity or ownership condition, it can remain in the regime if it remedies the breach.

Multiple companies in an ownership structure can elect to be QAHCs, thereby permitting stacks of QAHCs.

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Administration

Upon entry into (and exit from) the QAHC regime, there is a deemed disposal and reacquisition of ring-fenced assets at market value. For qualifying shares (any shares except UK property-rich companies), there should not be an entry/exit charge (assuming the UK's participation exemption applies on entry).

Annual returns must be submitted (in addition to CT returns) containing certain details of the QAHC's business.

If you wish to discuss these topics, please contact:
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About WTS Global

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