QAHCs and Fund Structuring Considerations

Over the past decade Luxembourg has become the fund domicile of choice for many UK-based private equity and venture capital fund managers ("**UK PE/VC Managers**"). Offering tax efficient structuring vehicles and access to a pan-European AIFMD marketing passport, Luxembourg currently continues to lead the way in the fund domiciliation market. However, operational and regulatory challenges to Luxembourg-based structures are increasing and, coupled with the introduction of the UK's Qualifying Asset Holding Companies ("**QAHC**") regime in 2022, it seems that UK PE/VC Managers now have good reason to consider the UK when choosing where to domicile their investment funds.

Introduction

UK PE/VC Managers currently face a number of challenges in connection with their Luxembourg domiciled funds, ranging from EU member states increasingly questioning the economic substance of Luxembourg structures, to ever increasing operational costs and an overheated local fund services market. Following the UK's introduction of the QAHC regime in 2022, UK PE/VC Managers have, for the first time in many years, reasons to reappraise the UK as a fund domicile. In this article, we discuss the key features of the QAHC regime and explore how it could affect fund domiciliation trends in the years to come.

The attraction and challenges of Luxembourg

The attraction of Luxembourg as a fund domicile is clear, with Luxembourg facilitating ease of access to European capital through the AIFMD marketing passport regime, offering numerous tax structuring options and affording access to an extensive tax treaty network. Following BREXIT, these benefits have increasingly led many UK PE/VC Managers to establish their funds in Luxembourg. However, the drawbacks of Luxembourg-based structures have increased over recent years. Establishing and maintaining economic substance in Luxembourg is increasingly expensive and subject to challenge from other EU member states, experienced and talented staff are difficult to find in the requisite numbers and even harder to retain and regulatory bureaucracy hinders operations.

With regard to economic substance, UK PE/VC Managers are increasingly being challenged on their structures' Luxembourg substance by other EU member states when seeking to access Luxembourg's network of double-tax treaties. As a result of the imposition of increasingly stringent requirements on substantive economic presence, local staffing headcount and local decision-making capabilities, UK PE/VC Managers have little choice but to increase their operational footprint in Luxembourg, resulting in significant additional overheads and operational complexity.

'The UK fund and portfolio structuring regime provides many of the advantages traditionally enjoyed by Luxembourg structures with fewer tax, operational and regulatory hurdles'

Turning to the AIFMD marketing passport, it is worth noting that a mere 3% of passported EU funds are registered to market in more than three member states. With that in mind, UK PE/VC Managers should carefully consider whether the cost (in time, money and human resource) of a Luxembourg domicile over a fund's lifespan outweighs the distribution benefits gained. Whilst gaining access to a pan-European marketing passport would certainly be beneficial for UK PE/VC Managers looking to raise substantial capital from a number of different EU countries, Luxembourg is a less compelling proposition for those undertaking more limited European marketing activity.

The QAHC regime

The UK's QAHC regime offers UK PE/VC Managers a genuine alternative to typical Luxembourg asset holding companies.

The QAHC regime was designed by HMRC with the private equity and venture capital industry in mind. As such, qualifying for the regime should be relatively simple for the majority of QAHC vehicles. Eligibility criteria includes:

- UK tax residence (noting that a QAHC does not need to be a UK company);
- certain ownership conditions;
- basic restrictions on corporate activity; and
- a restriction on the type of assets that may be held (generally speaking, assets held must be unlisted securities).

Subject to meeting the qualifying criteria, QAHCs benefit from:

- a zero corporate tax rate on capital gains;
- a zero withholding tax rate on interest and dividend payments;
- advantageous treatment of returns of capital to shareholders (returns to shareholders pursuant to share buy backs taxed as capital gains); and
- a low corporation tax profile in general.

As an additional advantage, QAHC assets are not subject to minimum thresholds or holding periods, in contrast to the requirements of the EU participation exemption.

In addition to the benefits outlined above, the UK has a network of double tax treaties to rival that of Luxembourg, with many treaties being similar to (and in some cases more advantageous than) Luxembourg's. Furthermore, for UK PE/VC Managers with substantive UK-based advisory businesses, those utilising the QAHC regime are unlikely to face the same level of scrutiny from EU member states on economic substance/commercial purpose, thereby avoiding the mounting costs of building out additional operational footprints in Luxembourg.

Fund regulation, structuring and distribution

The FCA continues to be a business-friendly and well-regarded regulator and English limited partnerships well understood vehicles for fund structuring. Although the UK and other non-European fund domiciles continue to await the AIFMD third country marketing passport, access to European capital in a number of the most significant (primarily northern) European states remains possible via national private placement regimes. As such, UK PE/VC Managers looking to raise capital in a targeted manner in specific European jurisdictions continue to have options available to them when drawing up their European fund distribution strategies.

Conclusions

Whilst Luxembourg remains a compelling choice for fund domicile, the introduction of the UK's QAHC regime coupled with the UK's extensive double-tax treaty network have helped to reposition the UK as a viable alternative. With QAHCs affording many of the advantages enjoyed by Luxembourg structures whilst offering managers the opportunity to benefit from lower establishment and operating costs and reduced tax and regulatory burdens, UK PE/VC Managers may want to take the opportunity to reappraise the UK as an option when making fund domiciliation decisions. We suspect that, given the benefits outlined in this article, many managers may come to the conclusion that a UK establishment is the better choice for their next fund.

For a more detailed review of QAHCs, the BVCA has published a comprehensive guide, accessible here.

If you are looking to raise capital and/or structure your fund and would like to discuss any of the points raised in this article in more detail, do not hesitate to contact us using the details provided.

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