Clients&FriendsMemo

The New UK Reserved Investor Fund

RIFs and QAHCs create an ambitious UK structuring toolkit

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Introduction

After a long gestation, the much heralded new UK fund structure, the Reserved Investor Fund ("**RIF**") is finally expected to be available from 19 March 2025.

On 25 February 2025 and 26 February 2025 respectively, the Co-ownership Contractual Schemes (Tax) Regulations 2025 and the Unauthorised Co-ownership Alternative Investment Fund (Reserved Investor Fund) Regulations 2025 (together, the "**Regulations**") were laid in Parliament, both coming into force on 19 March 2025.

The RIF is the latest product to be introduced in the UK following the Government's call for input under its Review of the UK Funds Regime published in January 2022. The RIF is complementary to other products implemented or amended under the review, in particular the Qualifying Asset Holding Company ("**QAHC**") which can be established within a RIF structure, and the two are considered together in this note.

Background to the RIF

The UK has long lacked an onshore private fund structure, which is not itself subject to product regulation by the UK Financial Conduct Authority ("**FCA**"), restricted to tax exempt investors or required to be stock exchange listed, which allows institutional and sophisticated investors to pool capital in assets through a vehicle that is transparent for the purposes of the taxation of income but exempt from capital gains (allowing investors to delay any capital charge until the disposal or realisation of their investment in the fund).

The RIF has been designed to be such a vehicle and to compete with equivalent products in offshore jurisdictions and European Union competitors such as Luxembourg and Ireland. The RIF has also been designed to not require "product regulation" of the fund vehicle itself. Rather, the

RIFs will be required to have a regulated UK manager and depositary, in a similar manner to the highly successful Restricted Alternative Investment Fund ("**RAIF**") in Luxembourg.

A RIF can operate as an umbrella fund with the sub-funds having segregated liability, with the manager of the scheme having authority to contract and bring actions on behalf of the RIF and/or any sub-fund. The Regulations confirm that investors in a RIF enjoy limited liability.

In terms of applications, the RIF is expected to enable simplification of current onshore and offshore limited partnership structuring and to provide a UK onshore alternative to offshore unit trusts and contractual schemes. In addition, the RIF may be considered as a more flexible conversion alternative for existing CoACS and exempt-unauthorised unit trusts ("**EUUTs**").

RIF Conditions

In accordance with the Finance (No 2) Act 2024 and the Regulations, a RIF needs to meet each of the following conditions:

1. be both an alternative investment funds ("**AIF**") and a collective investment scheme ("**CIS**"); as such, the RIF must have a UK authorised alternative investment fund manager ("**AIFM**") and a UK authorised Depositary overseeing custody of its assets and cash flows;

2. meet either a genuine diversity of ownership condition" ("**GDO Condition**") or a "non-close condition" ("**Non-Close Condition**") (both of these conditions replicate the equivalent tests which currently exist in the UK tax legislation governing disposals of UK-situated immovable property involving collective investment vehicles, which are known as the "non-resident capital gains tax rules" or "**NRCGT Rules**");

3. be a "Restricted RIF" by meeting <u>one</u> of the following requirements:

    a) be "UK property rich" (*i.e.* at least 75% of the total asset value of its assets is derived (directly or indirectly) from interests in UK real estate); or

    b) be restricted to investors who are exempt from tax on gains (other than by reason of non-residence) such as certain pension funds and investors who have sovereign immunity, similar to an EUUT; or

    c) not directly invest in UK real estate or in UK property rich companies (other than an exception which replicates a provision in the NRCGT Rules governing minor interests in UK property rich collective investment vehicles); and

4. must not allow units in the scheme to be issued to anyone other than:

    a) a professional investor;

    b) a large investor (*i.e.* a person who, in exchange for units in the scheme, makes a payment of, or contributes property with a value of, not less than £1,000,000); or

    c) a person who already holds units in the scheme.

Formation

To establish a RIF, the AIFM and Depositary will enter into a RIF deed and the AIFM will submit notifications to the FCA and H.M. Revenue & Customs ("**HMRC**").

Summary of UK Tax Treatment

Given the complexities of the taxation of limited partnerships and unit trusts in the UK, the Government has focused the RIF regime, at least for the time being, on a contractual fund structure. This is a relatively new concept in the UK which currently only exists for a contractual fund authorised by the FCA, such a fund being known as a Co-ownership Authorised Contractual Scheme ("**CoACS**"). The CoACS has provided a neat template for the new Co-ownership Contractual Schemes (Tax) Regulations 2025.

The new Regulations augment and amplify the statutory framework of the RIF, which was enacted in the UK's Finance (No 2) Act 2024 last year.

Taxation of Income

The RIF is treated as transparent for the purposes of the taxation of income such that a RIF will not be subject to corporation tax or income tax on the income generated. The income is treated as arising directly to the investors in the RIF. The RIF reports annually to HMRC and its investors, thereby enabling investors to comply with their tax filing obligations.

Taxation of Chargeable Gains

Investment in the RIF will be treated as being opaque for the taxation of chargeable gains from the viewpoint of the investor. Units in the RIF are treated as a chargeable asset for UK tax resident investors or shares for non-resident chargeable gains purposes under the NRCGT Rules. Investors are therefore only charged on their capital gain in the RIF units they hold. Any interest of the investors in the underlying property of the RIF is ignored for chargeable gains purposes. However, where a RIF invests in UK real estate, a non-UK resident unitholder must register with HMRC as a "non-resident landlord".

The RIF itself is treated as tax transparent for the purposes of taxation of chargeable gains. Accordingly, a RIF is not subject to tax on any gains realised on the disposal or realisation of its assets.

Breaches of the RIF Conditions

In the event the RIF conditions are breached, the RIF reverts to fully transparent status (subject to mitigation). In particular, for the purposes of chargeable gains, in the event of an unresolved breach, the scheme will be treated as a partnership and the participants will be treated as partners in the scheme. The Regulations provide, in a pragmatic manner, for various mitigations to be applied to breaches of the RIF conditions. One of the most notable is that there is an opportunity for a RIF that has breached the GDO Condition or the Non-Close Condition to rectify that breach within nine months. This should enable a scheme to remain a RIF while rectification is undertaken, although participants will be treated as selling and reacquiring their units for market value at the time of the breach if the breach lasts for at least 30 days (thereby ensuring that all untaxed gains during the period in which the RIF was restricted do not escape the UK tax net).

*Stamp duty land tax ("**SDLT**")*

For the purposes of SDLT in England and Northern Ireland, the RIF is treated as a company, with each sub-scheme of an umbrella RIF being treated as a separate company. No SDLT is charged on the transfer of RIF units. This should allow liquidity in the sale of RIF units in the secondary market, and is the same treatment as for a CoACS.

The RIF is subject to SDLT on the acquisition of a relevant asset. RIFs are not treated as a company for the purposes of SDLT group relief and reconstruction and acquisitions relief, with limited seeding relief (as for a CoACS and a property authorised investment fund). Separate rules apply for land taxation in Wales and Scotland.

*Stamp duty and stamp duty reserve tax ("**SDRT**")*

There is no UK stamp duty or stamp duty reserve tax ("**SDRT**") on transfers, or agreements to transfer, of units in the RIF. The RIF is treated as transparent on first principles for stamp duty and SDRT, with certain exemptions.

*Value added tax treatment of the RIF ("**VAT**")*

There is no special treatment for the RIF in relation to UK VAT. VAT therefore applies to the management of RIFs as it does to the management of other funds. In particular it is worth noting that there is no specific exemption for management fees, which must be taken account of in structuring. Supplies made will be subject to the usual VAT rules.

Interaction with the QAHC Regime

The QAHC regime was introduced in 2022 and simplifies the UK tax system for qualifying companies, increasing the UK's competitiveness as a holding company jurisdiction for investment structures, particularly for use by institutional investors and within fund structures. The combination of this holding company regime under the RIF now presents an interesting opportunity for UK-based fund and holding company structures investing in a variety of asset classes internationally.

The QAHC reforms came after a period of HM Treasury consultation, which focused on: (i) the reasons that institutional investors and funds use asset holding companies; (ii) the possible benefits of these being located in the UK; and (iii) barriers preventing the broader use of UK structures. The QAHC regime seeks to address these barriers.

Eligibility

Three main conditions must be met by a company in order to be a QAHC.

1. *Ownership*: QAHCs must be at least 70% owned by "Category A" investors. These include qualifying funds, certain qualifying investors (such as sovereign wealth and pension funds), public authorities, some intermediate companies and other QAHCs.

2. *Activity*: a QAHC's main activity must be the carrying on of an investment business.

3. *Investment strategy*: cannot include the acquisition of listed equity securities (other than in a number of limited situations, including certain take-private scenarios, or where an election is made).

A QAHC must also be UK tax resident, not a UK REIT, and not have equity securities listed or traded on a recognised stock exchange, or other public market or exchange.

Key regime benefits of using a QAHC

1. There is a straightforward exemption from UK withholding tax applying to all interest payments made by the QAHC (and, furthermore, the UK does not impose withholding tax on dividends or other distributions).

2. There is an exemption from the taxation of chargeable gains on qualifying shares (not UK property-rich) and overseas land.

3. There is no liability to corporation tax in respect of QAHC's overseas property income, provided the income is taxable elsewhere.

4. The repurchase of a QAHC's own shares or loan capital is exempt from stamp duty and SDRT.

5. The payment by a QAHC on the redemption, repayment or purchase of its own shares is not treated as a distribution.

6. Any interest arising on profit-participating loans and certain other "special securities" is treated as being fully deductible for UK corporation tax purposes.

Entry, exit and group considerations in the QAHC regime

1. *Entry:* Prior notification to HMRC is required when a QAHC is established. A deemed market value disposal and reacquisition of certain of the QAHC's assets takes place on entering the regime. However, in most cases an 'entry' charge is not expected to apply, in particular where the assets in question are within the scope of the UK's participation exemption.

2. *Losses:* Special rules to allow losses to be utilised across a group or 'stack' of QAHCs. However, QAHCs will not be able to form a group with non-QAHC entities.

3. *Breaches and exit:* HMRC must be notified of any breaches. However, the QAHC legislation provides flexibility in certain cases to ensure a breach of the activity or ownership conditions will not result in an asset holding company immediately ceasing to be a QAHC. The benefits of the regime are available until exit and assets will be rebased when leaving the regime without an exit charge.

Available strategies

The RIF has long been awaited by the UK's investment community as a means of rectifying a gap in the UK's offering of fund vehicles. The benefit of the RIF to UK-based institutional investors, including UK local government pension schemes, is in offering a cost-effective and attractive investment vehicle to develop UK-based opportunities.

However, the utility of the RIF is far wider when combined with a UK resident QAHC. Market experience since the introduction of the QAHC regime is that the rules are relatively straightforward to operate in practice. Since the commencement of the QAHC regime, QAHCs have been established for use as 'master' holding companies within funds and acquisition or financing vehicles for investments. HMRC have developed extensive guidance on the QAHC to ensure investors and fund managers have clarity on its application.

An advantage of the regime is that institutional investors can utilise existing capability, operations, and resources in the UK, alongside accessing UK asset management infrastructure and expertise. Operational frictions with establishing non-UK tax residence for offshore company by means of establishing and maintaining central management and control outside the UK are removed from the structuring decision matrix.

The combined structure of a RIF investing in a QAHC offers a viable strategy to invest in global private equity, credit, infrastructure and non-UK real estate strategies from a UK-located base of operations. Using the RIF and the QAHC in combination should allow a fund managers with a UK-located office to benefit from centring operational substance in the UK for both vehicles. The expense and management cost of locating substance in European or offshore jurisdictions can therefore be reduced. At the same time, the regulatory footprint of the RIF is light, operating with a UK AIFM and a UK Depositary but without the need for FCA approval.

The combination of a RIF with a QAHC therefore offers the investment community a tax neutral fund structure, based in the UK, which is comparable to other jurisdictions.

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Cadwalader attorneys have been heavily involved in the development and introduction of the RIF and the QAHC. If you have any questions, please feel free to contact any of the following Cadwalader attorneys:

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