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Asset Management Tax Checklist

What should be on your radar?

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Introduction

There is a lot going on in the world of tax which will be of interest to those in the asset management sector. Relevant developments include international projects (such as the ongoing push to implement the OECD's Pillar One and Pillar Two proposals and the publication of the EU's shell entity proposals) but the domestic UK position should not be overlooked, with several exciting initiatives in train.

In particular, for the last couple of years the UK government has been conducting a wide-ranging review with the aim of improving the UK funds regime (the **Review**). The Review has already yielded some tangible results, such as the introduction last November of the new long-term asset fund (**LTAF**) and the development of a new tax regime for qualifying asset holding companies (**QAHCs**) which is due to come into effect from April. In addition, following on from a call for input (**CFI**) forming part of the Review, the government has recently announced next steps in relation to a variety of other measures.

With so many tax developments progressing it can be difficult for asset managers to stay on top of things. This briefing provides a checklist of the key tax issues of which you should be aware (including potentially significant future developments) and sets out the actions that you should now be undertaking in preparation.

How we can help

We advise on all tax aspects of asset management and investment funds. We are currently assisting clients with many of the matters identified in this checklist and, through our membership of industry bodies, are involved in the development of several of the measures highlighted. If you would like to know more, please do get in touch.

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Hot topics

Tax development	Introduction	What does this mean for asset managers?
Introduction of QAHC regime from 1 April 2022	As part of the Review the government considered the attractiveness of the UK as a location for asset holding companies and, in response to feedback, is set to introduce a new tax regime for QAHCs. The wide-ranging tax benefits include a broad exemption from tax on gains from shares (other than in UK property rich companies) and non-UK land, a deductions regime that should keep taxable income very low (by giving deductions for profit-related interest), and a complete exemption for foreign property business income. In addition, there are tax benefits for investors, with certain of the normal tax rules disapplied to make it easier for returns from the QAHC to be passed to investors in capital form. For more information, please see our full briefing on the new regime.	The new regime is an exciting development and should allow the UK to compete with vehicles on offer in rival European fund centres, in particular Luxembourg and Ireland. Its availability will be particularly welcome for many managers who have been concerned about the need to build substance in Luxembourg, especially in light of the shell entity directive (ATAD 3) (see below).
Government announces next steps in review of UK funds regime	The government has recently published a summary of responses to the CFI (the Response) in which it sets out its next steps on a variety of issues. Developments announced include that the government will explore options for a new unauthorised fund vehicle in the form of a contractual scheme aimed at professional investors (see below), set up a working group to progress work on permitting distributions of capital by authorised funds and review the genuine diversity of ownership condition (GDO). For more details please see our briefing on the Response.	The Response shows that government is looking to address many of the concerns raised by stakeholders, albeit with different levels of priority. That being said, it also confirms that the government will not zero-rate fund management supplies for VAT purposes (see below), and that, as a result, it will not be taking forward industry suggestions for new unauthorised corporate and limited partnership fund vehicles. It is good news that the government is planning further significant and welcome reforms to the UK funds landscape, although these will not always go as far as some in the sector would have wished.

Tax development	Introduction	What does this mean for asset managers?
Implementation of OECD Pillar Two (global minimum corporate tax rate) from 2023	The main plank of Pillar Two is the Global anti-Base Erosion rules (GloBE rules) that seek to establish a global minimum corporate tax rate for multinational enterprises (MNEs) that meet a €750m turnover threshold. There will be various exclusions, including for investment funds that are ultimate parent entities of an MNE group and pension funds (and any holding vehicles used by such funds). The GloBE rules will impose top-up taxes where the effective rate of tax of a MNE in a jurisdiction is below the global minimum corporate tax rate (15%). The minimum tax rate will be effected by two rules: the income inclusion rule (similar to a CFC charge) and, where that rule does not apply, an undertaxed payment rule (UTPR). In addition to the GloBE rules, Pillar Two contains a subject to tax rule which will allow source taxation (for example, withholding taxes) on certain cross-border related party payments that are subject to tax below a minimum rate of 9%.	Asset managers will want to know the extent of the exemption for investment funds. The GloBE Model Rules were published in December and although the exemption in them is fairly wide-ranging some issues potentially remain. Things should become clearer when the commentary on the rules is published (expected to be soon). It is also hoped that the commentary will allow asset managers to assess how the GloBE rules will affect their own businesses and portfolio companies. The timetable for implementation is tight, with the OECD (ambitiously) asking jurisdictions to legislate the Pillar Two rules in 2022, with most of them taking effect from 2023 (the UTPR would take effect in 2024). Asset managers should therefore keep an eye out for the commentary and monitor proposals for implementation in jurisdictions relevant to them.
EU directive on shell entities (ATAD 3)	The EU Commission has published a draft directive designed to tackle misuse of entities resident in EU member states that do not have sufficient substance. Entities within the scope of the directive are subject to adverse tax consequences. There are also increased information reporting requirements which extend to entities at risk of being within scope as well as those that actually are. For more detail please see our recent briefing on the shell entities directive which includes a flowchart to help businesses navigate the new rules and assess whether the directive is likely to apply to them.	The directive is likely to mean that many funds will need to take steps to bolster the substance of their EU holding companies to prevent additional reporting or adverse tax consequences, and may increase the comparative attractiveness of the UK's new QAHC regime.

Tax development	Introduction	What does this mean for asset managers?
Corporate criminal offence of failure to prevent the facilitation of tax evasion (the "FTP Offence") – review of procedures	The FTP Offence, which was introduced in 2017, makes bodies corporate or partnerships ("relevant bodies") criminally liable if they fail to prevent the criminal facilitation of tax evasion by their associates (those performing services for or on behalf of them). This is a strict liability offence and the only defence is to demonstrate that either (a) they had in place reasonable "prevention procedures" or (b) it was reasonable to have no such prevention procedures in place. Relevant bodies were expected to undertake a risk assessment of their business when the FTP Offence was first enacted, which was to be used by them to develop policies and procedures aimed at preventing their associates from criminally facilitating tax evasion. This process cannot be a "one-off" event. Relevant bodies are expected to regularly review the risks they face and update their policies to mitigate them, particularly when their business model changes, impacting on the risk profile.	Given the amount of time that has passed since the FTP Offence was introduced, relevant bodies should consider updating their risk assessment and procedures. When doing so, any changes to working practices as a result of the Covid-19 pandemic should be taken into account.
HMRC's increasingly assertive approach in disputes with asset managers	Subject to a lull in 2020 due to the Covid-19 pandemic, the government has been increasingly focusing on compliance activities. In the Spring Budget, the government announced an additional £180m of investment in HMRC's technical and personnel compliance function, and it is likely that a significant chunk of this will go towards funding more enquiries. In recent times we have seen an increased focus by HMRC on the asset management sector, at least partly driven by disputes relating to the large amount of targeted anti-avoidance rules that were introduced between 2014 and 2017, and this looks set to continue.	Asset managers should carefully consider their tax position when structuring their affairs, bearing in mind the increased risk of scrutiny. It is also important that advice is taken early on in the dispute process, such as when the first informal query is received from HMRC, as the approach taken and responses given at that time can significantly affect the course of the enquiry. For more detail on early stage tax disputes, please see our interactive guide.

Other developments coming down the track

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Consultation on VAT treatment of fund management fees	In the Response the government has said that it will launch a consultation on the VAT treatment of fund management fees. We do not know exactly what it will cover but, in the Response, the government said that it will not look at zero-rating fund management fees due to the cost to the Exchequer. (Zero-rating is the gold standard for VAT treatment as it allows suppliers to recover their own VAT without having to charge VAT to clients). The consultation will be published "in the coming months".	The VAT rules relating to fund management services are unclear and incentivise UK fund managers to establish non-UK private funds rather than UK ones (broadly, because there is no VAT on supplies to the former, as they are treated as taking place abroad, but managers can recover their own related input VAT i.e. treatment akin to zero-rating applies). The current VAT rules relating to fund management fees are based on EU law and so Brexit should allow the UK to adopt a more coherent approach than its European competitors. It is hoped that that will be the outcome of the consultation, albeit some will be disappointed that zero-rating is off the table, as it would have given the UK a competitive advantage compared with rival EU fund centres.
Development of tax rules for LTAF	The LTAF is a new form of UK authorised fund that is designed to be focussed on long-term, illiquid assets and is particularly targeted at increasing defined contribution (DC) pension scheme investment into alternative assets. Although the LTAF was introduced in November 2021, the government is still working through how it should be taxed. Currently, existing rules for authorised funds apply, save that, as set out in our briefing, the genuine diversity of ownership (GDO) has been relaxed in relation to it.	Many asset managers are thinking about the extent to which they can make use of LTAFs. The current tax rules provide various advantages, but respondents to the Review suggested improvements that could be made to further increase the regime's attractiveness. Helpfully, in the Response, the government confirmed that it is exploring changes to LTAF taxation. Asset managers, especially those with significant DC pension scheme clients, will want to monitor developments in this area.
Introduction of unauthorised onshore contractual fund	The Response confirms that the government will work further to explore options for a new unauthorised fund vehicle in the form of a contractual scheme aimed at professional investors. It is expected that the tax rules applying to it would largely replicate those for the co-ownership authorised contractual fund.	A new form of tax privileged UK unauthorised fund is a potentially exciting development. The Response indicates that the government expects that, in the absence of VAT zero-rating (discussed above), the new vehicle will be primarily attractive to real estate funds. That makes sense but, as the rules develop, asset managers may want to model structures to see if the new vehicle can be made to work for other asset classes.

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Implementation of OECD Pillar One (new taxing right) from 2023	Pillar One aims to align taxing rights more closely with the location of customers or users. The rules will reallocate 25% of the profits in excess of 10% revenue of an MNE to market jurisdictions where the MNE has a substantial engagement in that market, regardless of whether it has a physical presence there. This measure will only apply to the largest businesses in the world – MNEs with annual global turnover above €20bn (reducing to €10bn in no earlier than seven years) that have a profitability threshold above 10% and do not fall within an exclusion. There will be exclusions for extractives and regulated financial services, the details of which are yet to be published.	Given the size of businesses to which Pillar One applies it is unlikely that many asset managers will be directly affected by the new rules. However, as the rules are not yet finalised, asset managers will want to keep an eye on developments (including the extent of the exemption for regulated financial services). As with Pillar Two, the timetable for implementation is tight, with the OECD envisaging that the additional taxing right for local jurisdictions will come into effect in 2023.
EU introduction of reverse hybrid rules from January 2022	The reverse hybrid rules potentially apply to entities that are incorporated or established in an EU jurisdiction that treats them as transparent but as tax opaque in the jurisdiction(s) of one or more associated non-resident entities holding in aggregate a direct or indirect interest in at least 50% of the voting rights, capital interests or rights to a share of profit. Where the rules apply, the home member state must tax the reverse hybrid on its income to the extent that that income is not otherwise taxed in that member state or elsewhere. However, this treatment does not apply to a "collective investment vehicle" (i.e. an investment fund or vehicle that is widely held, holds a diversified portfolio of securities and is subject to investor-protection regulation in the country in which it is established).	Asset managers with EU fund structures, if they have not already done so, should consider how the reverse hybrid rules apply to those structures.

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Changes to the REIT regime	As part of the fund review, the government is making changes to the REIT regime in April and considering a further batch of reforms. The changes coming into force in April include the option of an unlisted REIT for certain institutional investors. For more detail on the changes, please see our briefing. The second phase, confirmed in the Response, includes proposals to allow a REIT to hold a single property and amend the three year development rule.	The reforms should make the REIT structure more accessible for fund managers, especially in relation to institutional investors who can access the unlisted variety. Asset managers who have previously discounted the REIT from their range of real estate fund vehicles may wish to factor it into their thinking going forward.
Introduction of economic crime levy	A levy (from the AML regulated sector) is to be introduced to fund combatting economic crime. The levy will be paid as a fixed fee based on which of four size bands an AML-regulated entity's UK revenue falls. The bands range from entities with small UK revenue (not more than £10.2m), which will be exempt, to those with very large UK revenue (over £1bn), for whom the levy will be £250,000. The levy is to first apply for entities that are regulated during the financial year from 1 April 2022 to 31 March 2023, and the amount payable is to be determined, broadly, by reference to their size based on their UK revenue from periods of account ending in that year. Amounts will be payable after the financial year, so the first payment will be due in the financial year from 1 April 2023 to 31 March 2024.	The levy is likely to apply to many within the asset management sector including portfolio managers, collective investment undertakings and investment advisers. Potentially in scope entities should review their position and, where relevant, ensure that they have appropriate systems in place to allow them to comply with their obligations.
Introduction of 1.25% Health and Social Care Levy from April 2022 (the Levy)	The Levy will initially be collected by way of a 1.25 percentage point increase to the rates of National Insurance contributions (NICs) but from April 2023 it will be charged separately and the rates of NICs will return to their 2021/22 tax year levels. In the context of employments, the levy will be paid by both employees and their employers (i.e. an additional 2.5% in total). For the self-employed (such as contractors or partners) the levy is payable by the self-employed person only. The rates of tax on dividend income (above the £2,000 dividend tax-free allowance) will also be increased by 1.25 percentage points from April 2022.	The Levy will be an additional cost for all taxpayers, and asset managers will need to factor it in in relation to their own businesses and those of portfolio companies. Asset managers should review their arrangements to ensure that any indemnities for tax and social security are wide enough to cover the new levy from April 2023 (when it will be separate from NICs).

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