TRAVERS SMITH

Asset Management Tax Checklist

What should be on your radar?

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Introduction

The tax treatment of asset managers continues to be a hot topic. Tax and carried interest is in the headlines, we are keeping a close eye on certain tax cases in the courts and we are waiting for the outcome of consultations on VAT on fund management fees and the permanent establishment rules.

Away from pure tax, but very relevant to fund structuring, is the government's ongoing review of the UK funds landscape, including (hopefully) a new onshore contractual fund, the RIF.

Of course, international issues are just as important, and there are plenty of those to keep an eye on, including the upcoming start date for the GloBE rules in many jurisdictions (including the UK). In addition, we are continuing to see fund executives embrace globally mobile working practices, often giving rise to complex cross-border tax considerations.

With so much change, it can be difficult for asset managers to stay up-to-date. We wanted to give you a checklist of the key tax developments and suggestions as to what we think you should be doing now to prepare.

How we can help

We are currently advising asset management clients on the issues in this checklist and, through our membership of industry bodies, contributing to the development of new measures.

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?
Supreme Court decision in *Vermilion* on meaning of "employment-related security"	On Wednesday, the Supreme Court in *Vermilion* supported HMRC's broad reading of a rule that deems an award of securities to be "employment-related", and therefore potentially pulls that award into the ambit of the UK's employment-related securities tax code.	The employment-related security code imposes employment tax charges on arrangements involving certain securities. The case has some potentially important implications for asset managers, in particular on the circumstances in which awards of securities (including carry and coinvest) could be caught by the UK's employment tax code. Asset managers should consider how the Court's wide interpretation (of when a security is "employment-related") could impact on their arrangements.
Labour Party proposes to replace non-dom regime	The Labour Party has said that, if elected, it will abolish the current preferential tax regime for those tax resident but not domiciled in the UK. The non-dom rules will be replaced with a *"modern scheme for people who are genuinely living in the UK for short periods".* No further detail is available.	This would have a significant impact on asset managers. With the next UK general election due by January 2025 and Labour doing well in the polls, it is a good time to start thinking about the impact of this change on your business.
The future of carried interest	It is common for carried interest returns to be treated as capital rather than income for UK tax purposes, and therefore be subject to lower tax rates. This position is potentially under threat from two developments. First, the Labour Party has said that it will abolish the "carried interest loophole" if it comes to power. No further detail is available. Second, in June, the Good Law Project launched a legal challenge, arguing that HMRC should not have agreed with the BVCA in 1987 that typical private equity funds are investing. Instead, it argues that PE funds are likely to be trading with the result that carried interest is trading income and not capital gain.	As with Labour's plan to replace the non-dom regime (see above), its policy of abolishing the "carried interest loophole" would have a significant impact on asset managers, and thought should be given to how it would impact on your business. HMRC has pushed back robustly against the Good Law Project's challenge, and it is unclear whether it has been dropped.
Upper Tribunal decision in *Bluecrest* salaried members rules case	A member of a UK LLP has three different ways to show that they are a self-employed partner and not an employee for UK tax purposes. *BlueCrest* looked at 2 of these tests – variable pay and significant influence.	The Upper Tribunal in *Bluecrest* discussed several different aspects of the rules, and, importantly, held that the exclusions for significant influence and variable pay were wider than contended by HMRC . For those wishing to rely on either of those two tests, the decisions also emphasise the importance of having a strong paper-trail to evidence this for each member. For more information, see our briefing on the UT decision. GPs may be able to demonstrate that members have significant influence in circumstances beyond a seat on the LLP's executive committee: we recommend that managers look again at their arrangements.

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Miscellaneous income appeals	Over the last few years a series of cases have been working their way through the courts in which HMRC have successfully applied the, previously rarely used, "miscellaneous income" tax charge to an LLP member remuneration arrangement used by hedge fund managers. In two of the cases, *Bluecrest* (different from the *Bluecrest* case discussed above in the context of the salaried members rules) and *HFFX*, Court of Appeal hearings are due in November this year and by April 2024 respectively.	The remuneration arrangements that are the subject of the appeals were fairly aggressive and, due to changes in law, unlikely to still be being used by fund managers. However, the courts have so far agreed with HMRC that the miscellaneous income rules can be used more widely than many previously thought was the case. This has left asset managers unsure of the extent to which those rules could apply to their remuneration arrangements, so the Court of Appeal decisions are awaited with interest.
Implementation of Global anti-Base Erosion rules (GloBE rules) from 31 December 2023	The OECD's Global anti-Base Erosion rules (GloBE rules) seek to establish a global minimum corporate tax rate of 15% for multinational enterprises (MNEs) that meet a €750m turnover threshold. There will be various exclusions, including for investment funds and pension funds (and holding vehicles used by such funds). Broadly, the minimum tax rate will be effected by two rules: the income inclusion rule (IIR) and, where that does not apply, an undertaxed profits rule (UTPR). In addition, many jurisdictions, including the UK, intend to introduce a domestic top-up tax, so that any top-up tax arising from an under payment of tax by entities in their territory is retained locally, as opposed to in the parent jurisdiction. In several jurisdictions, including the UK and EU, the IIR, is to come into effect for accounting periods commencing on or after 31 December 2023, with the UTPR to be implemented later.	It is a difficult time for MNEs that are potentially within the scope of the GloBE rules, with the start date looming but many jurisdictions still in the process of finalising their domestic implementation regimes. Whilst it is not expected that investment fund themselves will be subject to top-up taxes, it will be necessary to confirm this on a case by case basis. For investment funds, it is more likely that the GloBE rules or domestic taxes will be relevant to the portfolio companies they hold and, if potentially in point, will need to be monitored both on acquisition and throughout the lifecycle of the relevant investment. In addition, large asset managers will need to consider whether their house arrangements will be subject to the GloBE rules or domestic top-up taxes in any of the jurisdictions in which they operate.
Government consults on introduction of new unauthorised onshore contractual fund – the Reserved Investor Fund (Contractual Scheme) or "RIF"	The Government has consulted on a new fund type, the RIF, which, for the right investor base, could be a viable onshore alternative to the Jersey property unit trust (JPUT). The RIF would be transparent for tax on income and not subject to tax on gains, with transfers of its units being free from stamp taxes. Provided certain conditions are met, investors would only be subject to gains tax when they dispose of their units. It is expected to be primarily of interest to commercial property funds due to its VAT treatment. It is proposed that the eligibility criteria for RIF status would include that it (i) is not closely held, (ii) is only closely held due to the presence of certain institutional investors, or (iii) meets a "genuine diversity of ownership" condition.	As the RIF will be unauthorised (although its manager would be subject to the AIF regulations), it should be flexible and easy to use. This, combined with the generous tax treatment being proposed, should make it attractive for investors in UK real estate. However, it will be important that in its (understandable) desire to address loss to the Exchequer, the Government does not add undue complexity which is not present in rival offshore structures (such as the JPUT) to ensure that the attractiveness of the RIF is not undermined. Under the proposals the RIF would be available to professional investors, as well as those who invest at least £1m (or have already invested in it).

Other developments coming down the track

Tax development	Introduction	What does this mean for asset managers?
Government consults on changes to permanent establishment (PE) rules	The Government has recently consulted on amending the UK rules relating to PEs so that, broadly, they are in line with the position set out in the current version of the OECD's model double treaty. The concept of PE is important because having a PE can bring non-resident traders within the UK tax net on their profits (deriving from the establishment). The proposals include expanding the range of agents that count as a PE, so that an agent who *"habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without modification"* is potentially caught. Currently, it is generally considered that an ability to conclude contracts is necessary. In addition, the existing exclusion for agents that are independent would be disapplied where they act exclusively (or almost exclusively) for closely related enterprises.	UK investment managers typically take care to ensure that they do not constitute a permanent establishment of their overseas clients, and, helpfully, the UK rules contain a specific exemption (the "investment manager exemption or "IME") designed to prevent that from occurring. However, the IME is not always applicable and so managers often structure their affairs so as to fall outside of the basic PE definition (without having to rely on the IME), for example, by entering into advisory rather than discretionary management arrangements. Although the proposals would appear to potentially jeopardise such structuring, the Government has indicated that it is not intending for them to impact adversely the UK asset management sector.
Reform to UK VAT fund management exemption	In February, a Government consultation on limited reforms to the UK fund management exemption closed. The government is considering the feedback and its response is awaited. Currently the exemption applies to management services provided to types of fund that are specified in a statutory list. Under the proposals (i) a characteristics based test will be introduced, with the exemption applying to any fund with certain features; and (ii) the current statutory list of exempt funds will be retained but not updated. For more detail, please see our briefing on the consultation.	The current exemption is unclear and gives rise to anomalies. However, with the Government having ruled out zero-rating (the gold standard for VAT treatment, with no VAT chargeable but the supplier entitled to full input recovery), more substantive reforms than those proposed would involve a difficult balancing act. A wider exemption would reduce the VAT payable by funds, but also the VAT recovery of managers. The limited nature of the proposals may be seen as an opportunity missed to improve the UK's comparative attractiveness, and so it will be interesting to see if the feedback to the consultation pushes the Government to introduce more ambitious measures.
Changes to the REIT regime	Following on from changes to the REIT regime made in April 2022 and 2023, the Government has published draft legislation (for inclusion in the next finance bill) for a further batch of reforms. The measures are generally aimed at making the regime more attractive, for example, making it possible, when applying the exemption from the close company condition for "institutional investors", to trace through intermediate holding companies. However, the proposals also include provisions restricting the ability of certain funds to benefit from the use of private REITs unless those funds either (i) meet the "genuine diversity of ownership test" (GDO) or (ii) are not closely held (or are only closed held because of the presence of an institutional investor).	The further relaxations to the REIT regime are welcome and should enhance its attractiveness. Restricting the ability of certain funds to use private REITs is in line with the recent trend of the Government using GDO compliance or non-closeness as a condition for collective investment arrangements to access preferential tax regimes. For example, see the discussion of the introduction of the RIF above. Helpfully, the draft legislation contains grandfathering provisions to protect existing structures where funds that will not meet the new requirements hold REITs.

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Luxembourg ratifies new double tax treaty with UK	In July Luxembourg ratified the new UK/Luxembourg double tax treaty (DTT) that was signed on 7 June 2022 and ratified by the UK last October. The new DTT differs from the current treaty in a number of respects, including introducing provisions that extend the availability of treaty benefits to certain Luxembourg corporate funds. Other headlines include the fact that the new DTT generally reduces withholding tax rates for dividends and royalties to 0% and makes significant changes to the tax treatment of UK property holding vehicles owned by Luxembourg residents.	The extension of treaty benefits to various types of corporate Luxembourg funds will be welcomed by fund managers. However, unless the fund is a UCITS, the availability of relief depends on the make up of its investor base, and so consideration will need to be given as to the practicalities of monitoring that base on an ongoing basis. If the UK and Luxembourg each notify the other that they have ratified the DTT by the end of 2023, the main provisions of the DTT will come into effect at various points in 2024.
ATAD 3 (anti-shell company directive)	In December 2021, the EU Commission published a draft directive designed to tackle misuse of entities resident in EU member states that do not have sufficient substance. Under the proposals, 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. However, political agreement is yet to be reached between member states, and it seems highly unlikely that the directive will come into effect on the originally proposed implementation date of January 2024. For more detail on the original draft directive, please see our briefing.	Although there was sympathy for the general anti-tax avoidance aim of the directive when it was published nearly two years ago, progress has been slow – there has been less agreement about what entities should be caught and the consequences for them. Given the potential impact on holding structures, asset managers will want to keep an eye on developments.
EU Commission proposes multiple new tax rules	In addition to ATAD 3 (see above), the EU Commission has proposed a number of new tax rules. Key ones include: 1. BEFIT – a new single pan-European set of rules for determining the tax base of large corporate groups. 2. SAFE – rules to tackle enablers that facilitate tax evasion and/or aggressive tax planning in the EU. 3. FASTER – new withholding tax procedures in the EU. 4. New common EU transfer pricing framework. 5. Rules allowing SMEs operating cross-border through permanent establishments the option to interact with only one tax administration – that of the head office.	It is far from clear which, if any, of these initiatives will ultimately be legislated (with or without significant amendment), especially given the need for unanimous member state agreement on tax matters. However, asset managers are likely to come across references to at least some of the proposals.
New SEC rules for private fund advisers require disclosure of net clawback arrangements	Fund documentation typically provides for amounts paid to fund managers to be clawed back by the fund in certain circumstances. The US Securities and Exchange Commission (SEC) has recently adopted new rules that prohibit certain fund managers from reducing the amount of clawback by actual, potential or hypothetical taxes unless the fund manager discloses, in writing, the pre-tax and post-tax amount of clawback to investors within 45 days following the end of the relevant fiscal quarter in which the clawback occurs.	If the fund documentation allows for clawbacks to be provided on a net of tax basis, fund managers who are subject to the new SEC rules should be mindful of the new notification requirement where a clawback arises. For more detail please see our briefing on the new SEC rules.

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