

## Upper Tribunal Overturns Decision on Tax Treatment of Management Fee Rebates

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The Upper Tribunal (UT) has found that amounts paid by Hargreaves Lansdown (HL) (an investment platform service provider) to its customers, which represented rebates received from investment fund managers, were “annual payments” subject to U.K. withholding tax, reversing the First Tier Tribunal’s (FTT) decision (Hargreaves Lansdown Asset Management Limited v. HMRC [2019] UKUT 0246).

### Recap of FTT Decision

During the relevant period, HL negotiated significant discounts to the annual management charges (AMC) levied by investment fund managers. Such discounts were typically structured as rebates, some or all of which HL passed on to its customers through what it described as a “Loyalty Bonus.” The FTT was strongly influenced by the way that HL advertised the bonus payments, finding that they were not “pure income profit” for the investors, as the investors had to bear the cost of the AMC in order to receive the bonus, and (according to the marketing documents) the bonus represented a reduction of their net costs. As such, in the FTT’s view, although three of the four characteristics of an annual payment were present (namely, the Loyalty Bonuses constituted income, were paid under a legal obligation and were capable of recurrence), the fact that the bonus was not “pure income profit” for the investors meant that the payments were not “annual payments” and therefore were not subject to withholding. Further detail of the FTT decision can be found [here](#).

### The UT Decision

The UT adopted a more technical approach and focused on where the legal obligation to pay the AMC lay. Although HM Revenue and Customs (HMRC) failed to adduce evidence showing whether it was the fund or the investor who was under an obligation to pay the AMC to the fund manager, the UT made the (somewhat unusual) move of informing the parties of the legal position regarding the payment of AMCs, taking note of relevant legal and regulatory provisions governing retail investment funds. This allowed the UT to conclude that the legal obligation to pay the AMC lay with the fund entity and not the investor. The UT therefore found that the AMC is neither paid by investors nor directly borne by investors (on the basis that investors do not actually put more money in to cover the AMC, but the costs are taken out of their investment). As

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such, the UT agreed with HMRC that the Loyalty Bonus is not, in fact, a rebate, but actually an amount that increases an investor's return from the fund. Since an investor did not need to do anything in order to receive this amount other than leave its investment in the fund, this amount constituted 'pure income profit' such that the Loyalty Bonus was an annual payment. HL was therefore obliged to withhold U.K. income tax from such payments to U.K. investors. (There is an exemption from withholding tax for annual payments received by non-U.K. investors in respect of such retail investment funds.) Hargreaves Lansdown has indicated that it does not intend to appeal the decision.

#### Comment

The UT's decision is consistent with HMRC's published guidance on the taxation of payments of "trail commission" (i.e., AMC rebates received from investment fund managers). Both the guidance and the UT decision focus on retail investment funds, but fund managers outside the retail context may wish to provide management fee rebates to investors as an alternative to, for example, issuing a different class of share in respect of different fee arrangements. While the structure of such funds may differ from the retail funds in Hargreaves Lansdown, the legal principles discussed in the case (and, particularly, the focus on who has the legal obligation to pay the AMC) may apply equally to nonretail funds. It may therefore be difficult to structure fee rebates paid by a U.K. manager such that they are not generally subject to U.K. withholding, although it may be possible to structure the rebates so that they are not annual payments for another reason (for example, because they are not payable under a legal obligation). In addition, although non-U.K. investors outside of the retail context are unlikely to benefit from the general exemption from withholding tax for annual payments, some investors may nevertheless be able to benefit from a different exemption, such as relief under a double tax treaty.

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