

U.K. Tax Alert

March 19, 2014

2014 U.K. Budget: Impact on Alternative Asset Managers

Chancellor George Osborne delivered his fifth coalition Budget today. In a wide-ranging statement, there are a significant number of tax-focused proposals that will make changes across the U.K. tax system. Some of these were anticipated (and well-trailed); others are more unexpected. We have summarized below the headlines that we believe will be of most interest to alternative asset managers. In the majority of cases, the draft legislation that underpins these changes is not expected to be publicly available until March 27.

Partnerships

The well-documented proposals on changes to partnership taxation (originally announced at Budget 2013 and the subject of a recent formal consultation) will take effect from April 6, 2014. This is despite recent industry and House of Lords requests for the implementation date to be put back one year.

As previously discussed in our earlier alerts, these proposals have been designed to counter what H.M. Revenue & Customs (HMRC) considers are:

- the disguising of employment relationships (and consequential reduction of employment taxes) in relation to salaried members of U.K. Limited Liability Partnerships (LLPs)
- tax-motivated allocations of business profits or losses in partnerships (not just LLPs) where the partners include both individuals and companies (mixed membership partnerships)
- tax-motivated disposals of assets through partnerships.

In addition, the proposed changes include a new income tax collection mechanism for partnerships operating as Alternative Investment Fund Managers (AIFMs).

Minor amendments are expected to the draft legislation that has previously been released. Amended legislation will be published together with revised guidance as part of Finance Bill 2014.

If managers structured as partnerships have not already considered the impact of these changes, we would strongly suggest that they do so now. Please do not hesitate to contact us to discuss this.

HMRC has also stated, in an open letter, its intention to clarify:

the requirements as regards limited partnerships and joint ventures for the purposes of Value Added Tax (VAT) registration. This will be covered in revised guidance on VAT registration which will be published in 2014/15, and will then be included in the HMRC partnership tax manual

its guidance on Stamp Duty Land Tax (SDLT) liabilities following changes in partnership profit sharing ratios. HMRC will review the relevant guidance to make this clearer, and it will also then be included in the HMRC partnership tax manual.

Investment Management

Abolition of Stamp Duty Reserve Tax applied to collective investment schemes

As announced previously (and incorrectly dubbed 'a tax break for hedge funds') this measure will abolish the Stamp Duty Reserve Tax (SDRT) charge for which fund managers are liable when investors surrender their units in U.K. unit trust schemes or shares in U.K. OEICs. The SDRT charge will be retained on non pro-rata in specie redemptions.

These changes will have effect from March 30, 2014.

U.K. management of offshore funds

Section 363A of the Taxation (International and Other Provisions) Act 2010 currently treats offshore UCITS funds as not being resident in the U.K. if they are tax resident in another EU member state. Following consultation over the summer, section 363A will be amended to include alternative investment funds with effect from December 5, 2013.

While the final legislation is still being discussed with HMRC, it is hoped that drafting issues appearing to prevent Cayman funds (for example) from falling within section 363A will be addressed. Whether managers will wish to regularly make use of this provision, given the possible VAT and stamp taxes issues that could arise, is another matter.

Review of loan relationships and derivative contracts

Following consultation, the U.K. Government will shortly issue a Technical Note setting out proposed changes intended to make the corporation tax rules on loan relationships and derivative contracts simpler, more certain and more robust against avoidance.

As part of these changes, legislation will be introduced in Finance Bill 2014 targeted at the taxation of certain collective investment vehicles, with the purpose of enhancing existing anti-avoidance provisions and clarifying aspects of the operation of the rules. These changes will have effect in relation to accounting periods beginning on or after April 1, 2014.

Legislation, previously intended for inclusion in Finance Bill 2014, to clarify and rationalise the taxation of loan relationships and derivative contracts held by a partnership will now be deferred to 2015.

U.K. bond funds to pay interest free of withholding tax where they are marketed to non-U.K. residents

Regulations have been made to implement this measure, which came into force on December 19, 2013.

Application of SDLT on certain authorised property funds

As part of the Investment Management Strategy, the Government will consult on the SDLT treatment of the seeding of property authorized investment funds and the wider SDLT treatment of co-ownership authorized contractual schemes.

Seed Enterprise Investment Scheme

This measure makes permanent the tax-advantaged Seed Enterprise Investment Scheme (SEIS) and the associated capital gains tax (CGT) relief for re-investing chargeable gains in SEIS shares.

These changes will come into force from Royal Assent to Finance Bill 2014 and, for CGT reinvestment relief, have effect for 2014-15 and subsequent years.

Annual investment allowance

This measure increases the maximum amount of the annual investment allowance (AIA) to £500,000 from April 1, 2014 for corporation tax and April 6, 2014 for income tax. This increased limit will apply until December 31, 2015, after which it will return to £25,000.

Managers and portfolio companies of investment funds may therefore wish to accelerate any planned capital expenditure qualifying for the AIA.

Personal Tax**Dual contracts**

As previously announced, the use of 'artificial dual contract' employment arrangements by U.K. resident non-domiciliaries will be countered by new legislation.

The new proposals will tax overseas employment income on an arising (rather than remittance) basis where, broadly, the overseas employment income is subject to tax at less than 65 percent of the U.K.'s additional rate of income tax (currently 45 percent).

The new proposals will take effect for employment income arising on and after April 6, 2014. Income which arises on or after this date but which is related to employment duties performed in a year prior to 2014-15 will not be subject to this legislation.

Given the proposed drafting of the above legislation, this is another reason for managers to carefully consider the 'Salaried Member' rules discussed earlier. This is because if an individual has a non-U.K. employment but a U.K. self-employment, the dual contract rules should not apply.

Remittance basis – capital gains tax and split year treatment

Legislation will be introduced in Finance Bill 2014 to ensure that capital gains made by a remittance basis user in the overseas part of a split year of residence are not charged to tax.

As the amendment corrects a default in the Statutory Residence Test, which has only been effective from April 6, 2013, it is hoped that the change will have retrospective effect.

Offshore & onshore employment intermediaries

As announced in Budget 2013 and following consultation, legislation will be introduced in Finance Bill 2014 to:

- strengthen obligations to ensure the correct, in HMRC's mind, income tax and National Insurance contributions (NICs) are paid by offshore employment intermediaries
- prevent avoidance of employment taxes and obligations by using onshore intermediaries to disguise employment as self-employment.

These changes will have effect from April 6, 2014, and we will review the draft legislation closely to ensure there is no impact on those partnerships already grappling with the 'Salaried Member' rules.

Social investment tax relief

As announced at Budget 2013, legislation will be introduced in Finance Bill 2014 to provide a range of income and capital gains tax reliefs, to provide incentives for investment by individuals in qualifying social enterprises. Income tax relief will be available at 30 percent of the amount invested.

These changes will have effect from April 6, 2014 and draft guidance will be published on March 27, 2014.

NICs: simplification for the self-employed

Following the consultation announced in Budget 2013 and the summary of responses published in December 2013, the U.K. Government will introduce legislation (when parliamentary time allows) to simplify the administrative process for the self-employed by using Self-Assessment to collect Class 2 NICs alongside income tax and Class 4 NICs.

These changes will have effect from April 2016, however HMRC considers that taxpayers will start to see the benefits after April 2015.

Taxation of high-value U.K. residential property held by certain non-natural persons (NNPs)

The current taxes (outlined below) that apply in respect of U.K. residential property held by certain NNPs (including companies, some partnerships and collective investment schemes) will be extended to properties worth more than £500,000. Currently these rules only affect properties worth in excess of £2m.

These taxes (which do not apply to genuine commercial businesses and other limited categories of exemption) are:

- SDLT at 15 percent on acquisition of a residential property
- an annual tax on enveloped dwellings (ATED). An enveloped dwelling is broadly the holding of residential property by a NNP vehicle
- CGT at 28 percent on any gain on disposal.

The extension of the 15 percent rate of SDLT for properties costing more than £500,000 will take effect for transactions where the effective date (normally the date of completion) is on or after March 20, 2014. Transitional provisions will apply to contracts entered into before March 20, 2014 but completed on or after that date.

There will be two new ATED bands. The first will apply to residential properties worth more than £1 million but not more than £2 million, whereby an annual charge of £7,000, will apply from 1 April 2015 (“**Band 1**”). An additional band for ATED applying to residential properties worth more than £500,000 but not more than £1 million, with an annual charge of £3,500, will apply from 1 April 2016 (“**Band 2**”).

All corporate and other “envelopes” affected by the new ATED bands will also be subject to CGT on disposal of the residential properties, at a rate of 28 percent.

The ATED-related CGT charge for Band 1 properties will take effect from April 6, 2015. The charge will apply only to that part of the gain which accrues on or after that date.

The ATED-related CGT charge for Band 2 properties will take effect from April 6, 2016. Again, the charge will apply only to that part of the gain which accrues on or after that date.

The CGT elements of this measure will be introduced in Finance Bill 2015.

CGT private residence relief final period exemption

As announced in Autumn Statement 2013, legislation will be introduced from April 6, 2014 to reduce the final period of ownership of a property which qualifies for private residence relief from 36 months to 18 months. A new relief will be introduced so that certain disabled people and people moving into care homes will receive final period exemption for the last 36 months of ownership.

With the above in mind, individuals may wish to give careful consideration to the timing of any disposal of residential property.

CGT: non-residents and U.K. residential property

As announced in Autumn Statement 2013, legislation will be introduced to charge CGT on future gains made by non-U.K. residents disposing of U.K. residential property.

A consultation on how best to produce the charge will be published shortly. These changes will have effect from April 2015 and legislation will be in Finance Bill 2015.

Anti Avoidance

Disclosure of Tax Avoidance Schemes (DOTAS) rules or those counteracted under the General Anti-Abuse Rule (GAAR).

This measure extends the requirement for taxpayers to pay any disputed tax up front to HMRC, where the disputed tax arises in relation to schemes:

- that are covered by the DOTAS rules; or
- counteracted under the GAAR.

The measure widens the circumstances where the disputed tax sits with the U.K. Exchequer during a dispute. Currently, repayments can be withheld while the matter is resolved but a taxpayer can include the tax advantage in their initial self-assessment and reduce their liability.

This new power is designed to remove the perceived cashflow advantage for the taxpayer of holding onto the disputed tax during an avoidance dispute. There is no change to the tax liability owed.

These measures will be applicable to all cases where there is an open enquiry or open appeal on or after the day on which Finance Bill 2014 receives Royal Assent.

The Government will also consult on extensions to the DOTAS “hallmarks” (the descriptions of schemes required to be disclosed) to be introduced by secondary legislation later in 2014, and proposals to strengthen HMRC’s powers to tackle non-compliance with the rules, with a view to legislating in the following Finance Bill.

Accelerated payments of tax in follower cases

As announced in the Autumn Statement and following a consultation that closed in February 2014, the government will legislate to provide that HMRC may issue a notice to the user of a tax avoidance scheme that they should settle an outstanding tax liability when the claimed tax effect has been defeated in other litigation. If the taxpayer does not settle, they risk a penalty and must make upfront payment of the tax in dispute to HMRC. The cash flow issues as described above for the DOTAS and GAAR scheme users apply equally here.

These measures will be applicable to all cases where there is an open enquiry or open appeal on or after the day on which Finance Bill receives Royal Assent.

VAT Avoidance Disclosure Regulations (VADR)

The government will consult on proposals to improve the VAT Avoidance Disclosure Regulations (VADR) regime, including placing the obligation to disclose primarily on the scheme promoter. Legislation will be in a future Finance Bill.

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