UK Budget Alert

March 20, 2013

Hedge Fund Tax Update 2013

Partnerships

The U.K. Chancellor of the Exchequer announced in today's Budget speech that the accompanying documents would include “New rules to stop the abuse of partnership rules…,” suggesting that a legislative change may have immediate effect. However, what was contained in the documents released was an announcement of a consultation period.

As the U.K. government considers that “The misuse of the partnership rules has been a feature of many avoidance schemes closed down in recent years.” It will consult on measures to:

- remove the presumption of self-employment for limited liability partnership (LLP) partners, to tackle the “disguising” of employment relationships through LLPs
- counter the “manipulation of profit/loss allocations (by both LLPs and other partnerships) to secure tax advantages.”

With respect to the second bullet, for hedge fund managers who consider that they have been driven by investors, commercial pressures and/or regulatory requirements to introduce deferral plans, at the level of the partnership, the suggestion that HM Revenue & Customs (HMRC) may choose to see these as “manipulation” will likely cause concern. Managers are therefore encouraged to participate, through their advisors or trade association if they prefer, in the consultation period to explain that such plans:

- have a clear and demonstrable commercial rationale
- have been and continue to be implemented in accordance with this rationale
- are therefore not in place to manipulate profits so as to secure tax advantages.

A consultation document will be published in the spring, with legislation anticipated in Finance Bill 2014. In addition, the Budget notes state that the Office of Tax Simplification (OTS) will carry out a review of ways to simplify the taxation of partnerships. The OTS will carry out an initial scoping exercise to identify which areas are most complex for taxpayers and will provide further details in due course.

Corporation Tax Rate Reduction

As part of the government’s stated aim to show that the U.K. is “open for business,” legislation will be introduced to reduce the main rate of corporation tax in most instances to:

- 21 percent for the financial year commencing April 1, 2014
- 20 percent for the financial year commencing April 1, 2015.

This change will be of interest to hedge fund managers established as corporations or who have corporate members of their partnership.

National Insurance Contributions: Process Simplification for the Self-Employed

The government is to consult on ways in which it might simplify the collection of Class 2 National Insurance Contributions (NIC) by doing so alongside income tax and Class 4 NIC. Following the consultation, the government will decide whether to make changes to the way Class 2 NIC are collected. Legislative change, if required, will then follow.

Subject to the first bullet under the heading "Partnerships," this possible change will be of interest to individual partners/members of hedge fund managers established as partnerships.

Employee Shareholders

The government has clarified the capital gains tax (CGT), income tax and NIC benefits for employees who, in return for the issue of shares (having a value between £2,000 and £50,000) in their employer company or its parent, are willing to give up their rights, amongst others, against unfair dismissal or to a redundancy payment.

The Finance Bill 2013 will contain legislation to exempt from CGT a disposal of shares acquired by an "employee shareholder" under their employee shareholder agreement. The exemption will apply on the disposal of all "employee shareholder" shares, subject to the limit that the value of shares that are eligible to be acquired under the scheme is capped at £50,000.

The new provisions will amend the existing legislation relating to income tax to ensure that the first £2,000 of "employee shareholder" shares do not come within the charge to U.K. income tax.

Amendments to existing legislation will also be made so that the first £2,000 of shares acquired under the "employee shareholder" scheme will be exempt from NIC.

Exemption Threshold for Employer-Provided Beneficial Loans

The threshold for employment-related beneficial (e.g., low interest rate) loans to be treated as earnings of an employment is to increase from the current threshold of £5,000 to £10,000 from April 6, 2014.

This change will be of interest to those hedge fund managers in the U.K. who make loans to their employees to assist, for example, with season ticket costs.

R&D Expenditure – Above the Line Tax Credit of 10 percent

From April 1, 2013, large companies will be able to claim R&D relief as a taxable credit up to the value of 10 percent of their qualifying R&D expenditure. The credit may also be payable, net of tax, even where the claimant has no liability to U.K. corporation tax.

The new scheme will initially be optional, such that companies eligible to claim under the current large company scheme may continue to do so. However, from April 1, 2016, the scheme will be mandatory for all large companies wishing to claim R&D relief.

Fund Tax/Investor Issues

In HM Treasury's U.K. investment management strategy document, also released today, a number of tax measures are announced or proposed. These include potentially extending statutory protection from becoming U.K. resident as a result of U.K. investment management to non-UCITs funds outside the U.K.

The document can be found at http://cdn.hm-treasury.gov.uk/uk_investment_management_strategy.pdf.

Offshore Fund Regulations

Changes are to be made to address certain technical issues as regards the operation of the offshore funds regulations.

The changes include ensuring that a potential offshore income gain cannot be avoided by a merger or reorganisation of the fund.

The government describes the changes, some of which had affect as of 3 p.m. today, as making aspects of the rules “fairer” and ensuring that investors are taxed in the same way as investors in equivalent U.K. funds.

Transfer of Assets Abroad and Attribution of Gains

Broadly, the transfer of assets abroad legislation (the TOAA rules) imposes a charge to income tax on U.K. ordinarily resident individuals (from April 6, 2013, the charge is likely to apply to U.K. residents as the concept of ordinary residence is expected be abolished) where there has been a transfer of assets, and as a result income becomes payable to a person abroad but the U.K. individual still receives a benefit from the arrangement.

The government has today confirmed that legislation will be included in the Finance Bill 2013 to introduce a new exemption from the TOAA rules where genuine commercial transactions take place overseas and to impose a charge under the TOAA rules would constitute a restriction to any EU treaty freedom(s).

Under the proposals, HMRC will retain the ability to apportion, and subject to tax, amounts attributable to part of a transaction that it considers not to be “genuine.”

There will be no change to the existing exemptions from the TOAA rules which include inter alia where it would be unreasonable to conclude that avoidance of tax was a main purpose of the arrangements.

Hedge fund managers that are either launching or updating their offering documents in future may wish to make sure that these changes are reflected within these.

Stamp Duty on Junior Shares

The government is to introduce legislation, taking effect from April 2014, that abolishes stamp duty and Stamp Duty Reserve Tax on share transactions in U.K. companies quoted on Small Company Growth Markets.

Personal Tax

Seed Enterprise Investment Scheme (SEIS)

It is currently the case that only gains that accrue to an individual in the 2012/2013 tax year are eligible for capital gains tax SEIS relief.

Measures will be introduced in Finance Bill 2013 to extend the availability of SEIS relief to include gains that accrue to individuals in the 2013/2014 tax year, provided the gains are re-invested in qualifying assets in the 2013/2014 or 2014/2015 tax year.

The current SEIS rules allow for the whole of a re-invested gain to be treated as exempt from capital gains tax and up to 50 percent of the amount subscribed is eligible for income tax relief. However, the proposed capital gains tax extension will be limited to an amount that is equal to only half the matched re-invested gain.

No changes to the income tax deduction have been announced in today’s Budget, and the cap of £100,000 will remain in place. Therefore, from April 2013, “qualifying investors” who wish to re-invest a chargeable gain of £100,000 or less into newly issued shares of a “qualifying company” should be eligible for income tax relief on up to 50 percent the amount reinvested and should benefit from a deferral of capital gains tax in respect of half of the chargeable gain.

Pensions Tax Relief

As announced in the Autumn Statement 2012, legislation will be introduced in Finance Bill 2013 to reduce the annual allowance to £40,000 and to reduce the standard lifetime allowance to £1.25 million for the 2014/2015 tax year onwards.

Following consultation, draft legislation for the restriction of the lifetime allowance has been revised to include various minor adjustments and several consequential changes in connection with previous protection regimes.

It has also previously been announced that the government will offer an individual protection regime in addition to a fixed protection regime.

Individual hedge fund managers are encouraged to discuss the impact of these changes with their personal tax adviser.

Annual Tax on Enveloped Dwellings

As announced in Budget 2012, legislation will be introduced in Finance Bill 2013 for an annual tax to be payable by certain non-natural persons that own interests in dwellings valued at more than £2 million. The tax will come into effect on April 1, 2013.

It was also announced in today's Budget that changes have been made to introduce additional reliefs, modify conditions for some of the reliefs, and the requirements to make returns if companies cease to be eligible for relief or become liable to an increased charge.

Legislation will also be in Finance Bill 2013 to introduce a CGT charge that is payable by certain non-natural persons when they dispose of interests in high value residential property in the U.K. on or after April 6, 2013.

Broadly, the new tax charge will be payable by these non-natural persons, wherever they are resident (i.e., including the U.K.), if they were liable to the new annual tax on enveloped dwellings on the property in question. CGT will normally be payable only on gains attributable to periods of ownership after April 5, 2013. However, it will be possible to elect for gains or allowable losses to be computed for CGT purposes by reference to the entire period of ownership.

The tax will be charged at 28 percent (the current highest rate of CGT, and above the current rate of corporation tax).

Managers affected by these new rules are encouraged to discuss the impact of these changes with their personal tax adviser.

General

General Anti-Abuse Rule (GAAR)

As widely anticipated, legislation will be introduced in Finance Bill 2013 for a General Anti-Abuse Rule to counteract tax advantages arising from what the government regards as abusive tax avoidance schemes.

The GAAR will apply to:

- income tax
- corporation tax (and amounts treated as corporation tax)
- CGT
- inheritance tax
- Stamp Duty Land Tax
- the annual tax on enveloped dwellings
- petroleum revenue tax.

Further details of the GAAR can be found at: http://www.hmrc.gov.uk/budget2013/tiin-4754.pdf, and those managers who are concerned that arrangements that they have entered into may be caught are encouraged to contact their advisors to discuss this.

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