Akin Gump
STRAUSS HAUER & FELD LLP

U.K. Tax Alert

December 5, 2013

U.K. Autumn Statement 2013

The Chancellor of the Exchequer today delivered a 130-page[1] Autumn Statement that contained a number of surprises, as well as expected updates on areas such as partnership taxation.

While the detailed rules for most of the announcements will not be released publicly until December 10, at the earliest, we have summarised below the headlines that we believe will be of interest to alternative asset managers.

Loan origination

The government intends to publish a consultation document considering how a regime to allow loan origination by investment funds might be introduced in the United Kingdom.

We consider that this announcement will be of considerable interest to our clients, and we will be participating keenly in the government's proposed consultation.

Partnership taxation consultation

As part of Budget 2013, the government announced a since widely discussed review of the U.K. taxation of partnerships. The government wished to tackle what it perceived as the:

- use of limited liability partnerships to disguise employment relationships;
- tax-motivated allocation of business profits to corporate partners. Such allocations often being subject to tax at relatively lower rates.

Akin Gump actively participated in the consultation, and we, amongst others, raised a range of concerns, including the difficult interaction with the provisions of the Alternative Investment Fund Managers Directive.

The Autumn Statement provides the expected public confirmation that, while the government remains committed to taking forward the proposed changes, the draft law will reflect the concerns that we and others have raised.

The changes will take effect from 6 April 2014, with the exception of anti-avoidance rules concerning so called tax-motivated profit allocations. The anti-avoidance rules come into force from 5 December 2013 in order, in HMRC's words, to protect against risks to tax revenue.

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National Insurance for the self-employed

Having launched a consultation on the subject at Budget 2013, the government will continue to work toward a simpler National Insurance contributions (NICs) process for the self-employed.

The Autumn Statement announces that a summary of the responses to the consultation, together with details of next steps, will be published in due course, and we would advise alternative asset managers to look out for developments in this area.

Employee ownership

At Budget 2013, the government announced its intention to continue to encourage the growth of the employee ownership sector. Further measures announced as part of the Autumn Statement include:

- a relief from capital gains tax (CGT) on disposals of shares that result in a controlling interest in a company being held by a trust used as an indirect employee ownership structure
- exemption from inheritance tax (IHT) for transfers of shares and other assets to employee ownership trusts, providing certain conditions are met
- an annual exemption from income tax on bonuses or equivalent payments up to an amount of £3,600 paid to employees of companies that are indirectly employee-owned
- an increase in the maximum annual value of shares that an employee can acquire with tax advantages under the Share Incentive Plans to £3,600 a year for "free" shares and to £1,800 a year for "partnership' shares", the Save As You Earn savings contribution limit will be doubled from £250 to £500.

While alternative asset managers have perhaps not been amongst the keenest to adopt employee share plans in recent times, due largely to the prevalence of partnership structuring, the changes above (in particular, the CGT and IHT exemptions) merit consideration.

Government response to the Office of Tax Simplification employee share schemes review

Following consultation announced at Budget 2013, the government used the Autumn Statement to announce that it will implement a package of simplifications proposed by the Office of Tax Simplification on non-tax-advantaged ("unapproved") employee share schemes.

The changes will take effect during 2014 and should be monitored closely by those alternative asset managers considering the "employ and reward with shares" model over the more traditional partnership structure.

National Insurance contributions

Although of potentially limited benefit to alternative asset managers, the government intends to abolish employer NICs for under-21-year-olds on earnings up to £813 per week. The £813 threshold is equivalent to the point at which higher-rate tax is charged.

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The government stressed in the Autumn Statement that no individual's state pension entitlement would be affected by this measure.

Corporation tax: associated companies' rules

The government intends to replace the associated companies' rules with simpler tests based on 51 percent group membership. The change will be effective from April 2015, when the main rate and small profits rate of corporation tax are unified at 20 percent.

Close company loans to participators

The government announced that it does not intend to make any immediate changes to the structure or operation of the tax charge on loans from close companies to individuals who are participators in them.

The announcement follows a consultation launched at Budget 2013.

Modernising the taxation of corporate debt and derivative contracts

The government will introduce legislation to enhance existing anti-avoidance provisions to:

- prevent abuse of the "bond fund" rules
- clarify and rationalise certain aspects of the bond fund rules
- permit corporate investors to make a claim in certain prescribed circumstances to disapply the bond fund rules.

Furthermore, legislation will also be introduced to clarify and rationalise the taxation of corporate partners where loan relationships and derivative contracts are held by a partnership.

These changes follow consultation on the review of the legislation governing the taxation of corporate debt and derivative contracts and are expected to feature in Finance Bill 2014.

Because the funds managed by alternative asset managers, and such management firms are frequently structured as partnerships, can often fall, intentionally or otherwise, within the bond fund rules, we would suggest that managers monitor this area closely.

CGT on gains made by non-residents disposing of U.K. residential property

This proposal was widely reported in the press, including our alert of November 22, 2013 which can be found here and a consultation on how best to introduce the new capital gains tax charge will be published in early 2014.

Following the consultation, any new law would be introduced from April 2015. The Chancellor's speech itself suggested that only gains accruing post April 2015 may be caught, as he said "…from April 2015, we will introduce capital gains tax on future gains made by non residents who sell residential property here in the UK". Whether this is the case or not will become clearer during the consultation.

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Social investment

From April 2014, the government intends to introduce a new social investment tax relief so as to encourage individuals to invest in social organisations.

The proposed relief would be available for both equity and certain debt investments in charities, community interest companies and community benefit societies to help them become self-sustaining in the long term.

The government will publish a road map for social investment in January 2014 setting out its next steps. These include:

- seeking state aid clearance for a larger tax relief scheme
- looking at options for supporting indirect investment
- making changes to regulations for community interest companies to make them more attractive to investors and social organisations.

Due to the generous and philanthropic nature of many within the alternative asset management industry, we felt these proposals were worthy of mention.

Avoidance

- The Chancellor of the Exchequer announced that the government will continue to take further steps to address perceived tax avoidance and evasion. Such steps include: **reducing the capital gains tax private residence relief final period exemption from 36 months to 18 months.** Those individuals who no longer occupy a property that was previously their principal residence, and that they intended to dispose of tax free within three years, would be advised to monitor developments in this area closely.

- **preventing high-earning, nondomiciled employees from avoiding tax by artificially splitting single employments to shift some of their employment income offshore and out of scope of U.K. tax.** A number of alternative asset managers have utilised the different employment and self-employment opportunities that their group structures can offer to provide services (for example, marketing) outside the United Kingdom, and so the draft law in this area is eagerly anticipated.

The Autumn Statement adds only that, from April 2014, U.K. tax will be levied on the full employment income where a comparable level of tax is not payable overseas on the overseas contract.

- **acting to prevent large professional partnerships and wealthy individuals abusing the rules on compensating adjustments in the transfer pricing code.** This announcement was originally made on October 25, 2013, and was quoted as being of particular relevance to those in the private equity industry.

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- **preventing employers and employment intermediaries from avoiding employer NICs and circumventing their employer obligations.** The Autumn Statement announces that the government is acting now to "level the playing field" so that companies cannot use employment intermediaries to disguise employment as self-employment and thus avoid employment taxes and deny employment rights to their workforces.

The government will consult on strengthening existing legislation to prevent employment intermediaries from being able to use so-called contrived contracts to disguise the employment of workers. Any changes will take effect from April 2014.

We will monitor this area closely, with a view to highlighting during the consultation any unintended consequences where alternative asset managers supply their services through partnerships, for example.

- **blocking an avoidance scheme using total return swaps:** The government will close down a tax avoidance scheme, with immediate effect, which has enabled companies to pay their profits to a company in the same group located overseas, thus escaping a corporation tax liability.

As alternative asset managers have used total return swaps in the past, including in relation to funds that might not avail themselves of the Investment Manager Exemption, we would suggest that the revised law be reviewed in detail and all (if any) necessary and immediate action taken.

Tax avoidance schemes and penalties

Autumn Statement 2013 confirms that the government will:

- introduce new requirements for users of failed avoidance schemes to oblige them to settle the dispute where the avoidance scheme they are using has been defeated in another party's litigation through the Courts, with penalties attached for non-compliance;

- consult on the scope for extending this power by widening the criteria for which taxpayers are required to pay any disputed tax up front;

- increase obligations and sanctions for "high-risk promoters" of tax avoidance schemes, by introducing objective criteria for identifying and publishing the names of high-risk promoters, seeking more information from them and applying penalties where there is failure to comply; clients of high-risk promoters will also be required to identify themselves to (HMRC).

In other news. . . .

While not included in the Autumn Statement, alternative asset managers may be interested to hear of a First-Tier Tribunal case in which it was recently held that, while a member of a limited liability partnership did not have authority to pursue an appeal to the U.K. tax authorities on behalf of the LLP, the member had a right to appeal an amendment to the LLP's return and could be substituted as the appellant. The case was that of *MCashback Software 6 LLP v. HMRC* (2013).

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Since HMRC continues to open enquiries into the tax affairs of managers, possibly buoyed by the statistic[2] that 80 percent of the avoidance cases heard in the courts are currently being won by HMRC, we would encourage managers to consider whether their LLP agreements adequately deal with tax enquiries and retain the control of them with certain members. If the LLP agreement provisions are insufficient, tax matters affecting the partnership could be prolonged, where one or more members do not accept, for example, any agreement reached with HMRC.

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[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263575/Autumn_Statement_2013.pdf

[2] Included in the Autumn Statement.

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