Akin Gump
STRAUSS HAUER & FELD LLP

U.K. Tax Alert

March 27, 2014

Finance Bill 2014 Published

The U.K. government has today published the final text of the 2014 Finance Bill. As discussed in our previous Alert, issued on March 19, the Finance Bill includes:

- the abolition of Stamp Duty Reserve Tax on certain dealings in collective investment schemes
- statutory extension of U.K. residence protection to Alternative Investment Funds ("AIFs")
- changes to the loan relationships rules, including anti-avoidance provisions affecting "bond funds"
- an overhaul of the taxation of partnerships, including the "salaried member" rules, mixed membership partnership rules and a statutory profit deferral mechanism for certain partnerships.

Alternative investment managers based in the U.K. are likely to focus primarily on the last of the above changes. This Alert therefore does the same.

Salaried Members

The legislation implementing the salaried member rules remains substantively unchanged from that issued on March 7. It remains the case that only if an individual member of a U.K. LLP meets **all** three conditions[1] then they will be subject to U.K. tax as an employee from April 6, 2014.

Where Her Majesty's Revenue & Customs ("HMRC") have made more substantive changes is in their guidance notes. Changes here include:

- A number of new examples concerning the "relevant period" and "relevant arrangements". For example, the relevant period for assessing Condition A need not necessarily be either the tax year or an accounting period, and will depend upon how long the current profits sharing arrangements are in force.
- Clarification that if a member is appointed to a "management committee" of a U.K. LLP, but the role of the management committee is largely administrative, then Condition B will be met (as such an individual will not have "significant influence").

[1] That is, broadly, (i) Condition A: more than 80% of the payments that they are reasonably expected to receive from the LLP constitute "disguised salary," (ii) Condition B: they do not have "significant influence" in respect of the LLP and (iii) Condition C: they have contributed capital to the LLP of less than 25% of their reasonably expected disguised salary for that tax year.

- A statement that if an individual member undertakes to contribute capital[2] to the partnership but subsequently fails to do so, they may be adjudged an employee retrospectively (post-April 6, 2014).

- Further instances and examples of when HMRC considers the anti-avoidance provisions of the new rules might deny a capital contribution counting for the purposes of Condition C.

- Making it clear that if HMRC reviews the position adopted in respect of a member and it is found that the LLP ought to have treated the individual as a salaried member, then this would be a Pay As You Earn failure. As a result, the LLP, as the employer, would be liable to pay over the amount that should have been deducted from the payments to the employee. In practice, we consider that whether the salaried member has already paid their self-assessment income tax at this time should impact the quantum of the payment then having to be made by the LLP to HMRC.

As stressed in our Alert of March 19, if managers structured as U.K. LLPs 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.

Mixed Partnerships

The question of mixed partnerships (i.e., any partnership[3] with individual and non-individual, such as company, members) has not attracted the same attention as the salaried member rules in recent months.

Given the wide-reaching implications of these changes, we would recommend that all managers with corporate member(s), and not just those that have used companies to implement potentially tax efficient deferral, consider the impact of the rules. For example, in deciding the “appropriate notional profit” that a corporate member can still receive post April 6, 2014, without individual members potentially being subject to tax on this, HMRC have rejected pleas to equate partnership capital to equity capital. HMRC has chosen instead to maintain the comparable of loan finance, and an arm’s-length interest rate should be applied to the corporate’s capital contributed to determine this limb of appropriate notional profit.

Alternative Investment Fund Managers: Deferred Remuneration

The mechanism previously discussed to mitigate some of the tax disadvantages arising from the deferral of payments to LLP members as a consequence of compliance with AIFMD-driven deferral mechanisms will be introduced for the 2014/15 and subsequent tax years.

Requests have previously been made to HMRC that the availability of the deferral mechanism should be extended to a wider group of managers. Changes have now been made. The mechanism will be available to a firm (an AIFM firm) that carries on an “AIFM trade.” An AIFM firm is one:

(a) the regular business of which is managing one or more AIFs, or

[2] Within the timelines given by the salaried member rules.
[3] Not just U.K. LLPs.

(b) which carries out one or more functions of managing one or more AIFs:

(i) as the delegate of, or

(ii) as the sub-delegate of a delegate of,

a person whose regular business is managing one or more AIFs.

An AIFM trade is a trade of an AIFM firm that involves the firm's activities mentioned above.

Only "restricted profits" can be allocated through the mechanism. Such restricted profits are amounts which are awarded to a partner in accordance with arrangements which are consistent with the ESMA Remuneration Guidelines. HMRC states that:

> "Arrangements which satisfy the remuneration principles which the Financial Conduct Authority requires to be followed by AIFMs will also be accepted as consistent with ESMA Guidelines."

HMRC's guidance goes on to say that:

> "Where an AIFM firm applies the [ESMA] guidelines, the mechanism may also apply to partners in the firm who are not within the scope of the ESMA Guidelines but are remunerated on terms consistent with them."

The above is subject to the restriction below regarding delegates and sub-delegates.

If the partnership is an AIFM firm which qualifies for the mechanism because it is a delegate or sub-delegate, the mechanism only applies to partners who are 'identified staff' for the purposes of the ESMA Guidelines.

The AIFM firm must elect into the mechanism, and then each partner can decide whether to elect his or her restricted profits into the new rules. An election must be made by the AIFM firm, to HMRC, within six months after the end of the first period of account for which the election is to have effect.

The Finance Bill and accompanying guidance contain a raft of detailed provisions as to how the mechanism will operate. If you are interested in learning more about these, which vary depending on, for example:

- If deferred remuneration vests in cash or instruments
- Whether the partner who was originally deferred receives the award
- If the individual is still a partner in the partnership at the vesting date, please do not hesitate to contact us.

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