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Tax Alert

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Autumn Statement 2014: Key Implications for U.K.-Based Alternative Asset Managers and Their Funds

Shortly after 12.30 p.m. today, the U.K. Chancellor of the Exchequer, George Osborne, delivered the last Autumn Statement before next year's general election.

We have summarized below what we consider to be the key announcements affecting U.K.-based alternative asset managers and the funds that they manage. We will circulate a further alert, on December 10, 2014, once additional draft legislation for inclusion in next year's Finance Bill is published. A number of the announcements summarized in this alert were accompanied by draft legislation today.

The announcements on 'disguised fee income' and Stamp Duty Land Tax (SDLT) are likely to have caught the eye both professionally and personally.

Investment Managers: Disguised Fee Income

While the Chancellor's headline announcement was intended to focus on changes to the U.K. stamp duty land tax regime, the attention of U.K. alternative asset managers will undoubtedly have been grabbed by his statement concerning disguised fee income.

Asset managers are specifically named and the U.K. government will introduce legislation, effective from April 6, 2015, to ensure that sums which arise to investment fund managers for their services are charged to income tax.

Somewhat cryptically, the Autumn Statement states that this change:

- **will** affect sums that arise to managers who have entered into arrangements involving partnerships or other transparent vehicles
- **won't** affect sums linked to performance, often described as "carried interest", nor returns that are exclusively from investments by partners

Those U.K. based hedge fund managers, in particular, who have previously entered into deferral, alignment and/or retention plans using corporate members of partnerships, and who have not yet unwound these in full for commercial reasons, may have initially feared yet another attack on such arrangements. However, a policy costings document that accompanied the Autumn Statement[1] provides comfort that hedge fund managers are unlikely to be the target of these proposed measures. The

[1] Page 37 of https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382330/AS2014_Policy_costings.pdf

government has the stated target of those private equity fund managers who, in the view of the U.K. tax authorities, have structured themselves in ways to avoid tax by enabling management fees to be charged to capital gains tax (CGT), rather than income tax. Such private equity managers will therefore eagerly await the draft legislation, expected on December 10, 2014.

Special Purpose Share Schemes

The U.K. government will legislate to remove what the Chancellor considers to be the unfair tax advantage provided by special purpose share schemes, commonly known as ‘B share schemes’. From April 6, 2015 all returns made to shareholders through such a scheme will be taxed in the same way as dividends.

Capital Gains Tax: Denying Entrepreneurs’ Relief for Disposals of Goodwill to Related Companies

This measure will affect:

- individuals
- trustees
- members of partnerships

who transfer their business to a close limited company in relation to which they are a “related party” and receive consideration in the form of cash or debt.

The changes are intended to mean that entrepreneurs’ relief (ER) will not be available to reduce CGT on disposals of the business’s goodwill to a close company to which the seller is related. Legislation will therefore be introduced in Finance Bill 2015 to amend the rules so as to exclude goodwill from the definition of “relevant business assets”. As a result, gains on disposals of goodwill to a close company by an individual who is a “related party” will be charged at the normal rates of CGT (subject to other reliefs).

This change is made alongside a measure to restrict corporation tax deductions when goodwill is acquired from a related party on incorporation.

The measure will apply to disposals of goodwill to a related close company on or after December 3, 2014, and will merit the attention of any U.K. LLPs that are in the process of/considering converting to limited company status in light of this year’s “mixed membership” rules.

Research and Development (R&D) Tax Credits

The government is to increase the rate of the “above the line credit” from 10 percent to 11 percent and will increase the rate of the small and medium enterprise (SME) scheme from 225 percent to 230 percent, from April 1, 2015.

Perhaps of equal help to alternative asset managers, who may have been put off claiming the relief by tales of industry peers having to (metaphorically, we understand) grapple with Her Majesty's Revenue & Customs inspectors enquiring, some years later, into whether R&D has taken place at all, the government will also introduce an advanced assurance scheme for small businesses making their first claim. The government has also undertaken to develop new guidance in respect of R&D tax credits.

The government is to also launch a consultation on the issues faced by smaller businesses when claiming R&D tax credits in January 2015.

Simplification of the Administration of Employee Benefits and Expenses

As announced at Budget 2014, the government will simplify the administration of employee benefits and expenses.

From April 2015 the government will provide a statutory exemption for trivial benefits in kind costing less than £50. From April 2016, the government will remove the £8,500 threshold below which employees do not pay income tax on certain benefits in kind and replace it with new exemptions for certain occupations/vocations. The government will also exempt certain reimbursed expenses and introduce a statutory framework for voluntary payrolling.

The new exemption for reimbursed expenses will not be available if used in conjunction with salary sacrifice.

Modernizing the Taxation of Corporate Debt and Derivative Contracts

Following the review announced at Budget 2013, the government will make wide-ranging changes to update, simplify and rationalize the legislation on corporate debt and derivative contracts. The Chancellor has stated that this will include a clearer and stronger link between commercial accounting profits and taxation, basing taxable amounts on items of accounting profit or loss. It will also include the introduction of a new relief for companies in financial distress and new rules to protect the regime against what the government considers tax avoidance.

Alternative asset managers should monitor these potential changes closely, not least to see if it will finally mean amendments to the current "bond fund" rules.

BEPS and Hybrid Instruments

While these measures may be primarily aimed at multinationals, their scope is much broader and asset managers should continue to closely monitor developments in the Base Erosion and Profit Shifting (BEPS) arena.

For example, the U.K. government has announced a consultation on the use of hybrid entities so as to implement the OECD's rules on mismatch arrangements. The U.K.'s anti-hybrid rules will be introduced with effect from 1 January 2017 with no grandfathering for existing structures. The detail in the consultation document will assist asset managers in assessing the impact of these new rules on their current fund structures and investments.

Withholding Tax Exemption for Private Placements

The government will provide for a new exemption from withholding tax on interest on qualifying private placements to help unlock new finance for businesses and infrastructure projects.

Peer to Peer Lending

Peer to Peer (P2P) lending is an increasingly popular proposition for alternative asset managers, and the Autumn Statement announces support for this activity, as well as crowdfunding platforms, through a package of measures intended to remove barriers to their growth from regulation and tax rules.

The U.K. tax proposals include:

- a new bad debt relief for lending through P2P platforms
- a consultation on whether to extend Individual Saving Account eligibility to lenders using crowdfunded, debt-based securities
- Withholding tax relief

The U.K. government will consult on the introduction of a withholding regime for income tax to apply across all P2P lending platforms from April 2017. The intention is to help many individuals to resolve their tax liability without them having to file for Self-Assessment. Given the range of structuring techniques available such that withholding tax does not arise already, this change may be of limited interest to alternative fund managers lending through P2P programmes.

Share Capital Reductions in Takeovers

The government will, by early 2015, bring forward amendments to section 641 of the Companies Act to prohibit reductions in share capital by target companies in takeovers conducted using schemes of arrangement in order to protect the stamp tax base.

Application of Stamp Duty Land Tax on Certain Authorised Property Funds

As part of the Investment Management Strategy, the government intends to introduce a seeding relief for property authorised investment funds (PAIFs) and co-ownership authorised contractual schemes (CoACSs) and intends to make changes to the SDLT treatment of CoACSs investing in property so that SDLT does not arise on the transactions in units, subject to the resolution of potential avoidance issues. Any changes will be legislated for in Finance Bill 2016.

Taxation of Resident Non Domiciliaries – Remittance Basis Charge

The annual charge paid by non-domiciled individuals resident in the U.K. who wish to retain access to the remittance basis of taxation will be increased. The charge paid by people who have been a “U.K.-resident” for 12 out of the last 14 years will increase from £50,000 to £60,000. A new charge of £90,000 will be introduced for people who have been a “U.K.-resident” for 17 of the last 20 years. The government will also consult on making the election apply for a minimum of three years.

The charge paid by people who have been a "U.K.-resident" for seven out of the last nine years will remain at £30,000.

Social Investment Tax Relief (SITR) – Enlarging the Scheme

The government is to seek European Union approval to increase the investment limit to £5 million per annum per organisation up to a maximum of £15 million per organisation and to extend the relief to small-scale community farms and horticultural activities.

The changes will come into effect on or after April 6, 2015, subject to European clearance.

The government also intends to make special purpose vehicles for subcontracted and spot-purchase social impact bonds eligible for SITR, through secondary legislation in autumn 2015.

The government will also consult early in 2015 on introducing a social Venture Capital Trust in a future finance bill.

Capital Gains Tax – ER

The government will allow gains which are eligible for ER, but which are instead deferred into investments which qualify for the Enterprise Investment Scheme (EIS) or SITR, to remain eligible for ER when the gain is realised. This will benefit qualifying gains on disposals that would be eligible for ER but are deferred into EIS or SITR on or after December 3, 2014.

And finally. . .

While not exclusively affecting U.K. based alternative asset managers, this announcement will generate many headlines (having already sparked heated debate in our London office) and so we have agreed to include it here.

The government will change the calculation of SDLT on purchases of residential property so that rates apply to the portion of the purchase price within each band, rather than the previous "slab system". The government will also amend the rates and thresholds so that the portion of the transaction value:

- up to £125,000 is charged at a rate of 0 percent
- the portion between £125,001 and £250,000 is charged at a rate of 2 percent
- the portion between £250,001 and £925,000 is charged at a rate of 5 percent
- the portion between £925,001 and £1,500,000 is charged at a rate of 10 percent and
- the portion over £1,500,000 is charged at a rate of 12 percent

These changes will take effect on and after December 4, 2014, although the Chancellor announced in his statement[2] that those who have already exchanged, but not completed, can choose the regime under which they wish to pay.

[2] And confirmed by the document found at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382420/sdlt-guidance-note.pdf

Contact Information

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