Client update
Five things that you need to know about the UK Government's Autumn Statement

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The Chancellor of the Exchequer gave his Autumn Statement yesterday in anticipation of his final Budget before the General Election next year. Amidst the good news, he announced a package of anti-avoidance and other revenue-raising measures, a number of which were unexpected and others which were predictable (notably those which follow the initiatives being led by the OECD). Some of the measures take effect immediately, some next April and others further in the future. We summarise below those which are likely to be of most relevance to our clients and friends.

TAXATION OF INVESTMENT MANAGEMENT FEES

The UK Government has announced a change in the way that investment management fees will be taxed in the hand of UK taxpayers. Information at this stage is fairly limited and we are awaiting the draft legislation, which has been scheduled for publication on December 10, 2014.

The new regime will be introduced effective from April 6, 2015, with the aim of ensuring that sums which arise to investment fund managers for their services are charged to UK income tax as trading income rather than under the more favourable capital gains tax regime. The justification for this change is that the management fee is in respect of work undertaken to manage the investment and is not dependent on investment performance and so trade-like in its nature.

The UK Government has stated that the new rules will "*affect sums which arise to managers who have entered into arrangements involving partnerships or other transparent vehicles, but not sums linked to performance, often described as 'carried interest', nor returns which are exclusively from investments by partners*." Given the limited information available prior to seeing this legislation, we do not propose any immediate action be taken.

ABOLITION OF THE LATE INTEREST RULES

Prior to yesterday's announcement, interest and similar costs on corporate debt, whilst generally deductible on an accruals basis for UK corporation tax purposes, was in certain circumstances deductible only when paid. Originally this was an anti-avoidance rule and was designed to prevent interest being deductible if not also taxable in the UK at the same time in the hands of the creditor. It therefore applied, for example, if the creditor was outside the charge to UK corporation tax or not subject to tax in another jurisdiction. Since the UK tax rules relating to the payment of interest treat both cash payment and "payment in kind" as amounting to payment for these purposes, advantage has been taken of the "late interest" rule to control the timing of the UK tax deduction for the interest (by triggering an interest payment in cash or PIK) so that it could be used as effectively as possible in acquisition structures used in LBOs and similar types of transactions. This rule is now being abolished with effect from yesterday, subject to transitional rules for existing loans which in general preserve the old rules for interest accruing until the end of 2015.

CONSULTATION ON HYBRID MISMATCH ARRANGEMENTS

In 2013, the OECD and G20 adopted a 15-point Action Plan to tackle a range of practices known as base erosion and profit shifting (which has spawned the initialism "BEPS"). BEPS refers to tax planning which takes advantage of mismatches between the tax systems of different countries in order to produce untaxed profits (base erosion) or the shifting of profits into lower tax jurisdictions (profit shifting).

The aim of the Action Plan is to develop a coordinated global approach to ensure that profits are taxed where the economic activities generating profits are performed. Amidst the various actions, which include preventing treaty abuse and a revisioning of the permanent establishment concept, is an action that proposes measures to prevent hybrid mismatch arrangements. A hybrid arrangement involves either:

- a hybrid instrument, such as an instrument which provides a debt-like return in the country of issue but an equity-like return in the holder's jurisdiction (for example a Luxembourg CPEC); or
- a hybrid entity which is an entity that is treated as transparent in one country but opaque in another (for example by reason of having made a check-the-box election for US tax purposes).

The concern around the use of hybrids is that they may give rise to tax deductions without corresponding income receipts or double deductions. As

part of the Autumn Statement, the UK Government has published a consultation about how it will progress the fight against hybrid mismatch arrangements, which will be in two parts:

- Rule A will deny a UK tax deduction where there is a deduction/no-inclusion outcome and will also deny a deduction where there would otherwise be a double deduction; and
- Rule B will be a fallback rule, applying where the counterparty jurisdiction does not have hybrid mismatch rules or where Rule A does not apply, so that the payment will be included as ordinary income of the UK payee.

The key points to note in the consultation document are:

- where arrangements are entered into between related parties there is no purpose test, instead the rules apply mechanically;
- where there is no tax avoidance motive, the proposed rules are curtailed by the requirement that the entities involved are related parties. The UK Government has adopted a slightly narrower definition of related parties than expected, which was one of the recommendations made by the BVCA in its representations to the OECD on this issue earlier this year;
- the UK Government has proposed an exception for hybrid arrangements which are used to achieve only timing differences of up to five years – this may help arrangements set up to overcome the issue of phantom income for investors in jurisdictions like the US, which taxes on an accruals basis;
- the UK government is consulting on whether mismatch arrangements entered into by UK LLPs should result in the LLP's being treated as opaque for all purposes; and
- mismatch arrangements involving different rates of tax are outside the scope of these rules.

The consultation will run until February 11, 2015 and it is expected that the new UK legislation will take effect from January 1, 2017. It is anticipated that there will be a transitional period allowing for the unwinding of arrangements but no grandfathering provisions.

STAMP DUTY ON UK TAKEOVERS

Takeovers of UK public companies are frequently structured as schemes of arrangement in order to eliminate potentially significant stamp duty costs on acquisition of the target company's shares (0.5% of the value of the amount paid in cash or securities). Rather than transferring the target company's shares to

the acquiring company, a statutory procedure requiring court approval is used whereby the target's shares are cancelled and new shares are issued to the acquiring company. At present, no stamp duty is payable if the transaction is structured in this way. However, the UK Government has stated that takeovers using schemes of arrangement should be treated in the same way as a conventional acquisition for stamp duty purposes and that it will therefore amend the Companies Act to prohibit reductions in share capital by target companies in takeovers conducted using schemes of arrangement. This means that any scheme of arrangement will have to be structured as a share acquisition subject to stamp duty. Regulations bringing this into effect are to be introduced by early 2015.

TAXATION OF RESIDENT NON-DOMICILES

Individuals who are resident but not domiciled in the UK are able to elect to pay tax on the remittance basis, so that any income and gains arising offshore are only taxable as and when they are brought into the UK. These individuals, if resident on a long-term basis, must pay an annual charge in order to be taxed on this basis. The UK Government has now announced plans for such individuals to pay a higher charge when they have been living in the UK for an extended period of time. The charge paid by a non-domiciled individual resident in the UK for seven of the last nine years will remain unchanged at £30,000; however, for such an individual resident in the UK for 12 of the last 14 years, the charge will increase from £50,000 to £60,000. Furthermore, a new charge of £90,000 will be introduced for a non-domiciled individual resident in the UK for 17 of the last 20 years. The UK Government will also consult on extending the annual election for taxation on the remittance basis to apply for a minimum of three years.

NEXT STEPS

We shall issue a more detailed briefing note on these issues following publication of the relevant draft legislation. In addition, on December 16, 2014 we are hosting a breakfast briefing session in London and a video conference meeting later in the day for US clients. Please do get in touch if you would like to attend either session.

Any member of our UK tax team would also be very happy to discuss any concerns you may have.

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Please do not hesitate to contact us with any questions.