

CLIENT UPDATE

SOME PRELIMINARY OBSERVATIONS: IMPACT OF THE REFERENDUM ON SCOTTISH INDEPENDENCE ON PRIVATE EQUITY AND OTHER ALTERNATIVE ASSET MANAGERS

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Tomorrow, Scotland votes in a referendum on independence. The outcome of the vote is far from certain, but whichever way the vote goes, there will be significant long-term economic, political, tax and legal impacts, including impacts (1) on private equity firms and other managers of alternative investment funds (“AIFs”) doing business in Scotland and (2) on AIFs (or their general partners) organized under Scottish law.

It is far too early for us to discuss any of these issues in detail. For example, in the event of a “yes” vote, no one knows for certain what currency an independent Scotland would adopt or what its relationship would be with the EU. Still, we thought you might be interested in our preliminary thoughts on the tax and legal issues likely to impact private equity firms and funds, and other AIFs and their managers, whatever the outcome of the referendum.

TAX ISSUES

If Scotland votes “no” on Thursday and remains part of the United Kingdom, Scotland will nevertheless receive additional taxing powers by 2016. For example, the Scottish parliament will have the power to set a new Scottish income tax on top of the UK government income tax.

If Scotland votes “yes” for independence, independence will begin no earlier than 2016. At that time, certain taxes could be increased (or

not), thereby impacting the tax burden on Scottish entities or firms doing business there. Independence could also result in adverse tax implications to existing fund structures simply as a result of Scotland becoming a separate taxing jurisdiction. For example, those fund structures that rely on VAT grouping between the general partner and manager of the fund may no longer be able to do so, there may be withholding tax implications on cross border payments, and new tax treaties may need to be negotiated between Scotland and other jurisdictions (including the UK). Much will also depend on whether Scotland is required to leave the EU, even if only for a temporary period.

REGULATORY AND OTHER LEGAL ISSUES

If there is a “no” vote on Thursday and Scotland remains part of the UK, it is proposed that more powers (in addition to the taxing powers discussed above) will be devolved to the Scottish parliament. It is difficult to know at this early stage what powers might devolve and how they might be used; there is currently little detail on this. But the general promise of additional legislative powers is one approach being used to encourage the Scots to vote “no”.

If the vote on Thursday is “yes”, then as a general matter an independent Scotland would presumably need to enact its own laws to replace all the UK laws that currently apply in Scotland, including, for example, the UK Companies Act, the UK Partnership Act and Limited Partnership Act, and the UK Financial Services and Markets Act. Additionally, Scotland would also have to negotiate with other countries a number of treaties that would cease to apply to Scotland once it became independent. An independent Scotland would also have to set up its own regulatory infrastructure, including regulatory bodies for energy, financial services, competition, consumer protection, rail, telecoms and pensions, and all of these could result in changes to the current UK position.

If and when Scotland has separated from the UK, any fund managers/advisers in Scotland that are currently authorised by the UK FCA and/or PRA would presumably need to be regulated by a new Scottish equivalent entity (which may impose different capital adequacy requirements, rules on remuneration and conduct of business rules). Transitional arrangements may be agreed, but this is not yet clear. In addition, Scotland would need to enact its own laws equivalent to the current UK “financial promotion” rules and its own rules to determine what activities are to be regarded as regulated under Scottish law.

It seems unlikely that Scotland, as an independent country, would be able to remain a member of the EU without any further action on its part. Assuming that is correct (and

there is some uncertainty on the point), if Scotland wished to remain in the EU, it would have to apply for membership of the EU. That application process would take time and there is no certainty that such an application would be successful.

If an independent Scotland was not part of the EU, this would have an impact on the current application of EU Directives to entities in Scotland. In particular, from a funds viewpoint in respect of the AIFMD, private equity funds and other AIFs established in Scotland or that have general partners in Scotland could no longer be EU-AIFs, and fund managers established in Scotland would not currently be eligible to be authorised under the AIFMD. Further, Scottish managers/advisers would not be able to benefit from the MiFID “passport” to provide their services across EU member states (and conversely other EU members would presumably not be able to passport their services into Scotland). Similarly, the UCITS regime would not apply to Scottish managers or funds. There might be transitional arrangements agreed with the EU for any period between Scotland formally separating from the UK until an EU membership application from Scotland had been considered, but that is currently unclear

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We look forward to learning and sharing more as events unfold in Scotland. Please do not hesitate to contact us with any questions.

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