Client Update
Tax Skirmishes for UK Investment Professionals

Fans of zombie horror will recognise the pattern: horrible events occur, followed successively by denial, flight to safety, and then acceptance of the new reality. Once in a safe place, inevitably complacency is followed by infiltration and attack and the process repeats.

A similar pattern has played out with the changes over the past few years in the UK tax rules affecting investment professionals. In quick succession came the disguised investment management fee rules, the carry rules, the income based carry rules and overlaying it all, the deemed domicile rules. The new reality had been settled for some months and therefore it was with some trepidation that we faced today's budget. In the story arch, an attack was due; and Budget Day brought with it a number of skirmishes.

CARRIED INTEREST

This one was stealthy, but not devastating to the industry as a whole: hidden in the papers accompanying today's UK budget is a proposal that removes certain transitional rules applying under the carried interest rules.

- As of today, carried interest arising to an investment professional that is attributable to a disposal of partnership assets made before July 2015, when the carried interest rules were introduced, is nevertheless taxable under the new rules (*i.e.*, with no base cost shift and subject to split sourcing for UK non-doms). This appears to be HMRC's response to some people claiming that carried interest arising in respect of whole fund carry, where some of the fund's investments had been disposed of prior to July 2015, fell within the transitional rules. Although HMRC had issued a written opinion that this interpretation was not correct, this change in legislation makes the position irrefutable. Investment professionals with carry relating to pre-July 2015 disposals that is held in escrow are collateral damage in this assault and will now receive such carry subject to the carried interest rules.
- HMRC appears to be concerned that the existing carried interest rules do not catch carried interest transferred to trusts and similar structures prior to the commencement date of the

carried interest rules and has moved to clarify that the rules do apply where an investment professional still "enjoys" such carried interest. These changes also have immediate effect.

- In the summary of impacts, HMRC estimates that this will increase the Exchequer's income by, a not insignificant, £650m over the next six years, which suggests that this will impact the industry.

REAL ESTATE INVESTMENT

A consultation has been launched on the tax treatment of gains accruing on disposals of interests in UK immovable property by non-residents. If the proposals are implemented, all gains arising on disposals of interests in UK land and buildings after April 2019 will become chargeable to UK tax, regardless of the residence of the person making the disposal.

There will also be a charge on the indirect disposals of UK immovable property (*i.e.*, the sale of an entity (or group) where at least 75% of the gross asset value of the entity at disposal is directly or indirectly derived from UK land). A seller is caught by the rules once they have held at least a 25% interest in the entity during the five years prior to disposal.

The impact of the proposed changes is ameliorated by the rebasing of value as of April 2019, so that only gains accruing after April 2019 are taxable. However, if the rebasing would increase the seller's taxable gain the rebasing election can (except in relation to indirect disposals) be revoked.

Application of these rules to collective investment schemes is being specifically considered; obviously, the impact to real estate funds could be significant.

We note that the scope of this proposal is limited somewhat by the UK's wide tax treaty network, meaning that these proposals will not apply to all holding structures (for example, it appears that Luxembourg holding companies may be outside the scope).

DISGUISED REMUNERATION

The employment income tax rules relating to disguised remuneration were extended this year to apply, in some circumstances, to partners. In the budget today, some tweaks to these rules were announced. A full technical briefing is promised on 1 December and we will publish a client update following such publication.

EMPLOYMENT STATUS CONSULTATION

As advance warning, in 2018 the government will publish a consultation considering options for reform to make clearer the employment status tests for both employment rights and tax purposes. This follows an independent review (the "Taylor Review") of modern working practices published in July of this year which considered, in particular, the implications of new forms of work on worker rights and responsibilities, and set out seven principles to address the challenges facing the, increasingly complex, UK labour market.

From a tax perspective, key points considered in the Taylor Review included:

- making the taxation of labour more consistent across employment forms by addressing, for example, the difference in national insurance treatment of employees versus the self-employed;
- addressing the lack of consistency between employment status for employment rights and tax law purposes; and
- aligning the two frameworks and being clearer about how to distinguish between what the Taylor Review suggested calling "Dependent Contractors" (people who are eligible for worker rights but who are not employees) from those who are legitimately self-employed.

Partners in UK-based LLPs may well be impacted by the results of this consultation and should watch this space.

BEPS: MULTILATERAL INSTRUMENT

No UK budget would be complete without a reference to BEPS: Base Erosion and Profit Shifting. The global nature of the BEPS project results in hundreds , if not thousands, of double tax treaties needing to be amended. Pragmatically, the OECD recommended that an overarching multilateral instrument be entered into between participating countries to blanket implement the necessary changes, in particular, including minimum standards to be implemented by participating countries in order to prevent treaty abuse and improve dispute resolution.

The multilateral instrument announcement included in the Autumn 2017 Budget is, above all, a technical measure amending the UK's existing statutory powers to give effect to the multilateral instrument, thereby amending the 117 double tax treaties notified by the United Kingdom to the OECD.

This change is very relevant to the funds industry because funds rely so heavily on double tax treaties to obtain relief from withholding taxes on investment and the multilateral instrument brings into play a new anti-abuse provision. For more details *see* https://www.debevoise.com/insights/publications/2017/07/treaty-benefits-in-a-fund-context.

For more information about BEPS, including our animated explainer videos, please *see* www.Debevoise.com/BEPS.

INVESTMENT MANAGEMENT STRATEGY

In, what may seem a strange sentiment to those working in the industry, who are feeling a little battered by recent UK tax changes, the budget statement contains a paragraph stating that "[t]he government will publish a new long–term strategy to ensure that the UK asset management industry continues to thrive and deliver the best possible outcomes for investors and the UK economy. This will include actions, to be taken forward in close collaboration with the industry, on skills, harnessing financial technology solutions, mainstreaming innovative investment strategies, and continuing a coordinated programme of international engagement." This is certainly something to look out for.

WHAT NEXT?

The Finance Bill is published on 1 December and we will publish a further update if anything new arises in that.

Finally, if these latest attacks leave you wanting to flee for safety, Wales is available to you for free next year when the, outrageous, Severn Bridge toll will be abolished.

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Please do not hesitate to contact us with any questions.

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