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TAX & INVESTMENT FUNDS UPDATE

Winter Tax Update: United Kingdom and Europe

During the last quarter of 2014 there were a series of announcements and developments in relation to both UK and EU taxation. As we move into 2015, we thought it would be helpful to pull together a summary of the more important aspects of these developments and to explain how, and why, they may be relevant to your business and operations in the coming months and years.

For ease of understanding, we have split the update into two; those developments which are specific to the UK tax regime, and those developments which have a wider EU or international application.

UK Tax Developments

Proposed new anti-avoidance rules for investment management fees

In December 2014 the UK Government announced a proposal to introduce a set of new anti-avoidance provisions which are aimed at the taxation of management fees arising to UK investment managers.

The genesis of the proposed new rules appears to be an intent on the part of the UK Government to limit the circumstances in which a return to UK based investment managers for the provision of investment management services (see further below) is not brought into charge to UK income tax and national insurance.

In very broad terms, the proposed new rules would be relevant to arrangements whereby: (i) a UK based individual performs "investment management services" (this is drawn very broadly and includes seeking funds, undertaking research and making investments); and (ii) a fee arises to the individual through a structure involving at least one partnership and such fee is not, in broad terms, brought into charge as income with respect to that individual. To the extent that the rules apply, the fee would be treated as trading income of the individual, with the consequence that it would be treated as an income receipt, rather than a capital receipt, in the hands of the individual.

The proposed new rules would not apply to a fee in circumstances where the fee: (i) is considered to be "carried interest" (see further below); (ii) represents a return or repayment of an investment made by the individual; or (iii) constitutes a "commercial return" on an investment made by the individual. The fee would be seen as "carried interest" only if, in broad terms, a 6% preferred return had already been paid to participants in the underlying investment.

Although subject to an ongoing public consultation, the new rules are proposed to be effective with respect to any fees arising on or after April 6, 2015 (with no grandfathering in respect of existing arrangements).

Although this would appear to be more relevant to the traditional private equity structures, given the varied ways in which investment funds provide compensation, the very wide scope of the proposed new rules could potentially be of significant relevance to a range of managers.

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UK Government transparency initiative and application to UK LLPs

As part of the UK's ongoing drive for greater transparency, the UK Government has been undertaking a consultation with respect to: (i) the establishment of a public register of interests in UK companies; and (ii) a prohibition on the use of corporate directors in UK companies. Although not a technical tax issue, this initiative has been of particular interest to UK based managers due to the impact such developments could have on any existing management structures involving corporate members in UK limited liability partnerships (LLPs).

In November 2014 the UK Department of Business, Innovation and Skills (BIS) published a discussion paper inviting comments on the circumstances in which the use of corporate directors of UK companies (including LLPs) should be permitted (the BIS Paper). Importantly, the BIS Paper states that there is currently no strong case to prohibit the appointment of corporate members to LLPs, since such a restriction would have the effect of hampering investment in LLPs.

Whilst we do not anticipate any restrictions being placed on the use of corporate members of LLPs in the short- to medium-term, the consultation process should be monitored for potential adverse policy developments.

UK country-by-country information reporting

On September 20, 2014 the UK Government announced that it would implement the country-by-country reporting template developed by the Organisation for Economic Co-operation and Development (OECD), as published in September 2014. Further to this, the 2014 Autumn Statement included measures for the introduction of mandatory country-by-country reporting by multinational entities with a parent company in the United Kingdom (MNEs).

Under the new measures, MNEs will be required to report to HMRC: (i) the amount of revenue and profit earned in each jurisdiction in which they carry on their business; (ii) the tax paid on such profits, and (iii) details of any assets and capital held in each such jurisdiction.

The measures are currently expected to take effect in the summer of 2015. We note this development as it could be of interest to managers who, for example, maintain investment structures with UK corporate holding companies.

Recent EU and International Tax Developments

U.S. and UK: FATCA reporting

U.S. FATCA

UK-resident financial institutions (UK FIs) subject to the reporting obligations arising under, or in connection with, the Foreign Account Tax Compliance Act (FATCA)[1] are required to submit their first FATCA return to the UK tax authority (HMRC) by May 31, 2015 (and on May 31, each year thereafter).

However, in order to be in a position to submit the FATCA return to HMRC there are a number of administrative steps that need to be taken by UK FIs, including: (i) registering with the U.S. Internal Revenue Service (IRS); (ii) obtaining a Global Intermediary Identification Number (GIIN) from the IRS; (iii) establishing and activating an account with the HMRC online services portal; and (iv) completing the HMRC FATCA registration process.

Although these are largely administrative steps, the timeline for completion of these steps should be borne in mind. For instance, the IRS is currently processing applications for registration, and issuing financial

[1] For a more detailed explanation of FATCA, please click here.

institutions a GIIN, within two weeks, and it can take several weeks to establish and activate an account with the HMRC online services portal.

UK FATCA

Separately, non-UK financial institutions (Non-UK FIs) that are registered in jurisdictions that have entered into intergovernmental agreements with the United Kingdom (for example, the Cayman Islands) may need to register with the relevant taxing or monetary authority of such jurisdiction. The registration deadline in such jurisdictions may be earlier than May 31, 2015. For instance, we understand that Cayman financial institutions are required to register with the Cayman Islands Tax Information Authority by March 31, 2015 in order to meet the current reporting deadline of May 31, 2015.

Accordingly, it is important that all financial institutions (whether UK FIs or Non-UK FIs) assess their current position and take all necessary steps to ensure that they are in a position to comply with their reporting obligations arising under, or in connection with, FATCA.

EU: financial transaction tax update

Following a meeting of the Council of the European Union (the Council) on December 9, 2014, the Presidency of the Council provided an update as to the status of the proposed EU financial transaction tax (FTT).[2] In summary, the Presidency of the Council noted that further work is required with respect to the following areas:

- the extent to which derivatives fall within the scope of the FTT;
- the taxation principles for transactions in shares and derivatives;
- the taxation principles underlying the FTT (for instance, whether the residence and/or the issuance principle should be applied); and
- the tax collection mechanism to be used.

The timing for the introduction of the FTT (if introduced at all) remains uncertain. Although the Italian Presidency of the Council had hoped that agreement would be reached in 2014, this did not materialize.

Notwithstanding, there appears to continue to be a level of political will amongst the 11 participating member states to introduce the FTT in 2015. On January 5, 2015, the President of the French Republic, François Hollande, was reported as stating that he had requested the French Finance Minister to *"call a meeting of the Finance Ministers of the 11 countries in January, to put the FTT into place. We must tax all financial products at a low rate, and the tax base must be as broad as possible."*

EU: amendment to EU Parent-Subsidiary Directive

On December 9, 2014 the EU Council announced that it has agreed to introduce an anti-abuse clause into the EU Parent-Subsidiary Directive (the PSD). The new clause will require EU Member States to refrain from granting the benefits of the PSD to an arrangement or a series of arrangements that are not genuine (*i.e.* not put into place for valid commercial reasons which reflect economic reality) having regard to all of the circumstances, and such arrangements have as their main or one of their main purpose the obtaining of a tax advantage which defeats the object or purpose of the PSD.

EU Member States will have until December 31, 2015 to transpose the anti-abuse clause into national law. The same deadline applies for the transposition of the amendments to tackle hybrid loan mismatches.[3]

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[2] For a more detailed explanation of the scope of the FTT, please click here.

[3] For a more detailed explanation of the amendments to the PSD to address hybrid loan mismatches, please click here.

This development is potentially of interest to any fund structure which utilizes an EU based entity to facilitate the tax efficient repatriation and/or circulation of returns.

OECD: exchange of information

In February 2014, as part of the OECD base erosion and profit shifting (BEPS) project, the OECD published its standard for automatic exchange of financial information, referred to as the common reporting standard (CRS).

As has been widely reported, the CRS creates a framework for participating jurisdictions to obtain information from financial institutions established in their jurisdiction, and for the automatic exchange of such information with other participating jurisdictions on an annual basis. The CRS sets out the financial information to be exchanged, the financial institutions that need to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions. The due diligence and reporting requirements are broadly similar to those arising under, or in connection with, FATCA.

On October 29, 2014, 51 jurisdictions signed a multilateral framework agreement (the Multilateral Competent Authority Agreement on Automatic Exchange of Information (the MCCA)) which gives effect to the CRS. In order for the MCCA to become operative, bilateral agreements will need to be concluded between the relevant participating jurisdictions and local legislation may need to be passed to provide the domestic legal framework. In terms of timing, of the 51 signatories to the MCCA, 47 have committed to work towards the first exchanges of information by September 2017.

Separately, on October 14, 2014 EU Finance Ministers reached an agreement to incorporate the CRS directly into EU law through an amendment to the EU Administrative Co-operation Directive. By doing so, EU Member States will automatically be required to collect and exchange financial information to at least the standard prescribed in the CRS, without the need for bilateral agreements between such EU Member States. It is currently anticipated that the first automatic exchange of information between EU Member States (with the exception of Austria, which has requested a transitional year) will take place by September 2017.

In light of this development, the European Commission has dropped its plans to amend the EU Savings Directive and, instead, is considering repealing this Directive.

If you have any questions regarding this update, please contact the following or the Sidley lawyer with whom you usually work.

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