Fund Manager Tax Checklist

WHAT SHOULD BE ON YOUR RADAR?

Introduction

The tax landscape for funds has never felt more complex and there is still more change to come.

Brexit is obviously high on fund managers' agendas and, although an asset manager's response to Brexit will be driven by regulatory factors – passports, equivalency, marketing and cross-border management – these decisions are likely to have significant tax implications too. But putting Brexit aside, we thought it would be helpful to produce a check-list of some of the other tax issues which fund managers should have on their radar as we approach the end of 2016. If the Chancellor announces changes in tomorrow's pre-budget report, then we will update the checklist.

How can we help?

We are currently working with clients on all matters in this checklist, helping them to consider, for example:

- the potential application of the BEPS principal purpose test to structures which are treaty-reliant
- the impact from April 2017 on deductibility for UK portfolio companies owned by structures which might include hybrids
- their first tax returns under the new DIMF and 2015 carried interest rules

If you need guidance on any of these matters, please do get in touch. Our contact details are at the end.

BEPS (and Brexit)

	INTRODUCTION	WHAT SHOULD YOU BE DOING NOW?	WHAT SHOULD YOU BE DOING OVER THE NEXT FEW MONTHS?
Treaty reliance (BEPS6)	The OECD has proposed that jurisdictions amend their tax treaties so that only persons which satisfy a principal purpose test ('PPT') or a limitation on benefits clause can rely on the convention. The PPT looks like the forward option for many jurisdictions at present.	Funds should have a good sense of which entities in their structures are treaty-reliant, and the extent (quantum) of that reliance. They should also understand whether their structures have more than one layer of protection (for example, debt might also be structured as a listed Eurobond) and whether these additional safety nets may be vulnerable when the UK leaves the EU (for example, where the extra comfort comes from an EU directive such as the Parent-Subsidiary directive).	If a fund is heavily treaty-reliant, now is the time to consider whether this is robust in a post-BEPS environment. Funds are unlikely to be able to conclude on this point yet, but the PPT will look at why the vehicle has been set up in the relevant treaty jurisdiction so a consistent narrative is most important. Footprint, functionality and investor identity may all play a part. It isn't just a numbers game but, if functionality and footprint are light, funds may want to consider their options for strengthening them and understanding the potential lead-time needed to do so.
Interest deductibility (BEPS4)	It is just possible that we may have a pleasant surprise in the pre-budget report on Wednesday if the Chancellor announces that the limitations on interest deductibility are to be delayed. This would bring the position into line with other EU nations that are not required to implement this measure until 31 December 2018. But don't hold your breath... HMT / HMRC have showed no sign that they will move on timing. If they do not, then the interest deductibility rules will come into force on 1 April 2017.	For existing portfolio companies, funds should have modelled the impact of the 30% EBITDA interest restriction on returns from UK companies and have identified which portfolio companies will fall under the group-wide £2 million annual de minimus threshold. The exact impact of the group ratio rule will need to be considered once the detail emerges. The other unknown is the extent to which the corporation tax rate will fall over the next few years: a rate of 15% (as suggested by George Osborne) would result in considerably less pain.	Any modelling developed for UK companies will need to be rolled-out for other EU jurisdictions because the EU Anti Tax Avoidance Directive will require member states to adopt similar rules by 31 December 2018. When the draft UK legislation is published (which we hope will be in the next month or so), portfolio companies / funds will need to dive into the detail, focusing their attention of those companies with the most to lose. For new investments, some funds now have a greater focus on equity. Funds should be developing a preferred approach: dividends may be taxed at lower rates than interest, but equity comes with down-sides too including potential restrictions on repatriating funds under the AIFMD and the need for distributable reserves for a share buy-back, causing difficulties if the group has losses (in particular, vehicles which cause dividend blockers). Despite the interest restriction, funds may not want to give up being creditors.
Hybrid rules (BEPS2)	The (exceptionally complex) UK hybrid rules will come into force on 1 January 2017 (2 years ahead of our EU counterparts). UK portfolio companies have started to ask funds for confirmation that there is nothing about the fund structures, instruments or investors which could result in a denial of tax deductions for the company.	If UK portfolio companies are paying interest or royalties up-the-chain to fund entities and those fund entities or feeder vehicles or instruments could be hybrids (even where outside the UK), funds will need to analyse the UK rules to ensure that their existence or effect does not inadvertently result in a denial of a deduction. Be warned – this is not an easy job.	Although the UK rules need to be the immediate focus, other EU countries will implement hybrid rules in relation to intra-EU hybrids under the EU's Anti Tax Avoidance Directive. The European Commission has published a draft directive which, if enacted, would extend those rules still further (so that they cover EU / third country interactions) on a similar time-frame.
Permanent Establishment – extended definition (BEPS7)	The OECD proposes that the definition of a permanent establishment is extended to include agents which "habitually play the principal role leading to the conclusion of contracts". At the same time, the definition of an "independent agent" is narrowing. These new definitions are likely to be included in the multi-lateral instrument which will amend treaties and which is intended to be open for signing by 31 December 2016. This reform has been welcomed by a number of governments so we would expect relatively high levels of sign-up for this measure.	Fund managers should have a strong sense of the roles played by their teams on the ground vs. the role played by the manager. They should consider whether these roles could result in a permanent establishment under the new rules and what steps could be taken to increase functionality and active decision making at the manager level. They should also understand what their fund documents say about creating a permanent establishment – no-one wants a fund or manager to have numerous PEs, but funds need to know whether they have contractually bound themselves to ensure they do not arise.	Once the multi-lateral agreement is published and nations start to sign, fund managers may need to draw up and implement new decision-making protocols. This may involve some internal training to ensure that teams on the ground don't cross the new lines.

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Compliance

	INTRODUCTION	WHAT SHOULD YOU BE DOING NOW?	WHAT SHOULD YOU BE DOING OVER THE NEXT FEW MONTHS?
Tax reporting regimes	Most asset managers are getting used to FATCA and the first reports under the OECD version, the Common Reporting Standard ('CRS'), will be due next year. Also coming online are country -by-country reporting and the requirement on large businesses to publish a tax strategy.	In the UK the first CRS reports must be filed with HMRC by 31 May 2017 so funds should ensure that their investor identification is complete. Country-by-country reporting is already in force for MNE (multi-national enterprise) groups with the first reports due 12 months after the end of the 2016 accounting period. Funds and asset management houses need to be certain whether or not they are out of scope. For example, they might be outside the rules if their consolidated group revenue for an accounting period does not meet the threshold of €750m, or if accounting exemptions mean they are not required to consolidate: fund managers should have already engaged with their auditors to understand the position in relation to their investment fund structures.	The UK's large business tax compliance rules require businesses over a certain size, including partnerships, to publish a tax strategy on the internet before the end of the business' financial year (for accounting periods commencing after 15 September 2016). UK Partnerships will be caught if their turnover in the previous financial year was more than £200 million, or their balance sheet exceeded £2 billion. Funds and fund managers should have already concluded whether they are within scope and so in-scope managers should have started to think about what their strategies should look like. When the first strategies are published towards the end of 2017, there may be considerable media interest.
Client notification obligations	Funds and other reporting financial institutions may be obliged to send notifications enclosing a HMRC factsheet about HMRC's new worldwide disclosure facility to certain UK resident individual account holders. The deadline for sending notifications is 31 August 2017.	Funds and fund managers need to understand the extent of the impact of these rules on them. Some aspects are relatively straightforward (such as identifying UK individual account holders), but other elements are potentially more complex – for example, working out whether they control any overseas person who might also have to comply or understanding whether referrals have been made to other financial institutions (such as custodians or trustees) which can also trigger notification requirements.	Funds and other financial institutions can choose to send notifications either (i) to **all** UK resident **high-value** account holders or (ii) to all UK resident individual account holders where the account in question (most likely the individual's equity/debt interest in the fund) is in a DAC / CRS jurisdiction. The notifications will then need to be sent and the reporting financial institution will also need to take steps to ensure that any controlled overseas persons also make any required notifications.
The corporate criminal offence of failure to prevent the facilitation of tax evasion	This is not an asset manager specific issue, but new rules will come into force next year which can make businesses liable for tax evasion related offences committed by those who perform services for the business unless the business can show that it had reasonable "prevention procedures" in place.	Identifying the extent of the impact on your business – particularly in relation to your relationships with consultants and other agents – not just your employees.	Businesses will want to ensure they have a formal policy in place including a risk assessment of their operational procedures and an action plan for business-wide training, communication, supervision and whistle-blowing. They will need to consider the terms of their contracts with agents and other suppliers and also think about the impact on due diligence when buying / selling investments.

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UK Tax Rules

	INTRODUCTION	WHAT SHOULD YOU BE DOING NOW?	WHAT SHOULD YOU BE DOING OVER THE NEXT FEW MONTHS?
Disguised investment management fee ('DIMF') rules and carried interest	Most fund managers are up-to-speed with the basics of the DIMF rules, but HMRC's approach to their application and to the 2015 carried interest changes (abolition of base cost and new non-dom rules) is starting to emerge.	Identifying amounts which could be DIMF and testing these against the rules / guidance. These might include, for example, profits arising in non-UK management companies and incentives (other than carry) offered to fund executives and consultants. Non-dom fund managers may also need some help in pro-rating their activities between the UK / elsewhere for the purposes of the new remittance rules for carry. Some houses may want to ensure that their non-dom executives take a consistent approach to this.	Keep an eye-out for the final version of HMRC's guidance on the DIMF and carry rules. Start to think about the help that individuals might need in completing their tax returns under the new carry rules – carry receipts now might now be taxed as both income and capital (with credits then needing to be claimed to avoid double tax).
Income based carried interest rules	Still no guidance yet from HMRC on these rules. People are starting to get used to thinking about average holding periods and the language to be included in fund and / or deal documents to help satisfy the conditional exemption and applicable T1/T2 tests.	For fund managers within the scope of these rules (where their carry is not an employment related security), fund managers should have systems in place to track average holding periods and a good understanding of whether – on a deal-by-deal basis – a particular investment is protected by the T1 / T2 mechanic or whether additional tracking is required each time cash is injected.	Look out for guidance from HMRC (although the indication is that this is still some way off).
Corporation tax loss relief	Changes to corporation tax loss relief will restrict the amount of profit that can be relieved by carried forward losses to 50% from 1 April 2017.	General partner entities with profits above the proposed annual allowance of £5m will need to determine whether or not losses accrued from the payment of the management fee in the early unprofitable years of a fund can be fully utilised going forward.	For some fund managers it may be worthwhile looking again at the corporation tax grouping position of the general partner entity with the manager and/or other GP entities to ensure the aggregate position is optimised. However, until the draft legislation is released it is difficult to gauge the full impact on the UK funds industry. Draft legislation is expected in early December 2016 for inclusion in Finance Bill 2017.

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