MACFARLANES

Tax developments impacting private capital managers

February 2024

Start

Tax developments impacting private capital managers

Private capital managers face an ongoing challenge to keep up to date with tax policy developments.

In light of this, we are pleased to present our tax policy monitor aimed at the private capital industry. In this document we set out the key legislative initiatives across the UK, the EU and the OECD. The document summarises the developments and explains the implications for private capital managers.

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We hope that the document provides a useful forward planning function to identify the changes on the horizon in the short, medium and longer-term.

Read more

Jurisdictions

UK

View developments

EU

View developments

OECD

View developments

For each jurisdiction we have colour coded the developments highlighting when action is required to be taken.

- Action likely to be required
- Action should be considered
- Monitor the development, but unlikely that action is required

UK

Other jurisdictions

Action likely to be required

- HMRC updated guidance on foreign entity classification

Action should be considered

- BlueCrest case and application of the salaried member rules to LLPs
- Vermilion case and the application of the “deeming” rule to awards of carried interest
- New tax fraud offence
- Transfer pricing documentation
- New UK-Luxembourg double tax treaty
- UK implementation of Pillar Two (global minimum tax)
- UK mandatory disclosure rules (MDR)

Monitor the development, but unlikely that action is required

- HMRC’s approach to Condition C of the LLP salaried member rules
- BlueCrest case on miscellaneous income
- Carried interest
- Qualifying Asset Holding Company (QAHC) regime updates
- General UK corporation tax changes
- Consultation on VAT treatment of fund management
- Stamp duties on shares consultation – transfer of partnership interests
- Consultation on permanent establishment (PE) rules, transfer pricing and DPT (Diverted Profits Tax)
- Corporate re-domiciliation regime
- Sovereign immunity from tax consultation

UK

Action likely to be required

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Other jurisdictions

HMRC updated guidance on foreign entity classification

Who it affects

Investors, house and house executives.

Further detail

HMRC has updated its guidance on foreign entity classification, in particular its treatment of US LLCs. The change in guidance relates to the Anson case (a Supreme Court decision dating back to 2015 that looked at the UK's treatment of LLCs and found in favour of the taxpayer). At the time, HMRC stated the decision was specific to the facts of the case, however in practice the Anson decision was applied more widely where similar operating terms to those of the LLC in Anson existed. The revised guidance appears to re-open points that were dealt with (and dismissed at earlier stages in the Anson case), in particular, the argument that the profits of an LLC belong to the LLC and do not therefore belong to the member as they arise.

Effect for investment managers

The revised guidance is particularly pertinent to the treatment of profits arising within and distributions from US LLCs and raises the prospect of double taxation for UK tax resident individuals who are members of a US LLC. Taxpayers are now left in a difficult position and will need to consider whether they file their tax return in accordance with the guidance which might result in double tax or continue to file in accordance with the Anson decision (contrary to the revised guidance).

Timing

The guidance was updated on 12 December 2023.

UK

Action should be considered

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Other jurisdictions

BlueCrest case and application of the salaried member rules to LLPs

Who it affects

House and house executives.

Further detail

The Upper Tribunal decision in the BlueCrest case was released on 18 September 2023 relating to LLP salaried member rules. LLP managers will be pleased that it has upheld the FTT decision.

The salaried member rules aim to ensure that only certain members of a LLP are taxed as self-employed individuals.

BlueCrest considered Condition A (variable remuneration) and Condition B (significant influence) although it is the decision in relation to Condition B, which is most illuminating. Condition B is met if the mutual rights and duties of the members of the LLP do not give a member significant influence over the affairs of the LLP.

We understand HMRC have appealed to the Court of Appeal.

Effect for investment managers

The rules have been an area of focus for HMRC in the recent past and we expect them to continue scrutinising taxpayers, looking at all three conditions.

In relation to Condition B, the decision materially broadens the availability of significant influence beyond HMRC's current approach in practice. On Condition B, the test effectively asks whether the firm draws the line between member and employee at an appropriately senior level. If they do, and the significant influence of the member to the financial or operational aspects of the business can be evidenced, based on this decision, they will have significant influence and will not be salaried members.

Managers might also be interested to follow developments on HMRC's approach to Condition C of LLP salaried member rules.

Timing

The decision was released on 18 September 2023.

UK

Action should be considered

Back to UK overview

Other jurisdictions

Vermilion case and the application of the “deeming” rule to awards of carried interest

Who it affects

House, house executives, and investee companies.

Further detail

The decision in the Vermilion case is the latest case to consider the application of the “deeming” provision of the employment related securities (ERS) legislation.

Where carried interest is treated as ERS, a tax charge can arise on the unrestricted value at acquisition (to the extent it is not acquired for the unrestricted market value) and certain reporting obligations are required, including making a section 431 election. Carried interest acquired by a partner is generally not treated as ERS.

In this context, the deeming rule means that the acquisition of ERS, where the right or opportunity does not arise “by reason of” employment, is treated as having arisen by reason of employment, if the right or opportunity is made available by a person’s employer, or a person connected with a person’s employer. Vermilion considered the scope of the deeming rule, and whether it applied to a share option that was originally acquired by an individual in their capacity as a consultant, where that option was subsequently replaced once the individual had become a director (treated as an employee for these purposes).

The Supreme Court found that, in the given scenario, the deeming rule was sufficiently broad such that the individual’s options should be treated as “employment related”. The facts of the case were such that the Court found that there was a causal link between the directorship and the acquisition of the option, such that the application of the deeming rule did not produce an unjust, absurd or anomalous result.

Effect for investment managers

The decision is potentially relevant where house executives are partners of an investment manager, but also directors of portfolio companies or other connected companies within the group structure. In such a scenario, it was generally considered the case that the deeming rule was not so broad to result in carried interest received by such house executives to be treated as ERS, simply because of an employment relationship that exists elsewhere in the structure.

Our view is that the decision of the Supreme Court in Vermilion does not change this analysis. We consider that it continues to be the case that the deeming rule does not apply where there is no real link between the employment or directorship in question and the acquisition, although there will obviously continue to be uncertainty as to how distant and insignificant the employment needs to be to avoid the deeming rule applying.

Timing

The decision was handed down on 25 October 2023.

UK

Action should be considered

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Other jurisdictions

New tax fraud offence

Who it affects

House and investee companies.

Further detail

The Economic Crime and Corporate Transparency Act 2023 (ECCTA) introduces a new “failure to prevent” regime addressing fraud, including cheating the public revenue. The regime has much in common with the corporate criminal offence of failing to prevent the facilitation of tax evasion (CCO) which was introduced by the Criminal Finances Act 2017.

CCO looks at the facilitation of tax evasion and applies to all businesses, while ECCTA’s focus is on fraud and limited to large organisations (definition adopted from the Companies Act 2006). Under ECCTA, “fraud” includes the common law offence of cheating the public revenue, but encompasses other statutory offences too (e.g. false accounting and false statements by company directors).

Effect for investment managers

This new regime will apply to all corporate entities in a large organisation (meeting at least two of the following criteria (i) more than 250 employees; (ii) more than £36 million turnover; and/or (iii) assets of more than £18 million).

A robust CCO risk (or bribery risk) assessment should provide a helpful basis for the new tax fraud offence, however the scope will be broader in light of the statutory offences under ECCTA.

A CCO risk assessment alone is unlikely to suffice. Accordingly, now might be the time to prepare for a refresh of your CCO risk assessment (important anyway if there have been material changes to your business in the meantime) and to include ECCTA considerations at the same time.

Timing

The new offence is likely to come into effect during 2024 once guidance is published.

UK

Action should be considered

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Other jurisdictions

Transfer pricing documentation

Who it affects

House, holding companies and investee companies.

Further detail

New rules have been introduced to prescribe the format in which transfer pricing records should be prepared.

From April 2023, large businesses (broadly businesses with consolidated revenues in excess of €750 million) are required to follow a standardised approach to transfer pricing documentation by reference to a local file and master file format. Only certain categories of transactions need to be included in the local file and a materiality threshold applies in some cases.

A summary audit trail is also under consideration to help HMRC with risk assessment and enquiries, however the details of this procedure are expected to be consulted on.

Effect for investment managers

The UK Government continues to search for ways to strengthen HMRC's ability to identify transfer pricing risk and challenge taxpayers.

Whilst the local file and master file documentation rules only apply to large businesses, the Government encourages all taxpayers that are required to apply transfer pricing to adopt this approach as best practice. As a result, smaller businesses are advised to consider such standardised documentation to ensure strong corporate governance.

Timing

For accounting periods beginning on or after 1 April 2023.

UK

Action should be considered

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Other jurisdictions

New UK-Luxembourg double tax treaty

Who it affects

Fund and holding companies.

Further detail

The UK and Luxembourg signed a new double tax treaty and protocol, replacing the existing treaty which dated back to 1967. On 8 December 2023 it was officially announced that the treaty was due to come into effect following ratification by the UK in 2022 and Luxembourg earlier in 2023.

One of the key changes in the treaty is the revision to Article 13 (capital gains) which means the UK will have taxing rights over the indirect disposal of UK property by a Luxembourg resident company. In 2019 the UK introduced rules around the taxation of non-resident capital gains which has meant certain gains arising (to the extent not treaty protected) have already been brought within the charge to UK tax. Following the treaty change, it will mean the UK will be able to tax Luxembourg tax residents. Although the treaty sets the property rich threshold at 50%, in practice the UK will only exercise its taxing rights under UK law where at least 75% of the gross value derives from UK real estate (as a treaty cannot impose a tax liability where none exists under domestic law).

The treaty also introduces a 0% withholding tax (WHT) for dividends except where dividends are paid by companies whose income is derived from immovable property and that distributes most of this income annually tax-free e.g. a REIT. Additional minor changes have been made to the residence article (aligning with the OECD Model Tax Convention) and the accompanying protocol provides treaty access for CIVs established and treated as body corporates in Luxembourg.

Effect for investment managers

The new treaty has implications for investors with UK real estate in their portfolio with Luxembourg holding structures. Under the terms of the new treaty, there will be an exposure to UK taxation on certain disposals of UK land.

Timing

The treaty entered into force on 22 November 2023. This means it will apply to WHT and other taxes on income and gains in Luxembourg from 1 January 2024. In the UK, the treaty applies to WHT from 1 January 2024, income and gains from 6 April 2024 and corporate tax for accounting periods beginning on or after 1 April 2024.

UK

Action should be considered

Back to UK overview

Other jurisdictions

UK implementation of Pillar Two (global minimum tax)

Who it affects

House and investee companies.

Further detail

The UK will apply its income inclusion rule (also known as the Multinational Top-Up Tax) and a Qualified Domestic Minimum Top-up Tax (QDMTT) broadly in line with the OECD Pillar Two model rules for accounting periods beginning on or after 31 December 2023. The UK has also committed to implement the Undertaxed Profits Rule (UTPR) for accounting periods beginning on or after 31 December 2024.

The QDMTT does not affect how much tax a business ends up paying, only where it is paid, as it effectively changes the priority of taxing rights. This means a QDMTT jurisdiction becomes the first in line to receive any top-up revenue from entities located in its jurisdiction. Without a QDMTT, that revenue would go to another country as determined by the Pillar Two rule order. The UK will also extend the QDMTT to UK-based groups, as well as multinationals.

The UTPR is a backup rule that allows a jurisdiction to claim top-up tax that has not been allocated under the IIR because, for example, the parent company's jurisdiction has not implemented the GloBE rules.

Effect for investment managers

While the rules are primarily aimed at large trading groups, in principle, they can affect any kind of entity that meets the scoping criteria (revenues of at least €750m) including houses, their funds, holding structures and underlying portfolio companies.

The UK proposals broadly mirror the OECD Pillar Two model rules. The effect for investment managers will depend on whether the group is caught within the scope of the rules, which is heavily dependent on the accounting treatment for the group and whether there is a consolidated group that meets the revenue threshold of €750m.

A number of exclusions may be relevant for investment vehicles that would remove them from the application of the effective tax rate calculation.

Purely domestic groups, who may have assumed the new minimum tax rules would have no effect on them will now need to consider the mechanics of the QDMTT if they breach the threshold. As the OECD continues to update the rules and commentary, groups will need to monitor how and when the updates are integrated into domestic legislation.

Timing

The MTT and QDMTT will take effect for accounting periods starting on or after 31 December 2023. The UTPR take effect for accounting periods starting on or after 31 December 2024.

UK

Action should be considered

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Other jurisdictions

UK mandatory disclosure rules (MDR)

Who it affects

House.

Further detail

The MDR came into effect on 28 March 2023 and implement the OECD's model MDR. They effectively repeal DAC 6 reporting requirements in the UK.

The MDR requires disclosure of Common Reporting Standard (CRS) avoidance arrangements and the use of opaque offshore structures (effectively, the scope of DAC6 hallmarks D1 and D2), however the territorial scope of the rules is wider as they operate at a global level, rather than EU level.

Effect for investment managers

While the scope of arrangements is broadly the same as the UK's reduced DAC6, it will be important to consider whether the wider territorial scope opens up a reporting requirement. Certain structures and arrangements will now be reportable irrespective of which jurisdictions are involved if the intermediary (e.g. advisers) or taxpayer has a UK nexus.

Timing

The rules came into effect on 28 March 2023 and the reporting requirement extends back to certain arrangements entered into from 25 June 2018 (in line with the commencement of DAC 6).

UK

Monitor the development, but unlikely that action is required

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Other jurisdictions

HMRC’s approach to Condition C of the LLP salaried member rules

Who it affects

House and house executives.

Further detail

The salaried member rules determine whether an individual member of an LLP should be taxed as an employee or self-employed partner. The rules contain three Conditions: A, B and C. If an individual satisfies any one of those conditions they will be treated as self-employed.

Condition C looks at the capital an individual has contributed to the LLP. An individual will satisfy Condition C provided that contribution is equal to at least 25% of their “disguised salary” (broadly, any component of their profit share that does not vary by reference to the LLP’s overall profits). This is a relatively clear-cut test and many LLP members in a variety of industries have historically relied on Condition C to establish that they should be taxed as self-employed.

Since the rules were introduced in 2014, HMRC’s practice has been to accept that, provided a capital contribution is genuinely “on risk”, it should count towards Condition C. However, we are aware of several ongoing enquiries in which HMRC wishes to test the purpose for which contributions were made, with a view to applying the salaried member rules’ TAAR if the purpose was to fail Condition C.

This is a new approach and it is unclear to what extent it represents a change in position from HMRC. Taxpayers should monitor developments and, where Condition C is relied upon, take care to document the commercial reasons for adjusting members’ capital contributions.

Effect for investment managers

If HMRC persists with this new, more restrictive, approach to Condition C and is successful, some individual LLP members could begin to be taxed as employees rather than as self-employed.

The main effect of this would be that their LLP profit share would become subject to employer National Insurance Contributions at a rate 13.8%.

Timing

Ongoing.

UK

Monitor the development, but unlikely that action is required

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< Other jurisdictions

BlueCrest case on miscellaneous income

Who it affects

House and house executives.

Further detail

In a recent case, the Court of Appeal upheld earlier decisions that members of the BlueCrest partnership were subject to income tax on payments made through a partner incentivisation plan (PIP). The payments which otherwise would have been paid directly to members were instead paid through a corporate member as PIP and special capital.

HMRC argued that the amounts received by the managers should be treated as miscellaneous income and subject to income tax. The Court decided that the payments were similar to a deferred bonus and due to the discretion of the corporate member there was an identifiable source.

Effect for investment managers

Given HMRC's success, managers can expect more scrutiny and may find HMRC more willing to deploy the miscellaneous income argument in similar arrangements.

Timing

The decision was handed down on 15 December 2023.

UK

Monitor the development, but unlikely that action is required

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Other jurisdictions

Carried interest

Who it affects

House and house executives.

Further detail

The treatment of carried interest will remain in focus ahead of the next General Election. The Labour Party have pledged to close the tax "loophole" and committed to spend the proceeds on the NHS workforce. There is a possibility that if they take office, a Labour Government may look at reforming the regime rather than abolishing it.

Effect for investment managers

If the Labour Party were to win the next General Election, it remains unclear how they will approach carried interest and how quickly changes would be made. While managers may decide to do nothing and just wait and see, it would be sensible for managers to consider how a change would impact team members and structures and identify what steps could be taken to adapt existing and forthcoming funds to keep options open.

Timing

A General Election is expected during 2024, although the last possible date is January 2025.

UK

Monitor the development, but unlikely that action is required

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Other jurisdictions

Qualifying Asset Holding Company (QAHC) regime updates

Who it affects

Fund and holding companies.

Further detail

The QAHC regime came into effect on 1 April 2022. The new regime provides an alternative vehicle to hold investment assets in the UK rather than through traditional Luxembourg or Irish structures. Amongst other changes, the legislation has been updated to make it easier for a multi-vehicle fund structure to qualify for the regime. This new rule will provide a means for feeder, parallel and aggregator funds to satisfy the GDO condition if they are party to a multi-vehicle arrangement and the arrangement meets the GDO condition. Multi-vehicle arrangements are defined as arrangements that result in investors in one of those funds reasonably regarding that investment as an investment in the arrangement as a whole, rather than in any particular fund.

The Finance (No.2) 2023 Act made a further change to the ownership condition by extending the GDO qualifying route to include alternative investment funds which are not collective investment schemes only by reason of being a body corporate and an amendment to the investment strategy condition that allows the holding of some listed securities.

Effect for investment managers

Under the previous rules the GDO condition operated on an entity-by-entity basis, however the new rules make an exception to this for multi-vehicle arrangements. More funds should be able to access the QAHC regime and utilise the simpler GDO route as a result of widened access.

Previously, the GDO route was only available to “collective investment schemes” which excluded bodies corporate, however this has been amended to include alternative investment funds which are not collective investment schemes only by reason of being a body corporate. Up until now, this has meant certain non-UK entities that might be construed as a body corporate (for example a Delaware limited partnership) were excluded from the less onerous GDO qualification route. This change of approach is very welcome for corporate funds.

The investment strategy condition seeks to ensure that the QAHC does not have an investment strategy that includes the acquisition of listed securities, save for in public to private or IPO situations. The amendment introduces an easement that would allow the QAHC to hold listed securities and meet the investment strategy condition, however the price of this relaxation is the denial of the distribution exemption.

Timing

The regime came into effect on 1 April 2022. Further changes have been made in Finance (No.2) Act 2023 which received Royal Assent on 11 July 2023. The inclusion of body corporates is backdated to 1 April 2022.

UK

Monitor the development, but unlikely that action is required

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Other jurisdictions

General UK corporation tax changes

Who it affects

House and investee companies.

Further detail

The main rate of corporation tax is 25% with effect from 1 April 2023. The full expensing scheme (100% capital allowances) was made permanent in the Autumn Statement 2023 (it was previously set to expire on 31 March 2026). A technical consultation on other aspects of the capital allowances regime will be undertaken during 2024. The Government has also consulted on R&D and has decided to introduce a single merged R&D scheme.

Effect for investment managers

The main rate of corporation tax applies to companies with profits over £250,000. A 19% rate is available for companies with profits less than £50,000 with marginal relief applying to companies with profits between those thresholds.

The full expensing policy is available on most plant and machinery while long-life capital allowances receive a 50% first year allowance. The structures and buildings allowance remains at 3%. The full expensing scheme is restricted to companies (and not available for partnerships or individuals to claim).

The single merged scheme mirrors the existing RDEC regime. Companies should receive a 20% tax credit that is recognised “above the line” as taxable income. In addition, the Government has introduced a regime for SMEs that provides enhanced rates of relief for R&D-intensive SMEs.

Timing

The corporation tax rates apply to accounting periods beginning on or after 1 April 2023. The capital allowances changes continue existing policy. The new R&D scheme applies to expenditure incurred on or after 1 April 2024.

UK

Monitor the development, but unlikely that action is required

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Other jurisdictions

Consultation on VAT treatment of fund management

Who it affects

House and fund.

Further detail

The Government has responded to its consultation on the proposed reform of the VAT rules on fund management.

The proposals had focused on codifying the existing treatment established under EU law, case law and guidance on the VAT exemption for supplies of management services to special investment funds (SIFs), however the Government has decided that it will retain the domestic statutory list unchanged rather than introduce a new test based on EU law criteria.

The Government will also seek to update guidance on the definition of "management", however it has decided not to define this in legislation.

Effect for investment managers

There will be no immediate legislative changes as a result of the decision to not proceed with the proposals. This means however, funds that rely on EU law rather than the domestic statutory list of funds should be mindful of the interaction with the Retained EU Law Act 2023, under which the concept of a SIF will fall away from 1 January 2024. Going forward, fund managers will only be able to rely on the Group 5 exemptions in Schedule 9 of VATA 1994.

Timing

Ongoing.

UK

Monitor the development, but unlikely that action is required

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Other jurisdictions

Stamp duties on shares consultation - transfer of partnership interests

Who it affects

House and fund.

Further detail

The Government embarked on a consultation in April 2023 to modernise stamp duties on shares. One of the proposals put forward in the consultation is to take partnership interests outside of the scope of stamp duty.

In practice, as HMRC acknowledges in its consultation, stamp duty is not normally paid on the transfer of partnership interests. We see this unfold in practice in two ways. First, there is no legal requirement to submit a transfer to be stamped, so if it is concluded that a stamped transfer of a partnership interest will never be required as a practical matter, stamping the transfer might be viewed as unnecessary (particularly as the absence of a stamped transfer should not prejudice the ability to write up the register of partners to reflect the transfer). Second, if the partnership interest has no UK nexus and the transfer is executed outside of the UK, then the transfer would be out of the scope of stamp duty.

That said, particularly in commercial secondary transactions, parties may (in view of stamp duty concerns) opt to execute a transfer of a partnership interest outside of the UK. In this respect, there is often detailed provision in secondary transaction documents allocating liability between the parties for paying any eventual stamp duty with respect to the transfer.

Effect for investment managers

If the proposal is adopted, this will be welcome news for fund managers engaged in secondary transactions.

Timing

Awaiting Government response from consultation.

UK

Monitor the development, but unlikely that action is required

Back to UK overview

Other jurisdictions

Consultation on permanent establishment (PE) rules, transfer pricing and DPT (Diverted Profits Tax)

Who it affects

House and fund.

Further detail

During the summer of 2023, the Government launched a consultation to update aspects of the PE rules, transfer pricing and DPT to align with international standards and provide better clarity. The Government has now responded to the consultation. The proposed changes to the PE rules bear most significance for the industry, in particular the proposals include changes to the definition of a deemed dependent agent. However, the Government has decided to take more time to consider this aspect before making a decision. The proposals expanded the definition to include someone who "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without modification" rather than someone that has the ability to conclude contracts.

Effect for investment managers

It will be important to monitor how the PE proposals unfold to ensure that international investors in funds advised from the UK do not inadvertently become subject to UK tax.

Timing

Further technical consultation will be undertaken and draft legislation can be expected summer 2024.

UK

Monitor the development, but unlikely that action is required

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Other jurisdictions

Corporate re-domiciliation regime

Who it affects

Holding companies and investee companies.

Further detail

The Government has set out proposals to introduce a re-domiciliation regime that would allow non-UK incorporated companies to move their place of incorporation to the UK. The policy remains at an early stage in its development therefore there is no indication of timing for implementation.

Effect for investment managers

If adopted, the proposals will reduce the complexity of administrating corporate migrations to the UK such as inserting a new holding company alongside a business transfer or changing tax residence. The existing routes are costly, contain traps for the unwary and do not represent a true corporate migration. The detailed design of the proposal is not clear however the introduction of an inward re-domiciliation regime would be of benefit to non-UK holding companies, in particular Luxembourg where migrating tax residence can be problematic. This would be beneficial in light of the QAHC regime.

Timing

Ongoing

UK

Monitor the development, but unlikely that action is required

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Other jurisdictions

Sovereign immunity from tax consultation

Who it affects

Investors.

Further detail

In the Spring Budget 2023 it was confirmed that the Government would not take forward its proposals to reform sovereign immunity from direct taxation.

There remains a risk that if there is a change in Government these proposals could be revived.

Effect for investment managers

These changes would have a significant impact on sovereign wealth fund's tax exposure in relation to, and their choices of holding structures for, UK real estate investments estate funds that have sovereign investors if they are taken forward.

Timing

The policy reversal was announced on 15 March 2023.

EU

Other jurisdictions

Action should be considered

- Public country-by-country reporting (CbCR)

Monitor the development, but unlikely that action is required

- ATAD 3: Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for improper tax purposes
- FASTER - Faster and Safer Relief of Excess Withholding Taxes - Proposal for a Council Directive to simplify withholding taxes refunds
- SAFE - Proposal for a Council Directive to tackle the role of enablers
- EU list of non-cooperative jurisdictions
- BEFIT Business in Europe: Framework for Income Taxation - Proposal for a Council Directive to introduce common corporate tax base
- Proposal for a Council Directive on Transfer Pricing
- Pillar Two implementation

EU

Action should be considered

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Other jurisdictions

Public country-by-country reporting (CbCR)

Who it affects

House and investee companies.

Further detail

Large multinational groups with consolidated revenues of more than €750m and active in more than one EU member state or in any third country that is listed on the EU list of non-cooperative jurisdictions (including the grey list which currently includes territories such as Hong Kong) will be required to publish CbCR.

Effect for investment managers

There is generally no exemption for investment funds in the adoption of public CbCR. The filing obligation applies either at the level of the management companies or the investment fund if the consolidated revenue test is exceeded. Reporting will be determined by whether or not investment fund entities and portfolio entities are consolidated under accounting standards.

Timing

The rules should come into effect for financial years beginning on or after 22 June 2024.

EU

Monitor the development, but unlikely that action is required

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Other jurisdictions

ATAD 3: Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for improper tax purposes

Who it affects

Holding companies.

Further detail

The EC published a draft directive (ATAD 3) to tackle the use of shell entities on 22 December 2021. The directive aims to provide Member States with greater tools to identify and prevent the use of shell entities through increased reporting requirements and sanctions.

Although, a number of amendments have been proposed by the European Parliament during the course of 2022 and 2023, it remains uncertain whether the directive will ever be agreed.

Negotiations have stalled around the concept of substance and the tax consequences. The latest proposal was presented in autumn 2023 with a two-stage approach that included an automatic exchange of information for entities meeting certain hallmarks together with the application of domestic tax consequences. The second stage would involve Member States sharing best practice on tax consequences with a view to harmonised measures being introduced at a later date. A further proposal was put forward which involved a minimum standard approach and a toolbox of tax consequences, however agreement on either proposals does not appear to be imminent as the proposals do not resolve the underlying issues.

Effect for investment managers

Asset holding vehicles may be caught by the proposals, and as such, it will be important to consider the full effect of the rules to see whether there is a reporting obligation. The scope of the rules is limited to EU entities, therefore the UK QAHC regime may offer a viable alternative as a holding jurisdiction. The EC does indicate it will explore the application of the rules to non-EU entities. For now, the proposals to regulate enablers under the EC's SAFE directive (set out below) appears to be the chosen mechanism to tackle non-EU entities however further measures may be proposed.

Timing

The original directive was due to take effect from 1 January 2024 however with no agreement on the rules a new effective date would need to be agreed. The original proposal also included a two-year look-back period for the assessment therefore any new proposal should be reviewed to see whether this still applies.

EU

Monitor the development, but unlikely that action is required

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Other jurisdictions

FASTER - Faster and Safer Relief of Excess Withholding Taxes - Proposal for a Council Directive to simplify withholding taxes refunds

Who it affects

Investors, house, fund, holding companies and investee companies.

Further detail

The EC published a new proposed directive on 19 June 2023 aimed at making WHT refund procedures for certain dividends and interest payments simpler and safer. The key proposals include:

- a common digital tax residence certificate;
- establishing a relief at source system and/or a quick refund process (50 days); and
- enhanced reporting requirements on large financial intermediaries to verify entitlement to treaty benefits with exchange of beneficial ownership information.

Effect for investment managers

Whilst the developments are welcome, there is a risk that investment funds, as intermediaries, may suffer new administrative or technical burdens as a result of the changes. The new procedures will initially apply to dividends and interest payments from publicly listed shares/bonds paid by EU tax resident entities. It remains unclear if the proposals will be extended to unlisted shares/bonds in the future.

Timing

If adopted, the proposals should come into effect from 1 January 2027.

EU

Monitor the development, but unlikely that action is required

Back to EU overview

Other jurisdictions

SAFE - Proposal for a Council Directive to tackle the role of enablers

Who it affects

House, holding companies and investee companies.

Further detail

The SAFE (Securing the Activity Framework of Enablers) proposals are designed to tackle the role of "enablers" in non-EU jurisdictions that facilitate tax evasion and aggressive tax planning in EU Member States.

SAFE will target intermediaries "who design, market and/or assist in the creation of tax arrangements or schemes in non-EU countries that lead to tax evasion or aggressive tax planning for the EU Member States." The policy options under consideration include a combination of:

- due diligence procedures to check whether an arrangement leads to tax evasion or aggressive tax planning in an EU Member State;
- mandatory registration for enablers that provide tax services to EU taxpayers; and
- code of conduct that enablers would be expected to comply with.

Effect for investment managers

The draft Directive has not been published therefore it is not clear how this framework will develop and the extent of the impact.

The definition of enabler has not been confirmed, but it may capture certain service providers and in-house tax professionals as well as tax advisers providing advice to any party involved in the arrangements.

The proposals will also seek to define what is meant by "aggressive tax planning" but it remains to be seen what will be agreed. The regime has some similarities to DAC6 and the UK's enablers legislation.

Timing

A draft Directive was expected in the first quarter of 2023 however it has not materialised. It is unclear how much progress will be made on this file during 2024.

EU

Monitor the development, but unlikely that action is required

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Other jurisdictions

EU list of non-cooperative jurisdictions

Who it affects

Investors, house, fund, holding companies and investee companies.

Further detail

The EU list of non-cooperative jurisdictions was updated in October 2023. Three jurisdictions (Antigua and Barbuda, Belize, and Seychelles) were added to the blacklist; while BVI, Costa Rica and Marshall Islands were removed from the list.

The blacklist now consists of the following 16 jurisdictions: American Samoa, Antigua and Barbuda, Anguilla, the Bahamas, Belize, Fiji, Guam, Palau, Panama, Russia, Samoa, Seychelles, Trinidad and Tobago, Turks and Caicos Islands, the US Virgin Islands, and Vanuatu.

The grey list now comprises of: Albania, Aruba, Armenia, Botswana, the British Virgin Islands, Costa Rica, Curacao, Dominica, Eswatini, Hong Kong, Israel, Malaysia, Turkey, and Vietnam.

Effect for investment managers

EU Member States are encouraged to apply sanctions to transactions involving jurisdictions on the blacklist. Structures may be caught by DAC 6 where it requires disclosure in relation to certain cross-border transactions (Hallmark C) involving black-listed jurisdictions.

The blacklist and grey list are also relevant for the EU's public CbCR measure as reporting on entities in these jurisdictions will be expected.

The EU Code of Conduct Group (responsible for the blacklist) are reviewing the criteria and facing calls for the scope to be expanded to include a minimum effective rate of tax.

Timing

The new list takes effect from 17 October 2023. The next edition is expected in February 2024.

EU

Monitor the development, but unlikely that action is required

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Other jurisdictions

BEFIT Business in Europe: Framework for Income Taxation - Proposal for a Council Directive to introduce common corporate tax base

Who it affects

House and investee companies.

Further detail

As part of the EC's pursuit to introduce a single harmonised corporate tax rulebook in the EU, a proposal has been put forward to introduce a common tax base which would be allocated to Member States in accordance with historic tax results. In the future the regime might expand to some form of formulary apportionment. The rules will allow Member States to flex the allocated tax base through their own domestic incentives or deductions.

The BEFIT rules would follow the scoping criteria of Pillar Two, i.e. broadly groups with consolidated revenues of at least €750m and would be mandatory for groups operating in the EU even if headquartered in a non-EU territory. It is anticipated that Pillar Two rules will continue to apply in addition to the BEFIT regime.

The proposals require unanimous approval by Member States which has not been forthcoming under previous guises of this project (namely the Common Consolidated Corporate Tax Base), however in light of Pillar Two agreement there might be more willingness to consider harmonisation.

Effect for investment managers

Unlike the Pillar Two rules, there is no carveout for certain financial institutions therefore larger houses and portfolio companies that meet the revenue threshold will need to monitor how this unfolds.

Timing

It is proposed that the rules would take effect on 1 July 2028.

EU

Monitor the development, but unlikely that action is required

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Other jurisdictions

Proposal for a Council Directive on Transfer Pricing

Who it affects

House, fund, holding companies and investee companies.

Further detail

This proposed directive aims to harmonise the application of the arm's length principle and associated OECD guidelines in all EU Member States.

Effect for investment managers

Codifying the OECD's transfer pricing guidelines should be welcomed by groups and provide additional certainty.

Timing

It is proposed that the rules would apply from 1 January 2026.

EU

Monitor the development, but unlikely that action is required

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Other jurisdictions

Pillar Two implementation

Who it affects

House and investee companies.

Further detail

Implementation of the Pillar Two rules is underway in most EU Member States.

Five Member States have elected to delay the application of the Income Inclusion Rule (IIR) and the Undertaxed Profits Rule (UTPR) because insufficient UPEs are within scope of the rules in their jurisdiction. The Member States that have elected to delay implementation are: Estonia, Latvia, Lithuania, Malta and Slovakia.

Effect for investment managers

The EU Directive implementing the Pillar Two rules broadly follows the OECD model rules. Member States have taken a variety of approaches to implement the Directive into domestic legislation, however the broad principles set out by the OECD apply. Houses with operations or investments in EU Member States are advised to monitor domestic implementation to ensure they can respond to any local divergence from the main rules.

Timing

The IIR is due to take effect for accounting periods starting on or after 31 December 2023 and the UTPR from 31 December 2024. Some Member States are yet to issue legislation even though the rules have taken effect.

Other jurisdictions

Monitor the development, but unlikely that action is required

- Pillar One
- Pillar Two

OECD

Monitor the development, but unlikely that action is required

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Other jurisdictions

OECD
BETTER POLICIES FOR BETTER LIVES

Pillar One

Who it affects

House and investee companies.

Further detail

The Pillar One proposals are designed to provide new taxing rights to market jurisdictions on residual profits earned by the largest multinational groups with an annual global turnover exceeding €20bn and 10% profitability.

Since the proposals were announced a number of consultations have been undertaken on what is referred to as “Amount A” (the new taxing right) and a draft Multilateral Convention (MLC) has been published. The other strand of Pillar One is “Amount B” which refers to efforts to simplify transfer pricing rules for distributors.

Amount A will be introduced by a new MLC to ensure the legal obligations of the jurisdictions implementing the rules do so in a coordinated and consistent manner. Amount B would be inserted into OECD transfer pricing guidelines.

Effect for investment managers

As the profit allocation rules will only apply to the very largest global groups. it is very unlikely that asset managers will find themselves within the scope of the rules when it is first introduced. However, the turnover threshold is anticipated to reduce to €10bn after a seven-year review period therefore larger asset managers may want to monitor the design of the financial services exemption to ensure they remain out of scope.

The Amount B rules do not have threshold criteria but will only be relevant for certain portfolio companies. The rules in this area should be welcomed as a way to reduce compliance and disputes.

Timing

There is considerable uncertainty as to whether Amount A will be implemented despite the recent publication of the draft MLC. Entry into force requires at least 30 ratifications and approval from significant jurisdictions including the US. The OECD has indicated it has ambitions for it to enter into force in 2025.

Amount B has an easier path to implementation, however there is a lack of consensus on certain aspects which may delay updating transfer pricing guidelines.

OECD

Monitor the development, but unlikely that action is required

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Other jurisdictions

OECD BETTER POLICIES FOR BETTER LIVES

Pillar Two

Who it affects

House and investee companies.

Further detail

Following publication of the OECD's GLoBE model rules for the introduction of a global minimum tax, further guidance has been published by the OECD periodically throughout 2023. The key developments have included the release of details about a series of transitional safe harbour rules. The OECD has also opened up the MLI for signature in order to implement the STTR. The STTR provides a mechanism for territories to impose tax on certain cross-border payments (where the nominal rate in the recipient country is below 9%).

Effect for investment managers

The GloBE rules will apply to groups with entities in more than one jurisdiction and consolidated revenues of at least €750m per annum.

The scope of the GloBE rules turns heavily on how the parent of the group in question prepares its consolidated accounts. An important question in an investment management context will therefore be which parts of the management and fund structure (or both) are required to prepare consolidated accounts and which entities are included in those consolidated accounts.

The rules also provide for an investment fund exemption. This means that both investment and real estate funds are "Excluded Entities". In each case, the exclusion only applies if the relevant entity is an UPE and it is therefore not a panacea for all funds wherever they may be situated in a group.

Timing

Implementation is expected by 31 December 2023.

MACFARLANES

Tax developments impacting investment fund managers

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