MACFARLANES

Tax developments impacting investment fund managers

February 2023

Start >

Tax developments impacting investment fund managers

Investment 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 investment management industry. In this document we set out the key legislative initiatives across the UK, the EU and the OECD taken from our global tax policy monitor. The document summarises the developments and explains the implications for investment managers.

If you are interested in the wider global tax policy monitor, please let us know.

Contacts


Damien Crossley
Partner
DD +44 (0)20 7849 2728
damien.crossley@macfarlanes.com


Rhiannon Kinghall Were
Head of Tax Policy
DD +44 (0)20 7791 4131
rhiannon.kinghallwere@macfarlanes.com


Joe Maughan
Associate
DD +44 (0)20 7791 4122
joe.maughan@macfarlanes.com


Sam Pettinger-Harte
Associate
DD +44 (0)20 7849 2686
sam.pettinger-harte@macfarlanes.com

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 in the selected jurisdictions.

Read more

Jurisdictions

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

EU

OECD

UK

Other jurisdictions

Action likely to be required

- HMRC carried interest guidance (s103KE)
- Improved input VAT recovery post-Brexit

Action should be considered

- Qualifying Asset Holding Company (QAHC) regime
- UK implementation of BEPS 2.0
- New UK-Luxembourg double tax treaty
- Transfer pricing documentation
- Challenge to VAT treatment of fund administration services

Monitor the development, but unlikely that action is required

- Off-payroll working (IR35) rule
- UK mandatory disclosure rules (MDR)
- Sovereign immunity from tax consultation
- Corporation tax rate increase
- Corporate re-domiciliation regime
- BlueCrest case and application of the salaried member rules
- OTS review of hybrid and distance working
- Review of non-dom regime
- Investment manager exemption (IME) extended to include crypto-assets
- Consultation on VAT treatment of fund management
- New UK-Brazil double tax treaty
- R&D tax credit changes

UK

Action likely to be required

Tax developments in the UK

Other jurisdictions

HMRC carried interest guidance (s103KE)

Who it affects

House, house executives.

Further detail

In January 2022 HMRC updated their guidance in relation to s103KE TCGA 1992, a clause which is designed to prevent double taxation on carried interest. The reference to "tax" has been re-defined and is now restricted to only allow UK taxes to be credited under s103KE. Previously, this provision had been used to obtain relief for non-UK tax charges.

Effect for investment managers

The change in guidance may trigger double tax in situations where foreign tax is no longer creditable under s103KE and there is no means to claim credit for UK taxes in the foreign jurisdiction. The impact is likely to be felt greatest by US taxpayers who are UK tax resident due to the timing of when UK taxes are creditable in the US.

We understand the British Venture Capital Association (BVCA) is engaging on a potential solution although it is unlikely to resolve issues arising in all circumstances, therefore houses with fund executives that have an exposure to foreign taxes should review the implications these changes have on the individual's tax position.

Timing

The revised guidance was published on 19 January 2022. It is not clear when a legislative fix will be published, and furthermore, it is unclear how the government will approach the intervening period (from when the guidance changed to the point at which the legislation takes effect).

UK

Action likely to be required

Tax developments in the UK

Other jurisdictions

Improved input VAT recovery post-Brexit

Who it affects

House, fund.

Further detail

Following Brexit the disposal of an investment to an EU counterparty is a transaction that gives entitlement to input VAT recovery, as is the making of a loan to a Luxembourg (or other EU) asset holding company.

In our experience many managers of UK private equity funds have yet to take advantage of their entitlement to increased VAT recovery.

Effect for investment managers

This change will often give rise to a significant improvement in input VAT recovery for UK private equity funds and the entities with which they are VAT-grouped.

In many cases there are opportunities to make claims going back to 1 January 2021.

Most UK private equity fund managers will operate a partial exemption special method to determine how much of their input VAT they are entitled to recover. In many cases the 1 January 2021 changes will give improved input VAT recovery without any need to alter the firm's partial exemption method. In some cases an adjustment to the partial exemption method is required to access increased VAT recovery.

Timing

Claims can be made dating back to 1 January 2021.

UK

Action should be considered

Tax developments in the UK

Other jurisdictions

Qualifying Asset Holding Company (QAHC) regime

Who it affects

Fund, 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. A number of changes to the ownership condition are anticipated in a forthcoming Finance Bill which will make it easier for parallel partnerships and feeder funds to qualify for the regime.

Effect for investment managers

The new rules introduce an elective and bespoke regime for certain qualifying investment arrangements by making a number of adjustments to the existing tax system to encourage wider use of UK holding companies. The crucial advantage of the new regime is that it is tax neutral like in other jurisdictions but is capable of being operated wholly from the UK and therefore cheaper and more efficient as well as easier to establish the necessary substance in territory.

In order to elect into the regime, the QAHC must meet certain eligibility criteria. The ownership condition is the most complex to satisfy but in its simplest form there is a requirement for the QAHC to be held at least 70% by "good" investors which includes widely held qualifying funds, such as Collective Investment Schemes (CIS) or Alternative Investment Funds (AIF) and other institutional investors like pension funds or sovereign wealth funds.

If the eligibility criteria are satisfied, a number of benefits are available, including a broad exemption on capital gains arising on the disposal of shares and overseas real estate; abolition of withholding tax on interest payments; deductions for interest on profit participating debt; and capital gains tax treatment on share buybacks. In line with other jurisdictions like Luxembourg, credit funds will only pay tax on a profit margin commensurate with their role as an intermediary holding company.

Timing

The regime came into effect on 1 April 2022. Further changes are expected in a forthcoming Finance Bill.

UK

Action should be considered

< Tax developments in the UK

< Other jurisdictions

UK implementation of BEPS 2.0

Who it affects

House, portfolio companies.

Further detail

The UK has published draft legislation to implement the “Multinational Top-Up Tax” in line with the OECD Pillar Two model rules to introduce a global effective minimum tax of 15% via the Income Inclusion Rule (IIR). The IIR is a top-up tax charged on a UK parent or intermediary company with foreign subsidiaries taxed below the minimum rate of 15%.

In the 2022 Autumn Statement the government announced its commitment to also implement a Qualified Domestic Minimum Top-up Tax (QDMTT) and the Undertaxed Profits Rule (UTPR).

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 an affect any kind of entity that meets the scoping criteria 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 once the details are published.

Timing

The IIR and QDMTT will take effect for accounting periods starting on or after 31 December 2023. The UTPR will be implemented no earlier than for accounting periods starting on or after 31 December 2024.

UK

Action should be considered

Tax developments in the UK

Other jurisdictions

New UK-Luxembourg double tax treaty

Who it affects

Fund, 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.

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 will also introduce a 0% withholding tax 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 Collective Investment Vehicles 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. Managers may seek to crystallise a gain before the treaty comes into effect, subject to the UK's non-resident capital gains tax anti-avoidance rules.

Timing

The treaty will enter into force once it has been ratified in both jurisdictions. The UK ratified the treaty on 12 October 2022 but is awaiting ratification in Luxembourg.

UK

Action should be considered

Tax developments in the UK

Other jurisdictions

Transfer pricing documentation

Who it affects

House, holding companies, portfolio companies.

Further detail

The existing UK tax compliance rules require that UK businesses retain sufficient records to demonstrate that their tax returns are complete and accurate, including any figures affected by transfer pricing rules. However currently there is no prescribed format in which such documentation should be prepared.

From April 2023, large businesses (broadly businesses with consolidated revenues in excess of €750m) will be required to follow a standardised approach to transfer pricing documentation by reference to a local file and master file format. The documentation requirements also include an audit trail summary that supports the pricing position that is detailed in the respective local file, however this is pending further consultation.

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 is likely to "encourage" 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. A decision on the commencement of the audit trail summary will be made in due course.

UK

Action should be considered

Tax developments in the UK

Other jurisdictions

Challenge to VAT treatment of fund administration services

Who it affects

House, fund.

Further detail

HMRC has apparently challenged the VAT treatment of fund administration services where a single buy-side entity contracted for services in relation to both funds which were VAT-exempt “special investment funds” (or SIFs) and others which were not SIFs.

It seems that in HMRC’s view the fact that the services were used in part in relation to non-SIFs meant that they were “tainted” and therefore subject to VAT in their entirety. Traditionally providers of such services have split their fees and only charged VAT on the non-SIF element.

Effect for investment managers

As far as we are aware the arrangements which have been challenged by HMRC is not unique to the investment manager and fund administrator concerned.

If HMRC adopts its present position as a more general policy then many funds could face increased VAT costs on their administration services.

It may be necessary for asset managers to review their structure and fund administration arrangements to mitigate against the risk of “tainting”.

Timing

The issue is ongoing. It is difficult to predict when or if HMRC will abandon its present challenge or adopt it as a more general policy.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

Off-payroll working (IR35) rule

Who it affects

House, portfolio companies.

Further detail

The off-payroll worker legislation affects the taxation of contractors who provide services through an intermediary entity (usually the contractor's own limited company). The legislation means that, if the contractor is providing services in the same way as an employee, they are subject to income tax and National Insurance Contributions in a broadly similar way to individuals who are directly employed.

From the introduction of the IR35 rules in 2003 until 5 April 2021, it was the responsibility of the contractor's intermediary entity to determine whether they should be taxed like an employee, or as a third-party contractor.

From 6 April 2021 the rules were changed, and the burden of that determination shifted from the contractor to the entity in receipt of the services (the "end user").

The government announced at the "mini-budget" in September 2022 that they intended to reverse this rule change, placing the burden of making the determination back on the contractor, however, this was subsequently reversed by the new Chancellor Jeremy Hunt on 17 October 2022. This means the responsibility remains with the entity in receipt of services.

Effect for investment managers

Investment managers that engage with contractors to perform roles such as non-executive directors, advisory roles, or back-office functions, will still be required to assess the tax employment status of the contractors where the contractor engages through an intermediary entity (such as a personal service company).

This remains a hot topic, and so investment managers should be aware of the wider responsibility under corporate criminal offence legislation, and so should have procedures and policies in place to identify "red flags" when engaging with contractors.

Timing

Ongoing.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

UK mandatory disclosure rules (MDR)

Who it affects

House.

Further detail

On 24 November 2022 the government published a response to the consultation on its plans to implement the OECD's MDR, and replace DAC6.

The MDR will cover Common Reporting Standard (CRS) avoidance arrangements and the use of opaque offshore structures (effectively, the scope of DAC6 hallmarks D1 and D2 which the UK currently enforces), however the rules will operate at a global level, rather than EU level.

It was originally proposed that the UK MDR would apply retrospectively in relation to CRS avoidance arrangements from 29 October 2014, however the government realised the eight year "look back" period would place a heavy burden on businesses. As such it is now proposed that arrangements entered into in the period from 25 June 2018 (in line with the commencement of DAC 6) will be within scope.

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.

Timing

The government has announced that the rules will come into force on 28 March 2023. The reporting requirement extends to certain arrangements entered into from 25 June 2018.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

Sovereign immunity from tax consultation

Who it affects

Investors.

Further detail

The government published a consultation in July 2022 setting out proposals to reform sovereign immunity from direct taxation.

Under the proposals, from 1 April 2024, sovereign immunity from taxation would be codified in statute. Under the new, reformed, regime the scope of immunity would be restricted so that it only applies to passive investment income, and not to trading income, rental income or gains on disposals of UK real estate. Sovereign Wealth Funds (SWFs) would become subject to UK corporation tax on their taxable income and gains in the same way that any non-resident company would.

Effect for investment managers

If taken forward, these changes will have a significant impact on SWFs tax exposure in relation to, and their choices of holding structures for, UK real estate investments. These changes are therefore important to both sovereign clients with direct investments in UK real estate, and to investment management clients that sponsor real estate funds that have sovereign investors.

The impact on other kinds of investment (e.g. private equity investment in private companies) is likely to be smaller, although clients in those sectors will still be interested in the proposals.

Timing

It is proposed that the changes would take effect from 1 April 2024, however, at the Autumn Statement it was stated that a decision on how to proceed had not yet been taken.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

Corporation tax rate increase

Who it affects

House, portfolio companies.

Further detail

The government announced that it would not proceed with cancelling the planned increase in the rate of corporation tax, therefore from 1 April 2023 the main rate of corporation tax will increase from 19% to 25%.

Effect for investment managers

The 25% rate was already included within Finance Act 2021 which received Royal Assent on 10 June 2021. Businesses that have made deferred tax provisions at the 25% rate of corporation tax will not need to make any changes.

Timing

1 April 2023.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

Corporate re-domiciliation regime

Who it affects

Holding companies, portfolio 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.

Certain eligibility criteria would need to be met in order to effect the re-domiciliation. The consultation discussed various tax consideration such as tax residency, loss importation and base cost.

Effect for investment managers

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, especially in light of the QAHC regime.

Timing

Ongoing.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

BlueCrest case and application of the salaried member rules

Who it affects

House, house executives.

Further detail

The decision in the BlueCrest case, released 29 June 2022 is the first case to consider the application of the salaried member rules in the investment management context. The salaried member rules treat a member of a UK LLP as an employee for tax purposes if three conditions are met. To avoid being treated as an employee, a member must therefore fail at least one condition.

BlueCrest considered Condition A (variable remuneration) and Condition B (significant influence) although it is its 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.

The two key finding were that (i) there is no justification in limiting significant influence to managerial influence; and (ii) "affairs of the partnership" is not restricted to the affairs of the partnership generally but can be over any aspect of the affairs.

Effect for investment managers

The decision (if upheld) materially broadens the availability of significant influence beyond HMRC's current approach in practice. On Condition B, the test is almost to ask 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 not be salaried members.

We expect HMRC will appeal the decision. They are likely to argue that, in relation to Condition B, there is significance in the word "significant" that the judge missed by focusing on whether an individual functions like a partner in a traditional partnership. On appeal, we might expect the logical conclusion of this decision to be somewhat narrowed but we would still expect that to leave the application of Condition B more in line with HMRC's original guidance and materially broader than their current approach in practice.

Timing

The decision was given on 29 June 2022.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

OTS review of hybrid and distance working

Who it affects

House, house executives, portfolio companies.

Further detail

The Office for Tax Simplification (OTS) has issued a report exploring the recent trends in hybrid and distance working and the implications for companies and employees covering income tax, social security, corporate residence and permanent establishment issues.

Effect for investment managers

Covid-19 accelerated the pace at which businesses and workers adopted flexible working arrangements, and the legislation that governs these types of arrangements has struggled to keep up. The easements introduced during the pandemic have largely been withdrawn and in any event, it would be difficult to argue that arrangements remained temporary or extraordinary some two years since the pandemic.

The two key tax concerns for companies are:

- the risk of inadvertently creating an overseas presence for corporation tax purposes; and
- the risk that staff working abroad become liable to income tax and social security outside of the UK.

The review is welcome however it remains to be seen whether it will prompt any immediate change in UK policy given there is also an OECD project on this subject in the pipelines.

Timing

Ongoing.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

Review of non-dom regime

Who it affects

House, house executives.

Further detail

Ahead of the 2022 Autumn Statement it was reported that Treasury officials were reviewing the UK's non-dom rules. Although no changes were announced there is continued political pressure given the Labour Party has proposed scrapping the non-dom status entirely. This has prompted the Chancellor to confirm at a recent Treasury Select Committee appearance that he has asked His Majesty's Treasury to undertake a cost-benefit analysis of the regime.

Effect for investment managers

This is an area that executives should continue to monitor ahead of a general election anticipated in 2024.

Timing

Unknown.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

Investment manager exemption (IME) extended to include crypto-assets

Who it affects

House, fund.

Further detail

The IME allows non-UK funds involving UK-based investment managers to carry out investment activities without becoming subject to UK tax. Following a consultation the government has confirmed it will add activities involving crypto-assets to the approved list of investment transactions. It has been confirmed that the definition of crypto-assets will mirror the OECD Crypto-Assets Reporting Framework definition, however the definition will be kept under review to ensure it remains relevant.

Effect for investment managers

The addition of crypto-assets to the IME list of approved activities will provide welcome clarification for non-UK based funds with UK investment managers and a signal that the UK is at the forefront of developing a regulatory and tax framework supporting the crypto-asset industry.

Timing

Transactions entered into from tax year 2022/23 onwards and accounting periods that include 19 December 2022 onwards.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

Consultation on VAT treatment of fund management

Who it affects

House, fund.

Further detail

The government has published a consultation on reforming the VAT rules on fund management. The proposals have narrowed significantly since the reforms were first announced in Budget 2020 (when zero-rating fund management fees was even considered) such that these proposals are only focused on improving legal clarity and certainty rather than fundamental policy change.

Effect for investment managers

The proposals focus 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). This includes retaining the list of exempt fund types and making legislative changes to define the eligibility criteria of the SIF exemption from VAT.

Timing

The consultation closes on 3 February 2023.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

New UK-Brazil double tax treaty

Who it affects

Holding companies, portfolio companies.

Further detail

A new UK-Brazil double tax treaty was agreed on 29 November 2022.

The new treaty is largely in line with the OECD model treaty and standards introduced through the OECD BEPS process. In general, the treaty reduces rather than eliminates withholding taxes, however the agreement to taper out withholding taxes on technical services will be welcome.

Although neither the UK nor Brazil impose a withholding tax on dividends the reduced rate may become more beneficial if a proposal to introduce a dividend withholding tax rate of 15% in Brazil is passed.

While many of the UK's other treaties reduce interest with-holding to 0%, the UK – Brazil treaty only provides for a reduction in the rates for certain interest payments including financing infrastructure and public utilities (7%) and other interest payments to unconnected banks and insurance companies, on bonds/securities trade on qualifying stock exchanges, and credit interest payments by purchasers of machinery and equipment (10%). A rate of 15% has been agreed in other cases, reflecting a 5ppt reduction in the UK's domestic rate of withholding tax on interest.

Effect for investment managers

Assuming the treaty takes effect, this will be seen as a beneficial development given that Brazil is the largest economy that the UK has not had an existing treaty with. Portfolio entities providing services may find the agreement particularly welcome given that withholding taxes on technical service fees will be tapered out over a four year transitional period. The UK's qualifying private placements exemption may now be relevant to Brazilian lenders to eliminate UK interest withholding tax in certain circumstances on interest payments by unconnected UK borrowers.

Timing

The treaty will enter into force once it has been ratified in both jurisdictions. This may take several years in Brazil.

UK

Monitor the development, but unlikely that action is required

Tax developments in the UK

Other jurisdictions

R&D tax credit changes

Who it affects

Portfolio companies.

Further detail

Following a series of piecemeal consultations and changes to the R&D tax relief regime, the government has announced it will consult on merging the two schemes (the R&D Expenditure Credit (RDEC) scheme and the Small or Medium-sized Enterprise (SME) scheme) that are currently in operation. The consultation explores the main differences between the regimes including the treatment of subcontracted R&D, the Pay As You Earn/National Insurance Contributions cap and additional support to certain (undetermined) preferential sectors.

Following the 2022 Autumn Statement, the government had already announced that the RDEC rate would increase to 20% (from 13%), the SME deduction rate would reduce to 86% (from 130%) and the SME credit rate would decrease to 10% (from 14.5%), effectively aligning the generosity of the two schemes from 1 April 2023. In addition the 2022 Spring Statement confirmed that datasets, cloud computing and pure mathematics costs would qualify for relief from 1 April 2023. At the same time, the government announced it would tighten the regimes by restricting the relief to UK activities and introduce new administration procedures.

Effect for investment managers

R&D intensive portfolio companies will be affected by these changes, although the planned merger into a single RDEC scheme may have less impact given that the government has already announced its intention to level the rates between the regime.

Timing

The consultation to merge the R&D schemes is open until 13 March 2023.

The other changes take effect from 1 April 2023.

EU

Action should be considered

- Public country-by-country reporting (CbCR)
- EU implementation of OECD Pillar Two global effective minimum tax

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
- Consultation to introduce a new EU system for withholding taxes (WHT)
- Proposal for a Council Directive to introduce a debt-equity bias reduction allowance (DEBRA)
- Proposal for a Council Directive to tackle the role of enablers (SAFE)
- EU list of non-cooperative jurisdictions
- Business in Europe: Framework for Income Taxation (BEFIT)

Other jurisdictions

EU

Action should be considered

Tax developments in the EU

Other jurisdictions

Public country-by-country reporting (CbCR)

Who it affects

House, portfolio 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) will be required to publish CbCR data.

Effect for investment managers

There is generally no exemption for investment funds in the adoption of CbCR and this will follow for 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.

A number of Member States have raised concerns around the legal basis of the measure as the directive was pushed through via a mechanism which only required qualified majority voting rather than unanimity.

Timing

EU Member States have until 22 June 2023 to implement the rules into domestic legislation. The rules should come into effect by 22 June 2024.

EU

Action should be considered

Tax developments in the EU

Other jurisdictions

EU implementation of OECD Pillar Two global effective minimum tax

Who it affects

House, portfolio companies.

Further detail

The EC has put forward a directive to implement the OECD Pillar Two model rules to introduce a global minimum effective tax rate. Hungary had blocked implementation, which led to the governments of five Member States (France, Germany, Italy, the Netherlands, and Spain) issuing a joint statement committing to implementation by 2023 irrespective of progress by the EU. On 12 December 2022 it was announced that EU member states had reached agreement.

Large groups with consolidated revenues of more than €750m will be brought into the scope of the global minimum effective tax.

Effect for investment managers

The EU directive largely follows the OECD model rules. The distinctions made in the directive are unlikely to have a major impact on the industry, however it is worth noting that the EU directive extends the reach of the proposals to domestic groups that meet the revenue threshold of €750m (to ensure the new rules do not discriminate between cross-border and domestic arrangements).

Timing

The rules are expected to commence for tax years starting from 31 December 2023.

EU

Monitor the development, but unlikely that action is required

Tax developments in the EU

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.

A number of amendments have been proposed by the European Parliament during 2022. It is anticipated that the next edition of the directive will have been subject to significant changes with rumours circulating that a number of exemptions may be removed.

Effect for investment managers

Under the current proposals, where an EU entity passes the gateway tests and does not qualify for a specific excluded entity exemption, it will be necessary to report whether certain indicators of substance are met.

If the substance indicators are not met (and the presumption of a shell entity cannot be rebutted), a series of tax consequences will apply. The tax consequences include denial of treaty benefits, denial of issuing tax certificates, and treatment of the entity as a flow-through entity.

Crucially for investment managers there is a proposed regulated financial undertakings exemption which will take investment firms, managers and funds (AIFs) out of the scope of the rules. However, as the rules apply on an entity-by-entity basis, under current proposals only the vehicle satisfying the regulated financial undertakings definition will qualify for the exemption, not the whole group or any subsidiaries owned by that entity. The exemptions remain a contentious area with some Member States pushing for them to be removed.

EU

Monitor the development, but unlikely that action is required

Tax developments in the EU

Other jurisdictions

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 in 2022. 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 directive proposes implementation by 30 June 2023 with a view to the rules applying from 1 January 2024.

A number of amendments acknowledge the ambitious nature of the timeline, therefore implementation is likely to slip, with some doubts as to whether the directive will be adopted given it requires unanimity from all EU Member States. It is not clear at this stage how easily it will pass, especially if there are significant changes.

EU

Monitor the development, but unlikely that action is required

Tax developments in the EU

Other jurisdictions

Consultation to introduce a new EU system for withholding taxes (WHT)

Who it affects

Investors, house, fund, holding companies, portfolio companies.

Further detail

The European Commission (EC) opened a consultation to develop a new WHT refund procedure. A number of options are under consideration including:

- harmonising procedures and forms (e.g. certificate of tax residency); or
- establishing a relief at source system; and in combination with the above
- enhancing administration to verify entitlement to treaty benefits with exchange of beneficial ownership information as a way to reassure residence and source countries.

Effect for investment managers

The work to modernise the WHT refund system is at an early stage. 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.

Timing

A draft Directive is expected in 2023.

EU

Monitor the development, but unlikely that action is required

Tax developments in the EU

Other jurisdictions

Proposal for a Council Directive to introduce a debt-equity bias reduction allowance (DEBRA)

Who it affects

Holding companies, portfolio companies.

Further detail

The EC is concerned that existing tax rules encourage companies to take on excessive debt by allowing them to deduct interest related to debt financing for corporate tax purposes.

The EC has issued a proposal for a Directive laying down rules for an allowance for equity and a further rule limiting the deductibility of interest.

The equity allowance is calculated by multiplying the increase in net equity by a notional interest rate restricted to 30% of EBITDA over a 10-year lifespan.

The interest restriction rule proposes that 15% of net borrowing costs are disallowed, and is expected to work in tandem with existing interest restriction rules introduced by ATAD 1.

Effect for investment managers

The equity allowance will provide a deduction for increases in equity which may prove beneficial for some equity-backed portfolio businesses.

The exemption will be supplemented by a limitation on the deductibility of interest related to loans. The interaction with existing interest restriction rules is likely to prove complicated and may result in further restriction on the deductibility of interest.

Entities subject to corporate income tax in one or more EU Member States, including European permanent establishments (but excluding certain companies in the financial sector) will be within the scope.

Timing

From 1 January 2024.

EU

Monitor the development, but unlikely that action is required

Tax developments in the EU

Other jurisdictions

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

Who it affects

House, holding companies, portfolio 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. This is in response to two key drivers. First, the European Parliament requested the Commission to improve regulations around tax intermediaries following a number of scandals and second, to provide a response to the ATAD 3 proposals designed to target shell entities established in non-EU jurisdictions.

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 determined as acceptable. Parallels may be joined with DAC6 and the UK's enablers legislation.

Timing

A draft Directive is expected in the first quarter of 2023.

EU

Monitor the development, but unlikely that action is required

Tax developments in the EU

Other jurisdictions

EU list of non-cooperative jurisdictions

Who it affects

Investors, house, fund, holding companies, portfolio companies.

Further detail

The EU list of non-cooperative jurisdictions was updated in October 2022. This involved Anguilla, the Bahamas, and Turks & Caicos Islands moving from the grey list to the blacklist.

The blacklist now consists of 12 jurisdictions: American Samoa, Anguilla, the Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos Islands, the US Virgin Islands, and Vanuatu.

Bermuda and Tunisia were removed from the grey list, whilst Armenia and Eswatini were added. The grey list now comprises of: Armenia, Barbados, Belize, Botswana, the British Virgin Islands, Costa Rica, Dominica, Eswatini, Hong Kong, Israel, Jamaica, Jordan, Malaysia, Montserrat, North Macedonia, Qatar, Seychelles, Thailand, Turkey, Uruguay, Russian Federation, and Vietnam.

A revised code of conduct was approved by EU Finance Ministers in November 2022 which will broaden the scope of the tax measures under scrutiny when examining harmful tax practices within the EU. The changes introduce the concept of ‘tax features of general application’ which is wider than the existing focus on preferential measures. Measures will be regarded as harmful where they are not accompanied by anti-abuse rules and where they lead to double non-taxation or the double/multiple use of tax benefits.

Effect for investment managers

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

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 widened scope may bring other territories onto the list at the next review anticipated in February 2023.

Timing

The new list takes effect from 4 October 2022.

EU

Monitor the development, but unlikely that action is required

Tax developments in the EU

Other jurisdictions

Business in Europe: Framework for Income Taxation (BEFIT)

Who it affects

House, portfolio companies.

Further detail

As part of the EC's pursuit to introduce a single corporate tax rulebook in the EU, a consultation has been published to explore a common tax base and profit allocation formula based on tangible assets, payroll numbers and sales by destination.

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). Furthermore, the resistance displayed by Hungary to Pillar Two may be replicated here. This initiative is unlikely to have a swift or smooth passage of adoption.

Effect for investment managers

The scope of the rules is yet to be determined but it is anticipated that it will broadly follow Pillar Two bringing entities that are part of a consolidated group with revenues of more than €750m. It is unclear how the rules would apply to asset managers and if there would be similar exemptions in line with Pillar Two principles.

Timing

The consultation runs until 5 January 2023.

OECD

Action should be considered

- Pillar Two

Monitor the development, but unlikely that action is required

- Pillar One
- Crypto-Asset Reporting Framework (CARF)

Other jurisdictions

OECD

Action should be considered

Tax developments issued by the OECD

Other jurisdictions

Pillar Two

Who it affects

House, portfolio companies.

Further detail

Following publication of the OECD's model rules for the "GloBE" minimum tax rules, a number of jurisdictions have published consultations or draft legislation to implement the new measures.

The new rules aim to ensure that large multinational enterprises (MNE) groups pay a minimum effective tax rate of at least 15% on profits in every jurisdiction in which they operate. This will be achieved by allowing countries to impose top-up taxes in situations where an MNE is taxed below the minimum rate.

The main rule is the Income Inclusion Rule (IIR). It will generally be applied by the home jurisdiction of the ultimate parent entity (UPE) in a corporate group and give them the right to collect all the top-up tax relating to foreign entities owned by the UPE.

There is also a backup rule – the Undertaxed Profit Rule. This is designed to allocate any top-up tax that has not been allocated under the IIR.

Pillar Two also includes the Subject to Tax Rule. This will apply before the GloBE rules and will give greater source taxing rights to developing countries in certain situations, however the detailed operation of these rules has not been published yet.

Effect for investment managers

The GloBE rules will apply to groups with entities in more than one jurisdiction and 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.

OECD

Monitor the development, but unlikely that action is required

Tax developments issued by the OECD

Other jurisdictions

Pillar One

Who it affects

House, portfolio 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). These have explored the operative framework, administration and tax certainty aspects of the rules. "Amount B" refers to efforts to simplify transfer pricing rules, and despite limited progress on this element, a consultation is expected by the end of 2022.

Amount A will be introduced by a new Multilateral Convention (MLC) to ensure the legal obligations of the jurisdictions implementing the rules do so in a coordinated and consistent manner. According to the OECD, this will include binding rules on all aspects of implementing Amount A, including the allocation of Amount A to market jurisdictions, the elimination of double taxation, marketing and distribution safe harbour, a simplified administration process, exchange of information, and the tax certainty process.

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.

Timing

Given the uncertainty around the technical detail and reaching political agreement it is unlikely that Pillar One will come into effect in the immediate future, although the OECD, through the Inclusive Framework, has said it aims to finalise the new MLC by mid-2023, for entry into force during 2024.

OECD

Monitor the development, but unlikely that action is required

Tax developments issued by the OECD

Other jurisdictions

Crypto-Asset Reporting Framework (CARF)

Who it affects

Investors, fund, portfolio companies.

Further detail

Following a mandate from the G20, the OECD published a framework providing for the automatic exchange of tax-relevant information on crypto-assets to complement CRS (Common Reporting Standard).

The aim is to bring greater transparency regarding crypto-asset transactions undertaken by certain cross-border investors.

Effect for investment managers

The compliance burden will fall on intermediaries that provide crypto-asset services involving the exchange or transfer crypto-assets, therefore only asset managers (or their portfolio entities) providing a service involving the trading or the exchange of crypto assets will fall within scope. The due diligence exercise will extend to determining the market value of the assets and the number of units being transferred, as well as supplying certain other information points about investors.

Timing

Implementation date will be determined by local jurisdictions adopting CARF.

Macfarlanes LLP
20 Cursitor Street London EC4A 1LT | T +44 (0)20 7831 9222 | F +44 (0)20 7831 9607 | DX 138 Chancery Lane | macfarlanes.com

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