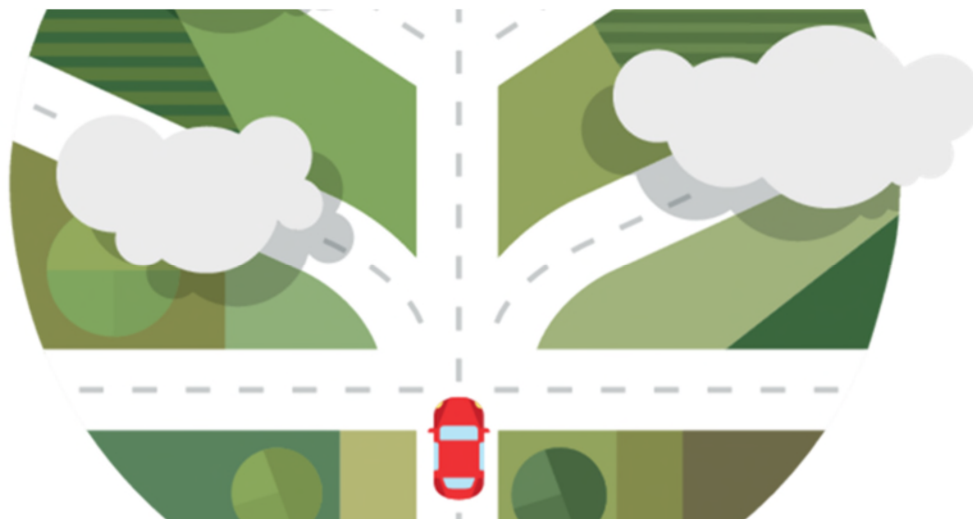

Private Equity
Tax Autumn Briefing

HMRC consultations seem to have been the flavour of the summer, with a large number of recent or ongoing HMRC consultations of importance to investment funds. We summarise here some of the key HMRC consultations of relevance to the industry.

Consultation on Proposals to clarify tax treatment of partnerships

On 9 August, HMRC published a consultation document on partnership taxation with responses due by 1 November. The stated aim of the proposals is to remove uncertainty by making the calculation and reporting of partnership profits clearer for tax payers. HMRC believe the changes will have no effect on the vast majority of partnerships. However, while a number of the proposals appear administrative in nature, they could have a significant

impact on the way in which some partnerships report to HMRC and the method by which profits are allocated.

The consultation is stated to be relevant to all types of partnerships, including general partnerships, limited partnerships, limited liability partnerships and foreign partnerships. Whilst the majority of the proposals will only be relevant for those partnerships which are currently required to file UK tax returns, some of the proposals in relation to the allocation and calculation of partnership profits could also impact on foreign partnerships with UK resident partners. A link to the consultation document can be found **here**.

We will be clarifying the proposals in a number of respects with HMRC and, in particular, ensuring that the practical implications of these proposals for investment funds and their managers are considered as part of the consultation process. We encourage fund managers to respond and/or discuss the potential implications with your usual Deloitte contact for consideration in our response.

A short summary of the proposals in the consultation document is set out below.

Investment income - tax administration

HMRC invite suggestions as to how the tax administration of partnerships with investment income can be improved. HMRC recognise that currently there are no specific provisions for investment funds and that this can create administrative difficulties for funds with a large number of partners, especially where a significant proportion of partners are non-UK resident. This proposal may provide an opportunity for some simplification and clarification of tax administration requirements.

Allocation and calculation of partnership profit

HMRC have raised a concern that in certain cases the allocation or calculation of a partner's profit is unclear or could lead to an inappropriate outcome. In particular, HMRC are concerned that the flexibility inherent in allocations of taxable profits may be seen by some to permit the manipulation of allocations for tax purposes (e.g. by allocating specific items of income and expenditure to particular partners or by determining profit shares after the end of

the accounting period). This could potentially impact certain partnership allocation provisions included in commercially agreed partnership agreements. HMRC are proposing to introduce new legislation seeking to address their concerns. Some of the key proposals relevant to the private equity industry are:

1. Providing that the basis of allocation of tax adjusted profit should be the same as the basis of allocation of the accounting profit/loss between the partners.
2. Requiring that the profit sharing arrangements in the partnership agreement are the determining factor in identifying the partners' profit shares (with this default position only capable of being overridden by notification to HMRC).

Each of these proposals would appear to have some practical implications and difficulties, including where the taxable partnership profits differ from the accounting profits.

Clarification of who is the partner chargeable to tax

HMRC propose to remove uncertainty as to who should be reported as a partner in a partnership for tax purposes. HMRC's proposal appears to place the onus on the partnership to represent to HMRC who the partners are, through their inclusion on the partnership return. The proposal does raise the question as to who the partnership needs to report as the partner where a partner is acting in the capacity as nominee. While HMRC's interest is likely to be ensuring that they have sufficient information on the partners enjoying the economic returns of the partnership to ensure that all UK taxable amounts are reported to HMRC, clearly the legal and commercial implications of this will need to be considered.

Business Structures that include partnerships as partners

Where structures involve tiered trading partnerships (i.e. one partnership is a member of another), HMRC are proposing that the tax return for the partnership generating the trading profit or loss should disclose the ultimate taxable persons. So to take a simple example, say Partnership A is a member of Partnership B, B's return would contain a partner page 7 for each of the partners of A. Whilst HMRC state that this proposal will not apply to investment fund

partnerships, the proposal could apply to tiered fund management partnerships

Trading and Property Income - tax administration

Where a partnership that carries on a trading or property business is unable to establish the details of all the partners or obtain unique tax reference numbers for them, HMRC wish to explore options for protecting the Exchequer e.g. by requiring the partnership to make a payment on account on behalf of the unidentified partners. This measure is only intended to apply to partnerships carrying on trading or property businesses. We would expect this proposal to have limited impact on investment funds and their fund management partnerships.

Consultation on possible reform of Substantial Shareholding Exemption

HMRC has been consulting on possible reforms to the Substantial Shareholding Exemption ("**SSE**"), with a view to possible legislation in Finance Bill 2017.

The consultation focused on ways in which the SSE can be reformed both to reduce its complexity and to improve the attractiveness of the UK as a holding company jurisdiction. Deloitte made representations as part of this consultation, including representations to cover the application of the proposed reforms to investment fund holding structures.

The application of the current SSE requirements to many investment fund holding structures can be uncertain, complex and subjective. Difficulties that can arise in practice for investment funds include:

- Technical issues/uncertainties as to whether the trading requirements are met pre and post disposal;
- Technical issues with identifying the group for SSE purposes, particularly where there are stakeholders investing at multiple levels in the structure;

- Difficulties meeting the substantial shareholding requirement, for example on staggered disposals; and
- Technical difficulties with the application of these rules to groups which include entities that do not have ordinary share capital (e.g. US limited liability companies).

The proposals in the HMRC consultation document seek to address a number of issues with the current rules. Very broadly, the proposals include exploring whether a more comprehensive exemption on share disposal gains should be introduced (more akin to the participation exemptions in Luxembourg and the Netherlands). As an alternative, the Government proposes to explore a number of amendments that could be made to the existing rules so as to remove some of the current uncertainty and complexity. Overall, these proposals are very welcome and will hopefully, if implemented, increase the attractiveness of the UK as a holding company jurisdiction for investment funds.

Consultation on Corporation Tax Loss Relief

The Government published a consultation in May regarding proposed reforms to corporation tax loss relief rules which are proposed to be included in the Finance Bill 2017.

The proposed reforms are two-fold:

- Firstly, the Government propose to allow the more flexible use of carry forward losses. Currently, carried forward losses can only be used in the same company and often against the profits from the same activities that gave rise to the losses, so the Government have acknowledged that these rules are overly restrictive. The proposal outlined in the consultation document would ease or even remove these restrictions such that carried forward losses arising post April 2017 could be relieved against taxable profits of group members and also against profits from different activities within the company itself. This proposal would be a welcome broadening of the existing loss relief rules and for private equity structures going

forward could alleviate concerns of trapped losses in UK holding companies.
- Secondly, from 1 April 2017 the Government propose to introduce an annual limit on the total amount of carried forward losses that can be relieved. The proposal outlined would limit the annual profit of a company/ group that can be relieved with carried forward losses to 50% of taxable profits after a £5 million annual allowance per group.
- There are a number of points that have been raised with HMRC, including the definition of a group for the determination of the £5 million annual limit. Hopefully, economically independent portfolio groups will not be considered to be one group for this purpose such that the annual allowance would have to be shared amongst them.
- We expect to see the outcome of the Governments consultation when the draft Finance Bill 2017 is published on 5 December 2016.

Consultation on Tackling Disguised Remuneration

On 10 August 2016, HMRC published a consultation on "Tackling Disguised Remuneration " which sets out extensions to be made to the Disguised Remuneration ("**DR**") rules, particularly in respect of loan arrangements which remain outstanding as at 6 April 2019.

In addition, this consultation also sets out proposals to extend the scope of the DR rules to cover self-employed individuals and members of partnerships - currently, the rules only apply to employees. These proposals could therefore potentially be relevant to Private Equity Executives, where they are members of a manager / adviser which is structured as an LLP.

The consultation document states that the extension of the DR rules to self-employed individuals is aimed at arrangements which seek to avoid a charge to income tax and National Insurance Contributions ("**NIC**") by depressing income of the trade by

diverting monies earned from the provision of the individual's services, through a variety of methods, with these amounts ultimately being received by the individual in the form of a loan or other non-taxable amount. The proposals are also aimed at arrangements where deductions for expenses are claimed by the business and the amounts that are claimed as deductions are received in the form of benefits by the individual.

HMRC is therefore proposing to tackle these types of arrangements by introducing new rules in the Finance Bill 2017. No draft legislation on this matter was published as part of this consultation, but HMRC have stated they intend to look to the substance of the arrangements, ignoring any steps or actions taken between the provision of services and the receipt of payments by the individuals.

Whilst we expect these rules to be aimed at contrived arrangements, it will be necessary to review the draft legislation once it has been published to consider whether any commercial arrangements could potentially be inadvertently caught within scope.

Changes to the taxation of non-UK domiciled individuals

HM Treasury have published the long-awaited response to the consultation document on the non-dom reforms and to the inheritance tax (IHT) position of UK residential property. Our client briefing on these changes can be found **here**.

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