

***Navigating the Maze:***  
AIFMD and New Tax Rules  
– A Channel Islands Funds’  
perspective

# *Introduction*

Mike Byrne - Jersey | David Waldron - Guernsey

Grant Lee



Rob Mellor



Tim Wright



Becky Brewer



Peter Brewin



Justin Woodhouse



Debbie Payne



David Waldron



Jameson Hyde



# ***Alternative Investment Fund Managers Directive (AIFMD)***

## Reporting to the Regulator & Substance

Grant Lee

Becky Brewer

## ***AIFMD – a reminder***

The key purpose of AIFMD is increase investor protection, improve transparency, monitor and prevent systematic risks and improve cross border marketing of funds. The key facts are:

Introduced by the EU following the financial crisis of 2007/8 – and the perceived role of hedge funds in exacerbating the crisis

Scope widened through legislative process to capture all non-UCITS funds (including non-UCITS retail schemes, investment trusts, private equity, real estate and hedge funds)

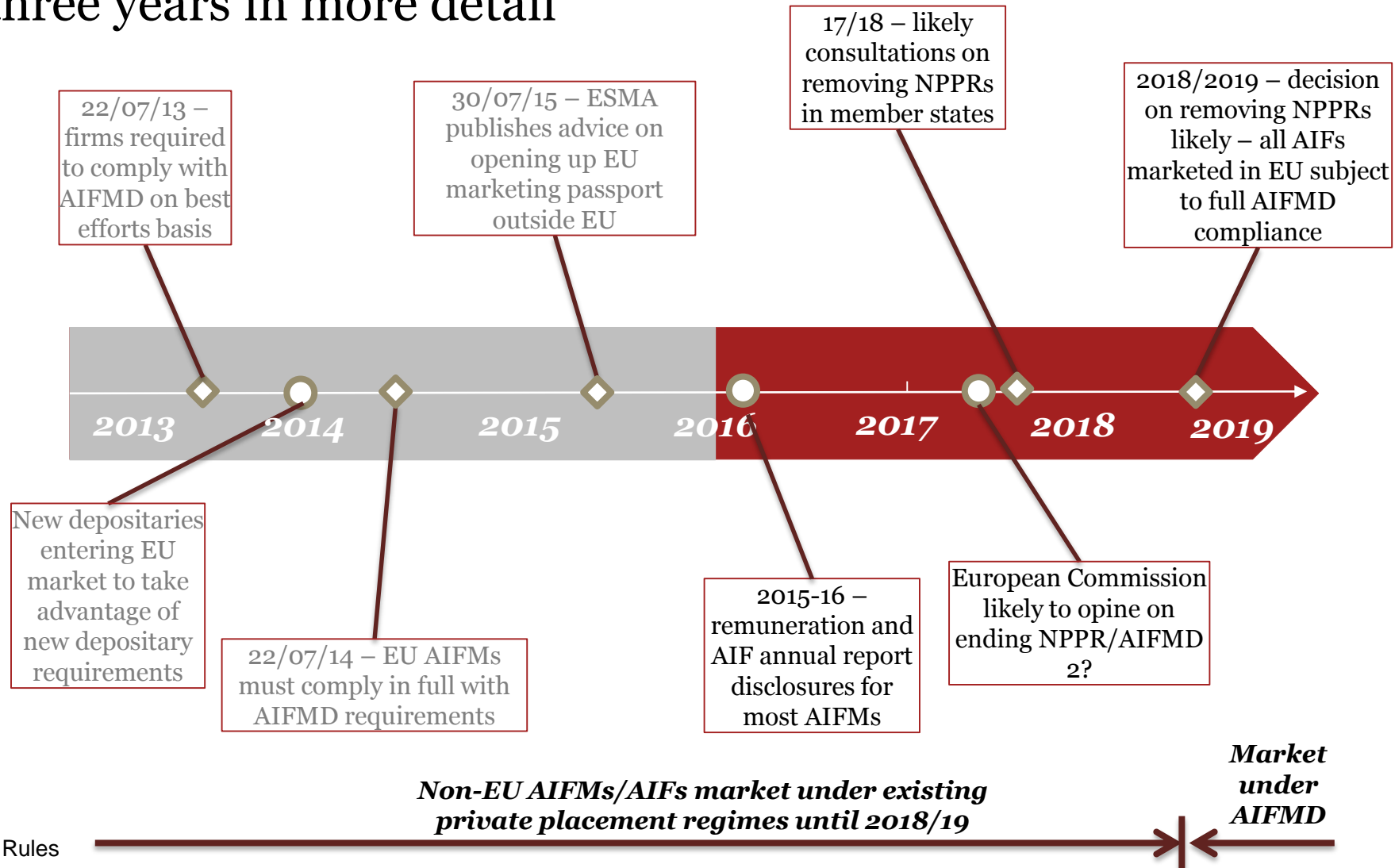
Regulates the fund managers of all these non-UCITS funds but not the funds

Gives fund managers regulated under AIFMD access to a marketing passport for their funds and establishes minimum requirements for operation of the funds captured by AIFMD

Extraterritorial reach of third country regime applicable to non-EU fund managers managing or marketing funds in the EU

# Where are we

## The next three years in more detail



# Reminder

## AIFMD scope

### What is an AIF and who is an AIFM?

#### AIF, if

- Not regulated by UCITS
- Invests funds of several private or institutional investors for a common purpose
- Investment is done in context to a defined investment policy

#### AIFM, if

- Capital investments are done for a number of persons/companies (=AIFs are managed)
- AuM > € 100m: Included are direct or indirect managed assets
- AuM > € 500m: If exclusively other AIFs are kept, no leverage is possible and shares in AIFs must be kept for at least 5 years

### AIFMD

Regulation (authorisation, risk management, valuation, remuneration and others)

Fund manager

Asset Management and public distribution

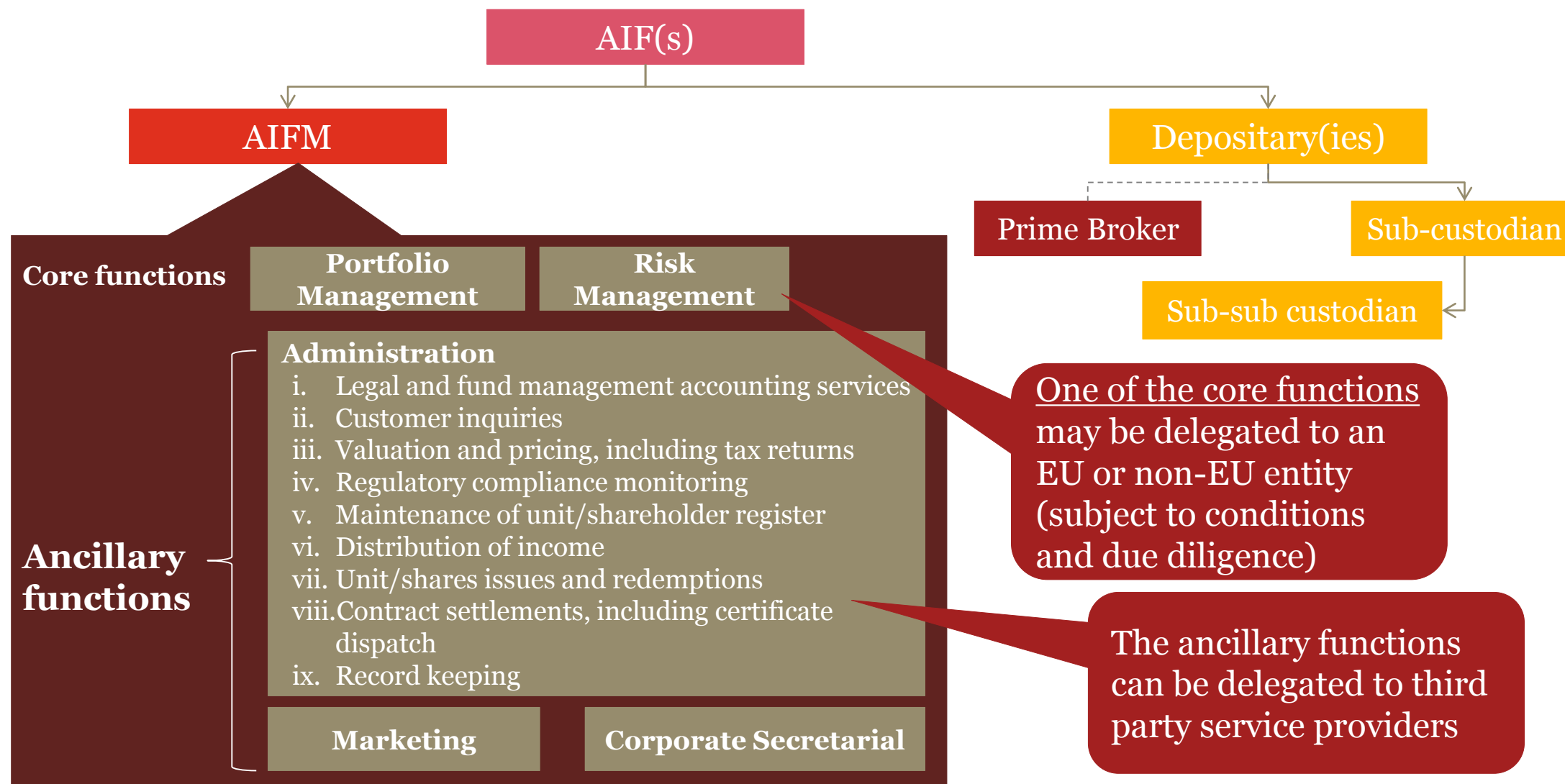
Hedge funds

Property funds

Private equity funds

Fund manager

## Reminder - main functions impacted by AIFMD



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# ***Regulatory reporting requirements***



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## ***Key considerations for reporting requirements***

- AIFMs will not be expected by national regulators to report until they are fully authorised
- Initial reporting will be aligned with the quarterly calendar year. The first reporting period starts from the first day of the following quarter after authorisation and runs until the end of the relevant reporting period.
- AIFMs have thirty days to submit their reporting to the relevant regulator. Managers of a fund-of-funds have forty five days for this submission.

### **Example**

An AIFM authorised in July 2015 would file its first reporting in January 2016 for the quarter ending December 2015, because it was authorised during Q3.

# ***AIFMD regulatory reporting periods and end dates***

	<b>Unleveraged fund</b>	<b>All other small AIF</b> <€1bn AUM by AIFM	<b>All other large AIF</b> >€1bn AUM by AIFM or >€500m AUM in AIF
<b>Full scope UK AIFM</b>	<b>Frequency:</b> Annually	<b>Frequency:</b> Half-yearly	<b>Frequency:</b> Quarterly
<b>Non-EEA AIFM that is <u>not</u> a small AIFM that is marketing in the UK</b>	<b>Reporting end date:</b> 31 December	<b>Reporting end dates:</b> 30 June, 31 December	<b>Reporting end dates:</b> 31 March, 30 June, 30 September, 31 December
<b>Small authorised UK AIFM</b>	<b>Threshold:</b> <€500m AUM by AIFM for unleveraged AIFs with no redemptions for 5 years  <b>Frequency:</b> Annually  <b>Reporting end date:</b> 31 December	<b>Threshold:</b> <€100m AUM in AIF	Not applicable
<b>Small registered UK AIFM</b>		<b>Frequency:</b> Annually	
<b>Non-EEA AIFM that is a small AIFM that is marketing in the UK</b>		<b>Reporting end date:</b> 31 December	

<sup>1</sup> AIFMs will be required to report within 1 month of the end of the reporting period., with an additional 15 days allowed for fund of funds.

<sup>2</sup> Assets under management (AUM) is the gross portfolio of assets in each AIF valued under the fund's valuation methodology. Each derivative position must be converted into its underlying assets using the conversion methodologies laid out in AIFMD Level 2 Delegated Acts.

<sup>3</sup> Including any assets acquired through use of leverage.

# Overview of regulatory reporting requirements

ESMA reporting template has now been developed on the foundation of Annex IV reporting template provided in Level 2 of the Directive and recommended by competent authorities to be used in the interim.

	AIFMD provisions	Data elements	Annex IV ref.	ESMA template ref.
1	AIFM-specific information to be reported [Art 3(3)(d) and 24(1)]	<ul style="list-style-type: none"> <li>Principal markets, principal instruments, value of assets under management</li> </ul>	Q1-3	Q1-38 AIFM file 24(1)
2	Detailed list of all AIFs which the AIFM manages (to be provided on request for the end of each quarter) [Art 24(3)]	<ul style="list-style-type: none"> <li>Detailed list of all AIFs which the AIFM manages</li> </ul>	Q1	-
3	AIF-specific information to be provided [Art 3(3)(d) and 24(1)]	<ul style="list-style-type: none"> <li>Identification of the AIF</li> <li>Principal exposures and most important concentration</li> </ul>	Q1-10 Q11-17	Q1-63 Q64-120 AIF file 24(1)
4	AIF-specific information to be provided to competent authorities [Art 24(2)]	<ul style="list-style-type: none"> <li>Identification of the AIF</li> <li>Instruments traded and individual exposures</li> <li>Market risk profile</li> <li>Counterparty risk Profile</li> <li>Liquidity Profile –Portfolio Liquidity Profile</li> <li>Liquidity Profile –Investor Liquidity Profile</li> <li>Liquidity Profile –Financing liquidity</li> <li>Liquidity Profile – Operational and other risk aspects</li> <li>Borrowing and Exposure Risk</li> </ul>	Q1-7 Q8-12 Q13 Q14-18 Q19-20 Q21-24 Q25 Q26-32	- Q121-136 Q137-147 Q148-177 Q178-185 Q186-209 Q210-217 Q218-278 Q281-295 AIF file 24(2)
	Results of stress tests [Art 24(2)(e)]	<ul style="list-style-type: none"> <li>Results of stress tests performed in accordance with point (b) of Article 15(3) of Directive 2011/61/EU</li> <li>Results of stress tests performed in accordance with the second subparagraph of Article 16(1) of Directive 2011/61/EU</li> </ul>		Q279-280 (free text) AIF file 24(1)
6	AIF-specific information to be made available to the competent authorities [Art 24(4)]	<ul style="list-style-type: none"> <li>AIF-specific information to be made available</li> <li>Borrowing and Exposure Risk</li> </ul>	Q1 Q2-7	- Q281-295 AIF file 24(4)

# Applicable provisions

AIFMD provisions	Full scope UK AIFM	Non-EEA AIFM that is <u>not</u> a small AIFM marketing in the UK	Small authorised UK AIFM	Small registered UK AIFM	Non-EEA AIFM that is a small AIFM marketing in the UK
<b>1</b> AIFM-specific information to be reported [Art 3(3)(d) and 24(1)]	✓	✓	✓	✓	✓
<b>2</b> Detailed list of all AIFs which the AIFM manages [Art 24(3)]	✓	✓			
<b>3</b> AIF-specific information to be provided [Art 3(3)(d) and 24(1)]	✓	✓	✓	✓	✓
<b>4</b> AIF-specific information to be provided to competent authorities [Art 24(2)]	✓	✓			
<b>5</b> Results of stress tests [Art 24(2)(e)]	✓	✓			
<b>6</b> AIF-specific information to be made available to the competent authorities [Art 24(4)]	✓ (if leverage on a substantial basis)	✓ (if leverage on a substantial basis)			

# Key regulatory reporting challenges

## Our analysis of reporting templates

Certain regulatory reporting questions present interpretive challenges. Other questions ask for data or information that the managers may not keep or track.

Regulation	Template	Areas that will require interpretation and strong technical understanding	Assessed difficulty level	Considerations for clients
AIFMD	Annex IV ESMA Reporting template	Schedule of investments	●	<ul style="list-style-type: none"><li>Have you mapped how your funds investments types map through to the asset and sub-asset types in the AIFMD reporting?</li><li>Are financial instruments traded by the fund, principal exposures and deal size monitored and analysed by you as set out in the AIFMD reporting form?</li></ul>
		Borrowings and Counterparty Credit Exposure	●	<ul style="list-style-type: none"><li>What type of information are you including in Borrowings and Counterparty Credit Exposure?</li><li>Are you tracking this information with counterparty details? If so, does it include details regarding collateral?</li></ul>
		Trading and Clearing Activity	●	<ul style="list-style-type: none"><li>Are you tracking which transactions are exchange traded versus over-the-counter (OTC)?</li><li>Are you tracking which transactions are cleared by a CCP versus bilaterally transacted?</li></ul>
		Portfolio Liquidity	●	<ul style="list-style-type: none"><li>Do you currently have a process in place or are developing a methodology to determine your investment portfolio's liquidity?</li><li>Do you monitor the redemption rates and frequency in the investor redemptions in accordance with the AIFMD reporting buckets?</li></ul>

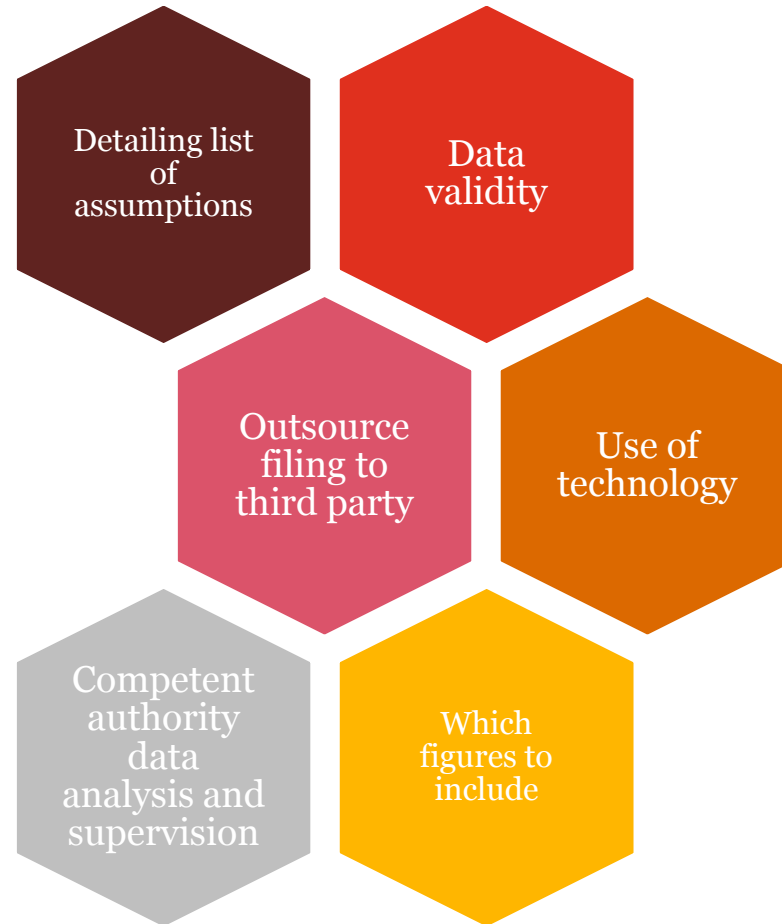
# Key regulatory reporting challenges

Our analysis of reporting templates

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Regulation	Template	Areas that will require interpretation and strong technical understanding	Assessed difficulty level	Considerations for clients
AIFMD	Annex IV ESMA Reporting template	Risk Information	●	<ul style="list-style-type: none"> <li>What type of risk analytics do you perform?</li> <li>Are Internal rates of return calculated on a net and gross basis for the funds by the manager on the frequency required by AIFMD?</li> <li>Do you calculate VaR (using either the Monte Carlo or historical simulation methods)?</li> <li>Do you perform stress testing over various market factors?</li> </ul>
		Asset Under Management	●	<ul style="list-style-type: none"> <li>Assets under management means total assets under management including any assets acquired through leverage. This will need to be calculated in accordance with AIFMD principles (Level 2 Article 2 and 10).</li> <li>Derivatives need to be converted into their equivalent position in the underlying asset and the absolute value of this position is to be used in calculations.</li> <li>Foreign exchange and interest rate hedging strategies that are not used to generate a return can be excluded.</li> </ul>
		Leverage	●	<ul style="list-style-type: none"> <li>Is leverage calculated using the Gross or Commitment Method as set out under AIFMD? For funds using “substantial leverage” there are additional reporting requirements.</li> </ul>

## *Typical AIFMD reporting issues...*



# AIFMD reporting – data and analysis

A reporting dashboard aimed at analysing the underlying data and a completed Annex IV report under AIFMD. The reporting data dashboard utilises underlying raw data. The advantages to the business are:

- Demonstrates oversight of the reporting by the AIFM if regulatory reporting is outsourced.
- A quick check of data quality in the completed form through analysis of blank and incomplete fields.
- Data integrity through providing summaries of top positions, country exposures and other key data included in AIFMD reporting.
- Reconciliation of raw data to the completed Annex IV form – proving ‘One Source of the Truth’.
- Comparison of multiple submissions where filings are made to a number of regulators for the same fund.
- Captures issues prior to submission to the regulator.





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# ***AIFMD reporting survey***

## The highlights

## ***Jersey Survey results: AIFMD and new tax rules***

**For Jersey & Guernsey domiciled AIFMs, which regime are you currently operating under?**

- Opted-in to the fully compliant regime = 0%
- Private Placement only = 70%
- Sub-threshold AIFM = 20%
- None = 10%

**Where the regulatory reporting is outsourced, do you think the level of service is:**

- Excellent, exceeding expectations = 0%
- Good, marginally above expectations = 33.3%
- In line with expectations = 66.7%
- Below expectations = 0%

**If you are performing regulatory reporting (including where you do so as an outsource provider), are you reporting under:**

- Private Placement = 100%
- Both = 0%
- EU passport = 0%

**Do you expense the cost of preparing and filing the Annex IV reports?**

- As a manager expense = 0%
- As a Fund expense = 66.7%
- Split the cost = 11.1%
- Yet to file and incur expense = 22.2%

**Where you report under Private Placement, how many country filings are you performing?**

- 1 = 12.5%
- 2-5 = 37.5%
- 5+ = 50%

**What is the time taken to prepare and file the AIF Annex IV report?**

- Less than 10 hours = 25%
- Between 10 and 30 hours = 50%
- Greater than 30 hours = 12.5%
- Uncertain = 12.5%

**Are you a quarterly or less frequent filer?**

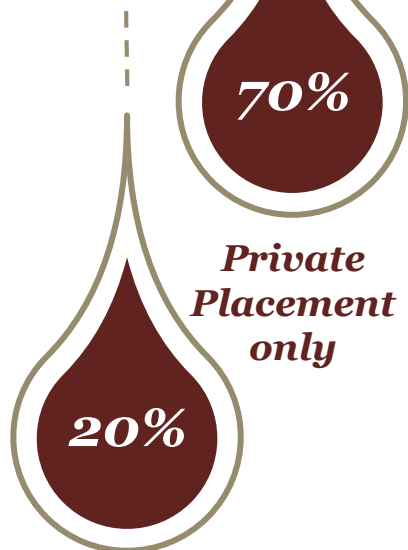
- Quarterly = 37.5%
- Other = 62.5%

**What can we do to solve the substance requirements for AIFMD in the CI?**

- Ensure local providers can offer both portfolio and risk mgmt. services = 60%
- Nothing – we already meet requirements for AIFMD = 40%

# Jersey Survey results: AIFMD and new tax rules

Operating under which regime?



Private Placement only

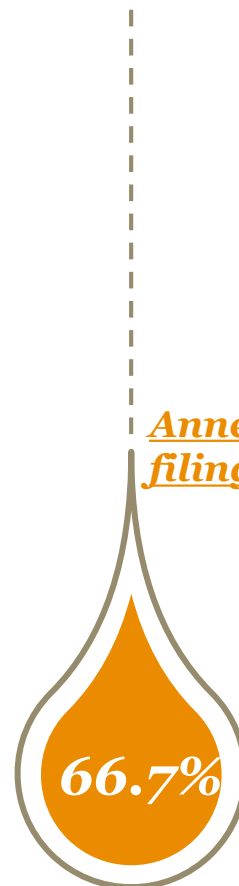
Sub-threshold AIFM

Level of outsourced service



In line with expectations

Annex IV filing



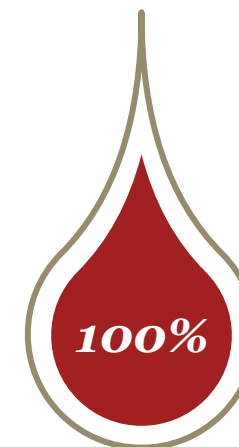
As a Fund expense

How many country filings?



2 - 5 filings

Regulatory reporting under

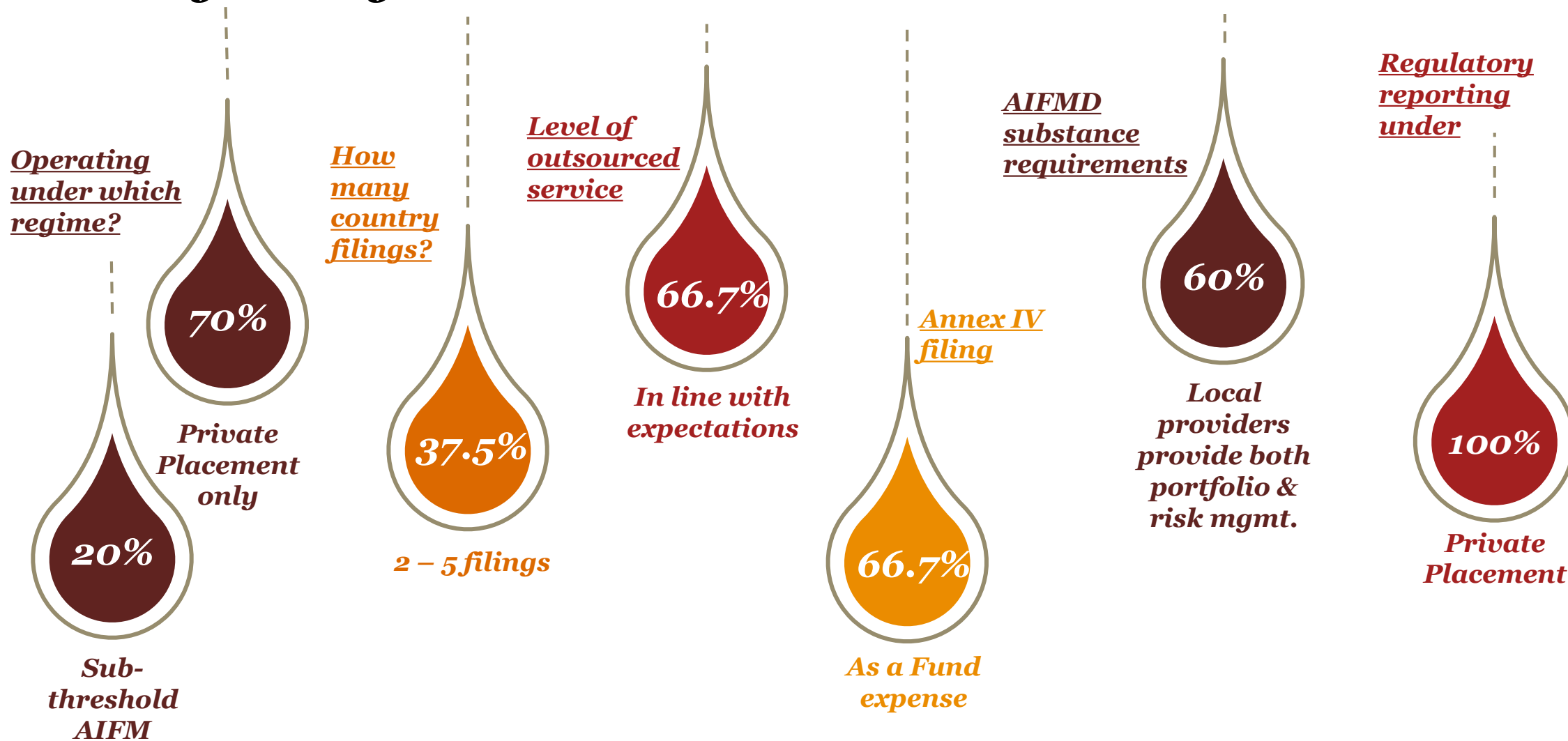


Private Placement

# Guernsey Survey results: AIFMD and new tax rules

<p><b>For Jersey &amp; Guernsey domiciled AIFMs, which regime are you currently operating under?</b></p> <ul style="list-style-type: none"><li>• Opted-in to the fully compliant regime = 0%</li><li>• Private Placement only = 70%</li><li>• Sub-threshold AIFM = 20%</li><li>• None = 10%</li></ul>	<p><b>Where the regulatory reporting is outsourced, do you think the level of service is:</b></p> <ul style="list-style-type: none"><li>• Excellent, exceeding expectations = 0%</li><li>• Good, marginally above expectations = 33.3%</li><li>• In line with expectations = 66.7%</li><li>• Below expectations = 0%</li></ul>
<p><b>If you are performing regulatory reporting (including where you do so as an outsource provider), are you reporting under:</b></p> <ul style="list-style-type: none"><li>• Private Placement = 100%</li><li>• Both = 0%</li><li>• EU passport = 0%</li></ul>	<p><b>Do you expense the cost of preparing and filing the Annex IV reports?</b></p> <ul style="list-style-type: none"><li>• As a manager expense = 0%</li><li>• As a Fund expense = 66.7%</li><li>• Split the cost = 11.1%</li><li>• Yet to file and incur expense = 22.2%</li></ul>
<p><b>Where you report under Private Placement, how many country filings are you performing?</b></p> <ul style="list-style-type: none"><li>• 1 = 12.5%</li><li>• 2-5 = 37.5%</li><li>• 5+= 50%</li></ul>	<p><b>What is the time taken to prepare and file the AIF Annex IV report?</b></p> <ul style="list-style-type: none"><li>• Less than 10 hours = 25%</li><li>• Between 10 and 30 hours = 50%</li><li>• Greater than 30 hours = 12.5%</li><li>• Uncertain = 12.5%</li></ul>
<p><b>Are you a quarterly or less frequent filer?</b></p> <ul style="list-style-type: none"><li>• Quarterly = 37.5%</li><li>• Other = 62.5%</li></ul>	<p><b>What can we do to solve the substance requirements for AIFMD in the CI?</b></p> <ul style="list-style-type: none"><li>• Ensure local providers can offer both portfolio and risk mgmt. services = 60%</li><li>• Nothing – we already meet requirements for AIFMD = 40%</li></ul>

# Guernsey Survey results: AIFMD and new tax rules



## *Many differences in local requirements under Art. 42*

For example...

Countries	Concept of marketing	Notification or authorisation	Additional regulator requirements
UK	■	■	■
Germany	■	■	■
France	■	■	■ (*)
Ireland	■	■	■
Luxembourg	■	■	■
The Netherlands	■	■	■
Belgium	■	■	■
Denmark	■	■	■
Finland	■	■	■

(\*) And local agent required

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# ***Future of Passporting for Jersey and Guernsey***

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## *Opening up the AIFMD passport*

- ESMA provided advice in July 2015 about *extending the AIFMD passport to non-EU AIFMs and AIFs*.
- At the moment the passport will be extended on an opt-in basis to countries that ESMA believe provide equivalent access for EU AIFMs and AIFs.
- *NPPR access still available* – though may be shut off in 2018/19.
- ESMA currently given **positive opinion for passport** to be opened up for firms and funds in Guernsey, Jersey & Switzerland.
- Also looked at **US, Hong Kong** and Singapore but **believes current local regimes are not equivalent with AIFMD**.



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# ***AIFM substance*** Jersey and Guernsey

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## ***Substance in the AIFM***

- An AIFM must use, at all times, **adequate and appropriate human** and **technical resources**.
- Have ***sound administrative and accounting procedures***.
- An AIFM **must not delegate portfolio or risk management** to the depositary or delegate to any entity with a conflict unless such entity is functionally and hierarchically separate...conflicts of interest identified and managed.
- An AIFM must ***not delegate functions to the extent that it becomes a letterbox entity***.
- The **liability of an AIFM to the AIF's investors shall not be affected by the delegation by the AIFM of any function to a third party**.

## ***Substance in the AIFM***

An AIFM may delegate to third parties subject to a number of requirements

The AIFM must be able to justify delegation on objective reasoning

The delegate must have sufficient resources and be sufficiently experienced

Delegation of portfolio management or risk management must be to authorised and regulated entities in a jurisdiction with which Jersey or Guernsey has a co-operation agreement

Delegation must not affect the supervision of the AIFM

The AIFM must demonstrate delegate is suitably qualified and capable, must monitor delegation and withdraw immediately if in investor's interests

# ***AIFMD tax considerations***

## Substance and Transfer Pricing (“TP”)

Rob Mellor

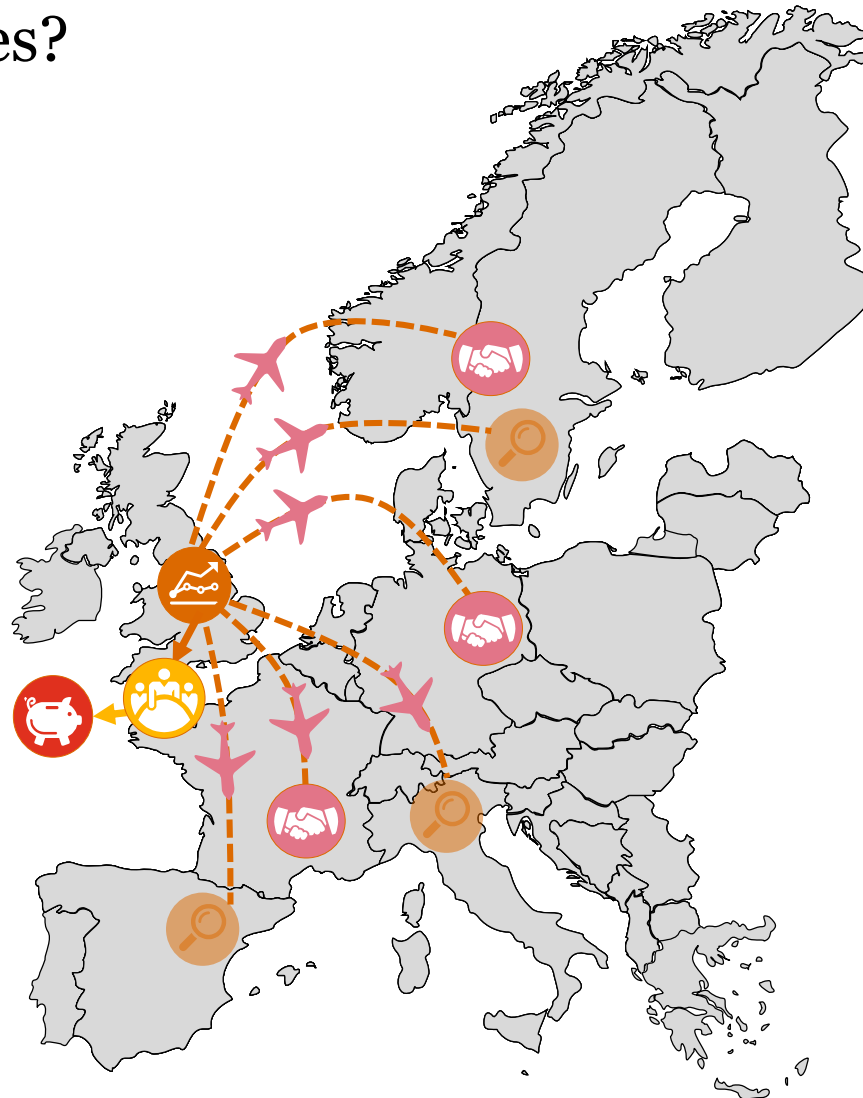
Peter Brewin

Jameson Hyde

# ***A typical CI Manager Structure***

What are the tax issues?

-  **CI Fund**
-  **CI AIFM**
-  **London Adviser Co**
-  **Investor locations  
(Registered for private  
placement)**
-  **Fund investments**
-  **Travelling Adviser Co  
employees**



**Tax issues requiring consideration:**

- 1. What information might be available to tax authorities?**
- 2. How might the various tax authorities assert taxing rights and over whom? (individuals?, AIFM? Adviser Co? Fund?)**
- 3. How much should Adviser Co be remunerated?**
- 4. Does AIFM have sufficient substance to support remaining retention of profits?**

# A question of substance

## The difference between tax and regulatory views

### *AIFMD Regulatory world*

### *Tax World*

Focus on **investor protection**



**Government perspectives**

Focus on **raising / protecting tax revenue base**

Capabilities of key employees / board members and actual performance of specified AIFM functions outlined in the Directive so as to avoid “Letterbox entity” classification.

**What is meant by substance?**



No one definition. Depending on what aspect of tax you are looking at, **Residence, beneficial ownership, VAT, permanent establishment, Diverted Profits Tax** and **transfer pricing** all require a different perspective on substance.

Focus is on the management of downside risks and control / governance procedures around mitigation of these.

**What do we mean by risk management?**



Focus is on how the effective management of risk generates **profits** for the business. To this extent it is the individuals in the organisation that have both the **capability** to assess, and **actually make decisions** on:

- i) the take on / lay off / decline of business opportunities;
- ii) how to respond to the risks associated with such opportunities; and
- iii) risk mitigation.

# The changing transfer pricing substance paradigm

## Commerciality

Are the arrangements consistent with how third parties would have behaved if tax were not a factor? This is a particular focus of Diverted Profits Tax (“DPT”), but is also relevant for transfer pricing.

## Legal contracts

Legal contracts are still the starting point of a TP analysis. However, there’s a new requirement to re-assess these if they allocate risks in a way that is not consistent with the conduct of the parties

## Actual Performance of Control Functions

New guidance states that mere parameter setting, meetings formalising decisions made elsewhere, or minutes of board meetings are not sufficient to evidence control. Need to be able to show actual decision making around risk management on specific opportunities

## Permanence

Focus is on how day to day decision making in the business is conducted rather than on decision making forums that are established to validate decisions made elsewhere.

Expect a focus on how decisions are made in the periods between board meetings as well as pressure on fly in decision makers.

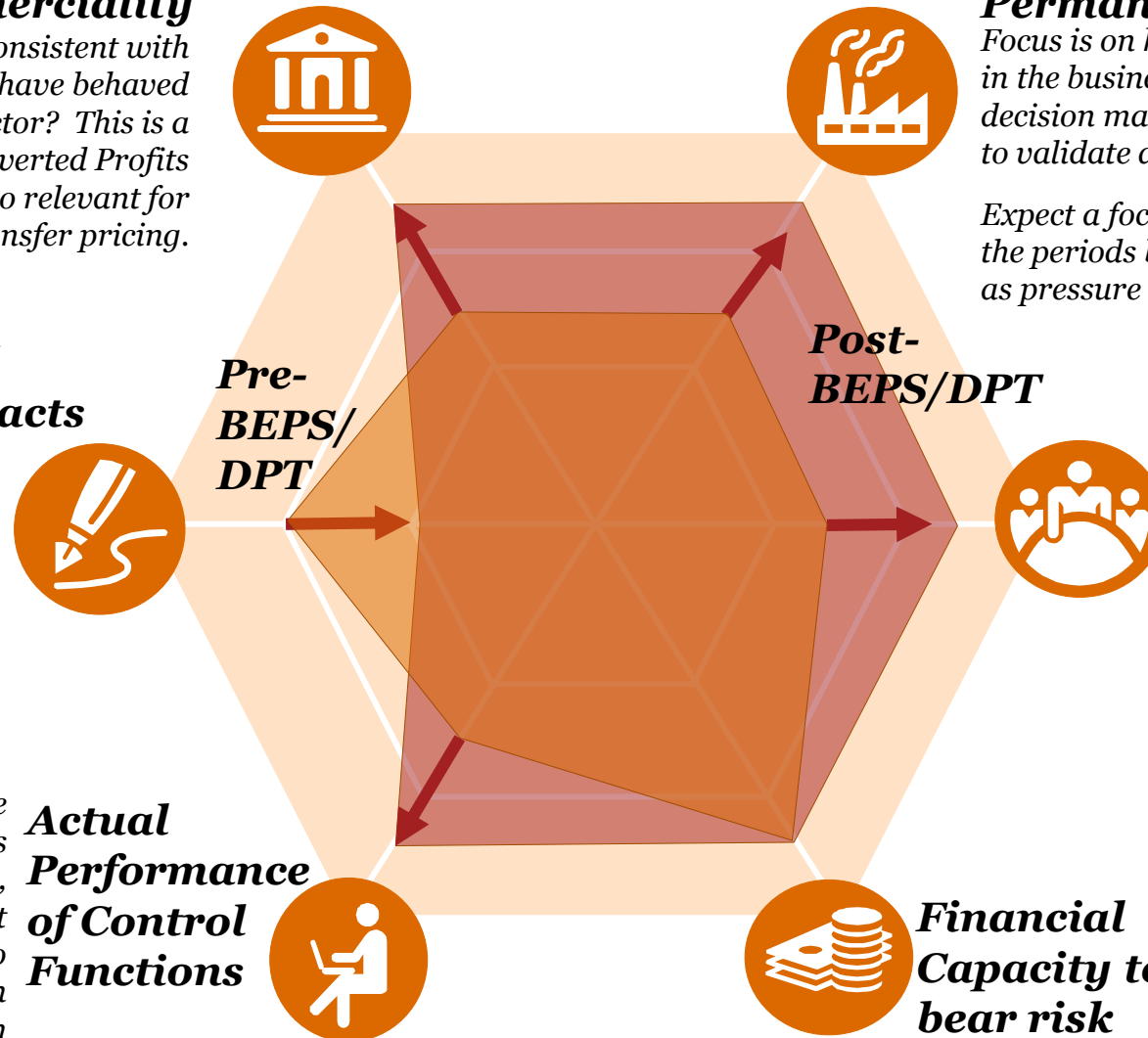
## Capability

In evidencing capability, competence and experience relevant to the decision being made are critical. As is access to the relevant information.

In cases where there are multiple parties that could be argued to be sufficiently capable and which are involved in decisions around risk management, responsibility for the risk should be allocated to the party with “most” control over the risk.

## Financial Capacity to bear risk

Having the necessary financial capacity to bear a risk remains essential in order to be attributed the upside profit potential.



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## ***What does this mean for groups with a CI AIFM?***

- 1. Evidence value generated by AIFM** - Need to clearly articulate the contributions to profits of all parts of the group in the context of the overall value chain. Benchmarking cost plus to Adviser Co and assuming that the AIFM is entitled to the residual profit will not be sufficient!
- 2. Understand your Substance** - Form a clear view of what the assets and risks are managed by the AIFM and consider whether you have the necessary substance locally to entitle you to the profits from these.
- 3. Understand your permanent establishment risk** - Understand where individuals actually spend their time and on whose behalf in order to manage the risk of inadvertent taxable presence.
- 4. Take a strategic approach to transparency** - Understand what information will need to be disclosed to overseas tax authorities through new TP documentation requirements/CbCR.
  - Consider preparing local TP documentation file
  - Ensure that information provided to tax authorities is consistent with regulatory reporting
- 5. Understand your DPT position** - If you have a UK operation, understand whether you are impacted by DPT.



# *The changing tax landscape for asset managers working in the UK*

Rob Mellor

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## ***Salaried Member Rules – April 2014***

- Are the partners really employees?
- Tests revolve around: reward / profit share, influence and capital at risk
- **Where rules apply**
  - Member treated as an employee for income tax and NIC purposes
  - Obligation on LLP to withhold PAYE / NIC on drawings
  - Tax deduction for profits paid to member (as now salary)
  - Employer's NIC is extra cost
- Care needs to be taken with Employment Related Securities issues – carry, co-invest, reduced fee share classes, equity participation at undervalue. But, also Disguised Remuneration (e.g. loans) etc.
- Annual obligation to document the treatment for each LLP member and their status.

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## ***Mixed partnerships – April 2014***

- Rules apply to all partnerships where there are “non-individual” members (companies, other partnerships, trusts)
- Aimed at profits allocated to corporate member which are ultimately intended to be destined for an individual LLP member (i.e. deferred or diverted profits).
- Just and reasonable reallocation of profits between individual and corporate where the mixed partnership rules apply
- A statutory deferral regime exist for AIFM firms

# ***The Trilogy of New 2015 / 16 Tax Changes***

## ***The Disguised Investment Management Fees rules***

***(From 6 April 2015 for sums arising 'directly or indirectly' and from 22 October 2015 for amounts arising to connected persons/companies or other persons where 'power to enjoy')***

Designed to prevent management fee income paid or benefitting individuals not being fully subject to UK income tax. Broadly all amounts in respect of the individual are in scope unless meet the definition of 'carried interest' or 'co-invest'

## ***Carried Interest rules***

***(From 8 July 2015 for sums arising 'directly or indirectly' and from 22 October 2015 for amounts arising to connected persons/companies or other persons where a 'power to enjoy')***

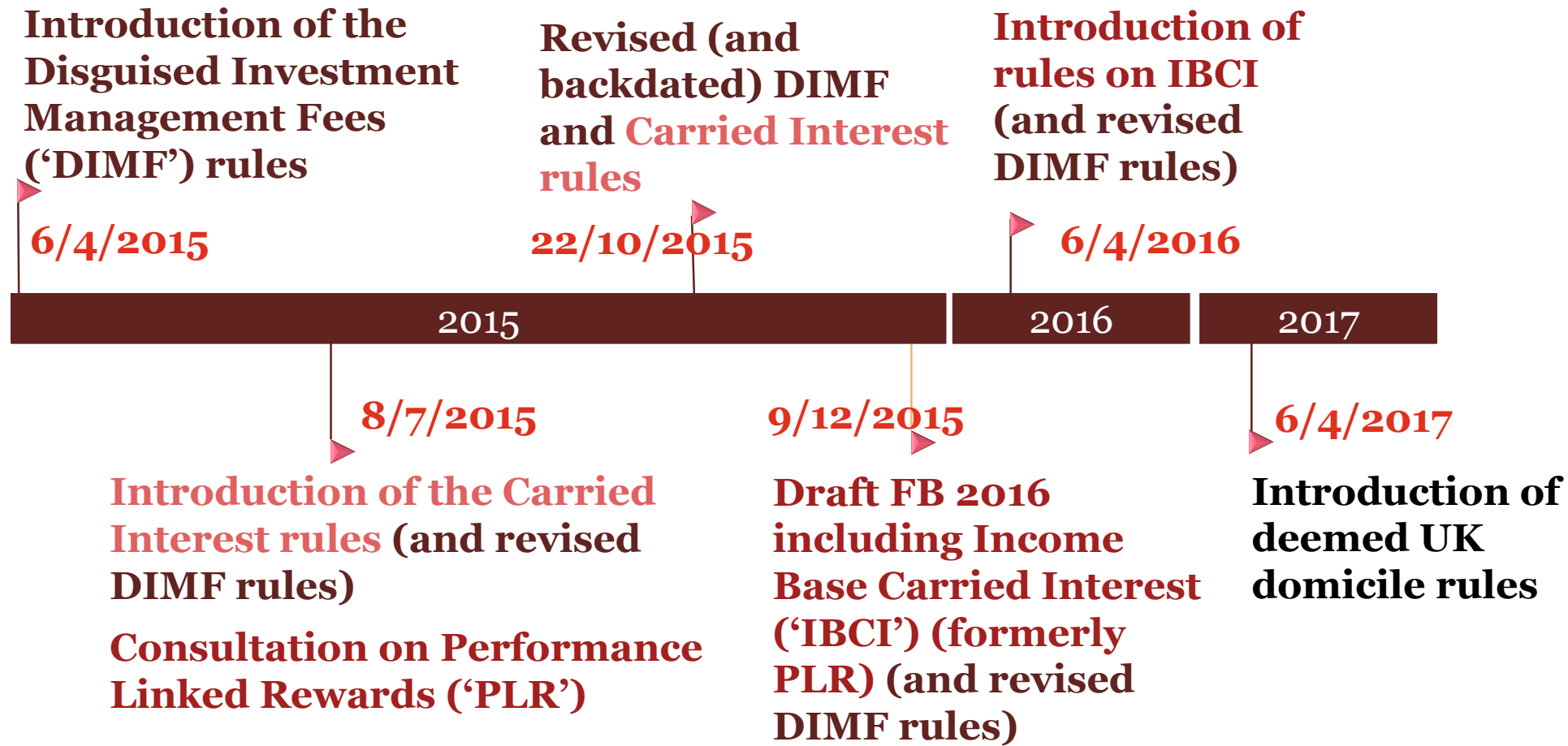
Designed to prevent 'base cost shift' to ensure carried interest is fully subject to UK capital gains tax rates and also fundamentally changes the tax treatment of non-doms

## ***Income Based Carried Interest rules***

***(Draft legislation published 9 December 2015 and will apply to sums arising from 6 April 2016)***

Designed to ensure carried interest from funds that are trading by reference to the average holding period of the investments be proportionally subject to UK income tax based upon a strict criteria

# *Timeline of recent UK tax changes for asset managers*



# ***DIMF rules – 6<sup>th</sup> April and 22<sup>nd</sup> October 2015***

## **Overview**

- From 6 April 2015 the rules apply to all ‘sums’:
  - Arising ‘directly or indirectly’ from an ‘investment scheme’
  - After 22 October 2015 the rules apply to amounts arising to individuals, connected persons (including trusts), connected companies and other persons where the individual has ‘a power to enjoy’ the sum.
  - The individual performs ‘investment management services’ in the UK (this includes, but not limited to: fund raising; research and due diligence; and acquiring, managing or disposing of investments).
  - Prior to 6 April 2016 the arrangements need to involve at least one partnership
  - And the sum received is be ‘untaxed’ (i.e. not taxed as UK trading or UK employment income).
- The rules apply to non-residents – even if they come to the UK for 1 day (i.e. ‘fly ins’). However, the individual’s activities needs to constitute a permanent establishment.
- Certain ‘carried interest’ and ‘co-investment returns’ are excluded.
- If the DIMF rules apply:

***Amounts arising to UK individuals are treated as profits of a deemed UK trade carried on by the individual (taxed at rates up to 47%)***

## *The new Carried Interest rules – 8<sup>th</sup> July and 22<sup>nd</sup> October*

### **Prevents Base Cost Shift and Cherry - Picking**

- Base cost shift removed - Carried interest amounts subject to tax at least at capital gains tax rate for UK doms (28%).
- The rules apply from 8th July 2015 (in relation to amounts arising to certain connected persons/companies/other persons where there is a power to enjoy, applies from 22nd October 2015).
- Applies to amounts arising to individuals, connected persons (including trusts), connected companies and other persons where the individual has “a power to enjoy” (subject to a deferral regime if the enjoyment is deferred).

### **No flat tax?**

- The ‘new’ rules provide for relief from double taxation where ‘income tax or another tax’ is paid on carry. A claim can be made for relief for the lower of the two taxes.
- There is a need to calculate the tax on carry both under the existing rules (e.g. for interest income) and the new rules and see which is higher.
- The implication being that other possible taxing provisions still apply to the carry and may have to claim relief from double tax in a tax return – updated tax return and guidance notes awaited for this new regime.
- Hence ‘income vs capital’ analysis / considerations are still applicable for carry returns.

### **TAAR**

- The rules include anti-avoidance which basically ignores any steps taken to circumvent the rules.

# *Carried Interest rules – 8<sup>th</sup> July and 22<sup>nd</sup> October*

How do the rules work for UK Non-Doms?

## **UK resident and non domiciled - remittance basis taxpayer**

- The new rules introduce the concept that HMRC appear to consider the carry as a fee for performance, but one that is taxable under capital gains.
- For UK sourced profits, the existing rules continue to apply to tax these fully in the UK.
- However non-UK sourced profits which previously may not have been taxed in the UK under the remittance basis, can now be brought into the UK tax net.
- **Hence for returns on non-UK assets, rather than respecting the location of the asset for the remittance basis, when carry profits ‘arise’ they are taxable or non-taxable (under the remittance basis) in proportion to the activity of the individual in the UK/outside the UK which gives rise to the carry.**
- Currently guidance is limited around how this UK/non UK apportionment will work in practice.
- The taxable amount is taxed as capital gains (i.e. 28%) irrespective of whether the character of the underlying investment return is income or gain, unless the investment return is UK source income, or offshore income which is remitted, which would be taxed at a higher rate under existing rules.



# ***Income Based Carried Interest***

Why do we have these rules?

## **Why?**

- Where investment funds are treated as investing as opposed to trading, potential for carried interest to be taxable as investing rather than a trading income.
- HMRC say that applying normal investment/trading principals to the activities undertaken by the fund can be difficult and resource intensive.
- Result is inconsistent treatment of managers carrying out broadly similar activities.
- Individuals who have received their carried interest by reason of their employment (or directorship), i.e. it is an employment related security, (“ERS”) already will be carved out of these rules (but this may be reviewed if abused).

**The draft legislation seeks to implement statutory tests to clarify the circumstances under which performance fees arising to fund managers may be treated as capital in nature.**

**But these tests will not affect the tax treatment of investors in the fund.**

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## ***Income Based Carried Interest***

- Determine whether carry is IBCI, and taxed at income rates, by reference to the weighted average holding period of the ‘relevant investments’ of the fund.
- ‘Relevant investments’ are those fund investments by reference to which carry is calculated.
- For example, if whole fund carry or deal-by-deal with whole fund clawback it is likely to be the entire portfolio.
- 3 step process for determining the average holding period = (1) multiply acquisition cost of the relevant investment x length of time held, (2) add together all the amounts, (3) divide by the total value invested by the fund in the ‘relevant investments’.
- All intermediate holding companies/structures are disregarded.
- Perform calculation on each occasion a sum of carried interest becomes payable. Need a 4-year weighted average holding period for full CGT treatment.
- “Conditionally Exempt Carried Interest” – 4-year average holding period test so carry arising in the first 4 years of the fund would automatically be income. Individual can make a claim for CGT treatment where believe the fund average holding period is likely 4 years plus and ‘reasonable to suppose’ (LPA/PPM) that the carried interest would not be taxed as trading income if it had arisen at a later date.
- 4-year weighted average test is complex with rules for Controlling PE, Originating debt funds, derivatives, hedging, etc.

# *Still to come - Deemed domicile rule*

## *Current rules*

- Distinction in tax regime for individuals not domiciled in UK.
- Liable to UK tax on all income and gains arising in UK.
- Can choose to pay UK tax on foreign income and gains only if/when remitted to the UK.
- Liable to UK IHT on worldwide assets only after become 'deemed UK domiciled' – broadly any individual resident in the UK for 17 of the past 20 tax years. Break deemed domicile for IHT after 4 years out of the UK.

## *Proposed regime*

- Changes to come into effect from 6 April 2017.
- Any individual resident in UK for 15 of the past 20 tax years will be deemed domicile for all tax purposes from 16th year.
- Lose ability to claim remittance basis – taxable on worldwide income and gains as they arise.
- IHT deemed domicile to be aligned with the above – so now deemed domiciled for IHT after 15/20 years as opposed to 17/20.
- Need to be out of the UK for more than 5 years to restart the clock.

Once an individual has been resident in the UK for 15/20 tax years they will be deemed domiciled for all taxes.

Deemed domicile status will apply from the 16th tax year of consecutive residence.

Split years will count as a year of residence.

Years spent in the UK as a minor will be taken into account.

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# *Discussion on the impact of AIFMD on remuneration*

Rob Mellor  
Tim Wright

# ***Tax updates: treaty abuse/BEPS/Country-by-Country Reporting/Onshore versus Offshore***

Justin Woodhouse  
Rob Mellor

# *Questions and closing remarks*

Justin Woodhouse

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# *Thank you!*

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# National Private Placement Regime (“NPPR”)

		EU AIF				Non-EU AIF			
		2013	2014	2015	2018	2013	2014	2015	2018
EU AIFM	EU Marketing under AIFMD passport	Passport available but AIFM must be authorized and consent of home state regulator required	Passport only applies			No passport available		Passport may become available depending on conditions being met by AIFM/AIF	
	EU private placement marketing	Private placement possible if host member state permits	No private placement			Private placement permitted			Possible decision to continue NPPRs
EU AIFM	EU marketing under AIFMD passport	No passport available	No passport available	Passport may become available if AIFM becomes authorized and cooperation arrangements in place		No passport available		Passport may become available depending on conditions being met by AIFM/AIF	
	EU private placement marketing	Private placement provided conditions are met			Possible decision to continue NPPRs	Private placement provided conditions are met			Possible decision to continue NPPRs



# *Passport recommendations*

## Jersey and Guernsey

