



Investment managers: disguised fee income

Who is likely to be affected?

Individuals involved in investment management for a private equity fund or other investment fund, who are members of a limited partnership or limited liability partnership, or involved in arrangements including partnerships. These individuals will be affected if they receive what are, in substance, management fees that are not otherwise chargeable to income tax.

General description of the measure

Sums received by these individuals which are for investment management services will be charged to income tax and Class 4 National Insurance contributions (NICs), however they are described and whatever the legal form of payment. The measure will not affect returns reflecting performance of investments under management, commonly known as carried interest, nor investments by managers known as coinvestment.

Policy objective

This measure makes the tax system fairer by putting beyond doubt that amounts received by individuals in respect of fund management services are charged to income tax and NICs.

Background to the measure

This measure was announced at Autumn Statement 2014.

Detailed proposal

Operative date

This measure will have effect on all disguised fees arising on or after 6 April 2015, whenever the arrangements were entered into.

Current law

Sums received by individuals who are partners in firms that manage investments are under current law taxable as trading income, subject to income tax and Class 4 NICs. Sums received as partners in firms that make investments are taxed according to the nature of the profits made by the partnership.

Proposed revisions

Legislation will be introduced in Finance Bill 2015 to introduce a new Chapter 5E in Part 13 of Income Tax Act 2007 to confirm the treatment of sums received by managers for investment management services.

New sections 809EZA to 809EZD will provide that where an individual provides investment management services for a collective investment scheme through an arrangement involving partnerships, then any sums received for those services will be treated as profits of a trade, unless already charged to income tax.

Sums will not be caught if they represent a return which varies by reference to profits on funds, or represent a return on investments by the managers.

The legislation will apply to amounts described, for example, as partnership profit shares or advances in anticipation of expected future profit shares.

Summary of impacts

Exchequer impact (£m)	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	-	negligible	+160	+80	+65	+55
These figures are set out in Table 2.1 of Autumn Statement 2014 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Autumn Statement 2014.						
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals, households and families	<p>This measure will have an impact on a small number of individuals in private equity firms or elsewhere in the investment management sector who are currently in arrangements to avoid paying income tax on income from managing funds.</p> <p>The measure is not expected to impact on family formation, stability or breakdown.</p>					
Equalities impacts	This measure will affect individuals receiving management fees from investment funds. These are likely to share protected characteristics with others of above average means, and equality groups represented in lower income groups are less likely to be affected.					
Impact on business including civil society organisations	This measure will have no impact on business and civil society organisations who are undertaking normal commercial transactions; it will only impact on the businesses that are using the avoidance schemes affected by this measure.					
Operational impact (£m) (HMRC or other)	The costs to HM Revenue & Customs will be negligible.					
Other impacts	<p><u>Small and micro business assessment</u>: small and micro businesses will only be affected if they participate in tax avoidance schemes.</p> <p>Other impacts have been considered and none have been identified.</p>					

Monitoring and evaluation

HMRC will assess the impact of the measure by monitoring information collected from tax returns and receipts.

Further advice

If you have any questions about this change, please contact Chris Murricane on 03000 585953 (email: chris.murricane@hmrc.gsi.gov.uk) or contact Richard Rogers on 03000 585521 (email: richard.rogers@hmrc.gsi.gov.uk).

1 Disguised investment management fees [j1012]

(1) In Part 13 of ITA 2007 (tax avoidance), after Chapter 5D insert –

“CHAPTER 5E

DISGUISED INVESTMENT MANAGEMENT FEES

809EZA Disguised investment management fees: charge to income tax

- (1) Where one or more disguised fees arise to an individual in a tax year from one or more collective investment schemes (whether or not by virtue of the same arrangements), the individual is liable for income tax for the tax year in respect of the disguised fee or fees as if –
 - (a) the individual were carrying on a trade for the tax year,
 - (b) the disguised fee or fees were the profits of the trade of the tax year, and
 - (c) the individual were the person receiving or entitled to those profits.
- (2) For the purposes of subsection (1) –
 - (a) if the investment management services by virtue of which the disguised fee or fees arise to the individual in the tax year are to any extent performed in the United Kingdom, the trade is treated as carried on wholly in the United Kingdom, and
 - (b) otherwise, the trade is treated as carried on wholly outside the United Kingdom.
- (3) For the purposes of this Chapter a disguised fee arises to an individual in a tax year from a collective investment scheme if –
 - (a) the individual performs investment management services directly or indirectly in respect of the scheme under any arrangements,
 - (b) the arrangements involve at least one partnership,
 - (c) under the arrangements, a management fee arises to the individual in the tax year directly or indirectly from the scheme (whether in the form of a loan or advance, by way of allocation of profits or otherwise), and
 - (d) some or all of the management fee is untaxed for the tax year; and the amount of the disguised fee is so much of the management fee as is untaxed for the tax year.
- (4) For the purposes of subsection (3) the management fee is “untaxed” for the tax year if and to the extent that the fee would not (apart from this section) –
 - (a) be charged to tax under ITEPA 2003 as employment income of the individual for the tax year, or
 - (b) be brought into account in calculating the profits of a trade of the individual for the purposes of income tax for the tax year.
- (5) In subsection (4) “trade” includes profession or vocation.

809EZB Disguised investment management fees: interpretation

- (1) For the purposes of this Chapter a sum which arises to an individual directly or indirectly from a collective investment scheme under any arrangements is a “management fee” except so far as the sum—
 - (a) constitutes carried interest (see subsection (2)),
 - (b) arises by way of return or repayment of an investment made by the individual in the scheme, or
 - (c) constitutes a commercial return on an investment made by the individual in the scheme (see subsection (4)).
- (2) For the purposes of subsection (1) a sum constitutes “carried interest” if it is a sum which, under the arrangements, is to, or may, arise to the individual—
 - (a) out of profits on the investments made for the purposes of the scheme, but only after—
 - (i) all, or substantially all, of the investments in the scheme made by the participants have been returned or repaid to the participants, and
 - (ii) each participant has received a preferred return on all, or substantially all, of the participant’s investments in the scheme, or
 - (b) out of profits on a particular investment made for the purposes of the scheme, but only after—
 - (i) all, or substantially all, of the relevant investments made by participants have been returned or repaid to those participants, and
 - (ii) each of those participants has received a preferred return on all, or substantially all, of the participant’s relevant investments;and for this purpose “relevant investments” means those investments in the scheme to which the particular investment made for the purposes of the scheme is attributable.
- (3) In subsection (2) “preferred return” means a return of not less than the amount that would be payable on the investment by way of interest if—
 - (a) compound interest were payable on the investment for the whole of the period during which it was invested in the scheme, and
 - (b) the interest were calculated at a rate of 6% per annum.
- (4) For the purposes of subsection (1) a return is “commercial” if—
 - (a) the return is at a rate reasonably comparable to what is (in all the circumstances) a commercial rate of interest, and
 - (b) the other terms governing the return are reasonably comparable to the terms governing returns to external investors on comparable investments made by them in the scheme;and for this purpose “external investor” means a participant in the scheme who does not perform investment management services directly or indirectly in respect of the scheme.
- (5) In this Chapter—

“arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable);

“collective investment scheme” has the meaning given by section 235 of FISMA 2000;

“investment management services”, in relation to a collective investment scheme, includes—

- (a) seeking funds for the purposes of the scheme from participants or potential participants,
- (b) researching potential investments to be made for the purposes of the scheme,
- (c) acquiring, managing or disposing of property for the purposes of the scheme, and
- (d) acting for the purposes of the scheme with a view to assisting a body in which the scheme has made an investment to raise funds;

“participant”, in relation to a collective investment scheme, is construed in accordance with section 235 of FISMA 2000;

“sum” includes any money or money’s worth (and “arise” is to be construed accordingly).

(6) For the purposes of this section—

- (a) a reference to profits on an investment made for the purposes of a collective investment scheme is a reference to profits or income arising from the acquisition, holding, management or disposal of the investment, and
- (b) a reference to an investment made by a person in a collective investment scheme is a reference to a contribution by the person (whether by way of capital, loan or otherwise) towards the property which is to be subject to the scheme (but does not include a sum committed but not yet invested).

809EZC Disguised investment management fees: anti-avoidance

In determining whether section 809EZA applies in relation to an individual, no regard is to be had to any arrangements the main purpose, or one of the main purposes, of which is to secure that that section does not apply in relation to—

- (a) the individual, or
- (b) the individual and one or more other individuals.

809EZA Disguised investment management fees: avoidance of double taxation

(1) This section applies where—

- (a) income tax is charged on an individual by virtue of section 809EZA in respect of a disguised fee, and
- (b) at any time, a tax (whether income tax or another tax) is charged on the individual otherwise than by virtue of section 809EZA in relation to—
 - (i) the disguised fee, or
 - (ii) where the disguised fee arises to the individual by way of a loan or advance, an amount which arises to the individual under the relevant arrangements for the

purpose of enabling the individual to discharge an obligation to repay the loan or advance;

and for this purpose, “the relevant arrangements” means the arrangements under which the disguised fee arises to the individual.

- (2) In order to avoid a double charge to tax, the individual may make a claim for one or more consequential adjustments to be made in respect of the tax charged otherwise than by virtue of section 809EZA.
- (3) On a claim under this section an officer of Revenue and Customs must make such of the consequential adjustments claimed (if any) as are just and reasonable.
- (4) The value of any consequential adjustments must not exceed the lesser of—
 - (a) the income tax charged on the individual by virtue of section 809EZA in respect of the disguised fee, and
 - (b) the tax charged on the individual otherwise than by virtue of section 809EZA in relation to the disguised fee or the amount mentioned in subsection (1)(b)(ii).
- (5) Consequential adjustments may be made—
 - (a) in respect of any period,
 - (b) by way of an assessment, the modification of an assessment, the amendment of a claim, or otherwise, and
 - (c) despite any time limit imposed by or under any enactment.”

- (2) In section 2 of ITA 2007 (overview of Act), in subsection (13)—
 - (a) after paragraph (h) insert—
“(ha) disposals of assets through partnerships (Chapter 5D);”;
 - (b) after paragraph (ha) insert—
“(hb) disguised investment management fees (Chapter 5E).”
- (3) In Schedule 4 to ITA 2007 (index of defined expressions), at the appropriate places insert—

“arrangements (in Chapter 5E of Part 13)	section 809EZA(5)”
“collective investment scheme (in Chapter 5E of Part 13)	section 809EZA(5)”
“disguised fee (in Chapter 5E of Part 13)	section 809EZA(3)”
“investment management services (in Chapter 5E of Part 13)	section 809EZA(5)”
“management fee (in Chapter 5E of Part 13)	section 809EZA(1)”
“participant (in Chapter 5E of Part 13)	section 809EZA(5)”
“sum (in Chapter 5E of Part 13)	section 809EZA(5)”.

(4) The amendments made by subsections (1), (2)(b) and (3) have effect in relation to sums arising on or after 6 April 2015 (whenever the arrangements under which the sums arise were made).

EXPLANATORY NOTE

DISGUISED INVESTMENT MANAGEMENT FEES

SUMMARY

1. Clause [X] applies to certain fees or other sums paid to investment managers, and provides that in some circumstances these sums will be charged to income tax. It applies to sums paid through structures involving partnerships, unless they are already charged to income tax as employment income or brought into account in calculating profits. Carried interest is excluded from the charge. Clause [X] will have effect in respect of amounts arising on or after 6 April 2015.

DETAILS OF THE CLAUSE

2. Subsection 1 introduces a new Chapter 5E into Part 13 of the Income Tax Act 2007 (ITA 2007). Chapter 9 contains four new sections, 809EZA to 809EZD.

3. Section 809EZA (1) explains the consequences that follow when a disguised fee arises to an individual from a collective investment scheme. These are that the individual is treated as carrying on a trade, and the fees are the profits from the trade.

4. Section 809EZA (2) explains where the trade is treated as being carried on. If any of the investment management services giving rise to the fees are performed in the UK, then the trade is treated as carried on entirely in the UK, otherwise it is treated as carried on outside the UK.

5. Section 809EZA (3) sets out the circumstances when a disguised fee arises. These are that an individual carries out investment management services under any arrangements, a management fee arises in whatever form for those services, the arrangements include at least one partnership, and the management fee is untaxed to any extent.

6. Section 809EZA (4) sets out the circumstances where a management fee is regarded as being untaxed for the purposes of sub-section (3).

7. Section 809EZA (1) defines a management fee. The conditions for a sum to be a management fee are that it arises from a collective investment scheme, and is not carried interest, the return of capital invested by the individual, or a commercial return on that capital.

8. Section 809EZA (2) defines carried interest, providing that it is a sum paid to an individual from scheme profits, paid after all, or substantially all, of the investments and any

preferred return have been paid to participants in the scheme. Section 809EZA(2)(b) explains how this is applied where the scheme profits and preferred return are calculated on the basis of particular investments.

9. Section 809EZA (3) defines the preferred return, providing that it is a return equivalent to at least compound interest calculated at the rate of 6% per annum on the sum invested for the period during which it was invested in the scheme.

10. Section 809EZA(4) defines a commercial return for the purposes of subsection (1), as a return comparable to a commercial rate of interest, and earned on terms reasonably comparable with external investors on comparable investments in the scheme.

11. Sections 809EZA (5) and (6) define various terms used in the Chapter.

12. Section 809EZA provides that no regard is to be had to any arrangements which are intended to bring about the result that the section does not apply.

13. Section 809EZA provides for the avoidance of double taxation on sums charged under s809EZA.

14. Section 809EZA (1) sets out when the section applies. It applies when income tax is charged in respect of a disguised fee under s809EZA, and at any time income tax or another tax is charged under another section in respect of that disguised fee. Section 809EZA (1) (b) (ii) provides for circumstances where a disguised fee has arisen in respect of a loan, and tax arises under another section on an amount used to repay that loan.

15. Section 809EZA (2) provides that to avoid a double charge to tax, the individual may claim a consequential adjustment.

16. Section 809EZA (3) provides that an officer of HM Revenue & Customs must make any consequential adjustments which are just and reasonable.

17. Section 809EZA (4) sets a limit on the consequential adjustment, which may not exceed the lesser of the income tax charged under s809EZA and the other tax charged.

18. Section 809EZA (5) sets out how the adjustments may be made.

19. Subsections (2 and 3) of the clause make consequential amendments.

20. Subsection (4) of the clause provides that the amendment has effect in respect of amounts arising on or after 6 April 2015.

BACKGROUND NOTE

21. This clause has been introduced to ensure that fees or other sums for investment management paid to managers of funds are charged to income tax. Structures have

increasingly been used by private equity firms in which annual fees are paid as priority partnership shares to avoid an income tax charge on the fees.

22. Sums received by managers which represent returns linked to investment performance (carried interest) or investment by managers (co-investment) will not be affected by this measure.

23. If you have any questions about this change, or comments on the legislation, please contact Chris Murricane on 03000 585953 (email: chris.murricane@hmrc.gsi.gov.uk).