Keeping up with Alternative Investment Funds

April 2022

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Introduction

Welcome to our April edition of Keeping up with Alternative Investment Funds.

Our newsletter this month includes a review of the new Uncertain Tax Treatment regime applicable to large businesses' returns filed on or after 1 April 2022.

In addition, this month we also have an article on ECJ Withholding tax reclaims update in Italy, as well as a note on interaction of the US foreign tax credit regime and the UK Research & Development Expenditure Credit.

There have been further development related to cryptoassets and the QAHC regime in the UK which we also touched on in the News Bulletin section of this newsletter.

PwC's 2022 Alts Industry Conference was held on 27th April, over 120 industry participants joined our in person event, thank you to everyone who attended the event.

The event kicked off with a fantastic presentation by Leo Johnson, PwC Disruption and Innovation leader looking at the global economic, technological, political and social forces of change and what the potential upside and downside scenarios are. We then moved on to an ESG panel which focused on the practical impacts at investor / fund, asset manager and portfolio level. Thank you to Maria Carradice from Mayfair Equity Partners for joining our panel.

The event then broke into three workstreams looking at:

(1) Remuneration and Retention strategy for AIF managers with a focus on equity events (M&A, IPO, Equity Redistribution) as a driver of value;

(2) A focus on asset manager tax enquiry trends in the UK, this panel was supported by Akash Nawbatt QC and included a discussion on how to manage the tax enquiry process and engagement with HMRC.

(3) Developments in Product Development, which picked up the trend for the retailisation of Alts through open ended fund products, the development of long term investment products for pension funds, the explosion of continuation funds within the private funds market, and the new UK Qualified Asset Holding Company.

Throughout the event, demonstrations were held of PwC tech solutions for alternative industry managers.

Please do continue to reach out to your usual PwC contacts if you would like to discuss any of the above, and please do share your feedback with us if there is a particular topic or issue you would like us to cover in the future.

Kind regards,

PwC Alternative Investment Funds team

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News Bulletin

EMI and crypto assets

Via a speech by John Glen MP on 4 April 2022, the government has announced that it will explore ways of enhancing the competitiveness of the UK tax and regulatory system to encourage further development of the cryptoasset market in the UK. Significantly, amongst other tax areas, the government will consult on extending the scope of the Investment Manager Exemption to include cryptoassets.

This news should be welcomed by UK Managers of digital asset products who until now have had little certainty that crypto investment activity would be exempt under the IME due to a lack of clarity regarding whether crypto investments/assets would fall within the acceptable white list of "investment transactions" which would be covered by the IME.

Qualifying Asset Holding Company regime

The new QAHC regime, which allows fund managers to align their investment holding vehicles or platforms with their UK economic substance, went live on 1 April 2022. HMRC Guidance on QAHC regime with further clarifications and examples is now also available as a part of the Investment Funds Manual.

In order to enter the regime, the company must meet the eligibility criteria and is required to make an entry notification to HMRC electronically. The details of the entry notification process could be found on the HMRC website here.

You can find our article on the QAHC regime in the January edition of Keeping up with Alternative Investment Funds

Dividend and NIC rate increase

From April 2022 the rates of Income Tax applicable to dividend income have been increased by 1.25% to 8.75%, 33.75% and 39.35% respectively. The rates of National Insurance contributions have also been raised by 1.25%.

EU review of AIFMD 2

Early news from the EU in terms of the AIFMD 2 review of delegation by EU funds and managers outside of the EU, suggests that the way forward will not include any specific limitations or restrictions on an EU entities being able to delegate outside of the EU. Instead the direction of travel looks to be focused on greater disclosure to local regulators as to the use of delegation to a non-EU entity, the precise functions being delegated and the extent of delegation compared to retained functions.

Uncertain Tax Treatment- regime enters into force

Large businesses with a turnover exceeding £200m and or £2bn balance sheet must now comply with the requirement to notify HMRC of "Uncertain Tax Treatments" in Corporation Tax, VAT and PAYE returns filed on or after 1 April 2022.

The UTT regime's entry into force comes at a time when asset and wealth managers are faced with increased coordinated HMRC enquiry activity in a number of areas, such as the application of the salaried and mixed members rules, carried interest, and transfer pricing; all of which combine to provide an additional layer of challenge for those within the scope of the UTT regime.

UTT

Legislation set out in Finance Act 2022, as well as HMRC's final published guidance sets out the circumstances ("triggers") following which a notification should be made in relation to UTTs where there is an amount of tax greater than £5m at stake.

- Trigger One- there is a provision in the accounts that a different tax treatment may be applied to the transaction. This includes both general and specific provisions irrespective of where the provision is presented in the accounts.
- Trigger Two- the tax treatment relies (wholly or in part) on an interpretation or application of the law that is not in accordance with how it is known that HMRC interprets or applies the law.

If one of these triggers are met, then a business is obliged to provide prescribed information to HMRC including details of the uncertainty and alternatives to the tax treatment.

Known positions

We anticipate that much of the difficulty posed by the high levels of enquiry activity across the asset and wealth management sector will be assessing at what point HMRC have a "known position" for the purposes of Trigger two.

HMRC's UTT guidance sets out two broad ways in which a position can become known: firstly, through published material such as statements of practice and bulletins; second, through a business's dealings with HMRC such as discussions with a CRM or specialist, or via a written view as to the correct tax treatment.

Clearly, the application of Trigger 2 may present challenges where the position published conflicts with or lacks clarity compared to HMRC's position via other (potentially not public) correspondence. The UTT guidance addresses the situation where HMRC have historically agreed a position but this is later conflicted by guidance (the answer is that a business is expected to have an awareness of HMRC's position notwithstanding the previous representation). However, the converse is not true where the position taken in HMRC's guidance is not agreed with by a court or Tribunal in subsequent litigation (the business is still expected to notify if the position is contrary to guidance).

A further area that will require significant thought by businesses is where HMRC guidance addresses a highly fact-sensitive test where guidance does not clearly consider the nuances of different businesses and industries. The approach taken by HMRC's UTT guidance is that a taxpayer is required to assess their own facts in relation to facts given in guidance and to determine whether HMRC's position can genuinely be considered to be known or unknown. The UTT guidance recognises that examples given in HMRC's technical guidance will not always be an exact fit with a business's facts; however, we anticipate that HMRC will take a robust view as to whether a position can be known from the examples given. There is clearly an expectation that a business will have to consider HMRC's guidance carefully and will not be simply able to take a position that examples given do not completely meet their facts.

A further area of difficulty is likely to arise in situations where a business has long-running enquiries into a number of areas of tax. Assessing the point at which HMRC's position becomes known, especially in areas where HMRC currently have ongoing sector-wide challenges will take careful and continuous monitoring to ensure compliance with the rules.

Uncertain Tax Treatment- regime enters into force (continued)

Exemptions

The operation of the general exemption from the requirement to notify is a key area to consider; in essence, where HMRC is aware of the uncertainty and how the business intends to treat it, there is no requirement for a formal notification under the UTT rules.

Conversations with a business's CCM that discuss the specific uncertainty and highlight the information that would likely be required by a formal notification are likely to prove important for clients looking to satisfy the notification requirements in a less formal way.

One situation where the operation of the general exemption is likely to prove important is where HMRC have issued protective assessments (as is common in PAYE compliance checks for example) as in many cases it may be that the criteria for a general exemption is satisfied.

Key points

- Broadly, businesses are required to assess their UTT position annually. This will necessitate a review of all positions taken as against their individual dealings with HMRC and the position taken in HMRC's guidance.
- We anticipate an increased focus by HMRC on UTT "governance" alongside other governance regimes, to ensure that risks are identified and assessed against known positions.
- In a scenario where a business takes a decision not to notify (especially where an enquiry is in progress) documentation setting out the rationale for that decision is likely to prove critical in the event of subsequent challenge.

Next steps

The UTT rules are "live" and potential returns which may lead to notification may be due almost immediately (e.g. PAYE reporting), depending on the nature of the tax uncertainty. As such, it is important to ensure that notifications are either made where required or the firms positions are documented where appropriate.

PwC are working with clients across the asset and wealth management sectors to ensure robust UTT governance and compliance is taking place. We are able to undertake UTT focused reviews and assist in the preparation of supporting documentation if needed. Please do not hesitate to discuss this issue with your usual tax contact or the individuals named below

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Interaction of US FTC regime and UK RDEC

On 28 December 2021, the US Treasury and Inland Revenue Services ('IRS') released final regulations (the '2021 Final Regulations' here) addressing various aspects of the foreign tax credit ('FTC') regime. The 2021 Final Regulations were published in the Federal Register on January 4, 2022, and represent the third set of final regulations that have been issued with respect to the core provisions of the US foreign tax credit regime following the 2017 Tax Cut and Jobs Act.

The 2021 Final Regulations are among the most significant developments in the US FTC regime during its 100+ year existence, as they fundamentally change the definition of what is a creditable foreign income tax. The regulations are expected to significantly reduce the amount of FTCs that taxpayers may claim.

US FTC Rules

Generally US taxpayers can claim a credit for foreign taxes suffered, subject to certain conditions being met. The finalised FTC regulations brought in various changes that could have a material impact on US groups. One of the relevant changes for UK subsidiaries is that FTCs for foreign income taxes offset by certain refundable credits are expected to be denied. The refundable credits are considered to include the UK Research & Development Expenditure Credit ('RDEC') regime in many cases, as well as other non-UK research and development regimes that will need to be assessed.

The impact of the changes to the FTC regulations depends on the tax profile of the particular group. For example, these regulations should not generally impact loss-making UK companies claiming RDEC (i.e. companies with no tax and therefore nothing to be offset by refundable credits) due to the mechanics of RDEC in this case. However, for those UK R&D companies that offset their RDEC against a UK tax liability, whether an RDEC claim remains as beneficial for the overall group depends on the US tax profile of the group – for example its GILTI position, or any check-the-box elections or high tax exceptions in place.

Click here for PwC's insights into the new FTC regime.

Next steps

The new rules apply for accounting periods beginning on or after 28 December 2021, and are therefore already in force for some groups. US parented groups with UK subsidiaries making RDEC claims should assess the impact of the new rules. There may be some potential ways to mitigate the impact of the change, which could include some simple fixes (such as group relief optimisation) or changes to the way the R&D operations are structured. Please do reach out to your usual contacts or the authors to discuss the potential implication of the new rules.

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ECJ Withholding tax reclaims update in Italy

On 7 February 2022, the Pescara Tax Court of First Instance ruled that a Luxembourg SICAV is comparable to an Italian investment fund and, therefore, is entitled to full refund of the withholding tax suffered on the dividends received from Italian companies. The judgment is of fundamental importance since it represents the first strong official confirmation by a Tax Court in Italy of the discriminatory tax treatment suffered by foreign investment funds in Italy on the dividends received.

Background

The case originates from a refund claim submitted by a Luxembourg investment fund in the form of Société d'investissement à capital variable ("SICAV") to the Italian tax authorities requesting the full refund of the withholding tax levied on dividends received from Italian companies during 2014, 2015 and 2016. It should be noted that the investment fund did not have access to the reduced dividend withholding tax provided by the Double Tax Treaty between Italy and Luxembourg.

The Luxembourg investment fund argued that the application of the dividend withholding tax on Luxembourg SICAVs by the Italian tax authorities, whilst Italian investment funds were exempt on the same type of Italian sourced income is discriminatory and a breach of the free movement of capital under Treaty on the Functioning of the European Union ('TFEU').

In the absence of a reply from the Italian tax authorities, the investment fund filed an appeal before the Tax Court against the 'silent' rejection of the refund claim.

The Pescara Tax Court of First Instance's Judgement

The Judges of the Pescara Tax Court of First Instance upheld the request for refund of the withholding tax suffered by the claimant. The Judges recognised that the claimant, being an investment fund in the form of a SICAV harmonised under Directive 2009/65/EC and subject to the supervision of the Commission du Surveillance du Secteur Financier ('CSSF') was comparable to an Italian fund, both being subject to the supervision of the respective competent authorities. In reference to relevant jurisprudence of the CJEU (i.a. Santander, C-338/11), the Judges confirmed that the application of the dividend withholding tax towards the non-resident SICAV was solely due to the fact that the foreign investment fund was not resident in Italy and therefore it constituted an infringement of Articles 63 and 49 of the TFEU.

Finally, the Judges highlighted that the discriminatory treatment was also acknowledged by the Italian legislator itself which, starting from 2021, abolished the withholding tax toward EU qualified investment funds (but with effect only from 2021 onwards).

Next steps

Notwithstanding the fact that the judgement refers to EU foreign investment funds and in particular to an EU investment fund in the form of a corporation, the reasons put forward by the Judges in upholding the position of the claimant appear to be applicable also to non-EU foreign investment funds as well as to foreign investment fund in a contractual form. Although it remains to be seen if the case will be appealed, this favourable judgement is of great interest for all the non-resident investment funds.

At present, Italian Tax Authorities are not processing these types of refund claims and our current expectation is that claimants would need to proactively initiate litigation in Italy in order to obtain a refund.

Therefore, asset and wealth managers will need to consider what action is appropriate in respect of claims already filed as well as any new refund claims for the years not yet statute barred in order to safeguard their rights to any refunds.

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