

Amendments 43-49 to Clause 37: Income-based carried interest

Summary

1. These amendments make technical changes to ensure that Clause 37 operates as intended.

Details of the amendments

2. Amendment 43 amends section 809FZN(2) introduced by Clause 37. The amendment ensures that, in testing when there is a relevant disposal for the purposes of section 809FZN (which applies a specialised calculation rule for certain investments by real estate funds which meet qualifying conditions) a taxpayer has to look to the "amount" invested by the fund rather than the "value" invested. This incorporates a clear commercial concept which will be easier for taxpayers to apply and which is already used in these rules at section 809FZK(3). Amendments 46 and 48 make similar changes to the bespoke calculation rules which apply to fund of funds and secondary funds. These changes ensure that a consistent test is used throughout the rules contained in Clause 37.
3. Amendments 44 and 45 amend sections 809FZO(3)(b) and 809FZO(4) introduced by Clause 37. Both amendments replace a reference to "company" with a reference to "underlying scheme" in the context of an investment held by a fund of funds. Funds of funds invest in other collective investment schemes which, in many cases, are not structured as companies. To ensure that the fund of funds rules apply as intended, this amendment therefore refers to the concept of an "underlying scheme" as the relevant investment. This term is already defined for these purposes as the collective investment scheme in which the fund of funds holds an investment at section 809FZO(3).
4. Amendment 46 amends section 809FZO(4)(a) introduced by Clause 37. As with Amendment 43, this amendment will mean that whether a relevant disposal has taken place for the purposes of the fund of funds rules in section 809FZO is tested by reference to the amount invested by the fund in question.
5. Amendment 47 amends section 809FZP(3)(b) introduced by Clause 37. This amendment serves a similar purpose to Amendments 44 and 45. This amendment replaces a reference to "company" with a reference to "underlying scheme" when talking about an investment held by a secondary fund. Secondary funds acquire investments in other collective investment schemes which, in many cases, are not structured as companies. To ensure that the secondary funds rules apply as intended, this amendment therefore refers to the concept of an "underlying scheme" being the asset held by the fund of funds (a term which is already defined for these purposes at section 809FZP(3)).
6. Amendment 48 amends section 809FZP(4)(a) introduced by Clause 37. As with Amendments 43 and 46, this amendment will mean that whether a relevant disposal has taken place for the purposes of the secondary funds rules in section 809FZP is tested by reference to the amount

invested by the fund in question.

7. Amendment 49 amends section 809FZP(6) introduced by Clause 37. This amendment changes the definition of secondary fund to include funds which, as well as acquiring interests in other collective investment schemes, also acquire portfolios of investments from other collective investment schemes. This amendment means that a fund which acquires both types of asset will still be able to benefit from the bespoke calculation rules contained in section 809FZP in respect of investments in other collective investment schemes provided the qualifying conditions are met. This bespoke methodology will still only apply to investments acquired in other collective investment schemes. The default calculation rule in sections 809FZC will apply in respect of any investment portfolios acquired by the secondary fund.

Background note

8. Managers of investment funds are rewarded in a variety of ways. Management Fees are charged to tax as income, and legislation in FA 2015 ensured that fee income could not be disguised as a form of capital receipt.
9. Managers also receive performance-based rewards, sometimes known as 'carried interest'. This is based on the performance of the funds that they manage and can take the form of a share in the fund's total return. Legislation in Finance (No. 2) Act 2015 ensured that where carried interest is taxable as a chargeable gain, the full amount would be taxable without reduction through arrangements such as 'base cost shift'.
10. In the 2015 Summer Budget the government also announced that it would consult on a new legislative test to determine when carried interest should be taxed as income or as chargeable gains. The intention is that this test should replace the current test, which is based on case law and is centred around the so-called 'badges of trade'. The case law underlying the test has mainly considered trades connected with areas such as manufacturing and retail. The test is more difficult to apply to a business such as asset management. The government has therefore decided to put in place a legislative test.