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Memorandum

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UK Budget 2015: Brief Private Equity Notes

The UK's Chancellor of the Exchequer, George Osborne, once again rolled out his favourite tax avoidance anecdote, that of the "banker who boasted of paying less tax than his cleaner", in today's Budget speech. The statement attributed to a banker was in fact made back in 2007 by a British private equity executive, and some of the tax favourable arrangements used in the private equity market have indeed been attacked.

Disguised Investment Management Fees

The raid on "Disguised Investment Management Fees" initially proposed in the Autumn has been confirmed, and will apply from 6th April 2015 (see our previous memo here: http://www.friedfrank.com/index.cfm?pageID=25&itemID=7053). However, revised draft legislation for this problematic proposal was not, as had been hoped, released today, so it seems we must wait until Tuesday, 24th March for this (the anticipated publication date for Finance Bill 2015). The brief wording of the Budget announcement suggests that one of the main complaints made about the initial drafting of the proposal – that it is too wide because it taxes a wide range of receipts, then excludes narrowly defined categories – hasn't been responded to. Hopefully, however, the definitions of the excluded categories, "carried interest" and "returns on investment", will have improved when we see the revised drafting next week.

Entrepreneurs' Relief and Structures

There was also an unexpected attack on the use of "Manco" structures, which have often been used to extend access to the UK's 10% "entrepreneurs' relief" capital gains tax regime to management equity. Entrepreneurs' relief is only available to shareholders with a minimum 5% holding in trading companies or trading groups. "Manco" structures have often been used to extend the availability of this relief to management with smaller interests, by offering shareholdings of 5% or more in management-owned investment SPV companies holding interests in the underlying business. The entrepreneurs' relief "joint venture" rules could deem such an SPV to be a trading company. It seems those joint venture rules are being withdrawn with immediate effect, with no grandfathering.

This may trigger some restructuring where Mancos have been used, although there is no guarantee such a restructuring could be effected in a tax neutral manner. Entrepreneurs' relief planning through the use of differential share class rights to enable management to satisfy the 5% requirement does not seem to be affected.

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In future, this development is likely to make use of the "Employee Shareholder" regime, which can give a 0% capital gains tax rate on exit, more attractive. Although the Labour Party has indicated a desire to abolish this regime should it gain power in this Spring's election, the likelihood of grandfathering for existing arrangements seems higher for participants in this, a statutory regime.

Diverted Profits Tax

Although it was confirmed that the new "Google Tax" would be introduced with effect from 1st April 2015 (see our previous memo here: http://www.friedfrank.com/index.cfm?pageID=25&itemID=7067), revised draft legislation has again not been released. As for the rules on disguised investment management fees, we must wait until next week.

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Author:

Nick Thornton

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Contact:

London

Nick Thornton +44.20.7972.9220 nick.thornton@friedfrank.com