

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

Section 74 and Schedule 17: Partnerships (Part 3): Alternative Investment Fund Managers: Deferred Remuneration Etc

Summary

1. This section and Schedule introduces a mechanism for members of alternative investment fund managers (AIFM) partnerships (including their delegates and sub-delegates) to allocate certain ‘restricted’ profits to the partnership.
2. These are profits that those members cannot immediately access because of requirements under the Alternative Investment Fund Managers Directive (AIFMD) (2011/61/EU) to defer remuneration of ‘key staff’.
3. The legislation imposes a charge to tax on these profits at the additional rate of tax (45 per cent) to be paid by the AIFM partnership.
4. It also sets out the capital gains treatment where the partner’s remuneration is in the form of instruments in the fund under management.

Details of the Schedule

5. Paragraph 15 inserts new sections 863H to 863L into Part 9 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).
6. New section 863H(1) states that new section 863I will apply to an AIFM trade of an AIFM firm if the AIFM firm elects for that section to apply.
7. Subsection (2) of new section 863H states that the election must be made within 6 months after the end of the first period of account for which the election is to have effect.
8. Subsection (3) of new section 863H contains definitions. An AIFM firm is a firm, the regular business of which is managing one or more alternative investment funds itself, or carrying out one or more management functions as the delegate or sub-delegate of the manager.
9. Subsection (4) of new section 863H defines the AIFM trade as a trade which involves the activities mentioned in new section 863H(3).
10. Subsection (5) of new section 863H says that subsection (3) is to be construed as if it were contained in regulation 4 of the [Alternative Investment Fund Managers Regulations 2013 \(S.I. 2013/1773\)](#).
11. New section 863I sets out a mechanism for collection of income tax if the election is made.
12. Subsection (1) of new section 863I applies to the ‘relevant restricted profit’ of a partner in an AIFM firm. This includes profit which has been reallocated to the partner under

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the excess profit allocation rules in the new section 850C in Part 2 (subsection (1)(b) of new section 863I).

13. Subsection (2) of new section 863I allows the partner to allocate all or part of the relevant restricted profit (“the allocated profits”) of the AIFM trade earned by that partner to the AIFM firm.
14. Subsection (3)(a) of new section 863I excludes the allocated profit from the partner’s taxable profit in the period of account.
15. Subsection (3)(b) of new section 863I treats the AIFM firm as if it was a partner in itself.
16. Subsection (3)(c) of new section 863I states that the income tax provisions will apply subject to subsection (5).
17. Subsections (4) of new section 863I stipulates that the firm is subject to income tax on the allocated profit. The profit is treated as chargeable under Chapter 2 of Part 2 ITTOIA for the tax year in which the firm’s relevant period of account ends. The rate of tax payable is the additional rate
18. Subsection (5) of new section 863I provides a power for HMRC to make regulations to modify applicable income tax provisions.
19. Subsection (6) of new section 863I defines ‘relevant restricted profit’ as including two categories of variable remuneration. The first category is deferred remuneration including remuneration in cash or instruments. The second category is upfront remuneration (i.e. remuneration which is not deferred) which vests in the partner in the form of instruments with a retention period of at least six months.
20. Subsection (7) of new section 863I limits the application of the mechanism to remuneration which is awarded to a partner under arrangements that are consistent with the AIFMD remuneration guidelines.
21. Subsection (8) of new section 863I limits the application of the mechanism in the case of AIFM firms which qualify for the mechanism only because they are delegates of AIFM managers to partners who are ‘identified staff’ as defined in the guidelines.
22. Subsection (9) of new section 863I states that terms used in subsection (6) to (8) have the same meanings in the AIFMD remuneration guidelines.
23. New section 863J sets out the tax treatment when the relevant restricted profit vests in the partner who initially allocated it to the partnership.
24. Two situations are covered. The first is where at the time the remuneration vests, the partner is still carrying on the AIFM trade, whether as a partner in the AIFM firm or otherwise (subsection (1) of new section 863J). In this case, under subsection (2) of new section 863J, the amount determined by subsection (5) of new section 863J is treated as a profit of the relevant tax year, made in the AIFM trade and taxable under Chapter 2 of Part 2 of ITTOIA 2005.
25. The second situation is where the individual in whom the allocated profit vests is no longer carrying on the AIFM trade (subsection (3) of new section 863J). In that case, the individual is not treated as receiving trading income but as in receipt of income liable to income tax in the relevant tax year (subsection (4) of new section 863J). This income tax is not chargeable under Chapter 2 of Part 2 of ITTOIA 2005 but is a stand alone charge on the individual.
26. Subsection (5) of new section 863J states that the amount which is treated as a profit or income is the amount of the allocated profit net of the income tax for which the AIFM firm is liable plus the amount of that income tax paid by the firm by the time when the vesting occurs or, if the tax is payable by the firm in the same tax year in which the individual is chargeable, so much of that tax as is paid.

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27. Subsection (6) of new section 863J specifies that the income tax which has been paid by the AIFM firm or is paid on time in the same year as the profits vest is credited to the partner in whom the income vests and is taken into account in determining the income tax payable by, or repayable to, that individual.
28. Subsection (7) of new section 863J defines the 'relevant tax year' as the year of vesting, in the case of deferred remuneration, and, in the case of upfront remuneration in the form of instruments, the tax year in which the allocated profit would otherwise have been chargeable to income tax for the partner.
29. Subsection (8) of new section 863J explains that terms used in this section take their meaning from the AIFMD remuneration guidelines.
30. Subsection (9) of new section 863J provides that the provision in the excess profit allocation rules which permits certain adjusting payments to be made without tax consequences is ignored for the purposes of this provision.
31. New section 863K gives a partner who has allocated profit to an AIFM firm under the mechanism, and in whom the profit then vests, the right to obtain from the firm a statement showing details of the amount of the profits, the tax for which the firm is liable and the tax paid.
32. New section 863L defines the AIFMD remuneration guidelines. The effect of these guidelines and the AIFMD is broadly that certain AIFM firms must defer 40 to 60 per cent of the variable remuneration of key staff by up to three to five years and pay at least 50 per cent of the variable remuneration in units or shares of the funds they manage, or equivalent ownership interests, rather than cash.
33. Paragraph 16 inserts a new section 12ADA into Taxes Management Act 1970 (TMA 1970).
34. Subsection (1) of new section 12ADA provides that where a partnership has made an election under 863H, an officer of HMRC may by notice require the firm to supply such information as the officer may reasonably require for the purposes of the operation of new sections 863H to 863L in relation to the firm and its members. Subsection (2) of new section 12ADA stipulates that the information must be provided within such reasonable time as is specified.
35. Subparagraph (3) inserts a reference to new section 12ADA into the table in section 98 of TMA 1970.
36. Paragraph 17 inserts new sections 59B and 59C into Taxation of Chargeable Gains Act 1992 (TCGA 1992).
37. Under the new section 59B, where there has been a disposal to the partner of instruments which are partnership assets for the purposes of section 59 TCGA 1992 and, by virtue of that disposal, the variable remuneration vests in the partner, both the persons making the disposal and the partner are to be treated as making the disposal and acquisition respectively for an amount equal to the allocated profit net of the tax for which the partnership was liable.
38. New section 59C has the same effect where there is a disposal of instruments by a company which is a partner in the partnership and the company would, as a partner in the firm, have been charged to tax on the allocated profit but for adjustments under the excess profit allocation provisions.
39. Paragraph 18 inserts a new section 189(2B) into Finance Act 2004. This is to ensure that income charged under new section 863J on vesting is also treated as partnership income for pension purposes.
40. Paragraph 19 inserts the charging of AIFM partnership profits into Step 4 in the calculation of income tax liability under section 23 of Income Tax Act 2007.

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41. Paragraph 20 gives power to HMRC to amend any Act by regulations for equivalent provisions to apply in future if necessary to other firms regulated under the Financial Services and Markets Act 2000.
42. Paragraph 21 provides that the amendments made by this Part (Part 3) of the Schedule have effect for the tax year 2014-15 and subsequent tax years.

Background Note

43. These provisions are part of a wider review of certain parts of the partnership rules announced at Budget 2013.
44. A consultation document *Partnerships: A review of two aspects of the tax rules* was published on the [GOV.UK](http://gov.uk) website on 20 May 2013 and the consultation closed on 9 August 2013.
45. This element of the partnerships review measure is discussed in the consultation document under the headings: *Partnerships with mixed membership – profits: Profit deferral and working capital arrangements*.