The British Private Equity and
Venture Capital Association
1st Floor North
Brettenham House
Lancaster Place
London WC2E 7EN

Partnerships Review Consultation
c/o Tax Administration Policy Team
HM Revenue & Customs
1C/06 First Floor
100 Parliament Street
London SW1A 2BQ

(email: partnership.review@hmrc.gsi.gov.uk)

9 August 2013

Dear Sirs,

Partnerships: A review of two aspects of the tax rules – Consultation document 20 May 2013

I am writing to you on behalf of the British Private Equity and Venture Capital Association (the "**BVCA**"), which represents the interests of members of the private equity and venture capital industry. The BVCA is the industry body and public body advocate for the private equity and venture capital industry in the UK. More than 500 firms make up the BVCA members, including over 250 private equity, mid-market, venture capital firms and angel investors, together with over 250 professional advisory firms, including legal, accounting, regulatory and tax advisers, corporate financiers, due diligence professionals, environmental advisers, transaction services providers, and placement agents. Additional members include international investors and funds-of-funds, secondary purchasers, university teams and academics and fellow national private equity and venture capital associations globally.

This letter has been formulated by the BVCA's Tax Committee, whose remit is to represent the interests of members of the industry in taxation matters. The BVCA welcomes the opportunity to submit formally its comments on the consultation document entitled "Partnerships: A review of two aspects of the tax rules" (the "**Consultation Document**") and how it might affect members of our industry. On 8 July 2013, the BVCA submitted a letter to you (the "**Original Letter**"). Following the submission of the Original Letter, a meeting was held with Mr Rogers on 16 July 2013. We continue to be of the opinion that the proposed changes outlined in the Consultation Document will have a negative impact on the private equity and venture capital industry which the BVCA represents, as well as the wider UK fund industry. We have, however, continued to work with HMRC and HM Treasury in considering certain aspects of the Consultation Document.

Issue one: disguised employment

General Comments

The BVCA's preference for the First Condition.

We note the proposal set out in the Consultation Document that there would be two tests for determining whether a person is a self-employed member being:

i. (broadly) a test looking at whether a person should properly be a partner based on ordinary case law principles (the "**First Condition**"); and

ii. a test based on economic criteria.

We also note that some changes may, inevitably, be required in this area given HMRC's concern that the provisions of section 4(4) of the Limited Liability Partnership Act are often read to give a presumption of self employment to LLP members. We have no objection to such a deeming rule being amended appropriately to remove any such presumption of self employment.

As set out in our Original Letter, our strong preference would be for any test determining salaried member status to be applied primarily by reference to the First Condition. The reasons for this are set out further below. Further we believe that, to do otherwise, creates a significant risk of there being a disparity between the tax treatment of LLP members and their employment law position. This would be a very odd result. An important commercial feature of LLPs is that self-employed members do not have the benefit of employment law rights. Yet if, as a result of the changes proposed, an individual is classified as a "salaried member" and in that capacity is liable to income tax and primary NICs as an employee, he or she may still not benefit from the employment rights generally granted to employees under employment law principles. This seems a bizarre policy result.

The BVCA considers that, viewed in isolation, the economic tests may produce odd results in a Venture Capital/Private Equity Model

We believe there is a risk, that unless applied carefully, the economic conditions could cause certain partners within venture capital/private equity businesses to be treated as salaried members in circumstances in which this would not be appropriate.

For reasons explained in our Original Letter, the LLP is now the industry standard entity through which investment management and advisory businesses operate in the UK (the "**Manager**"). The Manager will comprise key senior executives who are its members (the "**LLP Partners**") as well as less senior individuals who will either be employed by the Manager directly or by an entity within its group. The LLP Partners play a key role in management as further discussed below and are, therefore, distinct from the individuals who are employed by the Manager (or another group entity).

As far as the Manager and the fund investors are concerned, the "partner" status of the LLP Partners is not determined solely by their economic position. The LLP Partners will have responsibility for sourcing, making, managing and realising growth of the investments of the fund. Given the long term commitment made by investors in private equity and venture capital funds, and the trust they place in the Manager to utilise their money effectively over the life of the fund in order to create growth, investors have in recent years become increasingly concerned that the LLP Partners have a deeper body of expertise and that there are arrangements in place for effective succession planning so that the expertise of the

Manager is maintained through the life of the fund. Accordingly, as far as the Manager and the fund investors are concerned, the "partner" status of the LLP Partners is generally best determined by a wider range of factors which might be described as "human capital" including the involvement of the individual in the management of the business and the importance of the individual to the long-term performance of the business. These factors are in addition to the basis of the LLP Partners' profit allocation and exposure to risk.

The private equity industry also makes use of senior people who are not "employed" full time within the business. They may be senior executives of public companies or other people with significant industry experience who are effectively consultants and these people advise on the portfolio investments made by the private equity fund. For commercial reasons it is often desirable to make these people "partners" in the LLP so that they can be held out as part of the Firm. They will generally receive a fixed profit share in the nature of a retainer but otherwise have no other entitlement to a share in profits. These individuals will invariably have other clients. These individuals would not be regarded as employed if their services were rendered to a company for a fee so it seems wholly inappropriate for them to be regarded as employees, simply because of the financial arrangements agreed between themselves and the LLP. This illustrates again why we believe the first test, alone, would be most appropriate.

We are, therefore, concerned that the purely economic focus of the second proposed test for determining salaried member status might result in a number of individuals whom the businesses themselves and the fund investors would consider to be "partners" being treated as salaried members (or, at least, there being no certainty as to whether they should be treated as self-employed members or salaried members).

However, based on our discussions with HMRC and other professional bodies, we understand that there is a strong move towards the incorporation of an economic test either alone or alongside the First Condition. For this reason, we have commented on the three limbs of the economic test as set out below.

When considering each of these tests, we would ask that HMRC considers the context of the private equity and venture capital industry (and our comments set out above) and further understands how the industry may differ from other sectors affected by the proposals.

Overriding Need for Certainty

We believe that it is important that the new regime provides as close to certainty as is possible in determining whether or not salaried member status will result. The compliance burden and adviser costs which result from uncertainty are something which our members will be keen to avoid.

We would also note that the Alternative Investment Fund Directive ("**AIFMD**") is now in full force (subject to certain transitional provisions) and the first applications for licences under the Directive have recently been submitted to the FCA. This is at a time when it is desirable for the UK to look as attractive as possible in order that managers establish their businesses and their funds in the UK. The effect of this consultation is that, for the next 6 months at least, advisors will be uncertain as to whether to recommend the LLP business structure to their clients. It is important, therefore, that whatever new approach is adopted, businesses are not deterred from using the LLP structure as a result of any change in legislation.

Question 1: Whether the current definition of "salaried members" set out in 2.19 is appropriate to catch those members who should be subject to employment taxes and thereby provide a more equitable tax and NIC treatment.

In considering the relevant economic criteria, the consultation focused on 3 areas which are dealt with below.

In each case, the consultation indicates that a risk or entitlement will be ignored if it is not "significant". If this is to be the relevant test, we consider that an individual would not be a salaried member if he or she meets two of the three tests as this will acknowledge some flexibility in the arrangements.

Furthermore, it seems to us that the question of whether something is "significant" or not must fall to be determined by reference to the LLP in question and its own business; what may be insignificant in one context, may be significant in another. We think that it is important that this is made clear in the legislation since, for the reasons set out below, any approach that sought to apply a single set of numbers to the three tests would give rise to significant difficulties for our industry.

Limb 1: It is an indicator of self-employed status if a partner has significant economic risk (loss of capital or repayment of drawings) in the event that the LLP makes a loss or is wound up

In considering this test, one should start with understanding the nature of the Manager's business.

When considered in isolation, the business of the venture capital/private equity Manager is, by its nature, not particularly capital intensive. It is also a feature of the industry that private equity funds generally pay their management fees quarterly (or half yearly) in advance which also significantly reduces the need for working capital within the business. This means that the capital contribution of any LLP Partner to the Manager itself may be relatively small[1].

Further, although the Manager's income stream (in the form of its management fee) can be relatively stable, it may not always be so for the following reasons:

i. Many funds and the associated management fees are denominated in a currency other than Sterling and the management fee may therefore be subject to foreign exchange fluctuations.

ii. The management fee is calculated as a percentage of committed capital and although the percentage is a fixed number, at the end of the investment period of the fund

---

[1] Although not directly relevant to the assumption of economic risk in respect of the LLP we wish to highlight that in a typical fund structure managed via an LLP, those same LLP Partners are likely to have entered into significant co-investment obligations with third party investors. Under these co-invest obligations the LLP Partners are obliged to invest their own cash in the fund on broadly the same terms as external investors so that their interests are aligned and they share in the risk of investments made by the fund. Individuals are often required to invest in the fund between 1.5% and 5% of the total fund size so take on a considerable economic burden and risk outside of the LLP which would not be reflected in the strict application of the proposed economic tests.

Further, industry executives are also required to put aside amounts in order to meet regulatory capital and AIFMD obligations which is also money potentially at risk. Please refer to our discussion of 'regulatory capital' in Question 12 for further information.

(generally three to four years) or when a successor fund is raised, the management fee switches to a reduced percentage of net invested capital.

iii. Normally the period during which the committed capital is reduced would also be the period during which the Manager seeks to raise a new fund (such that a large proportion of aggregate management fee would again be predictable and stable). However there is inevitably significant uncertainty regarding not only the ability to raise a successful fund but also the size of that fund, particularly in the years since 2007. There have been a number of examples (all disclosed in the press) where a Manager has not been able to close a fund (either at all or to the size initially targeted) and the terms have been generally less favourable. This can have a significant impact on the predictability of the management fee – in some cases leading to the demise of the Manager.

Given the examples above it is clear that on a long term basis the quantum of the management fee is by no means guaranteed.

When seeking to apply the "economic risk" test in this context, we believe the following principles need to be clear:

i. An LLP Partner who makes a capital contribution to the LLP Manager should, in principle, be treated as satisfying the criteria of being appropriately at risk.

ii. Whether this risk is "significant" must be considered as a proportionate matter. For example, you should only need to show that the individual's level of capital at risk is commensurate with the overall capital requirements of the LLP.

iii. A minimum monetary threshold for the level of capital contribution would not be appropriate.

We also wish to highlight that the question of exposure to economic risk for LLP members does not sit comfortably with another area of law (transfer pricing) which may apply where the Manager receives a fee from the general partner, either cross-border (e.g. Guernsey) or from a GPLP structure where the income retained by general partner is taxed differently as a share of investment income gains of the individuals. Transfer pricing principles suggest that an "arm's length" fee should be applied which may well deliver a fairly predictable level of profit to the LLP, whilst the Consultation Document suggests that predictability is a 'bad thing'. How does HMRC propose to square this apparent conflict?

Limb 2: It is an indicator of self-employed status if a partner has an entitlement to a share of the profits of the LLP. Per consultation at 2.21 "an entitlement to share in the profits that for practical purposes would never be more than 5% of any fixed entitlement" is unlikely to be treated as significant

We believe it needs to be clear that this test is considered by reference to the individual partner's likely profit entitlement from the LLP, as opposed to the test being considered by reference to the profits made by the LLP in connection with the operation of its business. For example, if the LLP's profits over a number of accounting periods are relatively stable such that it is possible to calculate the likely level of each partner's entitlement to share in the profits of the LLP in any one accounting period, the test should not be failed. The test should, therefore, be by reference to the individual partner rather than by reference to the profits made by the LLP. We think that this is the only fair way to interpret these provisions and that this needs to be explicit in the drafting.

So, in other words, this test would be passed, provided it is clear that an individual partner is only entitled to a percentage of the LLP's profits. We consider the test should also be satisfied if it is clear that an individual is entitled to a fixed monetary amount rather than a percentage, but with such monetary amount (i) being wholly conditional upon there being sufficient profits of the LLP during the relevant accounting period, and (ii) being subject to repayment obligations in certain circumstances (for example, if total amounts distributed during the relevant accounting period exceed the total profits of the LLP for the whole accounting period, there might be an obligation to repay the shortfall).

We acknowledge, however, that there could be situations which HMRC might consider to be abusive and that rules would need to be introduced to counteract such arrangements (for example, where an individual partner is entitled to a guaranteed fixed monetary amount which is unrelated to the profits of the LLP and which is not subject to any repayment obligations).

Please also refer to our response to question (3) below.

Limb 3: It is an indicator of self-employed status if an individual member of the LLP has an entitlement to share in surplus assets on a winding up

We believe that it should be assumed that if a member of an LLP receives back an amount equal to his or her capital contribution on a winding up of the LLP, this would be sufficient to constitute an entitlement to share in "surplus assets on a winding up" for the purposes of the third limb.

If not, is the reference to "surplus assets" intended to refer to residual amounts remaining after the return of capital to members and any amounts due to creditors of the LLP on a winding-up? If so, clarity would be required as to what level of share would be required to satisfy the third limb and the extent to which this would be considered "significant" in the context of the fund management business outlined above.

In addition, if the entitlement of an individual LLP member to the surplus assets of the LLP in this context is subject to the discretion of, for example, the designated member of the LLP, would this test be satisfied?

Question 2: Is there a simpler alternative for delivering the same policy objectives, whilst reducing uncertainty and preventing avoidance?

We believe the issues identified in Part 1 of the Consultation Document could be fully addressed by enacting some minor amendments to the existing legislation. If the problem is that a deeming provision in the existing legislation is too wide, the obvious solution is simply to amend that provision so that it applies more narrowly. We consider that the first condition, along with a statutory removal of any presumption that might exist that the LLP members are self-employed, would be sufficient to protect the Exchequer from the sort of LLP membership arrangements discussed in the Consultation Document.

This would have the added benefit of ensuring that the tax position mirrored the position under general law and avoided the mismatch referred to previously.

Question 3: Are the conditions as currently framed clear enough or are there other criteria that you consider should be added that would more clearly achieve the policy aims?

Probationary period and retirements

As noted above, investors in private equity and venture capital funds have become increasingly concerned that appropriate arrangements are in place for effective succession planning.

One of the key advantages of the LLP structure is the ability to implement succession planning easily. The requirement for effective succession planning and the long term view of the involvement of key individuals in the business inevitably leads to those key individuals having different levels of management responsibility in the business (both the senior partners and more junior people promoted into the partnership with a view to their long term commitment to the business) and to them having different economic arrangements in relation to the capital that they might be required to invest in the business, the basis on which their entitlement to profits generated by the business are calculated and their interest in the capital value of the business on sale or winding up.

In relation to junior or new members of the LLP, for example, the three limbs of the second recommended test may not be met on day 1. In many situations, there will be a probationary period during which the tests cannot be met. Such a period is purely for commercial business purposes and unrelated to tax issues.

We would, therefore, recommend that if the second test is enshrined in specific tax legislation to tackle disguised employment, there should be a formal transition of grace period for junior and new members of up to three years. If, during the transitional period, it becomes clear that the three tests will not be met, the individual would be taxed as an employee from the date when it is clear that the tests will not be met (and not retrospectively).

Similarly, in relation to retiring members, it is common for such members to wind down their involvement at the end of their career. Although retiring members should meet the three limbs of the second test at some point before retirement, there may be a period in which not all three tests are satisfied. Accordingly, we would recommend that retiring members should also be given a formal transition or grace period of up to three years.

Impact of this regime on other areas of tax

Paragraph 2.12 of the Consultation Document states that if an individual member is classified as a "salaried member" he or she will be liable to income tax and primary (Class 1) NICs as an employee on his or her earnings from the LLP.

However, as outlined above, these rules are likely to create a divergence with employment law, such that, a person who is treated as if he or she were an employee under these provisions, may not actually be an employee under employment law. This will inevitably create complexity when applying other areas of the tax code which apply different provisions to those who are employees and those who are not.

In order to create clarity, in this context, we believe that it should be clear that a salaried member under these provisions is treated as an employee only for the purposes of these provisions. He or she should not be automatically deemed to be an employee for any other tax purposes. Therefore in applying the remainder of the tax code, one should consider

whether a person is an employee or not based on ordinary principles and without regard to the specific provisions applying under the new (salaried member) provisions.

Question 4: Is there an alternative to the proposed TAAR which would prevent attempts to sidestep the rules? How could a TAAR be expressed so as to ensure that it has the desired effect but does not apply inappropriately?

If the proposed tests are clearly drafted and the position of an individual is structured to ensure that they are a member of the LLP based on the proposed tests, we believe there should be no need for a TAAR.

Question 5: Guidance will be issued to indicate how the test will be applied. We would welcome view on any specific scenarios or points this guidance should cover.

We would be happy to meet with HMRC when considering drawing up their guidance to discuss the wide range of scenarios that can exist so that suitable guidance can be given for use by both HMRC and taxpayers. The focus should, however, be on giving taxpayers certainty in the application of the test rather than having to place reliance on HMRC guidance in determining whether the tests are satisfied.

A practical concern is the timing of the introduction of any changes. Transitional provisions should be included in the legislation so that there is clarity on when members who are classified as employees (and their LLPs) will be required to begin paying PAYE and NICs and how the profits of periods that span the date of change will be treated. This is particularly important in an LLP context where profits are allocated and distributed on an accounting period basis. LLPs may need to arrange additional sources of funding which may not be possible in the current banking environment thereby leading to cash flow problems for the business.

If implemented, we suggest that the new rules are applied to the first profit period commencing after 5th April 2014 as applying the new rules to distributions for part of an accounting period will give rise to transitional difficulties, particularly if profits distributed after the change in law relate to a period before that date. Similarly, deferred distributions of profit for an accounting period ending before the change in law should not be subject to PAYE/NIC, merely because the new law has effect at the time of the distribution.

Issue two: profit and loss allocation schemes

General comments

Investment Partnerships

Within the private equity and venture capital industry, limited partnerships are now very much the accepted choice as the fund vehicle. Limited partnerships have the advantage of being extremely flexible and agreements can be drafted to accommodate a broad range of commercial arrangements. One of the fundamental attractions in the UK of a limited partnership structure for private closed-ended funds is that the limited partnership is a flexible vehicle in terms of internal governance and control. The partnership structure is important to enable the changes in the memberships of the partnership to take place without the corporate law complexities and capital tax consequences arising from owning shares in a limited company.

As a general point, we believe it is fundamental that any legislation following from this Consultation is not extended to investment partnerships constituting collective investment schemes. The reasons for this can be summarised as follows:

- Creating uncertainty in the treatment of investment partnerships will inevitably discourage foreign investment in such vehicles, particularly at a time when certain jurisdictions are introducing vehicles similar to the English limited partnership (for example, Luxembourg's new "special limited partnership") with the aim of attracting the investment of funds that might otherwise be invested via a UK limited partnership and the attendant risk that the associated fund management activities will similarly migrate offshore.

- It is also important to emphasise the commercial necessity for stakeholders in private equity funds to have certainty over the UK tax treatment of private equity funds structured as limited partnerships. This requirement in part gave rise to the 1987 "Statement approved by the Department of Trade and Industry and Inland Revenue on the use of limited partnerships as venture capital investment funds" more commonly referred to as the "1987 Statement". The 1987 Statement sets out the framework which confirmed how the Inland Revenue would consider a private equity fund using a limited partnership as a fund vehicle, when structured materially as set out in the 1987 Statement. The comfort this has provided and continues to provide to UK based and other stakeholders has been of great importance in securing the position of limited partnerships as the vehicle of choice for private equity funds for the past twenty five years, for funds primarily based in or advised from the UK. If the proposals set out in the Consultation Document were to apply to investment partnerships, this would threaten to undermine the certainty and security given by the 1987 Statement. We believe that in excess of 50% of the entire European private equity and venture capital fund management business is based in the United Kingdom and this dominant position would be threatened by undesirable changes to the tax rules affecting investment partnerships.

- The breadth of the current proposals set out in the Consultation Document means that there is real concern that they could apply to commercial arrangements that are entered into between the numerous stakeholders in private equity and venture capital partnerships which will, as a matter of course, have a mixed membership. This approach produces significant uncertainty. There are concerns that if the proposed changes were to apply to investment partnerships, the advantages the UK has as a location for investment funds would be eroded and damage would be done to the UK's fund industry as a place to do business - we believe these rules will undo much of the work done in recent years to improve the UK's competitiveness as a centre for fund industry.

We, therefore, consider it to be fundamental that the proposed changes should not apply to investment partnerships constituting collective investment schemes.

Trading Partnerships

We do not agree with the implied premise of the Consultation Document that mixed partnerships (i.e. those which contain both corporate and individual partners) are objectionable per se. Indeed, during our discussions with Mr Rogers we received the impression that it is accepted by HMRC that there are entirely legitimate and commercially necessary reasons for a partnership to utilise a corporate partner. We have expanded on some of these commercial imperatives below.

It is relatively common for there to be both corporate members and LLP Partners in LLP Managers. This often occurs because the business of the Manager has migrated from a corporate to an LLP but for historical reasons, employment contracts, leases and other contractual commitments continue to reside with the corporate.

A corporate may also be used as a Designated Member to deal with certain administrative matters on a time effective basis. Given that the corporate continues to exist, the death or disability of any one or more of the individual partners therefore will not disturb the governance of the partnership. The corporate member may also be the vehicle that builds goodwill and / or is the vehicle through which a third party may take a stake in the group.

The use of mixed partnerships therefore represents a pragmatic solution to the structural issues that can affect partnerships and provides greater flexibility in a competitive world and given these roles, it is reasonable that the corporate member should receive a profit allocation for its services.

However, given the various initiatives in this area in our view the better way forward which carries the least risk of collateral damage is to target the legislation at the precise mischief that HMRC wishes to discourage i.e. mechanisms where profits are shifted to corporate members and then distributed in a manner that seeks to avoid further tax. The most straightforward approach must be to amend the legislation such that in these circumstances the amount is treated as a distribution, and if necessary bring back the equivalent of close company apportionment.

As currently drafted such LLPs are exposed to the profit allocation rules. We note that paragraph 1.13 of the Consultation Document states that in relation to profit and loss allocation schemes, the Government's objective is that tax advantages will not arise where there are inappropriate partnership allocations to a company or a similar vehicle. There is, however, no explanation regarding what is considered to be "inappropriate" for these purposes. We are concerned that this may result in the requirement for a transfer pricing analysis in order to defend the appropriateness of allocations to a corporate member. This could lead to significant cost and would be administratively burdensome from a compliance perspective. This issue was discussed with Mr Rogers at our meeting on 16 July 2013. We understand from that meeting that HMRC's objective is to target arrangements where there is a manifestly "excessive" allocation to a corporate member. It would, however, be necessary for the legislation to clarify what is considered to be "inappropriate" or "excessive" for these purposes. We would strongly recommend that this test is formulated in a manner which would avoid the cost and administrative burden of performing a transfer pricing analysis as well as the inevitable uncertainty and subjectivity which would result.

If, despite our comments above, the anti avoidance provisions could apply to LLPs in the fund management industry, we would, at the very least, expect that there should be exclusions from this regime for regulatory capital and deferred remuneration (see below).

Question 6: HMRC would welcome views on this approach to counteraction, particularly what other specific indicators should be taken into account and possible alternative approaches that would counteract the tax advantages (including timing advantages).

Whilst we believe that it would be appropriate to have a TAAR to counteract arrangements under which profit is allocated to a corporate member but then paid to an individual without further tax arising we do not believe that one needs to assess an individual on profit retained within a company. This is clearly discriminatory as compared with owner managed businesses constituted as companies where tax can be delayed indefinitely by retaining the

profit within the company. We see no good reason why this discrimination should be pursued.

We are prepared to accept that there should be a TAAR dealing with loss allocation schemes to limit the loss to the pro rata amount of capital contributed to the partnership. Incidentally, we are not aware of such schemes being prevalent in the private equity and venture capital industry and make this comment from a general tax perspective.

Question 7: Would the legislative approach set out above provide an effective deterrent and counter the schemes described?

We have serious concerns as to the impact of the proposals. The proposed solutions to the various arrangements identified in the Consultation Document are drafted extremely broadly. The provisions should be properly targeted and a balance struck between the need for taxpayers to have certainty and the need to counter abusive tax arrangements.

Question 8: Would the proposed changes impact on situations that are not in line with the stated policy objectives? If so, HMRC would welcome detailed explanation of why you believe these situations fall outside the intended target areas.

The proposals would undoubtedly impact upon the structures used in the private equity and venture capital industry which we consider to be outside the stated policy objectives. Please refer to our response to Question 12 below.

Question 9: Do you consider that there are circumstances in which this rule would give rise to outcomes inconsistent with the policy objectives and, if so, in what circumstances and how might these situations be addressed?

We believe that given the broad nature of the proposals set out in the Consultation Document, the proposed changes would have a detrimental impact on reasonable commercial arrangements. See above.

Question 10: As described above, it is proposed that the profit deferral arrangements will be tackled in the same way as the other mixed membership arrangements. HMRC would welcome views on whether relief could be given retrospectively in the event that a contingent profit awards does not ultimately vest. To prevent the risk of abuse, such relief could be confined to clearly defined circumstances and would also need to provide for additional tax charge to be imposed on other members in the event that those profits are re-allocated to other members.

Please refer to our response to Question 12 below.

Question 11: A possible alternative to the approach suggested in question 10 would be to allow a member subject to profit deferral arrangement to elect to be taxed as a salaried member, with the consequences then being as set out in paragraphs 2.24 and 2.25 above.

We consider this an unreasonable solution to the concerns with the proposals.

Question 12: Should there be any other exceptions to the proposed treatment? If so, please provide information why these cases should be excluded and suggestions on how these exclusions can be effected.

As noted above, the proposals set out in the Consultation Document are drafted extremely widely. We, therefore, believe that any legislation should include specific exceptions from

the proposed treatment. We repeat our comment made above regarding the need for certainty – the exceptions should not be dealt with by way of guidance.

Investment partnerships

For the reasons set out above, we believe it to be of paramount importance that the Consultation is not extended to investment partnerships structured as a collective investment scheme. An exception for investment partnerships should, therefore, be included.

Regulatory capital requirements

All FCA regulated LLPs are required to satisfy regulatory capital requirements so as to ensure that investors are adequately protected from any losses arising from negligence by the fund manager. It would be manifestly unfair for anti avoidance provisions to apply such that profits allocated to the corporate member for use in building up this capital would fall within income tax.

We would, therefore, recommend that specific exceptions are included in the legislation so that the proposals set out in Part II of the Consultation Document do not apply to profits allocated to the corporate member of LLPs if (i) those LLPs fall within the scope of the regulatory capital requirements and (ii) those profits are, in fact, used to satisfy regulatory capital requirements.

AIFMD and profit deferral

An overriding concern within the private equity and venture capital industry is that many Alternative Investment Fund Managers ("**AIFMs**") may soon be required under AIFMD to change the profit share of individual members including the introduction of deferral (the deferral does not appear to take any account of tax liabilities or the adjustment for tax liabilities if it turns out the remuneration was not due because performance targets have not been met). It would be manifestly unfair for the individual to whom such profits relate to suffer tax liabilities without having received amounts to fund such liabilities.

Indeed, as we are still awaiting clarity on exactly how AIFMD will impact on remuneration in the context of profit deferral we are unable to assess at this point how the proposals in the Consultation may impact on amounts deferred to comply with AIFMD. However we wish to bring this to your attention as another area in which our members could be caught between two conflicting regulatory requirements.

Question 13: Would there be situations that are not in line with the Government objectives? If so, the Government would welcome detailed explanation of why you believe these situations fall outside the intended target areas and, if possible, any suggestions on how these situations may be effectively excluded from the legislation.

The measures are broadly drafted and make few allowances for circumstances where the partnership or LLP can argue that the corporate member has an important commercial function. We have outlined above the situations where ordinary commercial arrangements within the private equity and venture capital industry should be excluded. In March 2013, the UK Government published an outline of their investment management strategy, aimed at improving the UK's competitive position. There is clearly a tension between that policy and the proposed changes set out in the Consultation Document, which may lessen the attractiveness of the UK as a location for fund management.

Question 14: Do you agree that the legislation can help the Government to meet the wider objectives of fairness without adversely affecting the flexibility of the partnership structure.

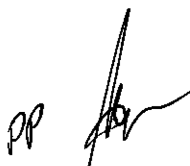
No. We believe that the proposed changes are too wide ranging and would have a detrimental impact on the flexibility of partnership structures as set out above. The combination of the two proposed measures set out in the Consultation Document will, if implemented, make LLPs far less flexible in terms of succession and financing. To date, the flexibility of vehicles open to asset managers has been one of the reasons behind the UK's success as a centre for fund management.

Question 15: Can interested parties offer views on any other likely costs that partnerships and their partners may incur in order to implement the changes?

Legal costs will inevitably be incurred by managers in reviewing existing fund structures and implementing any required changes. See also our comment regarding transfer pricing above under the heading "Trading Partnerships – Overview". Certainty of tax treatment should be a main objective of the Government's proposals so that taxpayers can apply the tests without the need for having to obtain extensive advice or guidance.

We would welcome the opportunity to comment on any draft legislation and to attend further meetings with HMRC in respect of the Consultation. If you have any questions in relation to our responses set out in this letter, please do not hesitate to contact me on 0207 872 6362 or David.Marks@apax.com.

Yours faithfully,



David Marks

Chairman of the BVCA Taxation Committee