HMRC

By email: dpt-tp-pe-reform@hmrc.gov.uk

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Reform of transfer pricing, permanent establishment and Diverted Profits Tax

The British Private Equity and Venture Capital Association (BVCA) is the industry body and public policy advocate for the private capital industry in the UK. With a membership of over 600 firms, we represent UK-based venture capital, private equity and private credit firms, as well as their professional advisers and investors. There are almost 13,000 UK companies backed by private capital which currently employ over 2.5 million people in the UK. In 2024, £29.4bn was invested by private capital into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. This increased investment has fuelled the growth of businesses across the UK, with six in ten (58%) of the businesses backed in 2024 being located outside London.

Thank you for this opportunity to respond to the consultation published on 28 April 2025. This builds on our response in August 2023 to the previous consultation on the reform of UK law in relation to transfer pricing, permanent establishment and DPT. Our response to the current consultation, set out in this letter, concerns the aspects most relevant to our members, namely the proposed changes to the definition of a permanent establishment (PE), the investment manager exemption (IME), and Statement of Practice 1/01 (SP 1/01).

Background

The fund industry is extremely competitive, with many other jurisdictions seeking to increase their share of the fund establishment, administration and management business. This, coupled with the UK's departure from the EU single market and the importance to private funds of access to the AIFMD, has led to many more funds being established outside the UK with non-UK AIFMs and UK investment advisers.

It is vital for the competitiveness of the UK fund industry that the use of UK investment advisers does not carry the risk of creating a UK PE for the funds' non-UK investors. Otherwise, private capital firms may need to consider moving their (often significant) investment advisory businesses outside the UK, resulting in a negative impact on the UK fund industry and the opportunities it brings for investment into UK businesses.

Overview of proposed changes to PE, the IME and SP 1/01

The proposed changes can be summarised as follows:

- to expand the definition of permanent establishment in section 1141(1) CTA 2010 to align it with the OECD Model Tax Convention 2017 (the "OECD Model") and extend it to include a person who "habitually plays the principal role leading to the conclusion of contracts, that are

routinely concluded without material modification by the [relevant non-UK resident] company"; and

- to make consequential amendments to the IME and to SP1/01 to cover persons who are involved, in a broad sense, in providing investment management services to the relevant non-UK resident company.

The BVCA is grateful for the Government's engagement with the industry on this topic to date. However, we are concerned that, under the draft legislation as published in April, there is a risk that UK investment advisers who provide advice to the non-UK investment managers and/or general partners of investment funds could be excluded both from being an agent of independent status and from the IME, and as a result could be brought within the extended definition of a PE. This risks creating an incentive for investment advisory businesses to relocate abroad, which would have a negative impact on UK competitiveness and may reduce opportunities for investment and growth in the UK economy.

We understand that HMRC would like UK investment advisers to benefit from the IME and SP 1/01 in the same way as UK investment managers. We consider, however, that further changes are needed to ensure that the application of the new rules to the private capital industry is clear, and has the effect intended by HMRC.

We would also draw attention to a point we raised in our response to the previous consultation in 2023, which is that our concerns are not confined to the (relatively uncommon) circumstance in which a fund itself is carrying on a trade. The more significant issue for our members relates to non-UK investors in funds, where the fund itself is carrying on investment activity, but the investor is investing in the course of a trading activity to which their holding of an interest in the fund could be attributed. For instance, non-UK banks or insurance companies commonly invest in funds in connection with their wider trading activities.

Now that the Government has decided to proceed with the changes to the definition of PE, we would urge HMRC to clarify its position and guidance in this regard and give clear comfort that all non-UK investors in private capital funds and co-investments (even those that are themselves non-UK financial traders) would not generally be treated as holding their interest in that structure as part of a trade carried on in the UK, provided that they are investing, in line with the vehicle's investment policy, for the medium to long term.

If this were made absolutely clear, then much of the concern for private capital funds about the revised definition of a PE would be removed. If, on the other hand, uncertainty remains about the interpretation, this may discourage this category of investor from investing through firms with UK-based investment advisers, which (as we have highlighted above) in turn risks driving these firms overseas.

Changes to CTA 2010

(i) New definition in section 1141(1)(b)

We note the limitation to the types of contract that are relevant in sub-sections (b)(i) and (ii) and that these are referred to in the OECD Model, but it is not clear to us that the sort of investment sale and purchase contracts that investment funds enter into (and in respect of which the UK investment

adviser might be considered the fund's investors' agent) fall within paragraph (i) or (ii). More clarity on this matter would be appreciated.

(ii) Section 1142(1A) – exclusion from agent of independent status and "closely related"

This goes to what we consider to be a fundamental question in this context, namely: who is the "company" (i.e. the non-resident potentially subject to UK tax) in the context of a UK investment adviser providing services to an investment fund structured as a limited partnership (probably non-UK) with investors?

In our view it is clear that this should be the investors, and that "closely related" should be tested by reference to each non-UK resident company investor. This is plain on the face of the legislation, which refers to the "company" as the non-UK resident that might be subject to tax. However, there are parts of SP 1/01 that raise questions in the context of a limited partnership fund, and we understand from our discussions that HMRC considers that, broadly speaking, the relationship to be tested should be that between the UK investment adviser and the fund as a body of investors.

In practice, the investment adviser will often be a member of the same corporate group as the general partner of the fund. In this scenario the investment adviser will be "closely related" to the general partner, and therefore presumably to the fund itself. If, however, the question is whether the UK investment adviser is closely related to the individual investors in the fund, then the answer is very likely to be no. This is therefore far from being an academic point, as in many cases it may determine whether the investment adviser can qualify as an agent of independent status.

(iii) Section 1143(2CA)

It would be helpful, in the context of the definition of "closely related", to clarify in guidance that the relevant "person" is the non-UK resident company investor in a limited partnership investment fund, rather than the fund as a whole. This is what the legislation refers to as the "company", as this is the entity which could be subject to UK corporation tax.

(iv) Section 1150 – expanded definition of "investment manager"

The amended SP 1/01 (discussed below) states that if a UK investment adviser were to carry out activities such that it constituted a PE under section 1141(1)(b), HMRC would consider it to be an investment manager for the purposes of the IME.

This clarification is helpful, but it is not wholly consistent with the FTT's comments in the *Millican* case[1] regarding "investment management services" in the context of the disguised investment management fee and carried interest rules in section 809EZE ITA. In that case, the Tribunal stated: "in order to fall within the definition [of investment management services] by virtue of the general words, as opposed to one of the specific paragraphs, an activity needs to involve investment management as opposed to investment advice."

It follows that, in our view, the draft legislation needs to be amended to make clear that investment advisers whose activities fall within section 1141(1)(b) are treated as providing "investment management services" within the definition of "investment manager". Otherwise, the revised rules

[1] Millican v HMRC [2024] UKFTT 618 (TC)

risk failing to achieve HMRC's stated objective of permitting investment advisers to benefit from the IME.

(v) Section 1150 – expanded definition of "investment transaction"

The definition of "investment transaction" in the draft amended version of section 1150 is "any transaction made by an investment fund, other than a transaction with an excluded subject matter". It is unclear whether this means, as we expect, "any transaction in the nature of transactions made by an investment fund" or whether the transaction must in fact be made by an investment fund.

We understand, from our discussions with officials, that the Government intends to amend the drafting here to remove the requirement for an investment transaction to be carried out by an investment fund. We welcome this change and would also note that it will be crucial to ensure that the revised wording is wide enough to cover transactions carried out by the widening range of investment vehicles used by the fast-evolving and innovative private capital industry, many of which may not fall within the legislative definitions of an AIF or CIS.

SP 1/01

We welcome the steps taken by HMRC in seeking to make clear that UK investment advisers within the scope of "permanent establishment" should be able to avail themselves of the IME and apply SP1/01. We also welcome the removal of the 20% test. There are, though, some respects in which we consider that SP 1/01 should be further amended.

(i) Paragraph 4

There is reference to "investment manager" and that it should be read to include "adviser". See above in respect of the section 1150 definition of "investment manager" and reference to the *Millican* case. While we agree that investment manager should clearly include investment advisers who might be a PE, we think that should be clarified in the legislation rather than only in the SP.

(ii) Paragraph 16

This is helpful in seeking to bring UK investment advisers within the scope of investment managers but we think that the statement "Where such arrangements are in place and operate as arranged, such an investment adviser will not fall within the definition in section 1141" is not entirely correct. This is because UK investment advisers might well be able to take the principal role in negotiating contracts for the non-UK investment manager or investment fund that they provide services to without acting outside their regulatory permission to "arrange" investments. This reinforces the need for express legislative provision to bring investment advisers within the definition of an investment manager.

(iii) Paragraph 17

Similarly, it is not necessarily the case that the risk of UK investment advisers creating a PE as a result of the expanded section 1141(1)(b) definition applies only "in exceptional circumstances". The wording here implies that if an investment adviser carries out the activities described in section 1141(1)(b), it would be acting outside its regulatory authority. Our understanding of the regulatory law on this point is that this interpretation is not correct, and that a UK investment adviser with FCA permissions to advise and arrange but not to carry out investment management could negotiate sale

and purchase contracts and "play the principal role leading to the conclusion of contracts, that are routinely concluded without material modification" by the fund or its investment manager.

We think that it would be helpful to reframe these statements, in conjunction with clarifying in the primary legislation (as set out above) that an investment adviser in a section 1141(1)(b) PE is treated as an "investment manager" and is viewed as providing "investment management services".

(iv) Paragraph 29/30

In the context of these paragraphs, we would repeat our comments above about the definition of "investment transactions" in section 1150.

(v) Paragraph 44

As discussed above, it would be useful to clarify that the "non-resident" in the context of investment advisory (or management) services provided to a limited partnership investment fund is the non-UK company investors in the fund and not the fund itself.

(vi) Paragraph 46

The question this paragraph poses is: in what circumstances it is appropriate to test the independent capacity of a manager against a fund? In the case of a (tax transparent) limited partnership investment fund, we consider that the independent capacity of a manager should be tested against the individual investors in that fund. On this basis, it is likely that it will be relatively easy in most cases to conclude that the UK investment adviser (or manager) is acting independently and is, as a general matter, an agent of independent status in relation to the fund investors. It would be helpful if this could be clarified in the SP.

(vii) Paragraph 48

The relevance of this paragraph goes to the question above: in our view it is not appropriate to test independence against a limited partnership investment fund. If the Government is not persuaded by this however, it would be useful to clarify that the lack of connection between fund partners extends to all analysis of the independent capacity test, including the discussion in paragraph 51 of the SP.

(viii) Paragraph 51

It would again be helpful to clarify in the context of services provided to a limited partnership fund that the test is against the individual fund investors and not the fund as a whole. If, contrary to our view, it is the latter, it would be useful to know that the investment funds established by the same sponsor which might have a body of common investors will be considered to be unconnected for the purpose of testing whether the investment adviser (or manager) received more than 50% of its fees from a single fund.

(ix) Paragraph 52

Again, it would be useful to have clarity on who the "non-resident" is in the context of services provided to a limited partnership investment fund.

(x) Paragraph 53

We would also welcome clarity on what is meant by "the aggregate interests in the feeder funds", whose interests these are and how the aggregate should be calculated.

(xi) Paragraph 64

The overall tenor of the SP is helpful on the customary remuneration condition but it is not entirely clear how industry standard carried interest would or would not fall within the discussion around individuals (particularly LLP members) receiving securities and the market value of the security being brought into account as UK taxable income.

As HMRC is well aware, carried interest is a standard element of overall investment manager/investment adviser remuneration from investment funds and their investors. Given that carried interest is subject to specific tax regimes under the disguised investment management fee (DIMF), carried interest and employment-related securities regimes, it would be helpful to state in the SP that commercially negotiated carried interest received as part of overall arm's length consideration agreed between fund managers and investors, alongside customary management fees, would be taken to satisfy the customary remuneration test.

Thank you again for the opportunity to contribute to this consultation. Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of these issues in more detail (please contact Rachel Gauke at rgauke@bvca.co.uk in the first instance).

Yours sincerely

Maria Carradice

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