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HM Revenue & Customs
dpt-tp-pe-reform@hmrc.gov.uk

Our ref Tax/OPEN/MSS

By Email Only

Dear HM Revenue & Customs

Reform of UK law in relation to transfer pricing, permanent establishment and Diverted Profits Tax – UK investment manager exemption aspects

We are pleased to share our feedback in relation to the aspects of the above consultation (the **Consultation**) that deal with the UK “investment manager exemption” (the **IME**) and the related proposed updates to Statement of Practice 1/01 (as amended) (**SP1/01**).

Simmons & Simmons LLP is an international law firm. We have a significant number of clients in the asset management and investment funds sector, including many undertaking alternative asset management strategies such as hedge fund management.

Of those clients, a large portion have a UK investment management presence (even where non-UK headquartered) for whom the IME is a critical part of the framework that enables them to manage the assets of alternative funds and other non-residents from the UK.

Introductory comments

We are generally supportive of the proposals relating to the IME set out in the Consultation. We have been involved in discussions with HMRC and HM Treasury in respect of a number of aspects for some time now, and it is clear that feedback that we and others have provided has been taken into account in formulating the proposed approach on updating the IME.

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We consider that the proposals as set out in the Consultation should maintain (and in some cases improve) the UK's competitiveness as a location from which to perform alternative investment management services.

We do, however, identify below a number of aspects where that competitiveness could in our view be further improved.

We focus below on the relevant provisions that apply for corporation tax purposes, although our comments, to the extent relevant, should be taken also to apply to the equivalent income tax provisions.

Question 10

We note the government's proposal to adopt a revised definition of a dependent agent permanent establishment (**DAPE**) under UK domestic law, aligned broadly with the approach set out in the 2017 OECD definition.

Given the broader application of this definition, we consider it essential that the IME should be clearly available in all relevant circumstances in order to provide relevant investment managers and their non-resident clients with certainty that the extended definition of DAPE will not result in increased exposure to UK taxes.

We note the importance of ensuring both clear legislation and clear supporting guidance (in the form of SP1/01) that together operate to provide this comfort and also to ensure that related issues, e.g. whether any provision for potential DAPE related taxes may be required in the context of a fund audit, can be appropriately managed.

In this regard, we consider it essential that if the government moves forward with the proposal to disapply the general "agent of independent status" treatment for certain closely related companies (see proposed s.1142(1A) Corporation Tax Act 2010 (**CTA 2010**)), it should be made clear that the IME (and the broker exemption) can still apply in such circumstances – at present s.1142(2) CTA 2010 only states that the IME and broker exemption apply "for the purpose of supplementing subsection (1)", but this drafting should be amended to reflect that these exemptions will also apply to circumstances that might otherwise fall within proposed s.1142(1A) CTA 2010.

Question 12

We welcome the intention to remove the residual income tax charge on non-resident companies with no permanent establishment. We have seen feedback from others questioning whether the current drafting approach covers off all possibilities of such a residual income tax charge arising and we encourage its removal in all cases under domestic law, such that it is not necessary to rely on a relevant double tax treaty (if available) to provide comfort on the position.

Questions 13 and 14

With regard to the proposals in these sections:

- we support the removal of the "if, and only if" construction, which we consider conflicts with the existing statutory language in s.1142(2) CTA 2010 and does not reflect our understanding of how HMRC has approached the IME in practice;
- we support the move from a "white list" of permitted investment transactions to an exclusionary approach based on carving out particular categories of transactions for policy reasons, but would note the following more detailed points:

- the proposed amendments to s.1150 CTA 2010 introduce the requirement for an “investment transaction” to be “made by an investment fund” – we understand this was an inadvertent narrowing of the definition based on a reading of the Investment Transactions (Tax) Act 2014 without taking account of the Investment Manager (Investment Transactions) Regulations 2014 which, when applying the white list in that Act for IME purposes, treat references to “fund” as being references to “non-UK resident” generally. We suggest that it is not necessary, when defining an “investment transaction”, to refer to the person conducting the transaction, and therefore the simplest approach would be to delete “made by an investment fund” in proposed s.1150(3) CTA 2010 and remove the related definitions in proposed s.1150(7) CTA 2010;
- proposed section 1150(5)(b) CTA 2010 implies that the requirement for a qualifying index applies to all derivative contracts – this should be amended to make clear that this requirement applies only to derivatives over land, aligned with the current position;
- whilst noting the exclusion of commodities, we would welcome further dialogue with HMRC over whether there could be circumstances in which commodities held for investment purposes but where delivery does not actually occur could fall within the scope of the IME (aligning with the approach for commodity derivatives), noting that in certain other jurisdictions, the IME-equivalent rules do permit certain commodity transactions;
- we understand that HMRC considers that other investment transactions, such as transactions in freight, energy and power contracts, are not excluded subject matter as they do not fall within proposed s.1150(4) CTA 2010 – we would welcome if this could be made clear in SP1/01 (see below); and
- we strongly support the removal of the 20% test, which we agree gives rise to practical difficulties in a number of situations – we note that it will be important to address the position of managers who are currently relying on a “qualifying period” of up to 5 years that extends into a future period where the 20% test will have been removed and propose that rather than requiring such managers to operate a “shadow” 20% test for the remainder of the relevant qualifying period, it would be preferable for Condition B in s.1147 CTA 2010 to be deemed to be satisfied in respect of all qualifying periods which are or may be ongoing at the point of transition to the new IME.

Question 15

We generally support the updates to SP1/01 contained in the draft published alongside the Consultation, but had a number of more detailed comments, as follows:

- we note that there is still some historic content in the proposed SP1/01, in particular at paragraphs 33 to 38. We suggest that the broad list in paragraph 33 remains helpful as guidance, although should be updated (as noted above) to cover freight, energy and power contracts and, potentially, to make clear that transactions in tangible assets such as art and cars are excluded. We understand that HMRC still feels the discussion about fees in the context of loan origination/syndication arrangements to be helpful, but this may perhaps sit better elsewhere;
- we welcome the addition of a new independent capacity safe harbour for funds that are qualifying funds under the QAHC regime in paragraph 46;

- we suggest that there should be a further safe harbour included in paragraph 46 for CLOs and similar debt issuance vehicles, to make clear that such vehicles can meet the independent capacity test as of right – the form of the further safe harbour is a matter for further discussion, but one approach could be to include the following additional limb: “the non-resident is a special purpose vehicle established for the purpose of issuing notes, loans or other instruments in one or more tranches and which in aggregate are issued wholly or mainly to independent persons, with a view to giving the holders of such instruments exposure to a pool of underlying assets acquired, originated or to be acquired or originated by the non-resident”;
- we do not support the addition of the new sentence at the end of the description of “actively marketed” in paragraph 49 – the existing concepts are well understood and already limit the active marketing safe harbour to situations where there are “ongoing genuine attempts” to meet the widely held test and where the terms offered to investors are neither prohibitive nor discriminatory;
- we are concerned that the proposed reduction in the substantial services threshold from 70% to 50% in paragraph 51 may affect existing structures where managers manage the assets of a small number of funds/managed accounts and volatility in performance and related fee income could result in a breach of the threshold more easily if this is set at 50% - whilst there is a “failure having taken reasonable steps” let out that might apply, this may be difficult to meet on an ongoing basis when the threshold has been reduced; and
- given the development in fund structures, such as the use of “below-the-fund” entities for financing, regulatory and other reasons, we suggest that paragraphs 53 and 54 should be supplemented to make clear that entities forming part of the fund complex should be able to benefit from the IME (so that, for example, in paragraph 53, you could look through such an entity controlled by the master fund to the feeder funds when seeking to demonstrate independent capacity), and it may also be appropriate to cross-reference these paragraphs from paragraph 46 and/or to make clear in paragraph 46 that “qualifying funds” include vehicles that are controlled by a qualifying fund.

Transition and related points

We encourage HMRC and the government to move forward with the proposals so that managers and their non-resident clients may benefit from an early commencement date.

When the investment transactions white list was expanded to cover designated cryptoassets, this change applied to the whole of the accounting period/tax year current at the time of the expansion, and assuming that any changes may be made during 2026, it would be helpful (for those funds or other non-residents operating a 31 December year end) that they would be able to benefit in respect of transactions undertaken since 1 January 2026, rather than having to wait until 1 January 2027.

For those managers who rely on the current 2016 version of SP1/01, we encourage HMRC to enable those managers who wish to continue to retain the benefit of that version (e.g. if the substantial services threshold were to be reduced despite our comments above) to be given a suitable transition period before the new SP1/01 applies to them.

Next steps

We would be very happy to discuss these topics further with you, should this be helpful, whether directly or through relevant industry bodies.

We would also be pleased to review and input on further drafts of the legislation and/or SP1/01.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'MS' followed by a stylized 'Shah'.

Martin Shah
Partner
Simmons & Simmons LLP