

# UK Government Targets Reform of the Investment Manager Exemption

Skadden

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If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

**James Anderson**

Partner / London  
44.20.7519.7060  
james.anderson@skadden.com

**Lorenza De Domenico**

Associate / London  
44.20.7519.7241  
lorenza.dedomenico@skadden.com

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One Manhattan West  
New York, NY 10001  
212.735.3000

22 Bishopsgate  
London EC2N 4BQ  
44.20.7519.7000

On 28 April 2025, the UK government published draft legislative amendments to:

- Align the UK's domestic tax rules on permanent establishments (PE) with the 2017 Organisation for Economic Co-operation and Development (OECD) Model Tax Convention.
- Modernise the Investment Manager Exemption (IME).

This followed a consultation launched in 2023 and a lengthy period of engagement with industry stakeholders on the proposed legislative amendments.

The UK's existing PE and IME rules, some of which are over 20 years old, have grown increasingly out of step with international norms and the practical realities of the asset management industry. HM Revenue & Customs' (HMRC's) goal with these amendments is to provide greater clarity and modernity for taxpayers in the context of cross-border investment management arrangements.

## Summary of the Amendments Relevant to UK Asset Managers

### Domestic Law – Basic PE Definition

The draft amendments introduce a number of significant changes to the UK's domestic tax legislation, with particular relevance for nonresident investment funds and UK-based investment managers.

- The definition of a “dependent agent” PE in UK law is updated to reflect Article 5 of the 2017 OECD Model Tax Convention. The new definition focuses on whether a person habitually concludes contracts — or habitually plays the principal role leading to the conclusion of contracts — without material modification by the nonresident.
- The exemption for agents of independent status is narrowed, in line with the 2017 OECD Model. Independence is now precluded where the agent acts exclusively or almost exclusively for one or more companies to which it is “closely related” (*i.e.*, under common control or meeting a 50% investment condition).

### The IME

The proposed amendments to the definition of “dependent agent” PE and exemption for agent of independent status may bring a larger number of arrangements within the scope of the UK charge to tax. The government accepts that this could adversely affect nonresident trading vehicles with UK-resident managers, and have therefore proposed certain changes to the IME.

- The IME is clarified as an interpretation of the general agent of independent status exemption, rather than an exclusive provision. This means that if the IME is not met, the general agent of independent status exemption may still technically be available.
- The “20% rule” (Condition D), which previously limited the IME where the investment manager and connected persons were entitled to more than 20% of the nonresident's profits, is repealed. The partial charging provision is also removed.
- A new statutory definition of “investment transaction” is introduced, which is exclusionary and therefore wider. (Transactions relating to UK land and physical commodities remain specifically excluded.)

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In addition, the government published a revised draft Statement of Practice on the treatment of investment managers and their overseas clients (SP 1/01). Notably, the revisions to the Statement of Practice clarify how HMRC will apply the “independent capacity” test (Condition C of the IME).

In particular:

- A new characteristic can be used to demonstrate independence for the purposes of Condition C of the IME: that the nonresident is a “qualifying fund” for the purposes of paragraph 9(1) Schedule 2, Finance Act 2022.
- There is new guidance on what is required for a fund to be “actively marketed”.
- The maximum threshold for the proportion of the investment manager’s business conducted with the nonresident to still demonstrate independence is reduced from 70% to 50%.

## Takeaways for UK Asset Managers

The IME is a cornerstone of the UK’s attractiveness to the asset management sector, providing certainty — as long as certain conditions are met — that nonresident funds can appoint UK-based investment managers without triggering a UK tax charge on trading profits.

The amendments, if enacted, would represent the most significant reform of the IME since its introduction and would be broadly positive for the sector. They would also introduce new compliance considerations.

In the main, the changes to the IME are welcome and represent an encouraging signal from government to the UK asset management sector. In particular, the proposed removal of the “20% rule” and widening of the scope of the IME to cover a wider range of transactions on an exclusionary basis are expected to significantly simplify compliance with the IME and future-proof the regime. The “20% rule” had never been a bright-line test anyway, given the “intention” component, which had led to some implementation difficulties by managers.

The removal of the “if and only if” wording clarifies that the IME is an exemption available in addition to the general agent of independent status exemption, rather than as the exclusive exemption applicable to investment managers. However, the amended agent of independent status exemption would be narrower than that currently adopted by the UK in its international tax treaties; there is therefore a question as to whether funds structured in treaty jurisdictions would maintain an advantage by relying on the treaty exemption rather than the UK domestic exemption (at least if and until such treaties are amended in line).

When establishing new structures, choosing established treaty jurisdictions such as Ireland or Luxembourg may provide more flexibility — access to local talent pools and infrastructure, optionality between the domestic and treaty path to exemption for investment managers, access to political counterweight through a jurisdiction looking to retain taxing rights in accordance with their treaty with the UK (including through the Mutual Agreement Procedure (MAP)).

Additionally, in the SP 1/01, HMRC noted that it does not consider that a manager failing the IME would be able to succeed under the general domestic exemption; although nonbinding guidance, it is clear that HMRC would have a presumption against independence for managers that fail the IME.

Should the 20% rule be abolished, if one of the remaining IME conditions are failed, all trading income attributable to the UK PE of a nonresident fund (including income arising from third-party capital unconnected to the manager) would become chargeable to UK tax.

This places increased scrutiny on the remaining conditions, particularly the “independent capacity” test (Condition C). It is unclear how this increased scrutiny will play out in audits and enforcement actions. HMRC has often been focused on the “20% rule”, and its removal raises the question of which condition HMRC will focus on moving forward.

The conditions to meet the “independent capacity” test are currently largely found in the SP 1/01. The government is continuing with this approach, as the revisions to the scope of the “independent capacity” test are found in the amendments to the SP 1/01 rather than the proposed statutory amendments.

Even though reliance on the SP 1/01 has generally been viewed favourably, as it provides both HMRC and taxpayers with flexibility, in light of the recent adverse judicial treatment given to HMRC guidance by the Court of Appeal in *HMRC v BlueCrest Capital Management (UK) LLP*, the fact that the “independent capacity” test continues to heavily rely on nonbinding guidance in its application may fail to provide taxpayers with the degree of certainty that the reform is meant to achieve.

The test seems to have been both expanded and narrowed:

- Expanded, by stating that “qualifying funds” as defined under the Qualifying Asset Holding Companies regime meet the “independent capacity” test regardless of whether they are widely held.
- Narrowed, by providing stricter guidance on the meaning of being “actively marketed”, and lowering the threshold for the substantial services test to 50% rather than 70%.

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Nonresident funds that are not “qualifying funds” will be faced with fresh compliance challenges. Of particular concern is the statement in SP 1/01 that “[o]perating on a business-as-usual basis with an expectation that the position will rectify itself is not sufficient”, as this may put significant pressure on capacity-constrained funds to show active fundraising efforts that demonstrate they are being actively marketed with the intention of becoming widely held.

The asset classes that are eligible for the IME are also seemingly being widened by making the definition of “investment transactions” exclusionary (although UK land and physical commodities remain excluded). We expect this change to be generally a positive development, as it will allow the IME to remain relevant as new asset classes emerge without the need for further extensive engagement to expand the list (as was the case for cryptoassets, which were only added to the list — with exclusions — in the 2022-23 tax year after years of industry engagement).

The new definition, however, is restricted to transactions of an “investment fund” (defined by reference to UK regulatory rules). This is a new limitation, as currently the IME is not limited to regulated funds, which could create issues for asset holding companies that carry out investment transactions (for instance, in a credit fund context).

It remains to be seen whether government will be open to industry feedback on this new limitation through the consultation process. We also note that the IME remains available for funds that carry out a mix of excluded and nonexcluded investment transactions; such funds could still access the IME for trading income arising from nonexcluded investment transactions, so that the charge to UK tax would be limited to trading income arising from any excluded investment transactions.