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Green Day Advisors Note: The real reason hedge fund managers need to quit the UK

You've been DIMF'd!

Much has been written in the press about concerns managers have keeping operations in the UK. Talk about the impact of Brexit features, most of it either misinformed or conjecture. The end of the non dom regime for many founders is painful, but no one writes about managers leaving the UK as a result. No one writes in the press about the disguised investment management fee regime (DIMF) either, probably because few have heard of it and even fewer understand it. And that's the problem. Because, managers, you've been DIMF'd. And staying in the UK is going to get a lot more painful as a result.

As advisor to managers for over twenty years, I have been involved with most of the migrations of managers from the UK, usually driven by tax. The tax increases that were imposed on individuals seven years ago meant many firms moved staff, and sometimes the founders, to other countries. Around that time I started moving over 50 management firms to Switzerland, and about the same number to Malta.

Several moved to other countries, or started operations in those other countries, but the numbers were quite small. The number of individuals who moved to Switzerland numbered in the hundreds, those moving to Malta numbered a few dozen. In total, the moves made some dent in HMRC's coffers, and forecasts at the time from Treasury of around £1.5b a year being raised from the tax increases was the usual PR nonsense, with a significant amount lost each year due to migration of fund management staff alone.

Let's start with Brexit. It's a clear certainty that Brexit will happen. EU negotiators were prepared to make the financial services sector a special case and allow up to five years beyond the two year negotiation/ ratification process to reach an accommodation, but their kindness will no doubt be tested by UK negotiators. Whilst investment banks and insurers understandably are making plans now, private equity firms, hedge fund managers and other boutiques need not get too excited until next year. Once we get past key European elections and negotiating begins in earnest, the path will become clearer. A hedge fund manager or other boutique firm who needs to establish an EU presence could set one up and be regulated in Malta in six months, for example, so there is no rush.

The non dom regime changes are problematic, especially for founders. Some have now found themselves fully taxed in the UK, and for some their time as a non dom will come to an end in the next few years. The non dom regime was a safety valve to deal with the UK's very high taxes. Its absence will bite. I am moving some managers out of

the country as a result, but it is a small number. Those that see their time as a non dom ending are making plans to leave in the coming years, but the timing is staggered according to when their status ends, when children finish school and so on, and therefore it is not so obvious that there is migration.

Which brings us to DIMF. In a nutshell, the intent of the regime is to tax founders, as individuals, on the profits earned by their business. The regime has had a short life, being around for less than two years, but has been extensively remodeled three times in that period, notably being extended beyond just firms that operated with a partnership in the group, widened to include performance fees, and also to include fees not just from funds but many managed accounts as well.

The DIMF regime is brought to you by the same HMRC team that brought you the partnership tax and disguised remuneration regimes. There is a theme, and it is the concept of power to enjoy. This concept means that if you, as a founder, have the potential to enjoy the profits of the business, even though you may have established legitimate trading operations in other countries and paid taxes there, HMRC retains the ability to tax you at a personal level in the UK on global income, net of expenses. Even if the profits of the business have been taxed in a UK company, you are not safe. Those profits can still be taxed to you as an individual.

One of the central tenets of any tax regime is certainty. There is no certainty here. And that is the reason many of the founders of my management firms have decided to leave. Not knowing whether you will be taxed as an individual on the global corporate profits of your business is a step too far. Sadly, in my wide experience, few (with some notable exceptions) personal tax advisors even know about the regime. Many of the large advisory firms don't believe it will be as bad as it seems, or think they can just plan around it, which displays a sad lack of reality. HMRC brought in this regime so they had full powers to tax whatever they saw fit to tax.

Having spent more time than most analysing the regime, and reviewing it with leading Tax Counsel, I can only say it is the worst tax regime I have encountered in more than twenty years as a tax advisor to the industry. It is time for managers to understand it fully and plan accordingly.

David Butler is a leading advisor to the hedge fund industry, having advised hundreds of management firms on their tax and regulatory position, amongst other issues, since February 1997.

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