Private & Confidential
Mr Chris Murricane
HM Inspector of Taxes
HM Revenue & Customs
100 Parliament Street
London SW1A 2BQ

4 February 2015

Dear Mr Murricane,

Re: Draft Finance Bill clauses: Disguised investment management fees

The British Private Equity and Venture Capital Association (the "BVCA") welcomes the Government's decision to consult on the draft clauses on disguised investment management fees.

The BVCA is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 500 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members have invested £30 billion in over 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 790,000 people and almost 90% of UK investments in 2013 were directed at small and medium-sized businesses.

We have already discussed our main concerns with you and understand that it is proposed to make a number of amendments to the clauses to address the issues that we have already identified, some of which we have expanded on below.

We support the objective of ensuring that amounts received by individuals for the management of investments are subject to income tax and national insurance contributions. However, as the Chancellor made clear in the Autumn Statement, carried interest has a particular tax treatment and it is Government policy that this should be preserved. It is important that any new rules do not impinge on that regime, which has operated effectively since 1987 and is critical in securing a successful private equity and venture capital investment sector. It is also important (and accepted in principle) that these rules should not impact on the tax treatment of returns derived by individuals from risk positions they have taken in the funds they manage. In addition, investment fund managers are required by the fund investors to invest increasing amounts into the funds that they manage as co-investment and it is equally important that the returns from such co-investment retain their investment nature for tax purposes.

Legislative Approach

Our first comment focuses on the approach taken to the framework and structure of the legislation. The legislation operates on an "if it's not out it's in" basis; s809EZB(1) provides that any sum an individual receives is taxed as a disguised investment management fee unless it fall within one of two very narrowly crafted carve-outs. We have concerns around the way these carve-outs have been defined, and will address those in a moment, but our larger concern is that the legislative framework is too prescriptive. The private equity and venture capital industry is dynamic. How

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funds are structured and the economic arrangements between participants change all the time. The difficulty of crafting carve-outs for carried interest and co-invest reflects the breadth of commercial arrangements structures in use at the moment and as agreed between the fund managers and fund investors.

But rather than define carried interest and co-investment for exclusion, we would prefer that a targeted definition of "management fee" is adopted. Under this approach the existing tax treatment would be preserved unless a value flow fell within the definition of "management fee".

We have already supplied you with some suggested wording for a revised definition of "management fee" (and we attach it again in Appendix A for reference). In essence, an amount would be taxed as a "management fee" if in all the circumstances it would be reasonable to conclude that the amount was consideration for investment management services and either the amount is not in substance variable depending on the performance of the underlying assets or it would be reasonable to conclude that the amount payable will not in practice vary depending on investment performance. Such drafting would clearly exempt all "mainstream" carried interest and co-invest arrangements as (in all cases) the outcomes for individuals will be affected by investment performance. This deals with the core concern behind the legislation without running the risk of sweeping up benign, wholly unobjectionable and commercially negotiated arrangements because they possess a minor feature which takes them outside a narrowly cast carve-out.

Definition of Carried Interest

However, if the draft legislation continues to take the approach of the current draft, the definitions of carried interest and co-invest must be addressed.

We have already supplied you with some suggested wording for a revised definition for acceptable carried interest (and we attach it again in Appendix B for reference). We also attach in Appendix C suggested drafting for acceptable co-investment which would recognise that the individual fund managers cannot necessarily fund the entirety of the co-investment individually, but that, when they do not, their returns will be subject to the external funding being repaid along with an "arm's length" return on it.

The definition of carried interest in the draft legislation does not reflect the diversity of carried interest models found in the industry; it is far too narrowly drawn.

Carried interest was described and addressed in the 1987 agreement on the use of limited partnerships as venture capital investment vehicles between the BVCA, the Inland Revenue and the Department of Trade and Industry. The subject was revisited in 2003 following the introduction of the employment-related securities regime in that year's Finance Act. This resulted in the publication of a memorandum of understanding (or "MoU") between the Inland Revenue and the BVCA. Neither of these documents is prescriptive when it comes to the detail of the legal form or economic terms of carried interest. Indeed, the MoU goes out of its way to confirm that the points it covers apply to all carried interest arrangements with economics which are appropriate for the fund in question and acknowledges that there will be many different sets of carry economics (e.g., the model in the MoU assumes an 8% whole fund hurdle but it is acknowledged that the performance hurdle may be lower, even zero). All carry models will be the result of commercial negotiation between the fund managers and fund investors and will reflect the fund investors' view

of the economics that will best align the managers to produce returns for the investors over the whole life of the fund.

The definition of carried interest in the draft legislation, however, requires that carry is paid out of the profits of the fund and only after investors have received all or substantially all of their investment in the fund (this is also modified to allow a deal by deal carry) together with a preferred compounding return of 6% per annum on their investments. This represents too narrow a definition; this is clear just from comparing this definition with the MoU. Whilst carry in most private equity funds is driven by cash returned to investors, there will be some funds that use net asset value to measure returns. Others will include a yield-based carry where some amount is paid to the carry holders before the investors have received all of their money back. This is particularly the case with infrastructure and long-term start-up venture funds, where assets will be held for a long time before realisation and there is a commercial necessity (attracting and retaining staff who might otherwise choose to work for a more traditional buyout house to continue to deliver value to the investors) to calculate and pay out carried interest before a significant part of the portfolio has been realised. Many funds will not meet the 6% hurdle condition; this is particularly the case in the venture capital sector where funds do not normally have a hurdle as investors accept that the inherent risks make the imposition of a hurdle unattractive and the potentially very high returns associated with one successful investment far outweigh that risk of making some payment to the carried interest holders without achieving a preferred return on their investment. This again is explicitly recognised in the MoU. Other funds which may have difficulty with the required hurdle are real estate and debt funds. Examples of funds not covered by the proposed definition will include cases such as:

- carried interest where the calculation is based on a valuation of the fund investments (e.g. where the carried interest is based on the value of listed investments);

- carried interest where there is no preferred return - over 40% of venture capital funds (see Appendix D);

- carried interest where the return is linked to a benchmark (e.g. where the return must exceeds an index);

- carried interest where the preferred return is less than 6% because of the nature of the assets invested in;

- carried interest where the calculation is based upon a segregated pool (e.g. currency of underlying assets or pools reflecting investor's investment preferences) of the fund's investments rather than where it is based on the value of all the fund's investments or of any particular investment; and

- carried interest which includes an element of annual yield-based payment (e.g. funds investing in income-producing assets with a long life fund).

We have attached at Appendix D data drawn from Preqin, an independent organisation that provides data on funds terms. The most salient point is that 41% of venture funds capital funds included within the dataset have a hurdle less than the proposed 6% and consequently if the legislation were to be enacted as proposed there would be a significant impact on this key sector which is vital to future economic growth and the performance of the UK economy.

We have suggested and already provided a definition of carried interest which reflects the terms of the MoU (which uses the commercial acceptability of carry terms to investors as the test to identify carried interest which benefits from the MoU). A further copy is provided at Appendix B. The return on carried interest received by an individual would fall within this definition of carried interest if a set proportion of investors are unconnected with the individual or, if there is a high level of connection (e.g. the fund is an in-house fund where an individual's employer is the main investor), the fund is set up on terms comparable to those you would expect if the investor base were made up of unconnected third parties.

Individuals may leave a fund manager and be required to dispose of their carried interest or they may be given an opportunity to sell their carried interest (particularly the case if the portfolio comprises assets to be held for a long period). It is important that payments such as these are not caught by these rules as long as the payment is not greater than the carry distributions they would receive if the fund were liquidated at that point.

Definition of Co-investment

Co-investment (i.e. individual fund managers making a financial commitment to the funds they run on terms comparable to the commitment made by the fund's investors) is an increasingly important factor in private equity and is a key part of any fund raising, with increasing levels of co-investment demanded by investors to align the fund managers' interests with their own. Historically investors required an average co-investment of 1%, but now it is not uncommon to see investors requiring 2-3% and 5% is also not uncommon. For a fund of any size this is a substantial commercial burden and in larger funds and particularly for junior partners this represents a significant burden which the individuals often cannot fund directly out of their own available resources.

The definition used to exclude co-invest at s809 EZB (4) essentially has three legs; Firstly, the amount received has to be a "commercial return" by reference to the amount invested by the individual. Secondly, the return must be reasonably comparable to a commercial rate of interest on that investment. Thirdly, the other terms governing the returns are comparable to the returns earned by other external investors.

This poses a number of issues. Firstly co-investment returns clearly have no similarity to a commercial rate of interest and therefore a comparator based on a commercial rate of interest is not appropriate, and as a result we understand it is HMRCs intention to remove this requirement.

However, the definition of comparable return is equally important as external investors may bear other costs not born by co-investors. That may include the management fee that is at the heart of this legislation, but also carried interest and similar costs and, therefore, any definition of comparable needs to take these factors into account. We believe that it is accepted (and will be confirmed in guidance) that a co-investment return will be reasonably comparable to the external investors' return if it is calculated free of carried interest and management fees.

However, most important is the fact that there is the variety of practice around funding co-investment (in a similar manner to carried interest) which needs to be taken into account. The increasing requirement for higher levels of co-invest has required managers and their business entities to be more flexible in how they fund their commitments.

In very straightforward cases (where the co-invest commitment level is low) individuals may be able to finance their co-invest from their existing resources or a borrowing from a third party (e.g. a bank). Even in this simple structure the individuals' net overall co-investment return will differ from that of investors, however, simply because of the funding cost (interest) on their borrowings and, therefore, their overall net return will differ from that of investors. We assume that it would not be suggested that this borrowing cost means that the sum which arises to an individual is not comparable to what investors receive even if the fund manager is mandated to pay the individual managers' interest and other loan obligations directly to the bank. The answer should not change if the loan comes from a different source (e.g. the individuals' employer) given the substantive body of legislation on beneficial loans and employment related securities which already provide significant coverage in this area.

In some cases there will not be a direct loan to the individuals but instead the financier may provide a loan or other funding to an entity (a corporate entity or partnership) which makes an investment in the fund using this leverage and the personal co-investment of the individual executives who also make an investment into that vehicle. This is simply a different funding arrangement. The co-investors make their individual co-investment in that entity and the entity will then invest into or alongside the fund. These arrangements would seem to be a problem as s809EZB(1)(b) seems to require individuals to participate directly into the main fund. That is an instance of a wider problem as executive co-invest is normally routed through a vehicle (however it is financed) to avoid the fund being cluttered up with a large number of relatively small investors.

More fundamentally, the return the individuals receive from an arrangement like this will be a share in the distributions from the fund as agreed with the financier. The financier will likely want to receive his investment in the vehicle back before the individuals receive anything and he will inevitably charge for his finance (he will want a return from the vehicle which reflects the time value of his money and rewards him for the risk he has taken). So, the return the individuals receive will not necessarily be comparable to the return an investor would make, and so is caught by the definition of disguised investment management fees, but equally it isn't compensation for services provided nor is it guaranteed or impervious to investment performance. This is another example of why our suggested alternative legislative structure is preferable to the current structure.

If an individual is an employee, his interest in this vehicle will be an employment related security and so the individual will either have to pay an amount equal to the unrestricted market value of that interest or face the prospect of immediate and/or future tax charges under the employment tax regime. This brings us to the fundamental principle of UK employment tax legislation that the tax point where an individual acquires an asset (most obviously here a security) is when the individual acquires an interest in securities. This starts with the case of Abbot v Philbin (39TC82) and runs through the 1987 BVCA agreement and the 2003 MoU. In principle the rules provide that where an individual acquires a security at less than market value the discount is taxed on acquisition and any subsequent growth in value is treated in a similar manner to any other investor such that the proceeds are taxed as dividend or capital gains. Co-investment as well as carry is within these rules (and co-investment is dealt with in the MoU, albeit that its main focus is on carried interest). This fundamental and long standing principle should be borne in mind in framing the legislation. We do not believe that this legislation is the time (or the way) to change such a fundamental, basic rule, and (in fairness) we do not understand the Government to be trying to do that. But we have identified instances where these proposals could have that effect. Again, that is another reason to use the more targeted approach to the structure of the legislation we suggested.

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Fund managers might also establish a house entity through which all co-investment in the funds that they manage is pooled, with the co-investment funding going into that entity and the entity then holding interests in a number of funds. As a result of managers joining and leaving the co-investment arrangements, while funding their proportionate interest in the co-investment generally, there might not be a precise alignment between the co-investment returns received by any one individual and that individuals' indirect investment in the particular fund that the return derives from. We think that it is important that any legislation, or published guidance, make clear that these sort of pooling arrangements would fall within any definition of acceptable co-investment returns since, in essence, they involve each individual making the appropriate co-investment commitment to the returns that they receive and the returns are not in any way "disguised management fee".

If the legislation is to keep its current structure, we believe that the drafting should take the same approach as the drafting we suggested for dealing with carried interest, i.e. co-investment arrangements are outside the scope of these rules if they are entered into directly or indirectly in the fund the individual is running on terms broadly comparable with those that apply to third party investors in the fund or, if not, if they are arrangements with unconnected third parties or on terms one would expect to be entered into with third parties. Some suggested drafting is attached at Appendix C.

<u>Wide scope of 'indirectly'; the position of individuals holding equity in a business</u>

We are also concerned about the potentially very wide scope of the word "indirectly" at s809EZA(3)(a) and s809EZB(1). This appears to catch almost anything derived by a person involved in asset management services who receives value ultimately derived from a collective investment scheme. For example, we understand there is no intention to pierce the corporate veil and the rules are not intended to apply to an individual who, for example, works in a fund management business who holds shares in the company running the business. Separately as drafted the rules are not also intended to apply to an individual engaged in such a business who is a member of a LLP fund manager and who sells their interest in the LLP. In all these cases, the value the individual has received is clearly derived indirectly from the investment funds the business manages and is clearly not akin to employment remuneration or trading profit.

The above illustrates the overarching nature of this draft legislation and why a more targeted approach would be preferred. If the legislation is to keep its current form, we would suggest that reference is made that does not apply to distributions made by an entity with which an individual has a qualifying connection and for capital gains derived by an individual from disposing of interests in such a vehicle. An individual would have a "qualifying connection" with a vehicle if he directly or indirectly holds an equity interest in it (e.g. LLP membership or shareholding) and the vehicle is part of the collective investment scheme or is otherwise involved in the provision of investment management services or is the parent undertaking of another such entity.

<u>Definition of "untaxed"</u>

The draft legislation states that all management fees are "untaxed" unless they are:

- charged to UK employment income tax, or
- brought into account in calculating the profits or a trade.

This definition appears to be very wide. For example, the following would be “untaxed”:

• salaries and bonuses of an employee who lives and works in Germany but has one business meeting in the UK,

• dividends received by an individual (given the definition of “ indirectly” discussed above) from a company that are subject to income tax in the normal way.

We have made further comments on the international aspects in the following section, but if the concept of “untaxed” remains in the final legislation we recommend that, overseas equivalents are also listed among the exclusions within the definition of “untaxed”.

Territorial scope

If a disguised management fee does arise, then the individual is taxed on it as if it were profits of a trade. The drafting clauses treat this trade as carried on in the UK if the investment management services are carried on to any extent in the UK. There are two issues here. First, it is not clear whether the reference to “the investment management services by virtue of which the disguised fee or fees arise” is a reference just to the work done by the individual in question or the wider business of which he is part (e.g. would the rules apply to an individual based wholly in the US if the business he works in runs an integrated cross-border fund and has a UK presence?). Even if the legislation is just focused on individuals, as there is no de minimis, this appears to mean that, for example, non-UK individuals who answer a phone call while on holiday in the UK, or attend a single business meeting in the UK, or even who do more substantive work in the UK but it is still a small proportion of their overall fund management activities, would be subject to UK income tax and national insurance contributions on all of their earnings (other than carried interest) as none of their compensation would otherwise be taxed in the UK.

This does not seem proportionate and we cannot believe that this sudden extension of the territoriality of UK tax just for the investment management community is the Government’s intention. If it is, many non-UK fund management businesses might wonder why they are being singled out for such adverse and discriminatory treatment.

Relying on double tax relief in an individual’s home state is not the answer. UK taxes may exceed local tax paid by the individual and there may be timing or characterisation difficulties in ensuring that full credit is available. The compliance burden of bringing non-UK individuals into the scope of tax for no apparent purpose should not be overlooked. The legislation should take a proportionate approach where individuals based outside the UK are concerned. The best and simplest approach would be to limit the scope of the legislation so that it does not apply to individuals who are not resident in the UK.

If that is not acceptable, we believe there should be a threshold on the number of days an individual is present in the UK before this new legislation applies. For example, it might be appropriate for a limit to be set so that it would only apply if the individual had been present and working in the UK for 60 or more days in a tax year and then it should only apply to an appropriate proportion of his earnings. This would be consistent with the legislation pertaining to Short Term Business Visitors.

Commencement date/grandfathering

The proposed s809EZA (3) provides that "a management fee arises to the individual in the tax year directly or indirectly (whether in the form of a loan or advance, by way of allocation of profits or otherwise)". Not surprisingly this drafting is extremely broad and we are concerned that the legislation could be retrospective or catch the same amounts more than once depending on the application of the new and old rules.

From our discussions with HMRC we understand the new rules will apply from 6 April 2015 and that amounts which have already arisen (i.e. been received) prior to that date will be dealt with under the existing legislation. We understand the intention that amounts should only be taxed once and therefore management fees including priority profit shares received prior to 6 April 2015 will be outside the new rules, even where the sums arise in another guise for tax purposes subsequently.

For example, if a fund makes a non-recourse loan to a general partner prior to 6 April 2015 and part of that loan "arises" to an individual (because the accounting profits have been allocated to him or some of the cash is distributed), the new legislation won't apply when an element of the fund's future taxable profits is allocated to match the loan. A loan on account or a fund general partner's share will be discharged (by being matched with allocations or profits or released in the unlikely event that the fund does not generate enough return to discharge the loan). Here, the value (or "disguised fee") has clearly arisen to the individual prior to 6 April 2015 and therefore the old regime should apply as receipts in the fund are allocated toward the general partner's share. Future general partner's share loans/cash distribution and allocation of receipts beyond those needed to match loans advanced pre-6 April 2015 - will all be in the new regime. This appears to us to be what s809 EZD (1) and (2) intend, since they imply that the later profit allocation would be taxed "otherwise than by virtue of s809EZA2". It is important, however, that this sort of issue is clearly dealt with in the rules.

Summary

Therefore our key observations are:

- It would be preferable to base the legislation on a definition of management fee, rather than including everything and then excluding co-investment and carried interest, as the legislation would be simpler, probably more robust and therefore more likely to achieve HMRC's objective.

- If the current structure of the legislation is maintained, the definitions of carried interest and co-investment will need significant amendment to deal with the variety of practice across the industry and also to deal with future commercial developments. We have submitted revised definitions of each which in our view encompass the variety of practices and we believe is the best way forward.

- The use of the term "indirectly" significantly broadens the legislation and could without care unintentionally pierce the corporate veil and result in all distributions including capital and income being within the proposed rules. For this reason a more targeted approach based on a definition of management fee appears preferable, otherwise appropriate exemptions would be required.

- If the concept of untaxed remains a key part of the legislation, the definition of untaxed would need to be expanded to include overseas equivalents.

- The legislation appears unintentionally to expose individuals performing investment management activities outside the UK to UK tax if they visit the UK for a day or even less. The charge needs to be proportional with an exception for persons spending minimal time in the UK. We have suggested 60 days based on the similar exceptions for Short Term Business Visitors.

- We understand the legislation will not be retrospective in any form and will only apply to management fees arising after 6 April 2015. The legislation should be clarified to provide certainty and ensure that the compliance process is as far as possible straight forward.

Please advise us if you would like us to expand any of the points raised in this letter or would like any further information from us. We would welcome such a dialogue.

Yours sincerely,

David R Nicolson

Chairman of the BVCA Taxation Committee

Appendix A

Definition of "Management Fee" (assumes legislation will be "reversed" so that only "management fees" (as defined) are caught and no carve-outs, etc. will be needed)

For the purposes of this Chapter a "management fee" is a sum which arises to an individual directly or indirectly from a collective investment scheme and which is paid or otherwise borne by the scheme or participants in the scheme (other than those involved in the provision of investment management services to the scheme) under arrangements which

(a) make it reasonable to conclude that the sum is consideration for investment management services provided in respect of the scheme, and either

(b) make it reasonable to conclude that the quantum of the sum will not be materially affected by the results of the scheme or the performance of the property subject to the scheme, or

(c) have the result in practice that the quantum of the sum is not materially affected by the results of the scheme or the performance of the property subject to the scheme.

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Appendix B

Alternative Carried Interest provision

New s809EZB(1)(a)

(a) is a payment made in respect of a carried interest (see subsections (2)-(11) below)

New s809EZB(2)-(6):

(2) For the purposes of subsection (1) a "carried interest" is a reference to the rights of a person as a direct or indirect participant in a collective investment scheme to receive distributions directly or indirectly from that collective investment scheme which

(a) do not fall within subsection (1)(b) or (c),

(b) are payable by the scheme at any time only if the scheme or the relevant part of the scheme is profitable at that time and do not exceed the profits of the scheme or the relevant part of the scheme at that time, and

(c) are only payable once any appropriate performance hurdle has been met.

(3) A collective investment scheme is "profitable" at a particular time if the aggregate of the amounts distributed to all participants in the scheme and the market value of the property which remains the subject of the scheme at that time exceeds the amounts invested in the scheme by participants.

(4) References to the "profits" of a scheme at any time is a reference to the amount by which the aggregate of the amounts distributed to participants in the scheme (other than distributions in respect of carried interest) and the market value of the property which remains the subject of the scheme at that time exceeds the aggregate of the amounts invested in the scheme by participants.

(5) Where a carried interest is calculated by reference to part only of the property subject to a collective investment scheme, the "relevant part" is a reference to that part of the property subject to the scheme and the relevant part is profitable at any time if the aggregate of the amounts distributed to all participants in the scheme in respect of the relevant part and the market value of the relevant part of the property which remains the subject of the scheme at that time exceeds the amounts invested in the scheme by participants in respect of the relevant part.

(6) References to the "profits" of a relevant part of a scheme at any time is a reference to the amount by which the aggregate of the amounts distributed to participants in the scheme (other than distributions in respect of carried interest) in respect of the relevant part and the market value of the relevant part of the property which remains the subject of the scheme at that time exceeds the aggregate of the amounts invested in the scheme by participants in respect of the relevant part.

(7) A "performance hurdle" is a reference to the level of return (whether or not realized and which may be zero) which the property which is the subject of the scheme or the relevant

pat of the scheme is required to have generated before any carried interest distributions are made.

(8) A performance hurdle is “appropriate” if at least [seventy-five per cent.] of the external investors (see subsection ([4])) measured by reference to the sums they have committed to invest in the scheme are not associated with any of the individuals who directly or indirectly perform investment management services in respect of the scheme.

(9) A performance hurdle is also “appropriate” if, having regard to the nature of the property which is the subject of the scheme and the investment and other objectives of the scheme, it would have been reasonable to conclude when the scheme was established that that performance hurdle would have been included in the carried interest arrangements in respect of the scheme if the participants in the scheme (other than persons involved in providing investment management services to the scheme) had been external investors (see subsection [(4)] above) who were not associated with any of the individuals involved in providing investment management services to the scheme.

(10) A payment is made “in respect of a carried interest” if it is

(a) a (direct or indirect) distribution made to the individual by the collective investment scheme in question by reason of his rights as a carried interest holder, or

(b) consideration received by the individual for the disposal of all or part of his carried interest as long as the amount of consideration received by the individual for such disposal does not exceed the amount of the distributions which would have been paid to him by reference to the part of his carried interest which he is disposing of if at that time the scheme had disposed of all of the property which is the subject of the scheme for a price equal to the market value of that property at that time and distributed the proceeds of such disposal in accordance with the arrangements constituting the scheme.

(11) For the purposes of this section:

(a) an external investor is “associated” with an individual if he is connected with that individual or is an employer of that individual or is connected with a person who is an employer of that individual or is connected with a person who is a partner in a partnership (other than a partnership which is a collective investment scheme) with that individual

(b) “connected” is defined in section 1122 of the Corporation Tax Act 2010 except that for these purposes the reference in that section to a “partnership” does not include a partnership which is a collective investment scheme

(c) “market value” is defined in sections 272 and 273 of the Taxation of Chargeable Gains Act 1992

(d) “an employer” is to be construed in the same way that “the employer” is construed under section 421B(8) of the Income Tax (Earnings and Pensions) Act 2003

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Appendix C

Suggested Co-investment text for legislation

1) New s809EZB(1)(b)

   "is paid to the individual under a qualifying co-investment arrangement"

2) Delete s809EZB(1)(c)

3) New s809EZB(4)

   "A qualifying co-investment arrangement is one

   (a) under which the individual makes an investment in the scheme (whether directly or indirectly) and the terms governing the repayment of that investment and the return to which it entitles the individual are reasonably comparable to the terms governing the repayment of investments made in the scheme by external investors and the returns to which their investment entitles them; or

   (b) under which the individual participates in the scheme indirectly and that participation is facilitated by finance provided by a person (A) who is not associated with any of the individuals who directly or indirectly perform investment management services in respect of the scheme and the payments to the individual in respect of that participation are regulated by the terms of the agreement with A under which A agreed to provide finance to facilitate that participation; or

   (c) under which the individual participates in the scheme indirectly and that participation is facilitated by finance provided by a person (B) who is associated with any of the individuals who directly or indirectly perform investment management services in respect of the scheme and the payments to the individual in respect of that participation are regulated by the terms of the agreement with B under which B agreed to provide finance to facilitate that participation and that agreement is on terms which at the time it was entered into it would be reasonable to suppose that a person who was not associated with any of the individuals who directly or indirectly perform investment management services in respect of the scheme would have been prepared to enter into in order to provide the finance which B has agreed to provide.

   For these purposes an "external investor" is a participant who does not perform investment management services directly or indirectly in respect of the scheme and "associated" is defined in section [809EZB(11)(a)]

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Appendix D

Analysis of preferred returns in venture capital funds

Our analysis, using data from Preqin, has shown that 60 venture capital funds worldwide, out of those who have disclosed the level of their preferred return to Preqin, have a preferred return of under 6%. The table below contains the relevant data, along with vintage and fund size. There are several US and Rest of the World based venture funds, but these funds may still have UK based carried interest holders.

In total:

60 out of 146 venture capital funds have a preferred return of less than 6%.

There are 105 funds who have not disclosed preferred return to Preqin (and whose hurdle could be less than 6%).

Vintage	Fund Type	GP Location	Geo Focus	Preferred Return (%)	Less than 6% hurdle?	Management fee %
2014	Venture (General)	US	US	0	Y	2
2014	Venture (General)	ROW	ROW	0	Y	2
2014	Venture (General)	Europe	Europe	0	Y	2.5
2014	Venture (General)	ROW	ROW	8	N	2
2014	Venture (General)	ROW	ROW	6	N	2.5
2014	Venture (General)	ROW	ROW	8	N	2
2014	Venture (General)	Europe	ROW	8	N	2
2013	Venture (General)	ROW	ROW	12	N	2
2013	Venture (General)	US	US	8	N	2
2013	Venture (General)	Europe	Europe	0	Y	2
2013	Venture (General)	ROW	ROW	4.27	Y	1.7
2013	Venture (General)	ROW	ROW	3	Y	1.75

Vintage	Fund Type	GP Location	Geo Focus	Preferred Return (%)	Less than 6% hurdle?	Management fee %
2013	Venture (General)	ROW	ROW	12	N	1.64
2012	Venture (General)	Europe	Europe	6	N	3
2012	Venture (General)	US	US	0	Y	2.5
2012	Venture (General)	ROW	ROW	8	N	1.5
2012	Venture (General)	Europe	Europe	8	N	2.5
2012	Venture (General)	ROW	ROW	8	N	2
2012	Venture (General)	Europe	ROW	8	N	2
2012	Venture (General)	Europe	Europe	8	N	2.5
2011	Venture (General)	Europe	Europe	8	N	2
2011	Venture (General)	Europe	Europe	6	N	2.25
2011	Venture (General)	Europe	Europe	5	Y	2.5
2011	Venture (General)	ROW	ROW	8	N	2.5
2011	Venture (General)	Europe	Europe	6	N	2.5
2011	Venture (General)	ROW	ROW	6	N	2
2011	Venture (General)	ROW	ROW	8	N	2.5
2011	Venture (General)	Europe	ROW	8	N	2
2011	Venture (General)	US	US	0	Y	2.5
2011	Venture (General)	ROW	ROW	8	N	2.25
2011	Venture (General)	US	US	0	Y	2
2011	Venture (General)	US	US	0	Y	2

Vintage	Fund Type	GP Location	Geo Focus	Preferred Return (%)	Less than 6% hurdle?	Management fee %
2011	Venture (General)	US	US	0	Y	2.5
2011	Venture (General)	Europe	Europe	8	N	2
2011	Venture (General)	Europe	Europe	7	N	2.25
2011	Venture (General)	ROW	ROW	8	N	2
2011	Venture (General)	ROW	ROW	5	Y	2.5
2010	Venture (General)	US	US	0	Y	2.25
2010	Venture (General)	US	US	8	N	2.5
2010	Venture (General)	Europe	Europe	0	Y	not disclosed
2010	Venture (General)	Europe	Europe	5	Y	2.25
2010	Venture (General)	ROW	ROW	8	N	2.5
2010	Venture (General)	US	US	7	N	2.5
2010	Venture (General)	ROW	ROW	0	Y	not disclosed
2010	Venture (General)	Europe	Europe	8	N	2.5
2010	Venture (General)	US	US	10	N	2
2010	Venture (General)	US	US	8	N	2
2010	Venture (General)	US	US	15	N	2.2
2010	Venture (General)	ROW	ROW	8	N	1.85
2010	Venture (General)	US	US	0	Y	2.25
2010	Venture (General)	US	US	0	Y	2.5
2010	Venture (General)	ROW	ROW	8	N	2.5

Vintage	Fund Type	GP Location	Geo Focus	Preferred Return (%)	Less than 6% hurdle?	Management fee %
2009	Venture (General)	ROW	ROW	15	N	2
2009	Venture (General)	US	ROW	8	N	2
2009	Venture (General)	US	US	8	N	2
2009	Venture (General)	ROW	ROW	8	N	2
2009	Venture (General)	ROW	ROW	8	N	2.5
2009	Venture (General)	Europe	Europe	6	N	2
2009	Venture (General)	ROW	ROW	8	N	2.25
2009	Venture (General)	US	US	0	Y	2.5
2009	Venture (General)	ROW	ROW	12	N	2
2008	Venture (General)	US	ROW	0	Y	2.5
2008	Venture (General)	Europe	Europe	0	Y	2.5
2008	Venture (General)	ROW	ROW	8	N	2
2008	Venture (General)	US	US	0	Y	2.5
2008	Venture (General)	Europe	Europe	5	Y	2
2008	Venture (General)	Europe	Europe	5	Y	2.5
2008	Venture (General)	Europe	Europe	8	N	2.5
2008	Venture (General)	Europe	Europe	8	N	2
2008	Venture (General)	ROW	ROW	8	N	2.5
2008	Venture (General)	US	ROW	0	Y	2.5
2008	Venture (General)	US	US	8	N	2

Vintage	Fund Type	GP Location	Geo Focus	Preferred Return (%)	Less than 6% hurdle?	Management fee %
2008	Venture (General)	US	US	8	N	2.5
2008	Venture (General)	ROW	ROW	0	Y	2.5
2008	Venture (General)	US	US	0	Y	2
2008	Venture (General)	Europe	Europe	7	N	not disclosed
2008	Venture (General)	US	US	8	N	2
2008	Venture (General)	ROW	ROW	10	N	2
2007	Venture (General)	ROW	ROW	7	N	2.5
2007	Venture (General)	US	ROW	5	Y	2.5
2007	Venture (General)	Europe	Europe	8	N	2
2007	Venture (General)	Europe	ROW	6	N	2.5
2007	Venture (General)	ROW	ROW	0	Y	2.5
2007	Venture (General)	Europe	Europe	8	N	2.5
2007	Venture (General)	ROW	ROW	20	N	3
2007	Venture (General)	US	US	8	N	2
2007	Venture (General)	Europe	Europe	7	N	2
2007	Venture (General)	US	US	6	N	2
2007	Venture (General)	ROW	ROW	10	N	2
2007	Venture (General)	US	US	0	Y	2.5
2007	Venture (General)	ROW	ROW	0	Y	not disclosed
2007	Venture (General)	US	US	0	Y	2.5

Vintage	Fund Type	GP Location	Geo Focus	Preferred Return (%)	Less than 6% hurdle?	Management fee %
2007	Venture (General)	ROW	ROW	8	N	2
2007	Venture (General)	US	US	0	Y	2.5
2007	Venture (General)	US	US	4	Y	2.5
2007	Venture (General)	Europe	Europe	8	N	2.3
2006	Venture (General)	Europe	Europe	8	N	8
2006	Venture (General)	US	US	8	N	8
2006	Venture (General)	Europe	Europe	4	Y	2.25
2006	Venture (General)	ROW	ROW	0	Y	not disclosed
2006	Venture (General)	Europe	Europe	6	N	2.5
2006	Venture (General)	Europe	Europe	5	Y	2.5
2006	Venture (General)	Europe	Europe	8	N	2.5
2006	Venture (General)	US	US	0	Y	not disclosed
2006	Venture (General)	US	US	8	N	2.5
2006	Venture (General)	US	ROW	8	N	2
2006	Venture (General)	US	US	0	Y	2
2006	Venture (General)	US	US	0	Y	2
2006	Venture (General)	US	US	8	N	2
2005	Venture (General)	Europe	Europe	7	N	2.75
2005	Venture (General)	Europe	Europe	6	N	2
2005	Venture (General)	US	US	8	N	not disclosed

Vintage	Fund Type	GP Location	Geo Focus	Preferred Return (%)	Less than 6% hurdle?	Management fee %
2005	Venture (General)	Europe	Europe	15	N	2
2005	Venture (General)	US	US	0	Y	2.5
2005	Venture (General)	US	US	0	Y	2.5
2005	Venture (General)	US	US	8	N	1
2005	Venture (General)	Europe	Europe	8	N	2.5
2005	Venture (General)	ROW	ROW	0	Y	2.5
2005	Venture (General)	US	US	0	Y	2.5
2005	Venture (General)	US	US	0	Y	2.5
2005	Venture (General)	US	US	8	N	2
2005	Venture (General)	Europe	Europe	6	N	2
2004	Venture (General)	US	US	0	Y	1
2004	Venture (General)	Europe	Europe	5	Y	2.5
2004	Venture (General)	US	US	8	N	2.5
2004	Venture (General)	US	US	0	Y	2
2004	Venture (General)	US	ROW	7	N	2.3
2004	Venture (General)	ROW	ROW	6	N	2.5
2004	Venture (General)	US	US	6.5	N	1.5
2004	Venture (General)	US	US	0	Y	2.25
2004	Venture (General)	US	US	0	Y	2
2004	Venture (General)	US	US	0	Y	2.5

Vintage	Fund Type	GP Location	Geo Focus	Preferred Return (%)	Less than 6% hurdle?	Management fee %
2003	Venture (General)	ROW	ROW	13	N	3
2003	Venture (General)	US	US	0	Y	not disclosed
2003	Venture (General)	US	US	0	Y	2
2003	Venture (General)	US	US	8	N	2
2001	Venture (General)	ROW	ROW	8	N	not disclosed
2001	Venture (General)	US	US	0	Y	2.5
2001	Venture (General)	US	US	0	Y	2.4
2001	Venture (General)	US	US	0	Y	6.12
2001	Venture (General)	US	US	0	Y	2.5
2000	Venture (General)	US	US	8	N	2.5
2000	Venture (General)	US	US	7	N	2.25
2000	Venture (General)	US	US	0	Y	2.4
2000	Venture (General)	US	US	0	Y	6.12
2000	Venture (General)	US	US	8	N	2