

EXPLANATORY MEMORANDUM TO
THE AUTHORISED INVESTMENT FUNDS (TAX) (AMENDMENT)
REGULATIONS 2009

2009 No. 2036

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs, on behalf of HM Treasury, and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Purpose of the instrument**

2.1 These Regulations amend the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) ("the principal Regulations") by inserting new Parts 1A, 2B and 4B into the principal Regulations. New Part 1A defines the general diversity of ownership condition ("the GDO condition") which details the conditions that must be fulfilled in order for the GDO condition referred to in Parts 2A, 2B, 4A and 4B of the principal Regulations to be satisfied. New Part 2B contains provisions to give certain funds (diversely owned authorised investment funds) certainty in relation to the tax treatment of investment transactions. New Part 4B, which is divided into 7 Chapters, deals with a particular type of authorised investment fund, Tax Elected Funds.

3. **Matters of special interest to the Select Committee on Statutory Instruments.**

3.1 None.

4. **Legislative Context**

4.1 Sections 16 to 19 of the Finance (No.2) Act 2005 provide the framework for a regime under which the majority of provisions relating to the taxation of authorised investment funds are contained in secondary legislation that is in the principal Regulations, rather than in primary legislation.

4.2 As a result of commercial development, the principal Regulations have required amendment from time to time.

5. **Territorial Extent and Application**

5.1 This instrument applies to all of the United Kingdom.

6. **European Convention on Human Rights**

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- *What is being done and why*

- 7.1 It was stated when the principal Regulations were made (29 March 2006) that it was intended that consultation with the authorised investment fund industry should continue, in order to ensure that the principal Regulations took account of commercial developments. (See the Explanatory Memorandum accompanying SI 2006/964.)
- 7.2 As a result of consultations, the principal Regulations have been amended on a number of occasions. It is intended that consultation will continue in the future and further amendments may be required to the principal Regulations in due course.
- 7.3 The amendments made by these Regulations have their genesis in the Investment Management Association/KPMG October 2006 report entitled “Taxation and the Competitiveness of UK Funds” (“the Report”), which identified certain tax barriers to the international competitiveness of the UK industry. Following publication of the Report, the Economic Secretary established a joint working group between the Investment Management Association, HM Treasury and HM Revenue and Customs (“HMRC”) to consider, as a result of the findings of the Report, the changes required to the UK tax system in order to enhance the UK’s competitiveness as a place for investment funds to locate.
- 7.4 In the 2009 Budget the Chancellor of the Exchequer announced the creation of a Tax Elected Fund (“TEF”) regime from 1 September 2009. The key features of the TEF regime, which is contained in Part 4B of these Regulations, are that it is elective subject to the authorised investment fund meeting certain conditions, and that it moves the point of taxation from the fund to the investor. Therefore, investors in such a fund will be taxed in broadly the same way as if they had owned the underlying assets and income directly. Taxation at the fund level, which is removed for a TEF by these Regulations, had been identified in the Report as a barrier to competitiveness in some cases.
- 7.5 At the Budget it was also announced that, as from 1 September 2009, rules would be introduced which would give authorised investment funds certainty that “investment transactions”, as defined by regulations 14F to 14N in Part 2B of these Regulations, would not be characterised as trading transactions for tax purposes. Authorised investment funds are not subject to tax on their capital gains (section 100 Taxation of Chargeable Gains Act 1992), but if the fund’s activities could be characterised as trading capital gains could then be exposed to tax as income profits from that trading activity. Uncertainty over this issue and the significant consequences for the tax position of the fund were identified in the Report as a barrier to the competitiveness of the UK. The certainty provided by these Regulations is open only to an authorised investment fund which meets the GDO condition in regulation 9A of these

Regulations. The Regulations also contain anti-avoidance provisions to prevent banks and other financial traders from exploiting the rules.

7.6 Since the introduction of the principal Regulations there have been various amendments to those Regulations as regimes have been introduced some of which rely on compliance with a GDO condition. On each occasion that a GDO condition has been inserted into the principal Regulations, the conditions have been simplified slightly. The new general GDO condition inserted as regulation 9A further simplifies the requirements that need to be met and applies to all the regimes in the principal Regulations which require compliance with the GDO condition, so that as a consequence of these Regulations there is now a standard GDO condition in the principal Regulations. Part 2B of these Regulations also provides for a clearance application in respect of the GDO condition.

- ***Consolidation***

7.7 This instrument amends the principal Regulations. HMRC has not consolidated the amendments as there is the possibility that a further substantial amendment may be required to the principal Regulations following a public consultation on whether to introduce a new type of authorised investment fund. If, following the consultation, the decision is taken to introduce a new type of authorised investment fund, a consolidation will be carried out at the same time. If, after the consultation the decision is taken not to introduce a new type of authorised investment fund, then a consolidation will be carried out in due course and HMRC will prepare a consolidated version for publication on its website.

8. Consultation outcome

8.1 Drafts of these Regulations have been the subject of formal public consultation and a number of detailed changes have been made as a result.

9. Guidance

9.1 Guidance on the instrument will be published in HMRC's Corporate Tax Manual.

10. Impact

10.1 An Impact Assessment has not been produced in relation to the insertion of Part 1A (the GDO condition) as that Part has no impact on business, charities or voluntary bodies.

10.2 An Impact Assessment has not been produced in relation to the insertion of Part 2B (diversely owned AIFs) as that Part has a negligible impact on business, charities or voluntary bodies.

10.3 An Impact Assessment in relation to the insertion of Part 4B (Tax Elected Funds) is attached to this memorandum.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The Government intends to monitor the effects of these Regulations on industry.

13. Contact

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