

**EXPLANATORY MEMORANDUM TO
THE OFFSHORE FUNDS (TAX) (AMENDMENT) REGULATIONS 2011**

2011 No. 1211

1. This explanatory memorandum has been prepared by HM Revenue and Customs 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 This instrument addresses technical issues in the operation of the Offshore Funds (Tax) Regulations 2009 (SI 2009/3001) (the principal Regulations).

- 2.2 This instrument also makes changes intended to simplify the operation of the principal Regulations in certain cases.

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

- 3.1 None

4. **Legislative Context**

- 4.1 The principal Regulations set out the rules for the taxation of investors in offshore funds.

- 4.2 This instrument amends the principal Regulations in order to address practical and operational issues identified by industry and by HMRC in aspects of the principal Regulations.

- 4.3 The instrument also makes changes to the principal Regulations to make them simpler to operate in certain cases and fairer by treating investors in offshore funds in a more closely comparable manner to investors in UK investment funds.

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 The changes described below relate to the calculation of reported income and are made to simplify or to improve the calculation.
 - 7.1.1 The rule relating to equalisation operated by some reporting funds for new and departing investors is revised to ensure that it will work for funds that do not make distributions as well as those that do.
 - 7.1.2 Provisions are made in relation to reporting funds that do not operate equalisation. These enable those funds to take measures to prevent the reported income of investors remaining in the fund from being artificially increased because some other investors have left the fund.
 - 7.1.3 Provision is made for a reporting fund to change its arrangements with regard to equalisation
 - 7.1.4 Simplified rules are provided for computing reportable income in the case of a reporting fund that is fiscally transparent.
 - 7.1.5 Provision is made to simplify compliance with the rules for a reporting fund which tracks a market index.
 - 7.1.6 Transitional provisions will provide for existing funds to operate the new rules for all reports made on and after the date these Regulations come into force but existing funds will retain the option to apply the previous rules for reporting periods ending before the Regulations come into force.
- 7.2 The two changes described below both widen the circumstances in which a reporting fund can apply rules in the OF regulations which treat certain categories of transaction as non-trading transactions for the purpose of calculating reported income.
 - 7.2.1 Provision is made to broaden the category of offshore funds that are treated as equivalent to an authorised investment fund in the UK (to include offshore funds similar to qualified investor schemes in the UK)
 - 7.2.2 Provision is made for an offshore ‘master’ fund to take into account the intended investors in a feeder fund in determining whether the offshore fund can meet the genuine diversity of ownership condition.

- 7.3 In the case of interests in certain non-reporting funds, a new exception is introduced to the treatment of disposal gains as income for tax purposes. This relates to disposals of interests in a fund investing almost wholly in unlisted trading companies.
- 7.4 Further minor technical changes are made as set out in the detailed explanatory notes to the regulations.

8. Consultation outcome

- 8.1 The amendments made by this instrument were announced on 30 November 2010 following discussions with relevant industry representative bodies and further developed through informal industry consultation. A full draft of the instrument was published on 28 February 2011 and changes to this reflect industry comment.

9. Guidance

- 9.1 HM Revenue and Customs is currently revising the guidance relating to offshore funds to reflect this instrument. It expects to publish a draft of the revised guidance for comment by 30 June 2011.

10. Impact

- 10.1 The impact on business, charities or voluntary bodies is negligible.
- 10.2 The impact on the public sector is negligible.
- 10.3 A Tax Information and Impact Note covering this instrument will be published on the HMRC website at:
<http://www.hmrc.gov.uk/thelibrary/tiins.htm>.

11. Regulating small business

- 11.1 The legislation applies to small business.
- 11.2 To minimise the impact of the requirements on small firms employing up to 20 people, the approach taken is that this measure is a simplification that will apply to all firms in the sector. No capacity issues have come to light in discussions or representations on the changes.
- 11.3 All interested parties had the opportunity to comment and informal discussions included industry representative bodies representing the range of firms operating in the industry sector.

12. Monitoring & review

12.1 The Government will continue to monitor industry developments and customer feedback to ensure that the revised rules are operating in the way intended.

13. Contact

John Buckeridge at HM Revenue and Customs Tel: (020) 7147 2560 or email: john.buckeridge@hmrc.gsi.gov.uk or Wayne Strangwood Tel: (020) 7147 2545 or email wayne.a.strangwood@hmrc.gsi.gov.uk can answer any queries regarding the instrument.