

**EXPLANATORY MEMORANDUM TO**  
**THE VALUE ADDED TAX (FINANCE) (No. 2) ORDER 2008**

**2008 No. 2547**

1. This explanatory memorandum has been prepared by HM 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. **Description**

2.1 This Order revokes the Value Added Tax (Finance) Order 2008 (S.I. 2008/1892) (“the Finance Order”) and varies Group 5 of Schedule 9 (VAT exemption for certain financial supplies) to the Value Added Tax Act 1994 (c. 23) (“VATA”) by redefining the categories of special investment fund whose management is exempt under that Group.

2.2 The management of authorised unit trust schemes and open-ended investment companies remains exempt. Trust-based schemes are removed from the exemption.

2.3 The management of collective investment schemes and of sub-funds of umbrella schemes which are recognised pursuant to sections 264, 270, 272 or 409 of the Financial Services and Markets Act 2000 (c. 8) (“FSMA”) has been included in the exemption. Such schemes or sub-funds are nevertheless excluded from the exemption if they have never been marketed in the United Kingdom or are not for the time being marketed in the United Kingdom and less than 5% of their shares or units are held by, or on behalf of, investors who are in the United Kingdom.

2.4 The management of closed-ended collective investment undertakings which fulfil certain criteria relating to their investment object, UK Listing status and trading of their shares on a regulated market has also been included in the exemption.

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

3.1 For the reasons explained in paragraph 4.8 this instrument is subject to affirmative procedure. The circumstances in which it was necessary to make and lay this instrument during the Recess, and for the instrument to come into force the day after it was made and laid, are explained in paragraphs 4.5 to 4.7. In summary, it became apparent that it was necessary to revoke and replace an Order which was due to come into force on 1 October 2008.

3.2 The explanatory note to this Instrument explains that:-

“A full and final Impact Assessment has not been produced for this instrument as a negligible impact on the private or voluntary sectors is foreseen.”

This is because the accepted Government practice is that no IA will be published for HMRC and HMT tax measures for which:

- the total effect of the changes across all UK business is less than £100,000 of administrative burden costs/savings and/or £3m of compliance cost in total; and
- the Department's Better Regulation and Policy team has confirmed that
  - there are no disproportionate impacts on any business or sector; and
  - there are no other issues which might make publication of an IA advisable.

This is such a measure.

HMRC are working with BERR to ensure that the next edition of the Statutory Instrument Practice reflects these changes.

#### **4. Legislative Background**

- 4.1 Article 135(1)(g) of the Principal VAT Directive (Council Directive 2006/112 EC) requires member States to exempt the management of special investment funds as defined by the member State in question.
- 4.2 Group 5 of Schedule 9 to VATA describes the finance supplies which are exempt from VAT and exempts the management of certain categories of investment funds.
- 4.3 Items 9 and 10 of Group 5 as amplified by Notes (6), (8) and (10) to the Group exempt services consisting in the management of authorised unit trust schemes, trust based schemes and open-ended investment companies.
- 4.4 The definitions of the categories of funds whose management is subject to the exemption need to be varied following the judgment of the European Court of Justice in JP Morgan Fleming Claverhouse Investment Trust plc and the Association of Investment Trust Companies v The Commissioners of HM Revenue and Customs (Case C-363/05).
- 4.5 The Finance Order, which is due to come into force on 1 October 2008, redefines the investment funds whose management falls within the ambit of the exemption. In particular it exempts the management of four categories of off-shore funds, namely those collective investment schemes which are recognised pursuant to sections 264, 270, 272 or 409 of FSMA.
- 4.6 HMRC consulted key stakeholders on the draft Finance Order. Following the laying of the Finance Order on 17 July 2008 and after further consideration some stakeholders expressed the view that the Finance Order's definition of off-shore funds would operate to exempt management services which were not intended to be included in the exemption. HMRC, following further consultation with key stakeholders, has concluded that the definition of off-shore funds provided for in the Finance Order requires further refinement.
- 4.7 Consequently Article 2 of this Order, which comes into force on 30 September 2008, revokes the Finance Order. Article 3 of this Order, which comes into force on 1 October 2008, reproduces the definitions of the funds provided for in the Finance Order but with a revised definition for off-shore funds so that only those schemes or sub-funds of umbrella schemes which are recognised pursuant to FSMA are exempted. The exemption does not apply to such schemes or sub-funds if they have never been marketed in the United Kingdom or are not for the time being marketed in the United Kingdom and less than 5% of their shares or units are held by, or on behalf of, investors who are in the United Kingdom.

4.8 This Order is subject to the affirmative procedure. Section 97(3) of the Act requires an Order to which that subsection applies to be laid before the House of Commons and provides that unless it is approved by that House within 28 days beginning on the date on which it is made it shall cease to have effect from the expiration of that period. Section 97(4)(c)(iii) applies subsection (3) to an order which varies Schedule 9 of the Act so as to abolish the exemption of a supply without zero-rating it. This Order considerably extends the category of funds whose management is exempted but it also removes the management of one category, trust based schemes, from the exemption and for this reason the procedure specified in section 97(3) applies.

## **5. Territorial Extent and Application**

This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

6.1 The Financial Secretary to the Treasury, Rt Hon Jane Kennedy MP, has made the following statement regarding Human Rights:

In my view the provisions of the Value Added Tax (Finance) (No. 2) Order 2008 are compatible with the Convention rights.

## **7. Policy background**

7.1 The changes made by the Order are a consequence of the ECJ's judgment in JP Morgan. The ECJ ruled that closed-ended funds, such as investment trust companies, are capable of definition as special investment funds for the purposes of the VAT exemption in Article 135(1)(g) of the Principal VAT Directive. It also made clear that, in exercising their discretion to define special investment funds in national law, member States must pay due regard to the purpose of the exemption, which is to facilitate investment in securities by means of collective investment undertakings by excluding the cost of VAT, and to the principle of fiscal neutrality. Funds which are similar to, and in competition with, funds which benefit from the exemption should be afforded the same VAT treatment.

7.2 The changes give effect to the principles expressed in the judgment by:-

(a) defining a new category of exempt fund which is a closed-ended collective investment undertaking fulfilling criteria relating to its investment object, investments, UK Listing status and trading of its shares on a regulated market; and

(b) extending the categories of open-ended collective investment schemes covered by the exemption.

7.3 The effect of the changes is to exempt the management of all similar collective investment schemes whose units or shares are made available for investment by the general public in the UK under comparable regulatory supervision.

7.4 The definition of closed-ended collective investment undertaking covers UK investment trust companies and venture capital trusts. It also includes similar off-shore

investment funds whose shares are available for investment by the UK general public under the same conditions.

7.5 Open-ended collective investment schemes established in the UK which are authorised by the Financial Services Authority to sell their units to UK investors consist of authorised unit trust schemes and authorised open-ended investment companies and are covered by the exemption. The management of open-ended collective investment schemes established outside the UK, or of sub funds of “umbrella” schemes established outside the UK, is also included in the exemption if the scheme or the umbrella scheme of which the sub-fund forms a part is recognised by the Financial Services Authority for the purposes of selling units or shares to investors in the UK. The exemption nevertheless does not apply to schemes or sub-funds which have never been marketed in the United Kingdom or which are not for the time being marketed in the United Kingdom and less than 5% of their shares or units are held by, or on behalf of, investors who are in the United Kingdom.

7.6 Trust-based schemes, which are schemes where the asset consists of a single real property, have been deleted as a category as there are none currently authorised to market their units and they do not sit with the principles expressed in the JP Morgan judgment.

## **8. Impact**

A full and final Impact Assessment has not been produced for this instrument as a negligible impact on the private or voluntary sectors is foreseen.

## **9. Contact**

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