

**EXPLANATORY MEMORANDUM RELATING TO
THE OFFSHORE FUNDS REGULATIONS 2004**

2004 No. 2572

1. This explanatory memorandum has been prepared by the Commissioners of Inland Revenue and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments. It has been prepared by the Commissioners of Inland Revenue.

- 2. Description**

These Regulations modify the taxation regime for offshore funds (sections 756A to 763, Schedule 27 and Schedule 28 ICTA 1988) to deal with matters arising from changes to the primary legislation made in Section 145 and Schedule 26 to Finance Act 2004. Offshore funds are collective investment schemes that are not resident in the UK and the changes in Finance Act 2004 allow separate sub-funds and classes of interest in an offshore fund to qualify for "distributor status" independently of the other sub-funds and classes of interest in the same overall fund. Those changes require modification to the primary legislation to deal with mainly administrative, procedural and transitional issues to cover the different circumstances relating to single funds, sub-funds and classes of interest.

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

The Regulations have effect for account periods of offshore funds ending on or after the date of Royal Assent to the 2004 Finance Act. This is to ensure that its effect matches that of the primary legislation.

- 4. Legislative background**

The Regulations are made by the Treasury, in exercise of the powers conferred upon them by section 758(7) and (8) of and, paragraph 21 of Schedule 27 and paragraph 9 of Schedule 28 to the Income and Corporation Taxes Act 1988 and section 145(2)(b) of the Finance Act 2004.

- 5. Extent**

The Regulations apply to all offshore funds that seek "distributor status". This status in turn determines the taxation treatment of any person who is subject to UK taxation on income or gains arising from an offshore fund.

6. European Convention on Human Rights

The Financial Secretary is satisfied that the Regulations are compatible with the Convention rights.

7. Policy Background

7.1 The purpose of the primary legislation is to provide offshore fund managers with more flexibility to tailor their products to different markets. Under the legislation as it stood before the 2004 Finance Act, all sub-funds and classes of interest within an overall offshore fund had to qualify for "distributor status" in order for each separate part to qualify. If a fund has distributor status a UK investor is subject to the chargeable gains rules on disposals of shares or units in the fund, but if it does not have that status a UK investor will be subject to tax on income on all amounts realised from such disposals.

7.2 Following a consultation in 2002, fund managers argued that they were constrained by UK tax rules to structure their funds in a particular way, even when marketing to investors outside the UK. The changes made in Finance Act 2004 take away some of those constraints. It will now be possible, for example, for a fund based on a single pool of assets to offer different classes of interest to investors in the UK and elsewhere to reflect local markets and preferences, whereas previously separate funds had to be established, leading to a greater number of separate funds, and hence higher costs, than might otherwise have been the case.

7.3 The Regulations address a number of mainly procedural consequences. For example, applications for distributor status must be accompanied by the "accounts of the fund". However, a class of interest will not have its own accounts - it will be dependent on the accounts of the overall fund. The Regulations ensure that this procedural matter is dealt with correctly.

8. Impact

The primary legislation and these Regulations are expected to bring economic benefits to fund managers and investors. There has so far not been any indication that the outcome will be otherwise, although it will take some time before the extent of any benefits can be quantified.

9. Contact

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