EXPLANATORY MEMORANDUM TO

THE INCOME TAX (PENSION FUNDS POOLING SCHEMES) (AMENDMENT) REGULATIONS 2006

2006 No. 1162

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before Parliament by Command of Her Majesty. This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 These Regulations provide that where a pension funds pooling scheme (PFPS) ceases to exist in a tax year it will remain a PFPS for that tax year if it has met the qualifying conditions for a PFPS throughout its existence in that tax year.

2.2 The effect of the Regulations is to distinguish between a PFPS that simply ceases to exist and a PFPS that, for any reason, otherwise ceases to meet the conditions for a PFPS in or at the end of a tax year. The latter will not be treated as a PFPS for that tax year.

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

None.

4. Legislative Background

4.1 The powers for the Treasury to make this order are set out in section 469(7) and (8) of the Income and Corporation Taxes Act 1988 (c.1) as amended by section 432(1) of, and paragraph 4 of Schedule 20 to, the Financial Services and Markets Act 2000 (c.8).

4.2 Section 469 Income and Corporation Taxes Act 1988 (c.1) provides for the taxation of all unit trusts that are not authorised by the Financial Services Authority. Section 469(7) provides that the Treasury may by regulations provide that any scheme described in such regulations shall be treated as not being a unit trust scheme for the purposes of section 469.

4.3 The Income Tax (Pension Funds Pooling Schemes) Regulations 1996 (SI 1996/1585) ("the 1996 Regulations") provide that a unit trust scheme that is a pension funds pooling scheme ("PFPS") shall not be a unit trust scheme for the purposes of section 469.

4.4 A PFPS has to meet certain conditions to qualify as a PFPS. The 1996 Regulations provide that a unit trust scheme which at any time in a tax year, or at the end of a tax year, ceases to have the characteristics specified is not a PFPS as regards that tax year.

4.5 These Regulations amend the 1996 Regulations.

5. Extent

5.1 These Regulations apply throughout the United Kingdom.

6. European Convention on Human Rights

These Regulations are subject to annulment and do not amend primary legislation. Accordingly, no statement as to compatibility with the Convention is required.

7. Policy Background

7.1 Unit trusts generally consist of arrangements by which investors `pool' their money and invest in a professionally managed portfolio of assets. The investors do not own the assets direct, but hold “units” which represent their proportion of the assets under management within the scheme. This pooling enables investors in such trusts to be able to spread or reduce the risks associated with investment. The reduction in risk is achieved because the wide range of investments in a unit trust reduces the effect that any one investment can have on the overall performance of the portfolio.

7.2 Pension funds are not within the charge to corporation tax, and as such are exempt from all taxation on the income and capital gains from activities that they undertake directly. However, in order to gain the advantages of economies of scale, and obtain a measure of risk spreading, pension funds also seek to pool their assets with other pension funds.

7.3 Without special arrangements, if pension funds were to pool their assets by setting up an unauthorised unit trust scheme (UUT) the income arising to the trustees would be regarded as their taxable income and not that of the pension funds. The pension fund participants would be treated as having received payments made by the trustees under deduction of tax in proportion to their rights in the unit trust scheme. Therefore, while pension funds could reclaim the tax paid by trustees, they could not reclaim any tax withheld by other jurisdictions in respect of the UUT’s offshore investments because that income is not theirs but is that of the trustees. The 1996 regulations were designed to disregard the normal tax rules for UUTs and allow income to flow through the PFPS to the pension funds as if the PFPS did not exist.

7.4 Certain conditions have to be met to qualify as a PFPS. Where a PFPS ceases to display these characteristics in or at the end of a tax year it will not be a PFPS for that tax year. However, the 1996 Regulations apply this rule to a PFPS which no longer displays the necessary characteristics simply because it has wound up. This is despite the fact that it did display those characteristics while it existed in that tax year.

7.5 These Regulations accordingly seek to ensure that where a PFPS simply ceases to exist but has met the qualifying conditions throughout its existence in a tax year it will remain a PFPS for that tax year.

7.6 These proposed Regulations have been welcomed by the financial services industry.

8. Impact

These changes will not give rise to any costs.

9. Contact

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