

EXPLANATORY MEMORANDUM TO
THE AUTHORISED INVESTMENT FUNDS (TAX) (AMENDMENT NO. 2)
REGULATIONS 2010

2010 No. 1642

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 The Regulations amend the Authorised Investment Funds (Tax) Regulations 2006 (S.I. 2006/964) to make new provision for the tax treatment of interest and dividend distributions made by authorised investment funds (AIFs).
- 2.2 This instrument will provide that corporation tax deductions for interest distributions made by AIFs will be reduced to the extent that those distributions are derived from dividend income which is exempt from corporation tax (CT).
- 2.3 The amendments made by this instrument will also provide in relation to dividend distributions to corporate investors that in a case where credit for foreign tax deducted has reduced the liability of the AIF to corporation tax, then the corresponding distribution will be treated as overseas income also with a credit for foreign tax.

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

- 3.1 The legislation is part of a package of anti-avoidance measures. The Regulations come into force less than 21 days after the date on which they are made. The Department regrets that compliance with the 21-day rule is not possible in this case. Unless the Regulations come into force as soon as possible, there is a danger that participants in the schemes that the Regulations aims to block will adjust distribution dates so as fall into the period between the laying of the Regulations and 21 days after that date, thus escaping the application of the Regulations.

4. **Legislative Context**

- 4.1 Interest distributions made by an AIF are treated as interest paid on a loan relationship to which the AIF is a party; this allows the AIF to get a corporation tax deduction in relation to the interest paid. However this treatment is not appropriate where the source of the distribution is

franked investment income. Therefore, this instrument makes provision to limit the ability to deduct interest distributions for CT to the extent that the interest distribution derived from dividends exempt from CT.

- 4.2 AIFs are within the charge to CT and are charged at a rate equal to the basic rate of income tax (lower than the standard CT rate). Where a corporate taxpayer holds an interest in an AIF and receives a dividend distribution then any part of that distribution that derives from taxable income of the AIF is treated not as a dividend distribution but as an annual payment subject to CT. The distribution is treated as having been made under deduction of tax at the basic rate of income tax.
- 4.3 There are restrictions which limit the right to repayment of the tax deemed to have been deducted.
- 4.4 The amendments made by this instrument replace the existing restrictions with a rule that, in a case where the CT liability of the AIF has been reduced by relief for foreign tax, a proportionate part of the tax deemed to have been deducted is treated as foreign tax and a corresponding proportionate part of the annual payment is treated as income from a foreign source.

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 In general the policy underlying the taxation of investors in AIFs is that they should be taxed in an equivalent manner to direct investors in the underlying investments.
- 7.2 This instrument prevents interest distributions from being used indirectly to create tax credits on dividend distributions treated as annual payments for corporate investors.
- 7.3 This instrument also addresses a specific problem which is that limitations on the treatment of foreign tax credits may not always apply, without this change, to a tax deduction that is treated as made from a dividend treated as an annual payment.
- 7.4 Specifically this may mean that without this amendment it may be argued that, contrary to the intention of rules for the relief of foreign tax, HMRC should repay tax credits which have their origin not in

amounts paid in United Kingdom tax, but in amounts deducted by foreign tax authorities.

- ***Consolidation***

7.5 This instrument amends the Authorised Investment Funds (Tax) Regulations 2006 by amending regulation 48, inserting new regulations 48A and 48B and deleting regulations 52 and 52A. There are no plans to consolidate the revised Regulations in the immediate future.

8. Consultation outcome

8.1 There has been no consultation with the industry on these Regulations because of the need to prevent forestalling.

9. Guidance

9.1 Draft guidance will be published for comment by HM Revenue and Customs as soon as possible.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible.

10.2 The impact on the public sector is nil.

10.3 An Impact Assessment has not been prepared for this measure.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 It is, however, not considered likely to have any impact on small business as typically small business would not be involved in using the schemes that this legislation aims to block.

12. Monitoring & review

12.1 The Government keeps the AIF regulations under review.

13. Contact

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