

**EXPLANATORY MEMORANDUM TO
THE AUTHORISED INVESTMENT FUNDS (TAX) (AMENDMENT)
REGULATIONS 2010**

2010 No. 294

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 To adjust the tax regime for authorised investment funds (AIFS) which invest substantially in offshore funds which may in turn retain untaxed income (non-reporting funds) so that the tax charge on disposal of such interests does not fall to the AIF but instead is charged on the (UK resident) investor in the AIF.
- 2.2 To reflect changes to the regulatory framework made by the Financial Services Authority (FSA) on 28 January 2010 and coming into force on 6 March 2010.
- 2.3 To update the list of qualifying investments that may allow an AIF to make interest distributions to include relevant investments in offshore funds.

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

- 3.1 None

4. **Legislative Context**

- 4.1 AIFs are within the charge to Corporation Tax and as such may be liable for corporation tax on an offshore income gain under offshore funds tax legislation (Regulations 17 and 18 of The Offshore Funds (Tax) Regulations 2009 (SI 2009 No. 3001). In the case of AIFs investing substantially in non-reporting funds this instrument amends those regulations to remove any charge as well as amending the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006 No. 964) (AIF Regulations) to impose a charge to tax on income on the investor in respect of any gains made on disposal of an interest in the AIF.
- 4.2 The instrument also amends the AIF Regulations to reflect changes to the terminology used in FSA regulations (The Collective Investment Schemes Sourcebook (Accounting Amendments) Instrument 2010 made on 28 January 2010).

4.3 Regulations 19 to 21 in the AIF Regulations cover the circumstances in which an AIF may make interest distributions and these are amended to update the list of qualifying investments for this purpose.

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 Under the powers delegated to it in the Financial Services and Markets Act 2000 the FSA proposes to make rules which will allow certain AIFs to invest in a wider range of offshore funds. The offshore funds involved may sometimes be of a kind that retains income without a tax charge arising on UK Investors (These are called 'non-reporting funds' in the Offshore Funds (Tax) Regulations 2009 (SI 2009 No. 3001).

7.2 When a UK resident investor (including an AIF) invests in a non-reporting offshore fund then any gain on disposal is charged to tax as income (to reflect the inclusion of untaxed income in the gain). In the case of an AIF this instrument moves the point of taxation on gains as income to the investor in the AIF. The reason for this is that if the gains were taxed in the AIF then institutional and tax exempt investors in such funds would be disadvantaged compared with similar investors in offshore funds.

7.3 The AIF Regulations with regard to the taxation are also amended to reflect changes made by the FSA to the Collective Investment Schemes Sourcebook and ensure that the two sets of regulations do not use conflicting terminology.

7.4 An AIF may make interest distributions (which move the point of taxation to the investor) if it is invested to a sufficient extent in interest bearing assets. These include other funds where those funds also meet the qualifying test. Amendments are intended to ensure that investments in offshore funds that meet the qualifying test will be treated in the same way as those in other AIFs that meet the test.

- *Consolidation*

7.5 This instrument amends the Authorised Investment Funds (Tax) Regulations 2006 by inserting a new Part 6A (and making amendments consequential on that) and making amendments to the main body of the Regulations consequent on the changes made to the regulatory framework by the Financial Services Authority. There are no plans to consolidate the revised Regulations in the immediate future.

8. Consultation outcome

- 8.1 Draft regulations covering the main purpose of this instrument (see paragraph 2.1 above) were published by HM Treasury on 19 January 2010 and comments received have been taken into account
- 8.2 A short informal consultation has been carried out.
- 8.3 There has been no formal consultation period as industry bodies have expressed the view that it is important to enable the proposed changes made by FSA to be available to industry as soon as possible.
- 8.4 However, as set out in the HMT document, it is the Government's intention to continue to work with industry and consider further development of these Regulations.
- 8.5 The other purposes of this instrument are minor amendments to the AIF regulations to align with regulatory changes which will be in effect from 6 March 2010 and to update the qualifying test.

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 and the public sector is considered negligible.

11. Regulating small business

- 11.1 An informal consultation exercise was undertaken where businesses were invited to comment, this included small business representatives. The exercise was conducted over a two week period and no adverse response was received, the legislation does not apply to small business.

12. Monitoring & review

- 12.1 The Government keeps the AIF regulations under review and, in particular, as explained above, intends to continue to work with industry to develop these Regulations.

13. Contact

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