EXPLANATORY MEMORANDUM TO

THE AUTHORISED INVESTMENT FUNDS (TAX) (AMENDMENT) REGULATIONS 2021

2021 No. 1270

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 These regulations amend legislation concerning the tax treatment of authorised investment funds (AIFs). Specifically, the amendments facilitate the introduction of a new type of authorised fund: the long-term asset fund (LTAF). This statutory instrument follows the introduction of the Financial Conduct Authority's rules for the LTAF.

3. Matters of special interest to Parliament

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

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

6.1 The Authorised Investment Fund (Tax) Regulations 2006 (S.I. 2006/964) ('AIF Regulations') set out the tax treatment of authorised investment funds which are open-ended investment companies (OEIC) or authorised unit trust schemes (AUT). Those regulations will apply to an LTAF (an authorised fund whose authorised fund manager operates, or proposes to operate, it in accordance with the rules in COLL 15 of the Financial Conduct Authority Handbook (long-term asset funds)), subject to the requirements of regulation 9A as amended by this instrument.

6.2 Regulation 9A of the AIF Regulations includes a Genuine Diversity of Ownership (GDO) condition. The GDO condition requires that a fund is widely marketed – and cannot be set up to give a limited number of investors a beneficial tax treatment.

6.3 Sections 17(3) and 18 of the Finance (No. 2) Act 2005 and section 152 of the Finance Act 1995 give the Treasury powers to make regulations to make provisions relating to authorised investment funds which are OEICs or AUTs.

7. Policy background

What is being done and why?

7.1 These regulations make changes to the AIF Regulations to facilitate the introduction of the LTAF. The LTAF is a new category of authorised fund, targeting investment in long-term, illiquid assets. An LTAF can be an OEIC, an AUT, or an authorised contractual scheme. These regulations do not make any amendments to the tax rules for authorised contractual schemes.

7.2 Regulation 3(2) inserts a new Part 2AA – long-term asset funds into the AIF Regulations. New regulation 14BA requires an LTAF that is an OEIC or AUT to meet the GDO condition for it to be subject to the tax rules generally applicable for OEICs and AUTs.

7.3 Regulation 3(1) inserts a new paragraph (8A) into regulation 9A of the AIF Regulations, which treats an LTAF as meeting the GDO condition where either the LTAF published its prospectus on or before 9 December 2021, or 70% of the units or shares in the LTAF are held by specified institutional investors. This treatment ensures that an LTAF that was in the late stages of being set up when these regulations come into force, and so could not reasonably have been expected to be aware of the requirement to meet the GDO condition, will still be subject the tax rules generally applicable for OEICs and AUTs. It also ensures that those rules apply to LTAFs that are at least 70% owned by specified investors who themselves are subject to certain rules requiring that they are widely held – this would apply, for example, to an LTAF set up for the benefit of a small number of specified pension schemes.

7.4 Regulation 4 disapplies Part 3A of the Corporation Tax Act 2010 (companies with small profits) for Qualified Investment Schemes, another form of AIF, where they fail to meet the GDO condition and are consequently not subject to the tax rules generally applicable to AIFs. This change is necessary due to changes to the rates of Corporation Tax due to take effect from 1 April 2023.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union

9. Consolidation

9.1 There are no plans to consolidate the legislation.

10. Consultation outcome

10.1 As this statutory instrument only makes minor changes a formal consultation was not undertaken. However, the government has undertaken engagement with industry stakeholders to ensure the legislation works correctly.

11. Guidance

11.1 HMRC has already issued guidance in relation to authorised investment funds in the Investment Funds Manual. That guidance will be updated to reflect the changes made by this statutory instrument before the legislation takes effect.

12. Impact

12.1 There is no significant, impact on business, charities or voluntary bodies. Businesses affected by these changes may incur small one-off costs of familiarisation with the amendments.

12.2 There is no significant, impact on the public sector.

12.3 A Tax Information and Impact Note has not been prepared for this instrument as it contains no substantive changes to tax policy.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses.

13.3 The basis for the final decision on what action to take to assist small businesses was that, although the changes do not discriminate between businesses few, if any, small businesses are affected. The impact on small and micro businesses is negligible.

14. Monitoring & review

14.1 The approach to monitoring is as follows. An LTAF will be able to submit a clearance to HMRC where it is unclear whether the GDO condition is satisfied. This information, together with continuing engagement with industry, will allow HMRC to closely monitor the operation of the rules and to consider whether further changes may be required to ensure that they are working as intended.

14.2 The regulations do not include a statutory review clause. They amend tax legislation and therefore fall within the exceptions at section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

15. Contact

15.1 Rebecca Hardern at HMRC Telephone: 03000 576963 can be contacted with any queries regarding the instrument or email: financialproductsbai@hmrc.gov.uk.

15.2 Richard Thomas, Head of Financial Products and Services, Deputy Director for Business, Assets and International, at HMRC can confirm that this Explanatory Memorandum meets the required standard.

15.3 John Glen MP, Economic Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.