EXPLANATORY MEMORANDUM TO

THE AUTHORISED INVESTMENT FUNDS (TAX) (AMENDMENT No. 2) REGULATIONS 2013

2013 No. 2994

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

2. Purpose of the instrument

2.1 These Regulations amend the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) (the "AIF Regulations") to allow interest distributions to be paid without deduction of basic rate income tax on units or shares (units) in AIFs that have been marketed to persons not resident in the UK.

These Regulations also amend the AIF Regulations to remove references to 'ordinarily' resident.

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

3.1 None.

4. Legislative Context

4.1 Regulation 26 of the AIF Regulations provides a list of circumstances in which an AIF paying interest distributions may do so without deduction of tax. These Regulations add an additional case to regulation 26 to permit payment without deduction of tax (gross payment) in cases where the units on which the distribution is paid are marketed to non-UK residents.

4.2 These Regulations also insert a new regulation 33A into the AIF Regulations which sets out the conditions for the additional case for gross payment to apply.

4.3 The abolition of the concept of ordinary residence was announced at Budget 2012. Legislation in Schedule 46 to the Finance Act 2013 removes the concept of 'ordinary residence' from primary legislation for most tax purposes, although it continues to exist in relation to some tax purposes. These Regulations are being made to remove corresponding references to being 'ordinarily' resident from the AIF Regulations from 6 April 2014.

4.4 Section 98(4E) (special returns etc) of the Taxes Management Act 1970, as modified by regulation 93A of the AIF Regulations, makes provision for penalties where an interest distribution is paid without deduction of tax when the conditions for doing so

were not fulfilled. Paragraph 116 of Schedule 46 to the Finance Act 2013 amends section 98(4E)(d) to remove the reference to 'ordinarily' resident. This amendment takes effect on the coming into force of regulations 7 to 11 omitting the reference to "ordinarily".

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

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

7. Policy background

7.1 Where units in an authorised investment fund are distributed by distributors marketing to investors resident outside the UK then the additional rule for paying interest distributions without tax being deducted will allow those distributors to sell units in a category where no tax is deducted without needing to make specific checks on the investors.

7.2 Gross payment of interest distributions will be subject to conditions to ensure that the relevant class(es) of units may only be targeted to non-residents of the UK and that any UK taxpayers who may acquire such units are aware of their obligation to account for tax.

7.3 The provisions for gross payment will take effect in relation to units acquired on or after the coming into force of regulations 1 to 6.

7.4 The concept of ordinary residence for tax purposes has no statutory definition and this creates uncertainty. The abolition of ordinary residence is part of the Government's plan to simplify the UK tax system and is being addressed at the same time as the introduction of a statutory definition of tax residence.

7.5 Most references to 'ordinary residence' and 'ordinarily resident' in the tax context are removed from primary legislation by Schedule 46 to the Finance Act 2013. This statutory instrument removes similar references from the AIF Regulations. The amendments made apply for the tax year 2014 –15 and subsequent years.

7.6 The AIF Regulations govern the taxation of authorised investment funds. Amongst other things the Regulations entitle interest distributions to be paid without deduction of tax where certain conditions are met. One such condition is the residence condition, which requires a declaration to be made that the participant is not ordinary resident. The declaration must contain an undertaking to notify if the participant becomes ordinarily resident. The amended legislation will require a declaration that the participant is not resident, and will apply to declarations made on or after 6 April 2014.

7.7 The Regulations have no effect on declarations made before that date. The effect of this is that the residence condition continues to be met where there is an existing declaration that the participant is not ordinarily resident. Similarly the notification obligation will continue to be engaged where the participant becomes ordinarily resident.

7.8 Whether a person becomes ordinarily resident for the purposes of the declaration and notification will be determined by reference to existing case law, and not by reference to the statutory residence test (which only contains rules relating to residence, and not to ordinary residence).

7.9 There are no plans to consolidate the amendments made by this instrument.

8. Consultation outcome

8.1 The element of this measure relating to gross payments of interest distributions was announced in Budget 2013 and a consultation was published by HMRC on 22 July 2013 and closed on 16 September 2013.

8.2 Seven responses were received from industry representative bodies, accountancy firms and a fund administrator, all supportive of the measure. Comments were confined to minor suggestions relevant to drafting.

8.3 A formal consultation on the specific changes to ordinary residence in this instrument was not undertaken, but a draft of the relevant parts of this instrument was published on the website of Her Majesty's Revenue and Customs. A formal consultation on the removal of ordinary residence (to which these changes are supplementary) was carried out in 2011, with further consultations on the details of the changes in 2012.

9. Guidance

9.1 HMRC will amend the relevant guidance to reflect changes made by these Regulations.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible as these Regulations permit and do not require the marketing of certain categories of unit to non-residents of the UK and will only be used to the extent industry perceives an advantage from them . The changes to ordinary residence are directed at individuals.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note relating to gross payments of interest distributions will be published on the HMRC Website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. A separate Tax Information and Impact

Note relating to the removal of ordinary residence in primary legislation and covering the relevant parts of this instrument was published on 11 December 2012 alongside the draft clauses for inclusion in Finance Bill 2013 and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 It is unlikely to impact on small business for the reason given in paragraph 10.1 above.

12. Monitoring & review

12.1 HM Revenue & Customs and HM Treasury will keep the policy under review and continue to liaise with industry from time to time to discuss the implementation of the proposed amendments, as part of ongoing engagement.

13. Contact

John Buckeridge at Her Majesty's Revenue and Customs, tel: 03000 585701 or e-mail john.buckeridge@hmrc.gsi,gov.uk (Gross payments of interest distributions) or Richard Davey at Her Majesty's Revenue and Customs, tel: 03000 585145 or email: richard.c.davey@hmrc.gsi.gov.uk (abolition of ordinary residence) can answer any queries regarding the instrument.