EXPLANATORY MEMORANDUM TO

THE AUTHORISED INVESTMENT FUNDS (TAX) (AMENDMENT) REGULATIONS 2009

2009 No. 2036

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs, on behalf of HM Treasury, 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 These Regulations amend the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) ("the principal Regulations") by inserting new Parts 1A, 2B and 4B into the principal Regulations. New Part 1A defines the general diversity of ownership condition ("the GDO condition") which details the conditions that must be fulfilled in order for the GDO condition referred to in Parts 2A, 2B, 4A and 4B of the principal Regulations to be satisfied. New Part 2B contains provisions to give certain funds (diversely owned authorised investment funds) certainty in relation to the tax treatment of investment transactions. New Part 4B, which is divided into 7 Chapters, deals with a particular type of authorised investment fund, Tax Elected Funds.

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

3.1 None.

4. Legislative Context

4.1 Sections 16 to 19 of the Finance (No.2) Act 2005 provide the framework for a regime under which the majority of provisions relating to the taxation of authorised investment funds are contained in secondary legislation that is in the principal Regulations, rather than in primary legislation.

4.2 As a result of commercial development, the principal Regulations have required amendment from time to time.

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 It was stated when the principal Regulations were made (29 March 2006) that it was intended that consultation with the authorised investment fund industry should continue, in order to ensure that the principal Regulations took account of commercial developments. (See the Explanatory Memorandum accompanying SI 2006/964.)

7.2 As a result of consultations, the principal Regulations have been amended on a number of occasions. It is intended that consultation will continue in the future and further amendments may be required to the principal Regulations in due course.

7.3 The amendments made by these Regulations have their genesis in the Investment Management Association/KPMG October 2006 report entitled "Taxation and the Competitiveness of UK Funds" ("the Report"), which identified certain tax barriers to the international competitiveness of the UK industry. Following publication of the Report, the Economic Secretary established a joint working group between the Investment Management Association, HM Treasury and HM Revenue and Customs ("HMRC") to consider, as a result of the findings of the Report, the changes required to the UK tax system in order to enhance the UK's competitiveness as a place for investment funds to locate.

7.4 In the 2009 Budget the Chancellor of the Exchequer announced the creation of a Tax Elected Fund ("TEF") regime from 1 September 2009. The key features of the TEF regime, which is contained in Part 4B of these Regulations, are that it is elective subject to the authorised investment fund meeting certain conditions, and that it moves the point of taxation from the fund to the investor. Therefore, investors in such a fund will be taxed in broadly the same way as if they had owned the underlying assets and income directly. Taxation at the fund level, which is removed for a TEF by these Regulations, had been identified in the Report as a barrier to competitiveness in some cases.

7.5 At the Budget it was also announced that, as from 1 September 2009, rules would be introduced which would give authorised investment funds certainty that "investment transactions", as defined by regulations 14F to 14N in Part 2B of these Regulations, would not be characterised as trading transactions for tax purposes. Authorised investment funds are not subject to tax on their capital gains (section 100 Taxation of Chargeable Gains Act 1992), but if the fund's activities could be characterised as trading capital gains could then be exposed to tax as income profits from that trading activity. Uncertainty over this issue and the significant consequences for the tax position of the fund were identified in the Report as a barrier to the competitiveness of the UK. The certainty provided by these Regulations is open only to an authorised investment fund which meets the GDO condition in regulation 9A of these

Regulations. The Regulations also contain anti-avoidance provisions to prevent banks and other financial traders from exploiting the rules.

7.6 Since the introduction of the principal Regulations there have been various amendments to those Regulations as regimes have been introduced some of which rely on compliance with a GDO condition. On each occasion that a GDO condition has been inserted into the principal Regulations, the conditions have been simplified slightly. The new general GDO condition inserted as regulation 9A further simplifies the requirements that need to be met and applies to all the regimes in the principal Regulations which require compliance with the GDO condition, so that as a consequence of these Regulations there is now a standard GDO condition in the principal Regulations. Part 2B of these Regulations also provides for a clearance application in respect of the GDO condition.

- ***Consolidation***

7.7 This instrument amends the principal Regulations. HMRC has not consolidated the amendments as there is the possibility that a further substantial amendment may be required to the principal Regulations following a public consultation on whether to introduce a new type of authorised investment fund. If, following the consultation, the decision is taken to introduce a new type of authorised investment fund, a consolidation will be carried out at the same time. If, after the consultation the decision is taken not to introduce a new type of authorised investment fund, then a consolidation will be carried out in due course and HMRC will prepare a consolidated version for publication on its website.

8. Consultation outcome

8.1 Drafts of these Regulations have been the subject of formal public consultation and a number of detailed changes have been made as a result.

9. Guidance

9.1 Guidance on the instrument will be published in HMRC's Corporate Tax Manual.

10. Impact

10.1 An Impact Assessment has not been produced in relation to the insertion of Part 1A (the GDO condition) as that Part has no impact on business, charities or voluntary bodies.

10.2 An Impact Assessment has not been produced in relation to the insertion of Part 2B (diversely owned AIFs) as that Part has a negligible impact on business, charities or voluntary bodies.

10.3 An Impact Assessment in relation to the insertion of Part 4B (Tax Elected Funds) is attached to this memorandum.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The Government intends to monitor the effects of these Regulations on industry.

13. Contact

Angela Nagarajah at HM Revenue & Customs Tel: 020 7147 2787 or email: angela.nagarajah@hmrc.gsi.gov.uk and Lee Harley at HM Revenue & Customs Tel: 020 7147 2597 or email: lee.harley@hmrc.gsi.gov.uk can answer any queries regarding the instrument.

Summary: Intervention & Options

Department /Agency:	Title:	
HM Treasury	Impact Assessment for the elective "Tax Elected Funds" regime for Authorised Investment Funds	
Stage: Implementation	Version: 1.0	Date: 15 July 2009

Related Publications: "Enhancing the Competitiveness of UK Funds" HM Treasury, 2009 and http://www.hm-treasury.gov.uk/consult_taxelected_funds.htm

Available to view or download at:

http://www..hmrc.gov.uk/ria/index.htm#full

Contact for enquiries: Stuart Gregory Telephone: +44 207 270 6029

What is the problem under consideration? Why is government intervention necessary?

The marketplace for Authorised Investment Funds (AIFs) has changed significantly in recent years with the introduction of cross border sales, particularly the pan-European retail UCITS[1].

The industry view, as reflected in the 2006 IMA[2] / KPMG report "Taxation and the competitiveness of UK funds" is that the way in which UK Authorised Investment Funds are taxed has made it difficult for them to market themselves competitively to UK investors, throughout Europe and the rest of the world.

What are the policy objectives and the intended effects?

The Government's main objective in these proposals is to ensure the UK remains a competitive place for funds to locate. This will be achieved by moving the point of taxation from the AIF to the investor, resulting in investors facing the same tax treatment as they would have had they owned the underlying Asset directly.

What policy options have been considered? Please justify any preferred option.

1. Do nothing – this would mean that AIFs and their investors would continue with their existing tax Treatment.

2. Introduce a new elective tax regime for Authorised Investment Funds, offering AIFs a tax regime that broadly taxes the investors as if they held the underlying assets directly.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The impact of the measure will be monitored under Hmar's broader plans for monitoring trends in the savings and investment sector. Compliance costs are routinely reviewed 1-3 years.

Ministerial Sign-off

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:

..... Date: 20.7.9

[1] Undertaking for Collective Investment in Transferable Securities

[2] Investment Management Association

Summary: Analysis & Evidence

Policy Option: 2	Description: Introduce a new elective tax regime for Authorised Investment Funds

COSTS

ANNUAL COSTS	Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition) Yrs	AIFs electing into the new regime will incur one-off costs which arise from adapting IT systems, familiarising themselves with the new rules, acquiring extra information, and disclosing information to unit/shareholders. These will vary across funds. There is a minimal additional burden to HMRC. Further details of these can be found in the Evidence Base (below).
£ Unquantified	
Average Annual Cost (excluding one-off)	
£ neg	Total Cost (PV) **£ Unquantified**

Other **key non-monetised costs** by 'main affected groups'

From the point of view of the Exchequer, the measure is forecast to be broadly revenue neutral

BENEFITS

ANNUAL BENEFITS	Description and scale of **key monetised benefits** by 'main affected groups'
One-off Yrs	Monetising the benefits arising from the policy is extremely difficult due to the scarcity of available data. Accordingly, as explained further in the Evidence Base, they have not been quantified.
£ Unquantifiable	
Average Annual Benefit (excluding one-off)	
£ Unquantifiable	Total Benefit (PV) **£ Unquantifiable**

Other **key non-monetised benefits** by 'main affected groups'

The elective nature of the regime means that there should be a net overall benefit for those who opt-in. TEFs who opt-in are likely to benefit from being able to market more competitively to UK investors, throughout Europe and the rest of the world.

Key Assumptions/Sensitivities/Risks The key sensitivity relates to the estimated number of AIFs that choose to elect into the regime and the one-off costs of converting. However, as the regime is voluntary, we expect funds to opt-in if they believe the benefits outweigh the costs. The overall net benefit for these funds will therefore be positive.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ **Positive**

What is the geographic coverage of the policy/option?				UK	
On what date will the policy be implemented?				1 September 2009	
Which organisation(s) will enforce the policy?				HMRC	
What is the total annual cost of enforcement for these organisations?				£ NEG	
Does enforcement comply with Hampton principles?				Yes	
Will implementation go beyond minimum EU requirements?				No	
What is the value of the proposed offsetting measure per year?				£ n \ a	
What is the value of changes in greenhouse gas emissions?				£ n \ a	
Will the proposal have a significant impact on competition?				Yes	
Annual cost (£-£) per organisation (excluding one-off)	Micro **n/a**	Small **n/a**	Medium **n/a**	Large **n/a**	
Are any of these organisations exempt?	No	No	N/A	N/A	

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ Neg Decrease of £ **Net Impact** **£ Neg**

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Background

Authorized investment funds (AIFs) are regulated by the Financial Services Authority and invest in a diversified portfolio of assets, including shares, securities, bonds and property with the aim of providing a return to their investors. The Tax Elected Fund regime has been the result of close consultation between the Government and industry.

Budget 2008 announced that the Government would engage with industry to consider a direct tax exemption for Authorised Investment Funds, taxing the investor as if they held the underlying assets directly.

In July 2008 the Government published a discussion paper[3] setting out its proposals for a special, elective tax regime for UK funds. In December 2008, the Government published a summary of responses to this discussion paper[4] and stated that it would continue to work with industry to address certain issues before issuing further proposals and draft regulations.

Following further discussions with industry, Budget 2009 announced the launch of the Tax Elected Fund regime from 1 September 2009. The new TEF regime will allow those funds which meet the conditions of the regime and wish to elect for TEF tax treatment to market themselves more competitively to UK investors, throughout Europe and the rest of the world.

Implementing Tax Elective Funds (TEFs)

The costs and benefits associated with a fund electing to be a "Tax Elected Fund" are heavily dependent upon the individual circumstances of the Authorised Investment Fund (AIF). Considering the particular circumstances of each AIF has been a key driver in making the regime elective, helping to guarantee that only those who perceive a net overall benefit will choose to opt-in.

However, forecasting with the necessary accuracy the number of funds that will do so is very difficult. This combined with current market conditions, with a reduced number of new fund launches[5], consolidation and product rationalisation, has made aggregate figures very difficult to quantify.

To reflect this, this impact assessment focuses on some of the potential costs and benefits that would be faced by individual funds rather than the effect on the wider AIF sector as a whole.

Costs

One-off

There are a number of costs that AIFs are likely to incur in entering the TEF regime. The most significant of these one-off up-front costs are: IT costs for changing systems to comply with the TEF regime for those converting from existing AIFs or development costs for new set ups. Both these costs will vary according to the flexibility of any existing systems and may also be shared / reduced due to single administrators covering multiple funds where the IT costs can be spread across multiple fund managers. For AIFs converting to the "Tax Elected Fund" regime there may also be a one-off cost of giving notice to unit/share holders that the AIF is joining the regime. This will be a cost arising for those that convert rather than new set ups.

---

[3] *Tax elected funds: a discussion paper*, HM Treasury, July 2008

[4] *Tax elected funds: summary of responses*, HM Treasury, December 2008

[5] "Firms which did launch new products in 2008 and early 2009 have done so in areas in which they already have in-house capabilities. Few firms are currently in a position to hire in expertise".(Hymans Robertson: Market briefing survey 2009)

On-going

Once an AIF has elected to become a TEF, additional on-going costs are expected to be relatively low. The fund will have to ensure that the type of income remains identifiable as it is passed on to its investors; this is referred to as "streaming". This may lead to some additional administrative cost and recognising this the Government has provided for an administrative easement for those funds that use "streaming" and will allow TEFs to provide annual tax information to their shareholders electronically[6] Based on available evidence, once appropriate IT systems are in place, this procedure should require relatively few additional resources. On this basis, the total on-going additional cost to TEFs is estimated to be negligible.

Overall, the total cost of the TEF regime is sensitive to the number of AIFs that choose to elect into it and whether these constitute new launches or existing funds changing their classification. Dependent on this, the Government anticipates that the net additional ongoing cost to AIFs complying with the new elective tax regime should be small in aggregate.

Change in Administrative Burdens

HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular the administrative burden on business of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model', an activity-based costing model which identifies what activities, including seeking advice and software costs.

As the measure implements minor changes to the way funds will report to HMRC, the change in the overall burden is likely to be small, especially once the TEF will have become familiar with the new procedure. Similarly, as TEFs put appropriate IT systems in place, any additional complexities of the reporting requirements to investors should be handled at a minimal additional cost, particularly if the fund makes use of the option to issue electronic vouchers to investors. On this basis, it is expected that this measure will have a negligible impact on administrative burdens.

Benefits

The TEF regime will enable AIFs that elect in to market themselves more competitively. Alongside the existing exemption from chargeable gains, subject to conditions, defined streams of income will not be taxable within an AIF that elects to be a TEF. The framework is based around moving the point of taxation from the AIF to the investor, with the result that investors face broadly the same tax treatment, as they would have had they owned the underlying assets directly. As in other leading fund locations, the fund will remain a taxable entity.

As explored in the Competition Assessment below, the new regime should enhance the capacity of UK funds to market themselves competitively to investors. To the extent that this occurs, UK funds will be able to increase their client base and market share both in Europe and globally. The TEF regime is elective. We therefore expect that fund managers (and implicitly their investors) will have made a positive assessment of the net benefits of the opting into the TEF regime. As such, while the available evidence limits us from assigning monetary amounts to these, the Government expects the aggregate benefits from the measure to be greater than the aggregate costs.

[6] As an alternative to the normal paper voucher

Competition Assessment

An important part of the industry's desire for changes to the tax rules is that they perceive themselves as currently being prevented from competing for investors due to the way in which Airs are currently taxed. The new TEF regime should enable funds located in the UK to market competitively to UK and international investors. This new regime is part of a wider package of tax and regulatory changes that the Government has made over the last two years for Airs, concluded within Budget 2009.

Small Firms Impact Test

We have publicly consulted on the development of the TEF with representative bodies, including the Investment Management Association and directly with industry stakeholders. The AIF industry shows significant variation in the amount of assets managed by each fund, ranging from the few million pounds to over several hundred million. As mentioned above, set up and operation costs will vary across firms and may in some cases be shared, as single administrators may cover multiple funds. However, the available evidence indicates the absolute cost of these is unlikely to vary systematically according to the size of the fund. As the regime is elective, the choice of whether to incur these costs will be down to the AIF itself.

Other Impacts

This measure has no impact on Race Equality, Disability Equality, Gender Equality or Human Rights. In addition, this measure has no or negligible impact on Legal Aid, Sustainable Development, Carbon Assessment, Other Environment, Health Impact Assessment or Rural Proofing.

Specific Impact Tests: Checklist

To be completed

Type of testing undertaken	*Results in Evidence Base?*	*Results annexed?*
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

STATUTORY INSTRUMENTS

2009 No.

INCOME TAX

The Income and Corporation Taxes (Electronic Certificates of Deduction of Tax and Tax Credit) (Amendment) Regulations 2009

Made - - - -	*July 2009*
Laid before the House of Commons	*July 2009*
Coming into force - -	*1st September 2009*

The Commissioners for Her Majesty's Revenue and Customs(**a**) make the following Regulations in exercise of the powers conferred upon them by section 132 of the Finance Act 1999(**b**).

Citation and commencement

1. These Regulations may be cited as the Income and Corporation Taxes (Electronic Certificates of Deduction of Tax and Tax Credit) (Amendment) Regulations 2009 and shall come into force on 1st September 2009.

Amendment of the Income and Corporation Taxes (Electronic Certificates of Deduction of Tax and Tax Credit) Regulations 2003

2.—(1) The Income and Corporation Taxes (Electronic Certificates of Deduction of Tax and Tax Credit) Regulations 2003(**c**) are amended as follows.

(2) In regulation 2 (delivering information electronically about distributions, dividends, interest payments and associated tax credits) in paragraph (1) after "234A(2)" insert "or (3)".

[abc]
[pqr]

July 2009 Two of the Commissioners for Her Majesty's Revenue and Customs

(**a**) The functions of the Commissioners of Inland Revenue were transferred to the Commissioners for Her Majesty's Revenue and Customs by section 5(2) of the Commissioners for Revenue and Customs Act 2005 (c. 11). Section 50(1) of that Act provides that a reference to the Commissioners of Inland Revenue shall be taken as a reference to the Commissioners for Her Majesty's Revenue and Customs.

(**b**) 1999 c. 16. By virtue of section 133(2) of that Act, provision made in exercise of the power conferred by section 132 or section 133(1) has effect notwithstanding so much of any enactment as would (apart from the provision so made) require the delivery of information in a form or manner which would preclude the use of electronic communications for its delivery. Section 132 was amended by paragraph 156 of Schedule 17 to the Communications Act 2003 (c. 21).

(**c**) S.I. 2003/3143.

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations amend the Income and Corporation Taxes (Electronic Certificates of Deduction of Tax and Tax Credit) Regulations 2003 (S.I. 2003/3143) which authorise the electronic delivery of certain documents, required or permitted to be given under the Income and Corporation Taxes Act 1988 and regulations made under it.

These Regulations amend regulation 2 which authorises the electronic delivery of information about distributions required under section 234 and 234A of the Income and Corporation Taxes Act 1988, the amendment inserts a reference to section 234A(3) to apply these provisions where a payment of dividend or interest is made into a bank account or building society account held by a person.

A full and final Impact Assessment has not been produced for this instrument as a negligible impact on the private or voluntary sectors is foreseen.