

Budget 2007



BN29

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CHANGES TO THE OFFSHORE FUNDS REGIME

Who is likely to be affected?

1. Offshore collective investment schemes ("offshore funds") and UK investors in those funds.

General description of the measure

2. Legislation will be introduced in Finance Bill 2007 to remove a restriction in the offshore funds regime on the structure of multi-tiered funds and to make three minor changes to assist the application of the regime. The changes will include amending the definition of an offshore fund, the treatment of losses on disposal of units or shares in non-qualifying funds and the meaning of eligible income for approved investment trusts.

Operative date

3. The changes for multi-tiered funds of funds and to the offshore fund definition will have effect for account periods beginning on or after 1 January 2007. The loss relief change will have effect for losses arising on or after 6 April 2007 for income tax payers, and on or after 1 April 2007 for corporation tax payers. The change for investment trusts will have effect from the date the Finance Bill receives Royal Assent.

Current law and proposed revisions

The multi-tier test

4. Section 760(3)(a) Income and Corporation Tax Act 1988 (ICTA) provides that an offshore fund (A) will not be certified as a distributing fund if more than 5%, by value of the assets of the fund, consist of interests in other offshore funds. In considering that test, paragraph 6 Schedule 27 ICTA provides that if a fund into which A invests is, or could be, a distributing fund without the aid of paragraph 6 then that investment shall not be regarded as an offshore fund for A's test. It will, however, still feature in determining the total value of A's assets. This effectively limits distributing offshore fund of fund structures to two layers.

5. The effect of the change will be that in determining A's status as a distributing fund, every fund in the structure below it will be able to rely on the wording in paragraph 6, thereby effectively removing the restriction to two layers in any fund of fund structure.

Definition of offshore fund

6. For offshore funds that are companies, the tax regime applies to UK investors if the fund meets the Financial Service Authority's (FSA) regulatory definition of an open-ended investment company (OEIC). This includes a condition that an investor is able to realise their investment within a reasonable period. The FSA takes the view that a reasonable period for these purposes should not exceed six months.
7. The offshore fund regime charges any gain as income when an investor disposes of a material interest in a non-distributing offshore fund. An interest is defined in section 759(2) ICTA as material if the investor can reasonably expect to realise their investment within a reasonable period. For the purpose of this test, in contrast to the FSA's view for OEICs, the period is seven years.
8. The change will mean that a seven year reasonable period to realise the investment will apply to decide if an open-ended company is within the regime.

Loss on disposal of units

9. Paragraph 3(5) Schedule 28 ICTA provides that where the computation of a gain under Schedule 28 would give rise to a loss, the gain on the disposal is deemed to be nil and, for the purposes of the offshore fund rules, no loss arises on the disposal. The loss has always been considered to be a capital loss which can be utilised under the rules in the Taxation of Chargeable Gains Act 1992 (TCGA).
10. However, section 392 (income tax) and section 396 (corporation tax) of ICTA could potentially allow claims for the loss computed under Schedule 28 to be set against profits under provisions listed in section 836B of ICTA (income tax) and profits under Schedule D Case VI (corporation tax). This measure will make it clear that such a loss can only be a capital loss.

Approved investment trusts

11. To be approved as an investment trust, a company's income must be derived wholly or mainly from shares or securities (section 842(1)(a) ICTA). Tax Bulletin 79 announced a change of interpretation, which meant that offshore income gains would no longer count for the purposes of meeting that condition.
12. This measure will exclude offshore income gains from this test. Offshore income gains will, however, remain taxable as income in the hands of approved investment trusts.

Further advice

13. If you have any questions about this change, please contact David Moran on 020 7147 2612 (email: david.moran@hmrc.gsi.gov.uk). Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk