

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of Property Authorised Investment Funds	
Stage: Implementation Stage	Version: 1	Date: Budget 2008
Related Publications: "Property Authorised Investment Funds: a discussion paper" (Published July 2007); "Property Authorised Investment Funds: next steps" (Published December 2007)		

Available to view or download at:

<http://www.hm-treasury.gov.uk>

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

Authorised investment funds (AIFs) are retail investment funds that are regulated by the Financial Services Authority. Currently investors in AIFs that hold property can face different tax treatment than if they had invested in the underlying real property or UK-REIT shares directly. The Property AIF regulations aim to allow a way to address this for those AIFs that invest predominantly in property.

What are the policy objectives and the intended effects?

The policy objective is for investors to face broadly the same tax treatment as they would have, had they invested in the underlying real property or UK-REIT shares directly.

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

1. Do nothing - this would mean that certain investors in AIFs would continue to face different tax treatment than if they had invested in the underlying property assets directly.
2. Implement the new property authorised investment funds tax regime - this would mean that investors would face broadly the same tax treatment as if they had invested in the underlying property assets directly.

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

The Government intends to monitor the effects of the policy on an ongoing basis.

Ministerial Sign-off For implementation stage Impact Assessments:

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:

Jane Kennedy.....Date: 14 February 2008

Summary: Analysis & Evidence

Policy Option:	Description:
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' The main costs of this measure are one-off costs: (a) adapt IT systems to comply with the PAIF regime and (b) if required, a shareholder vote to convert to an open-ended investment company.		
	One-off (Transition) Yrs			
	£ 5-7 m		1	
	Average Annual Cost (excluding one-off)			
	£ negligible		Total Cost (PV)	£ 5-7m
Other key non-monetised costs by 'main affected groups' None				

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' Investors and fund managers can, as far as possible, make investment decisions based on commercial considerations, which is an ongoing benefit. Because the regime is elective, the present value of benefits will exceed the present value of costs by definition of the choice to opt in.		
	One-off Yrs			
	£		1	
	Average Annual Benefit (excluding one-off)			
	£		Total Benefit (PV)	£
Other key non-monetised benefits by 'main affected groups'				

Key Assumptions/Sensitivities/Risks

The key assumptions made regard the estimated number of AIFs that choose to convert and the one-off costs of converting. However, as an elective regime, the net benefits should be positive.

Price Base Year 2008	Time Period Years 10	Net Benefit Range (NPV) £ Not below zero	NET BENEFIT (NPV Best estimate) £ Will be positive
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	April 2008				
Which organisation(s) will enforce the policy?	HMRC				
What is the total annual cost of enforcement for these organisations?	£ Negligible				
Does enforcement comply with Hampton principles?	N/A				
Will implementation go beyond minimum EU requirements?	N/A				
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?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro</td> <td style="width: 25%; text-align: center;">Small</td> <td style="width: 25%; text-align: center;">Medium</td> <td style="width: 25%; text-align: center;">Large</td> </tr> </table>	Micro	Small	Medium	Large
Micro	Small	Medium	Large		
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> </tr> </table>	No	No	No	No
No	No	No	No		

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ Negligible	Decrease of £ Negligible	Net Impact	£ Negligible

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

Evidence Base (for summary sheets)

Background

Authorised investment funds (AIFs) are collective investment schemes authorised and regulated by the Financial Services Authority (FSA) under the terms of the Financial Services and Markets Act 2000 (FSMA00). A collective investment scheme is a form of investment fund that enables a number of investors to 'pool' their assets and invest in a professionally managed portfolio of investments, typically gilts, bonds and quoted equities. Some investments, however, may be in unquoted investments or property. In effect, investors in such schemes are able to spread or reduce the risk that is associated with investment in such assets as well as gain the benefits of professional management. The reduction in risk is achieved because the wide range of investments in a collective investment scheme reduces the effect that any one investment can have on the overall performance of the portfolio. Authorised Investment Funds are used by both retail and institutional investors.

Implementing Property AIFs

Note that for the discussion below, the option of doing nothing is considered as the base case, with all costs and benefits assessed relative to status quo.

Costs

The overall total cost of the Property AIFs regime is sensitive to the number of AIFs that choose to elect into it. There are currently around 30 AIFs that invest primarily in property, and it is anticipated that the majority will choose to convert, so as a spot estimate for estimating costs and benefits below, it is assumed that 20 will choose to convert.

There are a number of costs that Property AIFs will incur for entering and remaining within the regime, the most significant of which are one-off up-front costs for entering the regime, the two most significant of which are:

1. IT costs for changing systems to comply with the new Property AIFs regime. These costs will vary according to the flexibility of existing systems and may also be shared due to single Administrators covering multiple funds so the IT costs can be spread across multiple fund managers. We estimate that this will cost around £500,000 per fund administrator and that the 20 PAIFs that choose to convert are covered by 4-8 fund administrators, implying total costs of £2-4 million.
2. Electing into the regime requires a shareholder's vote to approve becoming a Property AIF, changing the prospectus and, if necessary, approval of converting from an Authorised Unit Trust (AUT) to an Open Ended Investment Company (OEIC). This may be avoidable if funds have already included provisions to convert in their existing prospectus, but otherwise there are likely to be costs involved. Based on an estimate of £150,000 cost per PAIF, this would create total costs of £3 million if 20 PAIFs convert and all require a shareholder vote.

There is also the smaller one-off cost of giving notice to HMRC of the intention to join the regime, and, in the case of AUTs converting to OEICs, of completing a land transaction return in order to claim Stamp Duty Land Tax relief. These costs are assessed as negligible.

Overall, these estimates suggest overall costs of around £5-7 million.

Benefits

The Property AIFs regime will be an elective regime, so in the case of any fund opting in, both the fund managers and the investors will have made the assessment that the benefits to investors of becoming a Property AIF outweigh the costs. As such, the expected value of the benefits outlined below will be greater than the costs outlined above, even if monetary amounts cannot be placed on these benefits.

The current tax treatment of Property AIFs represents an economic distortion that will cause some investors to choose other routes for investing in property such as directly or via UK-REITs based on tax reasons rather than due to commercial factors such as expected rate of pre-tax return, (non-tax) transaction costs and liquidity. This in turn will mean that funds will not necessarily flow to the most productive investments where the pre-tax returns are highest, instead being invested where post-tax returns are highest. The distortion towards direct investment in property rather than AIF investment will also lead to increased transaction costs for investors, which represent a deadweight welfare loss. Introducing a tax-transparent vehicle for Property AIFs would allow investors and fund managers to make choices without distortions, as far as possible.

Besides the benefits of broadly aligning the tax treatment of Property AIFs with other forms of property investment, the proposed Property AIF regime will also offer greater visibility of total tax rate paid by investors, which will result in more-informed choices, lower search costs and reduced uncertainty. Lastly, most of the benefits identified for the introduction of the UK-REITs regime (<http://www.hmrc.gov.uk/ria/ria-reits.pdf>) will also apply to the Property AIFs regime, including:

1. Improving choice for small investors;
2. Improving liquidity;
3. Improving efficiency of use of commercial property.

It is not possible to directly estimate the benefits identified above. Therefore, any measure of the benefits involves a very high degree of uncertainty. However, as an elective regime, AIFs will only elect into the regime if the benefits from doing so exceed the costs.

Consultation

Following discussions with industry and representative bodies, the Government published a framework setting out the key features of a proposed Property Authorised Investment Funds tax regime at Budget 2007. In July 2007 the Government put out a discussion paper, providing a partial set of draft regulations which delivered certain parts of the framework, and set out how the Government intended to take forward the remaining parts. This was followed in December 2007 with a summary of responses to the discussion paper, a full set of draft regulations and an impact assessment. Links to all of these documents can be found here:

[http://www.hm-treasury.gov.uk/consultations_and_legislation/property/consult_property_nextsteps.cfm]

Competition Assessment

The Office of Fair Trading outlines four criteria for a Competition Assessment, asking whether the measure would:

1. Directly limit the number or range of suppliers?
2. Indirectly limit the number or range of suppliers?
3. Limit the ability of suppliers to compete?
4. Reduce suppliers' incentives to compete vigorously?

The answer to all four questions is no for Property AIFs, which instead are likely to enhance competition by allowing suppliers to choose the optimal fund structure and by allowing into the market any fund managers that previously opted out due to the adverse tax treatment of Property AIFs.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

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