
CERTAINTY ON TRADING AND INVESTMENT FOR AUTHORISED INVESTMENT FUNDS AND INVESTORS IN EQUIVALENT OFFSHORE FUNDS

Who is likely to be affected?

1. Authorised investment funds (AIFs) and UK-resident investors in equivalent offshore funds.

General description of the measure

2. Legislation will be introduced to give AIFs and UK-resident investors in equivalent offshore funds certainty that defined transactions will not be treated as trading transactions for tax purposes.
3. The legislation will set out a “white list” of transactions which, when undertaken by an AIF or equivalent offshore fund meeting a genuine diversity of ownership condition, will be treated as non-trading transactions. The legislation will also contain rules designed to ensure that financial traders cannot shelter profits from tax by routing them through an AIF or equivalent offshore fund. The rules applying to financial traders will not affect the tax treatment of the AIF or equivalent offshore fund.

Operative date

4. The legislation applying to AIFs will have effect on and after 1 September 2009 and the legislation applying to equivalent offshore funds will have effect on and after 1 December 2009.

Current law and proposed revisions

5. Section 468 of the Income and Corporation Taxes Act 1988 (ICTA), section 100 of the Taxation of Chargeable Gains Act 1992 and Statutory Instrument 964/2006 govern the tax treatment of AIFs. AIFs pay corporation tax (CT) on their income, but not on capital gains or capital profits from loan relationships and derivative contracts. Because profits from trading transactions are classed as income, an AIF is exposed to CT if any of its transactions are characterised as trading for tax purposes. Statutory Instrument 964/2006 will be amended by secondary legislation to

ensure that transactions appearing on a “white list” will not be characterised as trading when carried out by a qualifying AIF. This means that a qualifying AIF can be certain that these transactions will not give rise to trading income in any circumstances.

6. Chapter 5 of Part 17 and Schedules 27 and 28 to ICTA set out the rules for taxing UK-resident investors in offshore funds. These rules are being revised by secondary legislation, using the powers in section 41 of Finance Act 2008. Under the proposed new rules, the tax treatment of investors in an offshore fund will depend upon whether that fund is a “reporting fund”. A reporting fund will be required to calculate its “reportable income” which includes all profits from trading transactions but not capital gains or losses. The regulations will provide that, where the offshore fund is equivalent to an AIF (that would itself qualify to use the “white list”), transactions which appear on the “white list” will not be characterised as trading transactions for these purposes. This means that gains from these transactions will not be included in “reportable income” for the purposes of taxing UK-resident investors.
7. The secondary legislation being introduced will contain two safeguards. The first applies to the fund itself, which must meet a genuine diversity of ownership condition. This is to prevent abuse of the provisions by limiting their benefit to funds which are made available to a wide range of investors. For such funds, the characterisation of transactions as trading or non-trading will remain to be determined on the facts and by reference to general principles. The second safeguard applies to investors in the fund who are financial traders, for example banks and securities dealers.
8. Financial traders who hold interests in AIFs and equivalent offshore funds with access to the “white list” will be required to calculate realised and unrealised profits and losses on those interests and include these in their own trading results for tax purposes. This requirement will be overridden, however, where the financial traders already recognise those profits and losses as part of their trading result on the basis of fair value accounting. This second safeguard does not affect in any way the tax treatment of the fund and is designed to ensure that financial traders cannot gain an advantage by routing transactions through an AIF or equivalent offshore fund.

Further advice

9. If you have any questions about this change, please contact Lee Harley on 020 7147 2597 (email: lee.harley@hmrc.gsi.gov.uk). Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk