

Offshore funds manual – Definition: Contents

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OFM00001 - Definition of Offshore Fund – Sections 40A to 40G Finance Act 2008

Introduction

The definition of an offshore fund at Sections 40A to 40G Finance Act 2008 ('FA 2008') identifies the specific characteristics of arrangements that fall within the scope of the offshore fund regime.

Previously the tax definition of an offshore fund was based on the regulatory definition of a collective investment scheme. But the tax and regulatory definitions apply in quite different contexts. This could be a source of uncertainty for investors and the funds industry, but equally there was evidence that reliance on the regulatory definition was undermining the effectiveness of the tax rules. The move to a characteristics based approach redefines the boundaries of the offshore funds regime to ensure that it is more effective at delivering the intended policy objectives

This guidance explains the definition in more detail, and aims to provide non-UK funds, their managers and investors with as much certainty as possible.

OFM00002 - Characteristics based approach

The characteristics based tests apply to each 'arrangement' that may or may not meet the definition of an offshore fund.

The characteristics based approach also means that all UK investors in the same offshore fund face the same set of tax rules. (This is subject to certain preserved treatment for investments held before 1 December 2009 (see OFM00003)).

This is subject to the situation where rights of the investor change during the holding of their investment. If a change of rights causes the arrangement to fall within the definition of an offshore fund then the investor will be treated as holding an investment in an offshore fund from the date the rights change.

If an arrangement does not meet the characteristics set out in the legislation, it will not fall within the definition of an offshore fund. Even where an arrangement is an offshore fund, as defined, the regulations relating to the treatment of participants in offshore funds may take certain arrangements or funds outside of the scope of the regime where particular circumstances apply.

"Arrangements" includes all agreements and understandings, that is it has a wide meaning and is not limited to, for example, the documents establishing a fund.

OFM00003 - Transitional arrangements – Section 42A(6) Finance Act 2008

Holdings acquired before 1 December 2009 in arrangements that

- fall within the new definition of an offshore fund but which,
- on the date that the investor acquired them, were not an offshore fund within the previous meaning of Chapter 5 of Part 17 Income and Corporation Taxes Act ('ICTA') 1988

will be subject to preserved treatment, that is they will not be treated as relevant holdings in an offshore fund. (The treatment of 'material interests' in arrangements that were within the meaning of Chapter 5 of Part 17 will be dealt with in regulations).

The same treatment may apply to holdings acquired after 1 December 2009 but only where they were acquired under a written, legally binding agreement entered into by the participant prior to 30 April 2009 and the terms of the agreement are not varied on or after that date. If such an agreement was conditional, then all of the conditions must be satisfied before 30 April 2009 in order for this provision to apply.

OFM00004 - Meaning of 'offshore fund' – Section 40A Finance Act 2008

The definition of an offshore fund is limited to 'mutual funds' which take one of three forms and which are resident in, or based in, a territory outside the United Kingdom.

The meaning of the term 'mutual fund' is given by section 40B FA 2008, and is explained in more detail at OFM00010 to OFM00013. Those pages discuss each type of mutual fund in more detail, but broadly the definition is applied to a company, trust or any other vehicle or arrangement that is a mutual fund, that is to say one which meets the following characteristics –

- it is not UK tax resident;
- it exists to enable participants to take part in the benefits arising from acquisition, holding, managing, or disposing of assets of any description;
- the participants do not have day-to-day control of the management of the property whether or not they have the right to be consulted or give directions; and
- a reasonable investor would expect to be able to realise any investment based entirely or almost entirely by reference to the net asset value of the assets under management or alternatively, by reference to an index of any description.

The three forms of mutual funds that fall within the definition of an offshore fund are:

- a mutual fund constituted by a body corporate resident outside the United Kingdom (section 40A(2)(a) - see OFM00005)
- a mutual fund under which property is held on trust for the participants by trustees resident outside the United Kingdom (section 40A(2)(b) - see OFM00006); and
- a mutual fund constituted by other arrangements that create rights in the nature of co-ownership where the arrangements take effect by virtue of the law of a territory outside the United Kingdom (section 40A(2)(c) - see OFM00007).

Foreign partnerships within the scope of section 40A(2)(c) are specifically excluded from the meaning of an offshore fund given by section 40A(3) FA 2008.

OFM00005 - Corporate entities – *Sub-section 40A(2)(a) FA 2008*

All mutual funds constituted as incorporated bodies resident outside the United Kingdom fall within the definition of 'offshore fund', except for limited liability partnerships (LLPs) which are excluded by section 40A(6) FA 2008). It would though include, for example, open-ended investment companies and other companies with similar characteristics.

It is expected that relatively few fixed share capital companies will fall within the new definition. But under the characteristics based approach entities that have fixed share capital and that are structured in such a way that they share characteristics of open-ended share capital arrangements (that is, the share capital expands and contracts in response to demand) will be within the definition. So, fixed share capital companies that are predicated on the basis that investors will get a net asset value return or a return which is very close to net asset value may fall within the new definition.

See OFM00027 for further guidance on fixed share capital companies.

See OFM00010 for guidance regarding the meaning of the term 'mutual fund'.

OFM00006 - Property held on trust – *Sub-section 40A(2)(b) FA 2008*

All mutual funds where the property of the fund is held on trust for the participants (see OFM for the meaning of 'participant') by trustees who are resident outside of the United Kingdom will fall within the definition of 'offshore fund'. This would include, for example, overseas unit trusts.

The meaning is not restricted to arrangements that would be unit trust schemes for the purposes of the Financial Services and Markets Act 2000 (FSMA), so would include for example any unit trust scheme that was not a collective investment scheme for the purposes of FSMA.

See OFM00010 for guidance regarding the meaning of the term 'mutual fund'.

OFM00007 - Mutual funds constituted by other arrangements that create rights in the nature of co-ownership – *Sub-section 40A(2)(c) FA 2008*

All mutual funds constituted by 'other arrangements' (i.e. those not constituted by bodies corporate or where property is held on trust) creating rights in the nature of co-ownership where either the managers are resident outside the UK or the arrangements take effect by virtue of the law of a territory outside the UK are brought within the definition of an offshore fund.

This is subject to the important exception that mutual funds constituted by two or more persons carrying on a trade or business in partnership are not included as offshore funds within this section (section 40A(3)).

Co-ownership is not restricted to the meaning of the term in the law of any part of the United Kingdom, so would take its meaning from the law of the territory in which the arrangements take effect.

Examples of arrangements that are within the definition of an offshore fund by virtue of subsection 40A(2)(c) would include, for example, contractual arrangements such as Luxembourg *Fonds Commun du Placement* ('FCPs').

For offshore funds that are not corporate bodies or unit trusts see also OFM00008 ('application of Taxation of Chargeable Gains Act (TCGA) 1992 to interests in arrangements that create rights in the nature of co-ownership').

OFM00009 explains how arrangements that are transparent for income, but not for chargeable gains, are dealt with.

See OFM00010 for guidance regarding the meaning of the term 'mutual fund'.

OFM00008 - Application of Taxation of Chargeable Gains Act (TCGA) 1992 to interests in arrangements that create rights in the nature of co-ownership – Section 103A TCGA 1992

Certain contractual arrangements have long been treated as transparent for both income and chargeable gains purposes (for example, Luxembourg *Fonds Commun de placement* ('FCPs')). But whilst such funds came within the previous definition of an offshore fund, the offshore fund regime for taxing offshore income gains was not applicable as investors held, for chargeable gains purposes, interests in the underlying assets rather than in the fund itself.

This led to considerable difficulties for investors when they disposed of their interests, or when new investors were admitted to the fund, as capital gains computations could become very complicated. This is not the case for interests in offshore unit trusts which were and are subject to section 99 TCGA 1992, where for the purposes of tax on chargeable gains a unit trust is treated as if the fund was a company, and the rights of the participants in the fund were shares in that company. Section 103A TCGA 1992 now aligns the treatment of interests in arrangements that create rights in the nature of co-ownership with that of interests in unit trusts.

Section 103A will automatically apply with effect from 1 December 2009 for all interests in such funds held by capital gains tax payers, and for corporation tax payers from a date to be determined by Treasury Order (section 103A Taxation of Chargeable Gains Act ('TCGA') 1992). (This is to allow time for discussions to take place with industry about the changes for corporation tax payers.)

Acquisition costs for the rights in a relevant fund will be the acquisition costs that applied immediately before the 'effective date' – that is, the dates referred to above, or the date from which an election for earlier tax years or accounting periods applies (see below).

Transitional arrangements: Elections for earlier tax years and accounting periods

There is a facility to allow investors with existing interests to elect to treat their holdings in a relevant fund as opaque for chargeable gains purposes for previous years – from the 2003/04 tax year for capital gains tax payers and from accounting periods beginning on or after 1 April 2003 for corporation tax payers. An election for a particular year or accounting period will be irrevocable, and will mean that investments in the relevant fund(s) that is (are) the subject of an election will in all subsequent years or accounting periods be treated as opaque for chargeable gains purposes.

Elections are to be made by being included in a relevant self-assessment return or corporation tax return – a return will be a 'relevant return' if it is for the tax year, or accounting period, in respect of which the election is being made or any subsequent tax year or accounting period.

Where an election for opaque treatment is made, the investor is treated as if they had held an interest in a qualifying offshore fund (that is, one that had distributing fund status) for all years covered by the election.

OFM00009 - Arrangements that are tax transparent for income purposes

It is intended that regulations will provide that, subject to conditions, arrangements within the definition of an offshore fund that are tax transparent for income purposes but not tax transparent for chargeable gains purposes will be excluded from the charge to an offshore income gain.

Further details can be found in the HM Treasury document 'Offshore Funds: Further Steps' on the HMT website. Once the regulations are laid and approved, further guidance will be published.

OFM00010 - Meaning of 'mutual fund': General – Section 40B Finance Act 2008

The meaning of the term 'mutual fund' is drawn widely and encompasses any arrangements with respect to property of any description, including money - in other word, it does not matter what the underlying investments are.

Whether arrangements amount to a mutual fund depends on three conditions that must all apply to the 'participants' of the arrangements being considered. The conditions bring within the meaning of 'mutual fund' those arrangements that, broadly, have the characteristics of collective investment schemes.

'Participants' are those persons who take part in the arrangements and it makes no difference whether they directly own the underlying property of the arrangements or not. So, for example, there is no difference between a participant who has a share in a mutual fund constituted by a company (in which case under most forms of company law the participant would not have an ownership interest in the underlying property) and on the other hand, an interest in a trust or a partnership or other contractual arrangement which may well give the participant a direct ownership right (section 40A(5)).

The arrangements which may or may not be a mutual fund may constitute only part of a company, trust or contractual scheme. If arrangements relate to a number of separate pools of assets then each asset pool is considered separately. Similarly if an asset pool has different classes of interest then each class of interest is considered separately. For more details see sections 40C and 40D, which relate to umbrella arrangements and arrangements comprising more than one class of interest (see OFM00022 and OFM00023).

There are also exceptions to the definition of a mutual fund given by section 40E FA 2008 (see OFM00016).

Conditions A to C are considered in more detail in the following pages.

OFM00011 - Meaning of 'mutual fund': Condition A – Section 40B(2) Finance Act 2008

Condition A requires it to be the purpose or effect of the arrangements to enable the participants to 'participate in the acquisition, holding, management or disposal of the property, or to receive profits or income from those transactions or sums paid out of such profits or income'.

OFM00012 - Meaning of 'mutual fund': Condition B – Section 40B(3) Finance Act 2008

Condition B is that the participants do not have day-to-day control of the management of the property.

Merely having a right to be consulted or to give directions does not result in a participant having day-to-day control so, for example, the right to a vote at annual general meetings would not be considered to amount to day-to-day control.

OFM00013 - Meaning of 'mutual fund': Condition C – Section 40B(5) Finance Act 2008

Condition C requires that a 'reasonable investor' would as, participant in the arrangements, either

- expect to be able to realise the investment at, or almost entirely at, net asset value (NAV), or
- expect to be able to realise their investment on a basis calculated entirely or almost entirely by reference to an index of any description.

See OFM00014 for guidance on the meaning of a 'reasonable investor', and OFM00015 regarding realising an investment on a basis calculated entirely, or almost entirely, by reference to NAV or an index of any description.

The exceptions to the meaning of the term 'mutual fund' relate directly to Condition C, and so Condition C must be read in conjunction with section 40E FA 2008 (which provides the exceptions) for the purposes of determining whether or not arrangements come within the meaning of a mutual fund, and hence an offshore fund– see OFM00016.

OFM00014 - Meaning of 'mutual fund': Condition C: Meaning of 'reasonable investor' – Section 40B(6) Finance Act 2008

A 'reasonable investor' is not defined in the legislation. It is assumed that such an investor (whether an individual, corporate investor, or otherwise) would have read the documentation and taken account of all additional material and communications of any nature whatsoever provided by the fund.

Where the scheme documentation is not in written in a language that the investor can understand then it would be expected that the investor would have obtained a translation of the prospectus & any other relevant scheme documents or material.

OFM00015 - Condition C: Realisation of investment by reference to Net Asset Value ('NAV') or an index – Section 40B(5) Finance Act 2008

There is no definition within the legislation of 'almost entirely' as any sort of percentage limit of variation from NAV could be susceptible to arrangements seeking to avoid the intention of the offshore funds rules. It depends on what the arrangements are intended to provide – so if for example, buy-back arrangements normally take effect when there is a large discount to NAV, but may also be used in very exceptional circumstances to buy back at a very small discount or at NAV, that will not on its own mean that the arrangements may be a mutual fund.

Condition C, when read in conjunction with section 40E(1), provides a clear distinction between a mutual fund and a company organised in the way that, for example, an investment trust company in the UK is organised. Such a company is a closed-ended company in the sense that it does not allow investors to redeem their shares on request, nor does it issue new shares on request (but see OFM00016 where such closed-ended companies have a limited life). This contrasts with an open-ended investment company which is designed to enable investors to realise NAV and does so through its ability to issue or redeem shares at any time.

A reasonable investor in what may generally be regarded as a closed-ended company which meets Conditions A or B would normally only expect to be able to realise NAV on the liquidation of the company. So section 40E(1)(a) excludes from section 40B (*'meaning of 'mutual fund' etc'*) any case where a reasonable investor would only be able to realise the investment in the arrangements in the event of a winding-up, dissolution or termination of the arrangements, and where certain other conditions (condition 'X' or 'Y') apply (section 40E(1)(b) - see OFM00016).

It is not necessary that the investor obtains NAV directly from the fund. Where a reasonable investor could expect to receive NAV on selling their interest on a secondary market the fund will be an offshore fund if all other conditions are satisfied. For example, Exchange Traded Funds (ETFs) are usually operated in such a way that the quoted prices are at NAV or very close to NAV, and so would be expected to qualify as mutual funds. On the other hand, arrangements where a fund offered to buy back shares to keep a discount on the share price within a reasonable limit would not necessarily make the fund a mutual fund unless it was clear to a reasonable investor that such arrangements were intended to ensure that such purchases were at NAV or almost or very close to NAV.

Realisation of investment by reference an index

In some cases an investor may have a right to redeem at an amount not representing the assets directly invested in, but which is expressed in terms of an index. The fund manager may then invest the assets so as to produce a return as nearly as possible matching the index which is offered. In such a case Condition C will also be met. Again, this is subject to exceptions where conditions 'X' or 'Y' apply.

In most cases investments designed to produce an indexed return are likely to be non-income producing in which case see the exceptions set out at OFM00019 onwards (section 40E(4)). However it is also possible that they will be designed to produce a return for the investor that equates in substance to a return on capital invested at interest. In such a case the exceptions will not apply (section 40E(7)).

OFM00016 - Exceptions to the meaning of 'mutual fund': General – Section 40E
Finance Act 2008

In order to meet the definition of an offshore fund, arrangements must be a mutual fund. Section 40B provides three conditions, A to C, which must be met for arrangements to be a mutual fund - see OFM00010.

Even if all three conditions are met, section 40E provides exceptions to certain types of arrangements that would otherwise be mutual funds..

The exceptions are dependent on whether the arrangements are such that the only occasion on which a reasonable investor would expect to be able to realise an investment based entirely or almost entirely by reference to the net asset value ('NAV') of the property or an index of any description is on a winding-up, dissolution or termination of the arrangements ("termination event", such as in a case where there is a final redemption of a class of interest) (section 40E(1)(a) FA 2008), and on one of two conditions ('X' or 'Y') applying (section 40E(1)(b) FA 2008).

Section 40E(1)(a) has the effect that 'open-ended' arrangements (i.e. those which are designed to enable investors to realise NAV through their ability to issue or redeem shares at any time) cannot come within the exceptions provided by section 40E.

The conditions ('X' or 'Y' in the legislation – section 40E(1)(b)) do however except certain types of closed-ended arrangements from the meaning of a 'mutual fund'. Conditions X and Y are explained at OFM00017 and OFM00018 to 00021 respectively.

OFM00017 - Exceptions to the meaning of 'mutual fund': Condition X – Section 40E(2) Finance Act 2008

The most important exception, provided by condition X (section 40E(2)), is that a reasonable investor cannot expect the arrangements to terminate on a date fixed in advance.

Condition X requires that the arrangements are not such that they are designed to terminate on a date that is stated or determinable under the arrangements. As elsewhere "arrangements" has a wide meaning and is not limited to the documents establishing the fund, so can include all agreements and understandings.

This condition means, for example, that ordinary shares in any company with defined share capital (that is, **not** an open-ended company with variable share capital) and which does not have a limited life will NOT be an offshore fund.

Condition X would not be met where, for example, the scheme documentation or other agreements and understandings explicitly stated a date by when the arrangements were to wind up or that date could be determined by a reasonable investor. But where the arrangements provide for a continuation vote or similar action to determine whether they will persist beyond a given date that will not, in itself, mean that condition X is not met. It will all depend on whether a reasonable investor could expect that the arrangements will in fact terminate at a given date (section 40E(8)).

But even if a date of termination is stated or determinable, it is still necessary to consider Conditions Y1 to Y3 to determine if the arrangements amount to a 'mutual fund' – see OFM00019 to OFM00021.

OFM00018 - Exceptions to the meaning of 'mutual fund': Condition Y: General
– *Section 40E(3) Finance Act 2008*

As explained in OFM00017 even where Condition X is not met the arrangements being considered may still be excepted from the meaning of 'mutual fund' where the basic condition at section 40E(1)(a) and condition Y is met. Condition Y is expressed in terms of three alternative subconditions, Y1 to Y3. These conditions are explained at OFM00019 to OFM00021.

None of the conditions Y1 to Y3 can be met where the arrangements are designed to produce a return for participants that is equivalent, in substance, to interest and such arrangements will therefore meet the definition of a mutual fund and therefore will be an offshore fund (section 40E(7)).

OFM00019 - Exceptions to the meaning of ‘mutual fund’: Condition Y1: Not “relevant income-producing assets” – Section 40E(4) Finance Act 2008

Even if a date of termination is stated or determinable under the arrangements, the arrangements are not a mutual fund if none of the assets of the arrangement are “relevant income-producing assets” (see below). This is because the purpose of the regime is to ensure that income cannot be converted into capital by using offshore arrangements. To avoid unnecessary administrative burdens for arrangements that neither give rise to income at the fund level nor would give the investor an income flow if they invested in the underlying assets directly, closed-ended capital only arrangements are excluded from the definition of a mutual fund. This is designed to exclude arrangements which invest in assets intended to give a purely capital growth based return.

Relevant income producing assets means assets which produce income on which, if they were held directly by an individual resident in the United Kingdom, the individual would be charged to income tax (section 40F(1)). This is subject to limited exceptions, as follows -

- There may be cases where underlying assets are acquired (and on which income would arise) but which are hedged using derivatives (such as a total return swap). Section 40F(2) ensures that such assets so hedged are not regarded as income producing assets if no income arises or is expected to arise from the asset (after allowing for the effect of the hedging arrangements) or from the hedging arrangements themselves.
- A further exception applies where incidental income arises from cash awaiting investment being placed on deposit, provided that the sums in question and all income produced are subsequently invested in assets that are not themselves ‘relevant income-producing assets’ as soon as reasonably practicable (section 40F(3)).

However, condition Y1 will not be met where the arrangements are designed to produce a return for participants that is equivalent, in substance, to interest and such arrangements will therefore meet the definition of a mutual fund and therefore will be an offshore fund (section 40E(7)).

OFM00020 - Exceptions to the meaning of 'mutual fund': Condition Y2: no entitlement to income or any benefit arising from income – Section 40E(5)
Finance Act 2008

Even if a date of termination is stated or determinable under the arrangements, the arrangements are not a mutual fund if the participants have no entitlement to any income arising under the arrangements, or to any benefit arising from such income.

An example of an arrangement satisfying this condition might be the capital shares or units in an arrangement which split the rights to capital and income between the holders of different classes of interest, where the holders of capital shares or units are not entitled to any of the income or any benefit arising from the income.

However, condition Y2 will not be met where the arrangements are designed to produce a return for participants that is equivalent, in substance, to interest and such arrangements will therefore meet the definition of a mutual fund and therefore will be an offshore fund (section 40E(7)).

OFM00021 -Exceptions to the meaning of 'mutual fund': Condition Y3 – Section 40E(6) Finance Act 2008

When conditions Y1 and Y2 are not satisfied then the arrangements being considered may still be excepted from the meaning of 'mutual fund' if condition Y3 is satisfied.

Condition Y3 is satisfied if all of the income produced by the assets that are the subject of the arrangements is paid or credited to participants in such a way that any participant who is a UK resident individual will incur a liability to income tax on the amounts so paid or credited.

However, condition Y3 will not be met where the arrangements are designed to produce a return for participants that is equivalent, in substance, to interest and such arrangements will therefore meet the definition of a mutual fund and therefore will be an offshore fund (section 40E(7)).

OFM00022 - Umbrella funds and protected cell companies – Section 40C
Finance Act 2008

'Umbrella arrangements' means arrangements which provide for separate pooling of the contributions of the participants and the profits or income out of which payments are made to them. References to a part of umbrella arrangements are to the arrangements relating to a separate pool (or 'sub-fund'). Umbrella arrangements will not themselves be treated as an offshore fund. Instead -

- Each sub-fund and each class of interest is treated as an offshore fund in its own right,
- The umbrella fund is not treated as an offshore fund,
- The overall arrangements are disregarded.

The same approach applies to an individual cell within a protected cell company.

For both umbrella arrangements and protected cell companies, it would follow that each separate arrangement has the same residence status as the overall arrangement. In the case of a company, each separate arrangement is under the "central management and control" of the directors of the company which constitutes the overall arrangement. In a unit trust scheme, the trustees of the overall trust arrangements will also be the trustees of each separate arrangement, and so their residence status determines the residence of the fund.

It is not important whether or not participants have a right to exchange an interest in one pool or sub-fund for an interest in another.

OFM00023 - Classes of interest – *Section 40D Finance Act 2008*

Section 40D deals with a case where there is more than one class of interest in any arrangements. This includes the case where there is more than one class of interest in a part of umbrella arrangements (sub fund).

Where there is more than one class of interest in arrangements, each class of interest is treated as a separate arrangement and looked at separately for the purpose of determining whether the arrangements constitute a mutual fund and an offshore fund, and the main arrangements are disregarded.

“Class of interest” is not limited to share classes. There may be other forms of interest which entitle an investor to realise their investment on a basis calculated entirely or almost entirely by reference to the net asset value of the scheme property or an index. For example, certain types of loan may give a return which tracks NAV or is based on an index.

It is possible for an entity, particularly a company, to have a class of interest such as ordinary shares which does not constitute a mutual fund and another class of interest which does constitute such a mutual fund.

However, a particular class of shares can only constitute a single class of interest even if different types of holders of those shares enjoy different rights. For example, in the case of an exchange traded fund, the creation unit holders might have the right to redeem or issue shares directly but if that same class of shares were acquired by another investor on the secondary market then they would still form part of the same class of interest (see OFM00025 regarding Exchange Traded Funds).

OFM00024 - Particular arrangements: general

The following pages discuss particular issues with regard to the *definition* only, and further detailed guidance on the operation of the proposed new regulations will follow in due course, initially in draft form to allow for comments.

OFM00025 - Exchange traded funds

Exchange traded funds ('ETFs') are usually operated in such a way that the quoted prices are at net asset value ('NAV') or very close to NAV, and so would be expected to meet the characteristics set out in the legislation and to come within the meaning of a mutual fund, and to therefore be within the definition of an offshore fund.

As with other classes of interest, it is important to note that fungible shares can only constitute a single class of interest even if different types of holders of those shares enjoy different rights (see OFM00023 - Classes of interest).

OFM00026 - Property investment vehicles

Arrangements that are equivalent to a UK Real Estate Investment Trust ('REIT') will be outside the definition of an offshore fund. An arrangement that is equivalent to a UK Property Authorised Investment Fund ('PAIF') will, however, be within the definition of an offshore fund (this is because UK REITs are closed ended and do not have a fixed life whereas PAIFs, like other UK authorised investment funds, are open-ended arrangements). In simple terms, the same rules apply to property investment vehicles as apply to any other type of fund.

For more details concerning UK REITs, see the GREIT manual. For more details concerning PAIFs, see the Company Taxation manual at CTM48800 et seq.

OFM00027 - Fixed share capital companies

It is expected that very few fixed capital companies will fall within the new definition. However, the characteristics based approach does mean that the new definition will apply to entities that have fixed share capital if they are structured in a way that is similar to arrangements where the share capital is open-ended (that is, the share capital expands and contracts in response to demand). So, fixed share capital companies that are predicated on the basis that a reasonable investor would expect to receive a return when realising their investment based entirely or almost entirely by reference to the net asset value of the property or an index of any description will come within the definition of a mutual fund, and an offshore fund unless any of the exclusions apply.

The following pages consider specific examples of fixed share capital arrangements and their interaction with the offshore funds tax definition in more detail.

OFM00028 - Share buy backs and share issuance

The price or value of shares in fixed share capital companies may reflect either a discount or a premium to the net asset value of the underlying assets. It may also be the case in some circumstances that there is either directors' or investors' discretion to allow or require the buy back of shares if there is a discount of a certain level between the net asset value of the arrangements and the share price.

Provided the share buy back arrangements are made to prevent the discount becoming too large by reference to net asset value, and provided a reasonable investor cannot expect to realise their investment either entirely or almost entirely by reference to net asset value (or by reference to an index), such arrangements will be outside the definition of an offshore fund for UK tax purposes. Similar considerations apply where the shares trade at a premium.

However, share buy back arrangements that are specifically designed to allow tracking to net asset value will cause the company or share class to come within the definition of offshore fund.

When considering an investor's rights, account should be taken of all scheme documents, promotional documentation or communications to determine what guarantees or undertakings may have been given to the investor.

An undertaking or guarantee, etc, to buy back or redeem only a part of an investor's holding entirely or almost entirely by reference to the net asset value of the property or an index of any description can still constitute an expectation, so for example if the fund manager undertook to redeem or buy back an investor's shares in tranches the arrangements could still be within the definition.

Where no guarantees or undertakings are given when the arrangements are set up or the scheme terms are amended, a subsequent buy back or issue of shares would not, by itself, give rise to an expectation that a reasonable investor could realise their investment either entirely or almost entirely by reference to net asset value (or by reference to an index).

OFM00029 - Fixed life companies: general

The so-called 'seven year rule' that applied under the previous definition meant that if an investor could not realise their investment (by whatever means) within a period of seven years from acquiring that interest it could not be subject to offshore income gains treatment.

There is no similar rule within the new definition, and it is therefore possible that arrangements that are expected to terminate at a predetermined time may be within the meaning of a mutual fund and therefore possibly within the definition of an offshore fund, subject to certain exceptions provided by section 40E – see OFM00016.

The following pages provide further guidance regarding particular circumstances that may apply to fixed life companies, and the effect on the consideration of whether arrangements would be viewed as mutual funds.

OFM00030 - Fixed life companies: overseas corporate law

Under some overseas corporate law, certain companies must liquidate under certain circumstances within a particular time frame. Provided that none of the characteristics set out in the legislation and referred to in this guidance are met, this will not on its own mean that such arrangements will be within the definition of a mutual fund, and therefore an offshore fund, for UK tax purposes.

OFM00031 - Fixed life companies: company liquidations

An investor may have invested in a company or other arrangement which subsequently goes into liquidation, at which point the investor might reasonably expect to realise their investment at net asset value. However, if a company or other arrangement is outside the definition of an offshore fund before it goes into liquidation, then being in liquidation will not by itself bring that company or arrangement into the definition of an offshore fund. This may not apply, though, to intentionally extended or contrived liquidations.

Some overseas companies can be liquidated or reconstructed at any time. If there is a decision to do so, at the point of the approval of the reconstruction or liquidation the investors may obtain net asset value. However, the relevant point is whether a reasonable investor can expect the company to be liquidated or reconstructed in order to deliver net asset value. It is necessary to consider the reasonable investor's expectation to realise their investment either entirely or almost entirely by reference to net asset value (or by reference to an index) when the company was established (or there is a change in the investor's rights).

OFM00032 - Fixed life companies: continuation votes – *Section 40E(8) Finance Act 2008*

If a closed ended company is subject to a continuation vote that may lead to the winding up, dissolution or termination of the arrangements that will not by itself mean that the company will be a mutual fund, and therefore possibly an offshore fund.

That would not be the case, however, where the reasonable investor is in a position to *expect* that it will be wound up and so the company would have a 'fixed life' – and so would (subject to the other conditions being met) be a mutual fund (in other words condition X (section 40E(2)) could not be satisfied).

In considering this point, account is to be taken of all documents or assurances which a 'reasonable investor' could rely on to predict the outcome of such a vote or to ensure that they would be able to redeem their investment entirely or almost entirely by reference to the net asset value of the property or an index of any description.