

# **Tax Implications for Authorised Investment Funds following the New FSA Regulations (COLL)**

## **SUMMARY OF RESPONSES**

The Financial Services Authority (FSA) issued a new sourcebook (COLL) setting out the framework for the authorisation and operation of authorised investment funds (AIFs) in the UK. AIFs are both authorised unit trusts (AUTs) and open-ended investment companies (OEICs). The new regulations came into effect on 01 April 2004 and permit AIFs to undertake a wider range of investments and investment strategies. They also allow for the establishment of a new type of authorised non-retail fund for sophisticated and institutional investors – the Qualified Investor Scheme (QIS).

During the FSA consultation leading up to COLL it was recognised that some of the then proposed changes might have a read across to the taxation arrangements. In order to explore some of the issues that might arise from the new sourcebook the Inland Revenue published a Technical Discussion Paper on 21 July 2004 seeking views from interested parties on these issues.

The Paper asked for comments by 24 September 2004 on a number of specific questions as well as general views on simplification of the tax regime applying to all collective investment schemes. 28 replies were received and the main points are summarised below.

A common theme to emerge from the responses was that changes to the tax system could improve efficiency and promote the development of more diverse investment strategies. Two issues of immediate concern were the tax treatment of the new QIS, and the need to clarify the tax treatment for authorised unit trusts wishing to issue multiple classes of units.

The main points raised under each issue covered in the technical discussion paper are outlined below.

## **1. Taxation of Property Rental Income**

Under COLL AIFs are permitted to hold 100% of their assets in property and can defer redemption rights by up to six months. Previously there was no deferral option and the property investment limit was 80% of the fund's total assets. Currently rental income is subject to a corporation tax charge of 20% within a fund and rental income is distributed as part of any dividend distribution. We asked whether this tax "sticking" at the fund level would discourage funds from investing 100% in property and whether identifying property rental income separately would be a viable alternative.

Respondents made the following general observations:

- The present tax regimes covering property vehicles have resulted in limited choice for investors and in institutional and sophisticated investors using offshore vehicles. Investment decisions should be driven by considerations such as professional management and diversification of risk, rather than by tax.
- Investing in property via an authorised fund is unattractive to tax exempt investors as they cannot recoup any corporation tax paid at the fund level. AIFs are therefore disadvantaged compared to limited partnerships and offshore unit trusts.
- Historically it has been difficult for smaller pension schemes to gain exposure to property as an asset class as existing pension fund vehicles tend to have high subscription thresholds and limited liquidity. Any tax changes should therefore allow for tax effective co-investment by tax paying and tax exempt investors in order to establish funds of a viable size.
- Reform to property funds is long overdue and should not be delayed by complex issues such as capital allowances (CAs), stamp duty (SD) and VAT.

### **Full Streaming**

At present AIFs can make either a dividend or interest distribution but not both depending on the investments held within the fund. Views were sought on replacing the present arrangements with a "full streaming" arrangement whereby funds could pay both an interest and dividend distribution, together with a separate property distribution.

Responses covered the following points:

- Streaming of property rental distributions would be a possible way forward to prevent tax sticking at the fund level for exempt investors, but any system would have to be pragmatic in order for it not to be too costly to administer.
- AIFs should be able to treat the amounts distributed as property income as a deduction in computing their Schedule A tax liability. Withholding arrangements should then apply to ensure basic rate taxpayers do not have to file tax returns.
- The ability to stream would mean that investors' liability to tax would reflect the nature of the underlying assets in which the fund had invested. There would therefore be an alignment of tax treatment by the investor with the source of income received by the fund.
- In any streaming arrangements the ability for AIFs to benefit from double taxation agreements (DTAs) was important, and allowing distributions to be deducted as an expense in the CT calculation would achieve this.
- UK corporate, charity and pension fund unit holders should receive property related income as Schedule A income from an AIF, without deduction of tax.
- Full streaming would require considerable changes to fund administrative systems and distribution vouchers. Systems changes have a long lead-time so it would be important to give an indication of any changes early so the necessary system changes can be accommodated.
- Some thought that full streaming was potentially expensive and complicated for fund managers to administer as well as difficult for the retail investor to understand.

## **Other Options**

A number of alternative solutions were suggested to cater for the greater range of assets allowed under COLL:

- Treat property rental income as a type of income out of which a deductible interest distribution may be paid. This would ensure that no tax was suffered at the fund level, with investors being taxed on the income received; exempt investors would then be able to recover any income tax withheld. But AIFs

paying interest distributions out of rental income would be disadvantaged compared to direct investment in property as unclaimed CAs would not be available for investors to offset against their own tax liability on distributions.

- Land and property should be included as qualifying investments within the bond fund regime. An example was given whereby if more than 60% of a fund's income is from a bond and/or rental income, the fund could choose to make an interest type distribution. This would be treated as a deductible expense in computing corporation tax liability, with the payment being taxed as interest on the investor at the marginal rate of tax.
- Another option was to move away from a bond versus non-bond type arrangement to an equity versus non-equity fund regime. Funds with a certain proportion of assets in UK equities would pay a dividend with 10% tax credit. Any other fund (bond, property, mixed) would pay an interest distribution, but with a 20% repayable tax credit to set against the investors marginal rate of tax.
- Alternatively a dominant investment strategy could apply, but the current 60% rule would not suit such a regime.

## **2. Stamp Duty Land Tax (SDLT) and Stamp Duty Reserve Tax (SDRT)**

Although not impacted by the new COLL, it seemed opportune to seek views at this time on how we might handle the differences of treatment between AUTs and OEICs regarding stamp duty.

Comments in this area were centred on consistent treatment for both AUTs and OEICs.

- AUTs can be vested with property (seeded) by the first unit holder without incurring an SDLT charge whereas an OEIC cannot. Fund managers therefore tend to create AUTs in the first instance, and then convert them to an OEIC. This cumbersome process could be avoided by the introduction of a first investor exemption for a transfer into an OEIC, aligning the treatment with that of AUTs.
- The present distinction of treatment between an OEIC and an AUT arises from general law; given that they are intended to be similar vehicles, the opportunity should be taken to harmonise their treatment on this relief. Harmonisation

should also apply to SDLT on real property and should extend to REITs if they take the corporate form.

- Although COLL enables the launch of umbrella OEICs, with sub-funds across asset classes, including property, unless the SDLT position on seeding is changed, this flexibility will not be utilised.
- Issues around SDRT were also raised in the context of pension funds and charities. Exemption from stamp duty was sought for these vehicles on their acquisition of and dealings in units in AIFs. Those AIFs whose investors are restricted to charities should also be exempt from stamp duty on asset acquisitions.
- All transfers of assets in exchange for units in collectives should be exempt from stamp duty in order to reduce the competitive advantage of life assurance funds. This would mean allowing stamp duty relief on the exchange of units in an AIF for direct holdings of shares and vice versa, irrespective of any change in the proportions of shares held in the underlying fund.
- A Fund of Funds (FoF) surrendering units in the top fund should be exempt from stamp duty. A FoF not wholly invested in UK bond funds currently suffers stamp duty on its underlying assets, an SDRT charge on its surrender of units in the funds it invests in, and a further SDRT charge on the investor's surrender of units.

### **3. Distribution Rules**

#### **The investment test and extension of corporate streaming rules**

We asked whether the current test used to determine whether a fund can make an interest distribution was likely to lead to difficulties given the wider range of assets an AIF can invest in under COLL, and whether extension of the corporate streaming rules to those not in the charge to corporation tax might promote the use of AIFs by institutional investors.

Most respondents called for revision or removal of the 60:40 investment test and asked for an extension to the streaming of franked and unfranked income (currently available for corporates) to exempt investors, so allowing these investors to recoup corporation tax suffered at fund level. Other comments included:

- The 60% test is a rough tool that does not cater for balanced funds, which require flexibility to move into and out of relevant classes to protect investors' returns. The need to retain the ability to pay an interest distribution is preventing the industry from making full use of the wider investment powers offered by COLL.
- The nature of property investment income means there is less flexibility to adjust portfolios to meet particular investment ratio tests; any ratio may become distorted in times of falling markets and high redemptions due to an inability to dispose of property quickly.
- It is important that any changes should apply equally to all pension arrangements (individual retirement accounts, trust-based and contractual schemes). Removing tax suffered at the fund level would allow pension funds and charities investing in mixed equity/bond funds to compete directly with life companies.
- There could be an increase in balanced funds under COLL, and these would find the 60% "bond fund" test restrictive. One solution is to have full streaming, but other options need to be discussed with the industry to avoid increasing operating costs to the detriment of investors. Full streaming and the abolition of the 60% test will prevent tax conflicting with investment management requirements, but may prove costly.
- The daily investment test is onerous and requires a fund to be run at an effective 35% limit on equity exposure. A solution could be to introduce a rule such that the test is only failed if not breached by more than 5% (65:35) on any day and there were no more than 5 breaches in the period and the breach was cured within 5 days.

### **Other options**

A number of other options regarding the investment test were made, as follows:

- Replace the bond fund arrangements with a single equity threshold of 85%, below which a fund would be treated as "mixed" or non-equity. Compliance would be measured at the balance sheet date.

- Reduce the threshold to 40%, with aim of removing it over the long term in order to allow onshore hedge funds to replicate the flexible investing powers of offshore funds (OSFs).
- Include property in the assets included in 60% test.
- Allow rental income to be distributed by way of an interest distribution with the rental element unable to be paid gross to non-residents (NRs). Funds could then elect to pay a property income distribution if they wish.

#### **4. Equalisation**

Equalisation confers entitlement to income on new investors as if they had invested at the start of the distribution period. As COLL allows funds to choose whether or not to apply the equalisation rules there was concern that this may allow investors to turn income into capital. The responses were all of the view that this concern was unfounded and that both the regulatory requirement to treat all investors equally and accounting for accrued income within funds ensured this was not a serious problem. Particular points included:

- If an investor sells his equity *cum div* he will not receive income but will have a capital gain, and this is not unique to AUTs. Sales close to the end of a distribution period will be to the manager who will give the investor capital proceeds (not income). The manager then decides whether to hold, recycle or cancel units. If he cancels the units he will pay out partly capital and partly income on those units.
- The purchase price of units includes an amount in respect of accrued income on the investments since the end of the last distribution period. The first distribution paid to new investors includes a capital sum by way of repayment of this amount. The investor's taxable income is therefore reduced by this amount, and it is also subtracted from the purchase price of the relevant units in calculating the capital gain. This treatment applies to units or shares issued by AUTs or OEICs and to those resold by the manager where a box is operated.
- It is unlikely that fund managers would find it economic to encourage investors to turn sums of income less than the annual exempt amount (AEA) into capital.
- Equalisation is simply a method used by funds to ensure incoming and outgoing investors do not affect the value of units for the remaining investors.

It is calculated separately for each class of unit based on the income shown as available for distribution and is therefore difficult to manipulate, especially at the individual investor level. Funds themselves cannot manipulate equalisation to benefit any particular type or class of unit holder as this would breach their fiduciary duties and, in the case of AIFs, the regulations.

- Capital sums paid for income equalisation are returned to investors as an average amount per unit/share and similarly income equalisation on redemptions is averaged leaving no scope in an AIF for an investor to create an artificial return due to equalisation. The position is no different from disposing of a normal equity in a company before its ex-dividend date.
- It has always been possible for an investor to buy into, or dispose of, an enhanced income stream late in a distribution period.
- The application of equalisation under streaming and the allocation of expenses will need further consideration once a preferred route has been agreed.

## **5. Multiple classes of unit holders**

COLL now permits the issue of multiple classes of unit holders within authorised unit trusts, but this is not catered for by the tax regime. Most commentators called for an urgent update to the tax regime to allow AUTs to take advantage of this regulatory change.

Specific views included:

- Multiple classes of units allow different charging structures for different market sectors – retail, institutional, PEP/ISA, in-house funds – and for classes of interest to be denominated in different currencies. This should make institutional investment in a wide range of asset classes through AIFs attractive, so benefiting investors, as fund managers will have fewer, larger pools of assets to manage, which would represent a saving on administration costs.
- Different share classes have to charge expenses consistently (either to income or capital) as determined at fund level and the whole thrust of regulation is that there should be no discrimination between share or unit classes.

## **6. Accounting Issues**

### **Use of derivative strategies and the trading/investment argument**

COLL permits a greater range of investment strategies for the QIS, including taking short positions. The use of sophisticated financial instruments may lead to difficulties in determining whether returns should be designated as income or capital and we sought opinion in this area.

Most respondents made some comment on this issue, with the majority view clearly stated that there should be no changes to the current tax treatment of funds using derivatives to generate returns. In particular:

- Certainty of a fair tax outcome was seen as essential if UK funds are to survive in an increasingly competitive and international market place.
- The wider range of investments allowed under COLL has caused uncertainty of tax treatment, especially for complex derivatives where the split between income and capital is uncertain. A default position should be adopted such that the taxation of all assets within an AIF should follow the accounting treatment as set out in the SORP.
- The implication that the tax position of retail AIFs using derivatives might be reviewed alarmed some sections of the industry, and there was a call for confirmation – and possibly new guidance – of the current tax position of retail AIFs using derivatives.
- The SORP could be updated to address the treatment of short positions with subsequent guidance confirming a “general and prevailing” assumption that AIFs always invest rather than trade. A wider debate with industry about hedge funds, their taxation and their contribution to the UK should then follow.
- There is an industry working group looking in detail at the impact of IFRS (IAS 39) on AIFs, with the intention of ensuring that the current income/capital differentiation under the SORP is not disturbed. IFRS adopts a more prescriptive, rule-based approach to the preparation of accounts, rather than one based on general principles giving regard to the intent behind a transaction, so is likely to introduce a more restrictive regime in this area.

- The current approach is broadly working but needs adjustment to cater for taking short positions, perhaps through changes to the SORP or guidance from the Inland Revenue; the area moves too quickly to fine-tune the regime through the cumbersome process of legislation.
- Treating a derivative that hedges an existing investment as a trading activity but regarding other derivative activities as investments (and therefore not trading) is not appropriate. Derivatives have now become a mainstream product and form part of overall investment strategies designed to provide a total return, without necessarily drawing a distinction between capital and revenue.
- Consideration should be given to the investment strategy of a fund: if the objective is to make profit from holding investments then there is no good reason why those investments should not be derivatives.
- Applying the “badges of trade” to sophisticated investment management techniques is not easy and any uncertainty of tax treatment means the funds move offshore.
- The SORP (qualitative approach) and regulation (incorrect income/capital accounting treated as pricing error and heavily penalised by regulator) provide adequate protection to Exchequer in this area.
- The broader and legitimate role of derivative investment strategies in AIFs must be recognised. The use of derivatives is misunderstood, prohibiting the development of flexible and cost effective fund management in UK.
- A fund may use derivatives to provide a guaranteed return, generated as capital gains and not taxed until exit. This contrasts with life insurance products investing in unit trusts which are taxed on capital gains throughout the life of the investment.
- Further guidance on the treatment of the return from derivative and hedge fund activities would be welcome.
- In terms of hedge fund strategies the activities allowed by COLL are modest.
- Unit Trusts should not pay tax on the results of its central activities, whether or not those might otherwise constitute a trade; any charge should arise at investor level.

- It is important to recognise that AIFs provide investment, but also important that such recognition is not abused by the inappropriate use of AIFs as trading vehicles.
- The old trading versus investment distinction appears increasingly anachronistic and unsuitable for investment management activities. If the distinction is abandoned for AIFs the hedge fund industry may consider returning onshore. If IR requires an element of protection this should be restricted to extreme cases and a clear distinction between acceptable and unacceptable practice should be drawn.
- Funds are not companies and the ability to pool assets and use the expertise of an investment manager benefits all investors. So as well as ensuring investors pay their fair share the Government should remove tax obstacles that hinder the efficient operation of these funds.
- Derivatives are increasingly important in all funds and are heavily used by hedge funds. The UK regulatory system is moving to allow more hedge fund strategies onshore as this area is important for the UK economy as a whole. Creating a workable tax regime for them, with tax falling on investors rather than the fund, requires discussion with the industry.
- The use of derivative and hedging strategies may result in deferral of some tax because more of the return is received as capital and not subject to tax at the fund level. But these gains are caught when an investor realises that investment. If individual investors were able to undertake these directly they would be taxed under the normal income/capital divide.
- Investment via an AIF does seek to defer tax until an investor realises his holding. This also applies to funds investing wholly in securities and there is no policy justification for treating derivatives differently from other investments.
- Deferral of tax until investors realise their interest has become a primary driver behind the movement of investment into offshore funds. Similar deferral through UK funds will not erode Exchequer funds, but as investors would be able to switch to UK funds (as offshore hedge funds are repatriated) their ability to defer tax would return greater economic interest to the UK.

- There may be scope to build on the SORP to indicate how investment objectives might determine tax treatment. Any move to apply the full corporate tax regime for derivatives to funds would prevent funds being able to pursue derivative strategies.

## 7. Capital Distributions

Realised capital gains are normally reflected as an increase in the net asset value of an AIF, but there is no specific restriction on the distribution as dividends or surpluses. It may be easier under International Accounting Standards (IAS) to include realised gains in a distribution account and we asked whether a specific restriction might therefore be needed.

The overwhelming view was that there was no need for a specific legislative prohibition on the distribution of capital returns by way of a dividend by AIFs, as this is dealt with by regulation. Comments included the following:

- Profits realised on the disposal of an asset should rarely be treated as income.
- The accounts of an AIF include all management expenses in arriving at net income before tax in a statement of total return under COLL, so there is no need for a specific restriction in the tax legislation on distribution as income of realised gains from capital items.
- The distribution of realised capital gains should be prohibited but IAS will not blur the distinction between capital and revenue, so the issue should continue to be dealt with under current IR practice.
- If IAS impacts on the current prohibition of distributing capital, then it would be best to address this in a revised SORP.
- It is difficult to consider capital distribution alternatives until the larger issue of how IAS is to be treated is resolved.
- Any capital distribution would be a partial realisation by the investor and so outside the distribution account requirements, but it would be useful to clarify this.
- The introduction of limited redemption provisions in COLL together with capital protection products with fixed terms may encourage managers to make capital distributions at regular dates within the life of a fund. If capital

distributions are treated as partial disposals there is no requirement for special treatment, but the tax regime may need to refer more specifically to capital distributions to distinguish these from income distributions.

- Any capital distribution regime should allow non-UK tax credits to be passed through to unit holders.
- The distribution of realised capital gains should be prohibited, perhaps through a restriction similar to that in force for Investment Trust Companies, which directs that capital gains cannot form part of the distribution.
- It is inappropriate for a fund to convert capital into income, and this could be avoided by streaming.

## **8. Qualified Investor Scheme (QIS)**

COLL introduces a new category of AIF, the QIS available only to sophisticated and institutional investors. QIS has a lighter regulatory regime, can undertake a wider range of investment activities and can borrow up to 100% of its net asset value. The AIF regime was set up to provide a clear set of rules for taxing schemes and their investors within a tight regulatory framework. We asked whether such a regime was appropriate for this new non-retail scheme.

The majority view was that if a QIS was taxed as a company or trust none would be set up as high net worth individuals will invest in unauthorised unit trusts or go offshore.

Respondents made the following points:

- The AIF regime should apply to QIS and the market is currently stagnating due to uncertainty of tax treatment.
- QIS is a well-regulated and supervised product with limits on the level of derivative transactions in line with those for retail AIFs and UCITS (Undertaking on Collective Investments and Transferable Securities) funds. The additional flexibility of QIS was deemed necessary to attract sophisticated and institutional investors and any tax disadvantage would undermine this.

### **Subscription Test**

Views were mixed regarding a subscription test with some respondents thinking that if QIS were to qualify as an AIF there should be a minimum number of investors in order to prevent there being only one investor in the scheme. Some support was expressed for targeted anti-avoidance measures, but it was not considered fair or proportionate to the risk to bar QIS from the AIF regime. Other comments included:

- Any subscription test could be accidentally failed on launch or wind-up and setting a minimum number of unit holders would be easy to circumvent.
- Such a test could severely disadvantage the life industry, in which one institutional investor might be a QIS investor, but investing on behalf of a large number of individual retail customers. Introducing a subscription test would be arbitrary, introducing artificiality in structuring products and over-complication in managing them.
- QIS is aimed at the sophisticated investor, who is expected to invest larger sums and so there are likely to be fewer of them investing in each QIS.
- The QIS regime may remove the investment limits appropriate for mass retail market products, but the governance structures, independent oversight and custody, accounting and auditing standards and full disclosure, are the same as for UCITS and non-UCITS retail funds.
- The Government must balance the desire to close loopholes that allow some people to avoid paying tax with the need to reduce the costs of compliance for the majority.
- The purpose of QIS is no different from a retail fund – it is a vehicle for pooling funds from different parties for investment in a variety of assets. There is no obvious reason to treat it differently simply because it is aimed at more sophisticated investors.
- Any concern that QIS may be used for avoidance should be addressed in a way that does not prejudice the position for institutional investors, who will be the main QIS investors.
- 50% of money in retail AIFs is institutional and much of that is in institutional share classes. Taxing such money differently would be extremely complex and expensive to administer.

- IR should take measures to ensure the taxation of pooled investments is not open to abuse.

## **9. Wider Issues**

Views were sought on the possibility of introducing a single tax code to cover all unit trust schemes regardless of their regulatory status, and on how the taxation of collective investment schemes in the medium to long term could be modernised and simplified.

### **Common tax code for all unit trusts**

- Tax rules should continue to be linked to the Financial Services & Markets Act (FSMA) conditions in order for any beneficial rules to apply.
- No changes should be made to the unauthorised unit trust (UUT) or Pension Fund Pooling Scheme (PFPS) regimes until the tax treatment of QIS is clear.
- If funds are able to adopt full streaming, existing UUTs may convert to AIFs provided there was no additional stamp duty liability on conversion.
- UUTs are important offshore and there could be difficulties in structuring venture capital arrangements if managers are unable to use unitisation to give investors tax transparency.
- Users of UUTs would not want them taxed as companies, as they could have set themselves up as such from the outset if desired.
- The round-tripping of payment of tax by a fund and its reclaim by investors is unnecessary and time-consuming and could be abolished without risk.
- The UUT qualification test (which must be passed in order to gain exemption from CGT) means that many property funds go offshore to bypass the restriction on eligible investors.
- Bringing UUTs investing in securities into the AIF regime – provided full streaming is introduced – will reduce the complexity and costs of administering these schemes.
- A single tax regime for all funds is fundamental to the success of any reform, but the rules governing investors are a matter for the regulator rather than the tax authorities. The savings to providers of operating only one scheme could be passed on to investors by way of cheaper products.

- UUTs fulfil a valuable role within the landscape of investment funds in the UK providing exempt holders (pension funds or charities) with the opportunity of pooling investments on a neutral basis. The recovery of tax borne on income is a burden but fund managers and investors have learned to cope with this.
- The UUT regime should not be dismantled in the short to medium term but longer term, if changes are made to the AIF regime to ensure it is the unit holder who is taxed rather than the fund, the UUT regime could eventually disappear.
- UUTs are used to shield investment funds from the risk that they could be treated as trading for tax purposes where property development work is undertaken. The key feature of a UUT that allows this is that it is opaque for income tax purposes. There may therefore be certain UUTs and PFPSs who do not wish to convert to the AIF regime.
- Some investors prefer pooling their funds only with other institutional funds.

### **Pension Fund Pooling Schemes (PFPSs)**

Given the relatively low uptake of the special rules for pooled pension funds we asked about the viability of the current scheme.

A number of commentators made mention of the PFPS regime and their comments included:

- Mass conversion of PFPSs to AIFs will not happen because PFPSs can take advantage of US dividend tax treatment for UK pension fund clients (0% withholding compared to 15% within pooled insurance fund). The stamp duty regime is also more favourable for PFPSs than for AIFs with regard to UK securities.
- PFPSs may convert to AIFs if the corporate streaming rules are extended and funds can continue to gain access to Double Taxation Agreements (DTAs).
- PFPSs will remain the vehicle of choice for Pan-European pension fund management.
- There would be no future for PFPSs if full streaming is permitted and FoFs are permitted direct holdings.

- PFPSs were created to allow multi-national companies to pool the investment management of their various international subsidiaries' pension schemes. There is no reason to think that schemes formed for this purpose would convert to AIF status (or even be able to do so in practice).
- The pooling of pension funds investments continues to have the potential to bring additional funds under management to the UK so it would be wrong to abolish the vehicle designed to facilitate this.
- The PFPS regime could be extended so that it is not limited only to pension fund investors.

### **Modernisation and Simplification**

Finally we asked for suggestions on how we could modernise and simplify the taxation of both authorised and unauthorised investment funds. Comments included:

- Reform must be aimed at encouraging offshore investments onshore. There would be no loss to the Exchequer as no revenue is raised from these vehicles at moment, but the tax take could increase due to the additional income received by staff and service providers.
- Significant changes should only be considered in context of savings vehicles generally, including offshore funds and insurance-based products, to ensure investor choice is not distorted by the tax position.
- Consideration should be given to the basis on which other EU Member States tax savings, as differences in treatment create tax distortions and competitive disadvantages.
- The needs of the UK funds industry must take precedence when IR are formulating changes so that the UK can compete with other EU jurisdictions who have achieved success through taking a long-term view rather than chasing the short-term tax revenues.
- For investment funds to remain a major component of the UK financial services industry tax policy will be key. Rather than framing policy with specific attention to protection against avoidance, IR should legislate to meet the requirement for UK funds to be competitive in the international market with avoidance tackled as necessary, but not being a driver for that legislation.

## **Structure of legislation**

Several commentators made specific mention of the cumbersome structure of the current legislation governing AIFs in the context of simplification and felt that a revamp of the tax legislation was now due to make it more intuitive.

Specific comments included:

- Primary legislation refers to AUTs, and OEICs link into this via statutory instruments, which is cumbersome and can give rise to drafting discrepancies.
- The SORP governing AIFs uses the term ‘authorised funds’ (defined by FSA) and treats the two types of fund (AUT and OEIC) as equivalent. Tax legislation should apply the same terminology and, at the very least, have only one body of legislation covering both AUTs and OEICs.

## **LIST OF RESPONDENTS**

Association of British Insurers (ABI)  
Alternative Investment Management Association (AIMA)  
Association of Property Unit Trusts (APUT)  
Aviva PLC  
British Property Federation (BPF), Investment Property Forum (IPF) and Royal  
    Institution of Chartered Surveyors  
Chartered Institute of Taxation (CIOT)  
Close Fund Management  
Deutsche Asset Management Group  
Ernst & Young  
Eversheds LLP  
Fidelity Investments  
Financial Services Authority (FSA)  
Futures and Options Association (FOA)  
Henderson Global Investors  
HSBC Asset Management Ltd  
Investec Fund Managers Ltd  
Investment Management Association (IMA)  
KPMG Tax  
Law Society's Company Law Committee  
Linklaters  
Merrill Lynch  
Schroder Investment Management Ltd  
Scottish Widows Investment Partnership  
Simmons & Simmons  
Standard Life Investments Ltd  
State Street Global Advisers Ltd  
Threadneedle Investment Services Ltd  
UBS Global Asset Management (UK) Ltd