Offshore funds:

further steps

December 2008

HM TREASURY

HM TREASURY

Offshore funds: further steps

December 2008

© Crown copyright 2008

The text in this document (excluding the Royal Arms and other departmental or agency logos) may be reproduced free of charge in any format or medium providing it is reproduced accurately and not used in a misleading context.The material must be acknowledged as Crown copyright and the title of the document specified.

Where we have identified any third party copyright material you will need to obtain permission from the copyright holders concerned.

For any other use of this material please write to:

Office of Public Sector Information
Information Policy Team
Kew, Richmond
Surrey
TW9 4DU

e-mail: licensing@ospi.gov.uk

HM Treasury contacts

This document can be found in full on our website at:

hm-treasury.gov.uk

If you require this information in another language, format orhave general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558
Fax: 020 7270 4861
E-mail: public.enquiries@hm-treasury.gov.uk

Printed on 75% recycled paper.
When you have finished with it please recycle it again.

ISBN 978-1-84532-505-3
PU640

Contents

		Page
Chapter 1	Introduction	3
Chapter 2	Definition of 'offshore fund' for tax purposes	5
Chapter 3	Framework for offshore funds and investors	13
Annex A	Draft primary legislation	17
Annex B	Draft regulations	27

1 Introduction

Summary

The Government introduced powers in Finance Bill 2008 to modernise the offshore funds tax regime and issued partial draft regulations for consultation. The Government also announced in Budget 2008 that it would continue discussions with stakeholders with the intention of introducing a new definition of an offshore fund for UK tax purposes in Finance Bill 2009.

This paper sets out further steps in the reform of offshore funds taxation. It includes draft regulations on the modernisation of the regime for further consultation and sets out the Government's proposals for a new definition of an offshore fund. The Government seeks stakeholders' views on the proposals and in particular, the Government welcomes views as to whether the draft legislation delivers the policy intention set out in this paper.

Background

1.1 The UK tax regime for offshore funds was introduced in 1984. Broadly, its purpose was to prevent certain offshore funds being used to convert income flows into capital gains for tax purposes. Prior to its introduction, a UK investor could accumulate income in an offshore fund and be subject only to tax on capital gains on realisation of the investment. In contrast, a combination of regulatory and tax rules meant that UK investors had to pay tax annually on income from UK funds. The purpose of the regime remains the same.

1.2 One of the Government's main objectives in making changes to the offshore funds tax regime is to remove UK tax barriers to multi-tiered fund structures. At the same time the Government aims to:

- simplify the operation of the offshore funds tax regime;
- provide more certainty to UK investors and funds;
- achieve, to the extent possible, economic parity with the position of UK investors in UK authorised funds, whilst recognising that the Government has no taxing rights over non-UK vehicles themselves;
- strengthen existing anti-avoidance rules so that UK investors who choose to invest into offshore funds do so based on commercial decisions and not to obtain unintended tax advantages; and
- implement a modernised regime at no increase in cost to the UK Exchequer.

1.3 The Government published '*Offshore funds: a discussion paper*' in October 2007 and '*Offshore funds: next steps*' in March 2008. Draft regulations on the modernisation of the regime were published shortly after Finance Bill 2008 was introduced.

1.4 This paper sets out how the Government intends to change the definition of an offshore fund for UK tax purposes and seeks views on whether the draft primary legislation within this document meets these proposals. This paper also clarifies certain aspects of the policy on the

modernisation of the offshore funds tax regime and the Government welcomes views on the revised draft regulations included within this document.

1.5 Interested parties should send their comments by Wednesday 11 February 2009 to:

Sue Harper
Assets, Savings & Wealth Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: +44 (0)207 270 6031

Email: sue.harper@hm-treasury.gov.uk.

1.6 Subject to responses to this paper, the Government remains committed to introducing a new definition of an offshore fund in Finance Bill 2009 and introducing the new rules for the operation of the regime from 1 October 2009, together with transitional arrangements.

Confidentiality disclosure

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

The Department will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

2 Definition of 'offshore fund' for tax purposes

Background

2.1 In the 2007 Pre-Budget Report the Government published a discussion paper[1] on proposals for a new definition of an offshore fund for UK tax purposes. The Government stated that its aim was to simplify the current rules and give more certainty to non-UK funds, their managers and investors. In introducing a new definition, the Government's intention was also to counter tax advantages being obtained where an offshore arrangement is technically outside the current tax definition of an offshore fund but the arrangements are economically the same.

2.2 The Government carefully considered the responses to the discussion paper and in a further paper published alongside Budget 2008[2], announced that it had decided not to legislate for a new definition in Finance Bill 2008. The Government stated that it intended to continue its discussions with industry in order to introduce a new definition in Finance Bill 2009.

2.3 Since Budget 2008 the Government has held informal discussions with industry stakeholders to develop its proposals further and would like to thank them for their contributions to date.

2.4 The Government is now in a position to present further proposals for a new definition and to publish draft legislation. This builds on the approach set out in the 2007 Pre-Budget Report. Subject to responses to this consultation the Government intends to introduce a new definition in Finance Bill 2009.

Characteristics based approach

2.5 The current tax definition of offshore fund is based upon the regulatory definition of 'collective investment scheme' as set out in the Financial Services and Markets Act 2000 (FSMA) with modifications for tax purposes.

2.6 The Government's proposal, as set out in the October 2007 discussion paper, is to detach the tax definition of offshore fund from the regulatory definition and instead base the tax definition on characteristics. The Government's aim in moving to a characteristics based approach is to counter unintended tax advantages being obtained where an offshore arrangement is technically outside the definition of an offshore fund but the arrangements are economically the same. The Government also wants to simplify the current rules and give as much certainty as possible for non-UK funds, their managers and investors.

2.7 The Government received a number of responses on the proposed move to a characteristics based definition of offshore fund and summarised these in *Offshore Funds: next steps*. The Government has taken account of these responses and feedback provided in further meetings in developing the draft legislation which provides for a new definition.

2.8 The Government believes that moving to a characteristics based approach will deliver the Government's aim of countering unintended tax advantages being obtained when an offshore

[1] *Offshore funds: a discussion paper* HM Treasury, October 2007.
[2] *Offshore funds: next steps* HM Treasury, March 2008.

arrangement is technically outside the definition of an offshore fund but the arrangements are economically the same. The Government also believes that having one definition of offshore fund for tax purposes will be simpler for non-UK funds, their managers and investors to engage with and provide more certainty than under the existing mixed regulatory/tax approach. The Government intends to provide as much certainty as possible about which arrangements fall within the characteristics by setting out the principles in legislation and HM Revenue & Customs detailed guidance. If an arrangement does not meet the characteristics set out in the draft legislation, it will not fall within the definition of offshore fund.

2.9 The Government has also made a number of adjustments to the wording of the characteristics that were proposed in the original discussion paper following responses received. For example, the Government has revised the characteristic which was previously described as entitling investors to realise substantially the net asset value of their interest on realisation.

2.10 The Government has also set out draft proposals for transitional rules in this document, including grandfathering, which deal with the situation where existing arrangements do not fall within the current definition of offshore fund but which will be brought within the proposed definition in Finance Bill 2009.

2.11 The new definition will be applied to a company, trust or any other vehicle or arrangement which meets the following characteristics:

- it is not UK tax resident;
- 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 property or an index of any description.

2.12 A HM Revenue & Customs note accompanies the draft legislation in Annex A giving guidance on what is meant by 'reasonable investor' and 'entirely or almost entirely'.

2.13 The Government considers that a rule focusing on the ability of a reasonable investor to realise their investment based entirely or almost entirely by reference to net asset value gives, to the extent possible, parity with the treatment of UK open-ended companies. The Government's expectation is that very few fixed share capital companies will fall within the new definition.

2.14 By legislating a characteristics based approach the Government's intention is that the proposed new definition will only affect entities that have fixed share capital if they are structured in a way that mimics arrangements where the share capital is open-ended (that is, the share capital expands and contracts in response to demand). The Government considers that 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 should fall within the new definition.

2.15 The Government is aware that changes to the definition of an offshore fund may cause concern for investors in certain existing investment vehicles. The Government continues to invite product providers and other interested parties who might be concerned about the implications of the proposed new definition on their particular circumstances to discuss their concerns with HM Treasury and HM Revenue and Customs in order to determine whether any additional provisions or changes to the current draft provisions are required.

Share classes

2.16 Under the current rules, section 756C ICTA states that a class of interest in an offshore fund is regarded as a separate offshore fund for income attributable to that class. Following responses summarised in *Offshore funds: next steps* the Government will replicate this treatment within the new definition of offshore fund.

Umbrella funds and protected cell companies

2.17 In line with the current rules in section 756B ICTA, an 'umbrella fund' itself will not be treated as an offshore fund. Each separate fund within an 'umbrella fund' structure will need to be considered to determine whether it falls within the new tax definition of an offshore fund in its own right. In addition, the application of the offshore funds definition to an individual cell within a protected cell company will need to be determined on its own particular facts. This is identical to the current rules.

Unit trust schemes and similar arrangements

2.18 A unit trust scheme is defined in section 237 Financial Services and Markets Act (FSMA) as a 'collective investment scheme under which the property is held on trust for the participants'. The definition of unit trust scheme for the purpose of the current offshore funds tax rules is based upon this definition.

2.19 The Government does not intend to have a separate tax definition of a 'unit trust scheme' for the offshore funds tax regime. Subject to the paragraphs on tax transparency below, an arrangement constituted as a trust and meeting the characteristics would be within the definition of offshore fund.

Arrangements that are tax transparent for income purposes

2.20 The Government intends that arrangements that meet the characteristics which are tax transparent for income purposes but not tax transparent for capital gains purposes will be excluded from the definition of an offshore fund by regulations, provided that they hold no or only a *de minimis* level of investment in Non-Reporting Funds. This restriction is intended to prevent UK tax advantages being obtained by using these types of arrangements to shelter offshore income gains from UK tax.

2.21 The Government will continue to consider what an appropriate *de minimis* level of holding in non-Reporting funds would be for these purposes. The Government's current thinking is that the level should be set at around 5 per cent of assets under management. The Government welcomes views from industry together with supporting evidence on this point.

2.22 Under general principles of UK taxation, arrangements which are UK tax transparent for both income and capital gains purposes are not themselves considered to be offshore funds. Taxable UK investors are subject to tax on the income and gains as they arise or as they are brought into account. These principles will be unaffected by the changes to the offshore funds definition.

Non-tax transparent entities

2.23 Contractual arrangements that are neither considered to be bodies corporate nor considered to be transparent for UK tax purposes will, for the purpose of the new definition, be treated as if they were an open-ended body corporate.

Bodies corporate

2.24 On the basis of the new characteristics based approach, offshore arrangements that are constituted as bodies corporate will only be within the new offshore fund tax definition if they meet the characteristics set out in paragraph 2.11 above.

Other arrangements

2.25 The Government recognises that industry would like clarity on certain types of offshore fund arrangements. Paragraphs 2.26-2.38 consider some of the types of arrangements that have been brought to the Government's attention during the period of consultation and the Government's proposed treatment of such arrangements.

Capital only arrangements

2.26 In paragraph 1.1, the Government stated that the purpose of the regime is to ensure that income cannot be converted into capital by using offshore arrangements.

2.27 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, the Government is intending to exclude capital only arrangements from the new definition of an offshore fund.

2.28 The Government recognises that capital only arrangements may unintentionally or incidentally give rise to a small amount of income. The Government is considering how such amounts of income can be taken into account in deciding if a fund is capital only. The Government is considering whether to introduce a *de minimis* provision to allow for this circumstance and welcomes views from industry together with supporting evidence.

Exchange traded funds

2.29 Most exchange traded funds will meet the characteristics set out in paragraph 2.11 above and will therefore be within the new definition of offshore fund.

2.30 However, if a listed arrangement results in the share value reflecting almost entirely the net asset value of the underlying assets due to commercial factors or market trends rather than a pre-planned arrangement, then this will not be within the definition of an offshore fund. This will be the case whether the arrangement is primary or secondary traded.

Property investment vehicles

2.31 To achieve, to the extent possible, economic parity with the position of UK investors in UK investment vehicles, arrangements that are equivalent to a UK-REIT[3] will be outside the definition of an offshore fund. An arrangement that is equivalent to a UK Property Authorised Investment Fund[4] will, however, be within the definition of an offshore fund.

Bodies corporate: fixed share capital companies

2.32 As set out in paragraph 2.13 above, the Government's expectation is that very few fixed capital companies will fall within the new definition. By legislating a characteristics based approach the Government intends that the proposed new definition will only affect entities that have fixed share capital if they are structured in a way that mimics arrangements where the share capital is open-ended (that is, the share capital expands and contracts in response to

[3] Part 4, Finance Act 2006.

[4] The Authorised Investment Funds (Tax) Regulations 2008 No. 705.

demand). The Government considers that fixed share capital companies that are predicated on the basis that investors will receive a net asset value return or a return which is very close to net asset value should fall within the new definition.

2.33 The following paragraphs set out the Government's policy on specific examples of fixed share capital arrangements which have been brought to its attention during the consultation and the interaction with the offshore funds tax definition.

Share buy backs and share issuance

2.34 The Government is aware that 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.

2.35 The Government is also aware that, in some circumstances, 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 an investor cannot reasonably expect to realise their investment either entirely or almost entirely by reference to net asset value (or by reference to an index), the Government considers that these arrangements will be outside the definition of an offshore fund for UK tax purposes.

2.36 However, in order to deliver the Government's aim of countering unintended tax advantages being obtained when an offshore arrangement is technically outside the definition of an offshore fund but the arrangements are economically the same, the Government's intention is that share buy back arrangements that are specifically designed to allow tracking to net asset value will cause the company or share class to be within the definition of offshore fund.

2.37 Equally, where the shares trade at a premium, either directors or investors may have the discretion to allow or permit the issuance of new shares in order to prevent the value of the shares exceeding the value of the underlying assets. Provided the investor cannot reasonably expect to realise their investment either entirely or almost entirely by reference to net asset value (or by reference to an index) then the Government considers that these arrangements will not be in the definition of an offshore fund for UK tax purposes. However, share issuance arrangements that are designed to allow tracking to net asset value will cause the company or share class to be within the definition.

Split capital investment companies

2.38 The Government will continue to consider the position for split capital investment companies to ensure that a new offshore funds definition does not give rise to unintended tax advantages. The Government welcomes further information on these types of companies in order that it can take this issue forward.

Removing the seven year "material interest" rule

2.39 In order to deliver its aims of increasing simplicity and certainty, the Government intends that the characteristics will apply to each arrangement equally. In other words, an arrangement will either fall within the new definition of offshore fund or not and this will determine the tax treatment of its UK investors. This means that all UK investors in the same offshore fund will face the same set of tax rules.

2.40 In order to achieve this, as set out in '*Offshore funds: a discussion paper*' the concept of 'material interest'[5] will be abolished. This will make the taxation of interests in an offshore fund easier to understand, increase certainty for UK investors and mean that all UK investors in the same offshore arrangement will be taxed in the same way.

2.41 The Government is aware that the removal of the so-called 'seven year rule' may create some uncertainty at first, in particular for companies or their shareholders where the entity is expected to wind up at a predetermined time. In order to manage this, the Government is providing certainty for some types of arrangements that have been brought to its attention. Paragraphs 2.42-2.47 set out examples of situations on which the Government can give certainty. The Government welcomes comments and examples if clarification is sought on other types of arrangements.

2.42 The Government understands that, under some overseas corporate law, certain companies must liquidate with a certain time frame. Provided none of the characteristics set out in paragraph 2.11 above are met, such arrangements will not be within the definition of an offshore fund for UK tax purposes.

2.43 Questions have been raised about the position of an investor who invests in a company or other arrangement which goes into liquidation (at which point the investor might reasonably expect to realise their investment at net asset value). 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 bring that company or arrangement into the definition of an offshore fund.

2.44 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 investors can be guaranteed or 'reasonably expect' the company to be liquidated or reconstructed in order to deliver net asset value. The Government does not intend to include companies in the definition if investors cannot 'reasonably expect' or be guaranteed to realise their investment at net asset value when the company was established.

2.45 Government also needs to provide for the situation where certain arrangements may permit the rights of the shareholder to change during the holding of their investment. The Government can envisage a situation where an arrangement is outside the characteristics set out in paragraph 2.11, but then for something to change (for example, the rights given to investors in a certain share class) which means that arrangement (or one of that arrangement's share classes) then meets the characteristics. In order to prevent the offshore fund tax definition being circumvented by this type of activity, the Government will provide that, if a change of rights causes the arrangement to fall within the definition of offshore fund, then the investor will be treated as holding an investment in an offshore fund from the date the rights change.

2.46 In contrast, where a change of rights causes an arrangement to fall outside the definition of offshore fund, the Government will provide that an investor will continue to be treated as holding an investment in an offshore fund and welcomes views on whether an elective deemed disposal mechanism is required.

2.47 The abolition of the seven-year rule will not result in investors in a limited partnership, whatever its nature, becoming liable to income tax on an offshore income gain as a result of the disposal of their interest in the partnership.

[5] Income and Corporation Taxes Act 1988, section 759

Interests that are currently excluded from the 'material interest' definition

2.48 Current tax legislation excludes various interests from the definition of a 'material interest' in an offshore fund. These are discussed in the following paragraphs.

2.49 The Government seeks views from those that use the current exclusion for an interest in respect of any loan capital, debt issued or incurred for money which, in the ordinary course of a business of banking, is lent by a person carrying on that business. The Government does not think that this exclusion is still required, but would like to receive comments from interested parties on this point.

2.50 To prevent double taxation[6], the Government intends that the new definition of an offshore fund will continue to exclude rights arising under a policy of insurance.

2.51 In addition, the current legislation[7] excludes shares from the definition of a material interest in an offshore fund if:

- the shares are held by a company and the holding of them is necessary or desirable for the maintenance and development of a trade carried on by the company or a company associated with it;
- the shares confer at least 10 per cent of the total voting rights in the overseas company and a right, in the event of a winding up, to at least 10 per cent of the assets of that company remaining after the discharge of all liabilities having priority over the shares; and
- not more than ten persons hold shares in the overseas company and all the shares in that company confer both voting rights and a right to participate in the assets on a winding-up.

2.52 The Government does not think that these exclusions need to be replicated within the new definition of offshore fund and seeks views on this point.

Other legislation relying on the definition of 'offshore fund'

2.53 The Government notes that, when the new definition is enacted, other legislation relying on the existing definition of an offshore fund will subsequently be amended, either through primary or secondary legislation.

Commencement

2.54 Subject to responses to this discussion paper, the Government intends to introduce the new definition in Finance Bill 2009. It is intended that the new definition will take effect from 1 October 2009, subject to transitional provisions.

Transitional Provisions

2.55 The Government recognises that investors in certain offshore arrangements may be impacted by the proposals to change the definition of an offshore fund and to remove the seven-year material interest rule. The Government will therefore introduce transitional provisions for existing investments to facilitate this change.

---

[6] Gains from overseas insurance policies are subject to tax in accordance with Chapter 9 Part 4 Income Tax (Trading and Other Income) Act 2005.

[7] Income and Corporation Taxes Act 1988, section 759.

Arrangements brought within the new definition of offshore fund

2.56 A UK investor may have an existing investment in an offshore arrangement that is currently outside the definition of a material interest in an offshore fund but which will be brought into the offshore funds tax rules by the change in definition. To prevent existing investors being adversely impacted by the change in definition the Government intends to introduce grandfathering provisions.

2.57 The Government intends that investments made in such arrangements prior to 1 October 2009 will remain outside the offshore fund tax rules.

2.58 Investments made on or after 1 October 2009 will be subject to the new rules.

Arrangements to be excluded from the new definition of an offshore fund

2.59 A UK investor may have an existing investment in an offshore vehicle that is classified as a material interest in an offshore fund under the current definition but will not be an interest in an offshore fund under the new definition.

2.60 Government intends that investments made in such arrangements prior to 1 October 2009 will obtain chargeable gains tax treatment on the future disposal of their investment.

2.61 If the Government finds evidence that these transitional rules are being exploited, the Government will take immediate action to address this.

3 Framework for offshore funds and investors

Background

3.1 This chapter outlines further details on the modernisation of the offshore funds tax regime following '*Offshore funds: a discussion paper*' and '*Offshore funds: next steps*' that described the proposed framework governing offshore funds, for Reporting Funds investing into other offshore funds and for UK investors.

3.2 Partial draft regulations were published in May 2008 on which comments were invited. The Government is grateful for responses received to that consultation and has made changes to take into account the comments made. The Government is now publishing a further set of draft tax regulations for consultation.

3.3 The following paragraphs highlight some of the changes that have been made in this draft set of regulations following responses received. They also reiterate and clarify the Government's policy intention on the way the modernised offshore funds tax regime will operate.

Clarifications

3.4 Following responses to the partial draft regulations, the Government would like to provide further clarity on a number of different matters within the regulations in order to provide more certainty to funds, managers and UK investors.

3.5 Advance certification: The purpose of the advance certification process is to allow investors in an offshore fund to have certainty about their UK tax position. The Government wishes to be clear that the requirement for annual submission of information from an offshore fund is not intended to be an extension of the application procedure. The Government requires annual information in order to allow HM Revenue & Customs (HMRC) to monitor that the offshore fund is continuing to operate in accordance with the rules.

3.6 Requirements for reported income: The Reporting Fund will be required to report income on its website together with appropriate provisions to cater for investors who do not have internet access. It is not the Government's intention to require names and addresses of investors to be reported to HMRC.

3.7 10 per cent margin: The Government's purpose in providing a 10 per cent margin in the calculation of reportable income is to allow for Reporting Funds to have a 'margin for error' when computing their reportable income. It is not the Government's intention for offshore funds to firstly compute their reportable income and subsequently report 90 per cent of this amount to investors. If that approach is followed, any mistakes identified in the calculation may constitute a breach and income may have to be re-reported to investors. The Government is also clear that, if there is evidence that the 10 per cent margin is being deliberately exploited, the Government will take steps to revise it.

3.8 Pension funds which invest in Non-Reporting Funds: The Government does not intend to introduce specific provisions to provide that pension funds which invest into Non-Reporting Funds are exempt. HMRC guidance will make clear that if an offshore income gain arises from an investment held for the purpose of a registered pension scheme, it will be exempt from tax.

3.9 **Timing for UK investors:** UK investors are subject to tax on actual distributions on an arising basis. The draft regulations provide that investors who hold an investment in a Reporting Fund at the end of its period of account should declare its reported income regardless of whether that investor continues to hold their investment on the reporting date. UK investors will not be subject to double taxation.

3.10 The Government recognises that there are a number of technical issues areas which are yet to be addressed in the regulations. These include:

3.11 **Negative reportable income**: There may be occasions on which a Reporting Fund computes its reportable income and this is a negative amount. The regulations provide that, on these occasions, the Reporting Fund must report nil to investors. The Government continues to explore the feasibility of including provisions to allow a negative amount of reportable income to be carried forward to reduce reportable income in future periods.

3.12 **Nominees or other third parties**: The Government is considering introducing regulations to require Reporting Funds to provide information to nominees or other third parties so that UK investors can access the relevant information (or details of where the investor can obtain that relevant information) on a Reporting Fund.

3.13 **Constant net asset value funds**: Certain arrangements are constituted by shares that maintain a constant face value. Income is accrued and is either distributed to the investor on a regular basis or is reinvested by the purchase of new shares.

3.13.1 Where this type of arrangement meets the characteristics set out in paragraph 2.11 of Chapter 2, it will fall within the definition of an offshore fund. However, the Government wishes to reduce the administrative burden for these types of arrangements given that their regular distribution arrangements do not convert income flows into capital gains. The Government has therefore provided that either a manager or the fund itself will be able to make a declaration to HMRC that the arrangement meets a constant NAV fund definition. Where this declaration is made, the offshore fund will not be subject to the full Reporting Fund requirements and will not be required to submit information to HMRC for each period of account.

3.13.2 HMRC will publish a list of offshore arrangements that make a constant NAV declaration.

3.13.3 A constant NAV fund that has made a declaration must inform HMRC if changes are made to the arrangement that result in the constant net asset value definition no longer being met. If the fund wishes its investors to receive income and gains treatment from the date that its status changes, it will have to comply with the full Reporting Fund requirements.

Equalisation Provisions

3.14 The Government has considered whether to introduce equalisation provisions following the mixed responses received to the partial draft regulations. The Government has not included any equalisation provisions within the draft legislation but will continue to consider this point.

Breaching Provisions

3.15 The provisions for breaching Reporting Fund conditions have been revised since the publication of the partial draft regulations to clarify the Government's position.

3.16 Draft regulation 81 makes clear that any breaches of the offshore fund tax rules that are rectified without HMRC intervention and within a reasonable period will have no consequences for UK tax purposes.

3.17 The Government has also included provisions to deter Reporting Funds from repeatedly breaching the requirements of the regime. However, in order to ensure that these rules operate

fairly, if a single event results in non-compliance for more than one area of the offshore funds tax rules, this will only be counted as one breach.

3.18 Draft regulation 87 specifies that 'serious breaches' will result in the offshore fund no longer being permitted to maintain Reporting Fund status.

3.19 In addition, if an offshore fund has made a deliberately misleading statement or a wilful omission in the advance approval process, the fund's Reporting Fund status will be withdrawn with retrospective effect. In all other cases, a fund's Reporting Fund status will only be withdrawn prospectively.

Commencement

3.20 Subject to further comments received on the draft regulations, Government intends to lay the regulations so that an offshore fund will be able to apply for Reporting Fund status with effect from 1 October 2009.

3.21 Offshore funds may apply to HMRC for advance approval to HMRC for Reporting Fund status. The Government also realises that some offshore funds may wish to obtain Reporting Fund status retrospectively to allow existing funds to obtain Reporting Fund status and to facilitate the speed at which new funds can be launched.

3.22 In order to facilitate this, the Government envisages that offshore funds will be able to retrospectively apply for Reporting Fund status within 3 months of the start of the first period of account for which the offshore fund wishes to have Reporting Fund status.

3.23 The Government recognises that some offshore arrangements will require time to comply with the new operational rules. The Government intends to accept applications for 'distributing status' from offshore funds under the current legislation for the first period of account beginning on or after 1 October 2009. This will allow time for existing funds to transition into the new tax regime.

Transitional provisions

3.24 The Government intends to introduce transition provisions for investments in existing offshore funds that move into the new offshore funds tax regime.

3.25 Moving from a non-distributing fund to a Non-Reporting Fund: Government does not believe that transitional provisions are required for investors in an arrangement that currently does not have distributor status and will become a Non-Reporting Fund under the new proposed regulations.

3.26 Moving from a non-distributing fund to a Reporting Fund: The Government recognises that arrangements that currently cannot have or do not have distributing status may wish to become a Reporting Fund under the new regulations. In order that existing investors can benefit from the new status the Government intends to extend the elective deemed disposal mechanism in the draft regulations so that investors will be able to benefit from the fund's change in status from the effective date of change. If investors do not take advantage of the deemed disposal mechanism then they will be charged to income tax on their offshore income gain when they eventually dispose of their investment in the fund.

3.27 Moving from a distributing fund to a Non-Reporting Fund: A distributing fund may not wish to become a Reporting Fund under the new offshore funds tax regime. The Government does not envisage that transitional provisions are required for this circumstance. An application should be submitted to HMRC for the final period in which distributing status is required under the current offshore fund tax rules. Investors which remain in the fund after the date the fund

becomes Non-Reporting will be treated in accordance with the rules for Non-Reporting Funds when they realise their investment.

3.28 Moving from a distributing fund to a Reporting Fund: The Government does not envisage that transitional provisions are required for investors in an offshore fund that has always obtained distributor status for the period of their investment where the fund will also obtain this status for the periods prior to it becoming a Reporting Fund.

Government intends to provide for transitional provisions for investors who are, under current tax rules, anticipating an offshore income gain because, during the period of their investment there were one or more periods in which distributor status was not obtained. For these investors to benefit from the Reporting Fund status, the Government intends to extend the elective deemed disposal mechanism to allow investors to take advantage of the fund's change in status from the effective date of the change.

Transitional rules for investors who apply for distributor status on behalf of offshore funds

3.29 In paragraph 3.12 of "*Offshore funds: next steps*", the Government set out that it does not intend to reproduce the current legislation that permits investors to obtain distributor status on behalf of a fund within the modernised regime. The Government recognises that transitional rules for current investors in non-distributing funds will be required in order that investors are not disadvantaged by this change.

A Draft primary legislation

A.1 This annex sets out draft clauses on the new definition of an offshore fund, together with accompanying notes. Subject to consultation responses, the Government will legislate for a new definition in Finance Bill 2009. The Government welcomes comments on any aspect of the current draft.

A.2 HMRC intends to issue guidance on the definition of an offshore fund and has drafted a preliminary note to facilitate understanding of the draft clauses.

SCHEDULE 1

Section 1

OFFSHORE FUNDS

New definitions in FA 2008

1 FA 2008 is amended as follows.

2 Before section 41 (tax treatment of participants in offshore funds) insert—

“40A Meaning of “offshore fund”

(1) This section and sections 40B to 40E have effect for this group of sections.

(2) “Offshore fund” means—

(a) a mutual fund constituted by a body corporate resident outside the United Kingdom,

(b) a mutual fund under which property is held on trust for the participants by trustees resident outside the United Kingdom, or

(c) a mutual fund constituted by other arrangements that create rights in the nature of co-ownership where—

(i) the persons managing the property that is the subject of the arrangements are resident outside the United Kingdom, or

(ii) the arrangements take effect by virtue of the law of a territory outside the United Kingdom.

(3) “This group of sections” means this section and sections 40B to 42.

(4) References to participants in arrangements (or a fund) are to persons taking part in the arrangements (or the arrangements constituting the fund), whether by becoming the owner of, or of any part of, the property that is the subject of the arrangements or otherwise (and references to participation in arrangements or a fund, however expressed, are to be read accordingly).

(5) In this section “co-ownership” is not restricted to the meaning of that term in the law of any part of the United Kingdom.

40B Meaning of “mutual fund” etc

(1) “Mutual fund” means arrangements with respect to property of any description, including money, that meet conditions A to C, subject to—

(a) sections 40C and 40D, and

(b) the exceptions made by or under section 40E.

(2) Condition A is that the purpose or effect of the arrangements is to enable the participants—

(a) to participate in the acquisition, holding, management or disposal of the property, or

(b) to receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.

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

(4) For the purpose of condition B a participant does not have day-to-day control of the management of property by virtue of having a right to be consulted or to give directions.

(5) Condition C is that a reasonable investor participating in the arrangements would expect to be able, under the terms of the arrangements, to realise an investment in the arrangements on a basis calculated entirely, or almost entirely, by reference to—
   (a) the net asset value of the property that is the subject of the arrangements, or
   (b) an index of any description.

(6) The Treasury may by regulations amend condition C.

40C Umbrella arrangements

(1) In the case of umbrella arrangements—
   (a) each part of the umbrella arrangements is to be treated as separate arrangements (subject to section 40D), and
   (b) the umbrella arrangements are to be disregarded.

(2) "Umbrella arrangements" means arrangements—
   (a) which provide for separate pooling of the contributions of the participants and the profits or income out of which payments are made to them, and
   (b) under which the participants are entitled to exchange rights in one pool for rights in another.

(3) References to a part of umbrella arrangements are to the arrangements relating to a separate pool.

40D Arrangements comprising more than one class of interest

(1) Where there is more than one class of interest in arrangements (the "main arrangements")—
   (a) the arrangements relating to each class of interest are to be treated as separate arrangements, and
   (b) the main arrangements are to be disregarded.

(2) In relation to umbrella arrangements, "class of interest" does not include a part of the umbrella arrangements (but there may be more than one class of interest in a part of umbrella arrangements).

40E Meaning of "mutual fund": exceptions

(1) Arrangements are not a mutual fund if—
   (a) a reasonable investor participating in the arrangements would expect to be able, under the terms of the arrangements, to realise an investment in the arrangements on a basis mentioned in condition C in section 40B only in the event of the winding up, dissolution or termination of the arrangements, and
   (b) condition X or Y is met.

(2) Condition X is that the arrangements are not designed to wind up, dissolve or terminate on a date stated in or determinable under the arrangements.

(3) Condition Y is that—

(a) the arrangements are designed to wind up, dissolve or terminate on a date stated in or determinable under the arrangements, and

(b) none of the assets that are the subject of the arrangements are income-producing assets.

(4) The Treasury may by regulations provide that arrangements are not a mutual fund—

(a) in specified circumstances, or

(b) if they are of a specified description.

(5) Regulations under this section may include provision having effect in relation to the tax year and accounting periods current on the day on which the regulations are made.

(6) In this section "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 (subject to subsection (7)).

(7) An asset is not an income-producing asset if—

(a) the asset, or the income it produces, is hedged and, taking account of that hedging, no income arises or is expected to arise from the asset, or

(b) ... ."

3 (1) Section 41 (tax treatment of participants in offshore funds) is amended as follows.

(2) In subsection (2), omit the definition of "offshore fund" (and the "and" before it).

(3) Omit subsections (3) to (5).

4 (1) Section 42 (regulations under section 41: supplementary) is amended as follows.

(2) In subsection (2), for paragraphs (a) and (b) substitute—

"(a) an offshore fund comprising a part of umbrella arrangements, and

(b) an offshore fund comprising arrangements relating to a class of interest in other arrangements (see section 40D)."

(3) In subsection (6), for "and "offshore fund" have" substitute "has".

5 After section 42 insert—

"42A Regulations: procedure

(1) Regulations under this group of sections are to be made by statutory instrument.

(2) Regulations under section 40B(6) may not be made unless a draft of the instrument containing them has been laid before, and approved by a resolution of, the House of Commons.

(3) A statutory instrument containing any other regulations under this group of sections is subject to annulment in pursuance of a resolution of the House of Commons."

Repeal of old definitions in ICTA

6 In Chapter 5 of Part 17 of ICTA (offshore funds), omit—

(a) section 756A(1) to (3) (definition of offshore fund),

(b) section 756B(1) and (2) (treatment of umbrella funds), and

(c) section 756C(1) and (2) (treatment of funds comprising more than one class of interest).

7 In consequence of the repeals in paragraph 6, omit—

(a) in FA 2004, paragraph 3 of Schedule 26, and [inserted ss756A to 756C ICTA]

(b) in FA 2007, section 57(2). [inserted subsections (3) and (4) of s756A ICTA]

8 (1) The Treasury may by regulations make further provision consequential on paragraphs 2 and 6.

(2) The regulations may modify an enactment, including subordinate legislation (within the meaning of the Interpretation Act 1978 (c. 30)).

(3) The regulations are to be made by statutory instrument.

(4) A statutory instrument containing the regulations is subject to annulment in pursuance of a resolution of the House of Commons.

(5) "Modify" includes amend, repeal and revoke.

Commencement

9 (1) The amendments made by this Schedule come into force on such day as the Treasury may appoint by order made by statutory instrument.

(2) An order under this paragraph may appoint different days for different purposes.

Offshore Funds

HM Revenue & Customs Notes

1. These notes explain the background and purpose of the draft legislation contained in the Schedule. They also deal, at the appropriate places, with issues that have been raised in connection with approach to the definition of offshore fund outlined in Chapter 2 of this document and HM Treasury's documents "*Offshore funds: a discussion paper*" and "*Offshore funds: next steps*".

2. Paragraph 2 of the Schedule inserts five new sections into what the draft legislation calls "this group of sections", by which it means the new sections 40A to 40E of the Finance Act (FA) 2008 together with the existing sections 41 and 42 of that Act. Those two sections prospectively repeal all of the offshore funds legislation in Chapter 4 Part 17 of the Income and Corporation Taxes Act 1988 (ICTA), apart from the definitions in sections 756A to 756C.

3. These new sections 40A to 40E will replace sections 756A to 756C which are therefore repealed by paragraph 6 of the Schedule, with paragraph 7 making consequential repeals as a result of those ICTA repeals.

4. Another draft of regulations that it is intended to make under section 42 FA 2008 (the "2009 regulations") is included in Annex B of this document. These regulations establish a new framework for the taxation of participants in offshore funds, replacing the provisions of Chapter 5 Part 17 of ICTA other than sections 756A to 756C. If the legislation in this Schedule is enacted in Finance Act 2009, amendments will be required to those regulations to take account of the changes introduced by the Schedule. One change that will be made to the draft regulations that should be noted in particular is that the rule in regulation 23 of the current draft regulations, which is a restatement of the "seven year rule" in section 759 of ICTA, will be removed, as the provisions of section 40A to 40E, and in particular section 40B(5), make the seven year rule redundant.

New Section 40A FA 2008

5. This section establishes the meaning of "offshore fund" and is similar to section 756A of ICTA.

6. Subsection (1) provides that sections 40A to 40E apply for the "group of sections", that is sections 40A to 42 FA 2008. Subsection (2) is the main definition of offshore fund; but in order to fully understand what is meant by an offshore fund it is necessary to know what the term "mutual fund" as used in section 40A(2) means and that is covered in section 40B. Section 40A(2) limits the meaning of offshore fund to those mutual funds which take one of three forms and which are resident in, or based in, a territory outside the United Kingdom (i.e. offshore).

7. Paragraph (a) of subsection (2) covers a mutual fund which is constituted by a body corporate outside the United Kingdom. If an unincorporated association is capable of being a mutual fund, it will come within section 40A(2)(b) or (c).

8. Paragraph (b) of subsection (2) covers a mutual fund where the property is ***held on trust*** for the participants in a case where the trustees are resident outside the United Kingdom. This would embrace all entities which are regarded as unit trust schemes under the current definition in section 756A, but,

unlike the definition in that section, it is not limited to those unit trust schemes which are such schemes for the purposes of the Financial Services and Markets Act 2000 (FISMA). It would therefore include a unit trust scheme which was not a collective investment scheme for the purposes of FISMA.

9. Paragraph (c) of subsection (2) covers a mutual fund constituted by other arrangements 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. This is very similar to the rule in section 756A(2)(c). The type of entity that this applies to includes, for example, a limited partnership. HMRC is aware that there is a view that some contractual arrangements (e.g. a Luxembourg *Fonds Commun de placement*) are sufficiently similar to unit trusts to be treated as unit trusts for some or all tax purposes. For the purpose of the offshore funds definition in this Schedule, it does not make any difference whether such an arrangements falls within section 40A(2)(b) or (c), nor is it intended that this will impact on investors.

10. "***Co-ownership***" is defined in subsection (5), or rather is stated not to be restricted to the meaning of that term in the law of any part of the United Kingdom. It would thus take its meaning from the law of the territory in which the arrangements take effect.

11. Section 40A(4) defines what is meant by ***participants*** in arrangements (a term relevant for section 40B in particular) or a fund; that is, for example, an offshore fund or a mutual fund. It is defined as being the persons who take part in the arrangements or the arrangements constituting the fund and it makes no difference whether the participants actually become the owner of the property subject to the arrangements or not. That last point deals with the 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 property that is the subject of the arrangements and, on the other hand, an interest in a trust or a partnership or other contractual arrangement which may well give the participant such an ownership right.

New Section 40B FA 2008

12. Section 40B is the key to the group of sections: it defines what is meant by a mutual fund. In particular subsections (2), (3) and (5) set out the three conditions which must be met for any arrangements with respect to property of any description, to be treated as a mutual fund. The three conditions in those subsections contain the characteristics-based test mentioned in Chapter 2 to this document. Sections 40C and 40D, to which the definition is subject (see section 40B(1)(a)) follow parts of section 756B and 756C of ICTA in dealing with umbrella arrangements and with arrangements comprising more than one class or interest, while section 40E provides exceptions to the general rule.

13. Condition A in section 40B (subsection (2)) 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 (e.g. dividends from a corporate mutual fund). This condition echoes that in section 235(1) of FISMA.

14. Condition B is that the participants do not have day-to-day control of the management of the property and subsection (4) explains that merely having a right to be consulted or to give directions does not result in a participant having day-to-day control. This condition is based broadly on section 235(2) of FISMA and it is this rule that prevents an ordinary general partnership from being regarded as a mutual fund.

15. There is however nothing in this section mentioning the pooling of risks as being a characteristic of a mutual fund. While generally such funds would be set up to enable investors who would otherwise be averse to putting their money directly into a particular share etc. to pool their funds with many other investors so as to be able to afford professional management and a wider spread of assets than would be possible under direct investment, not all mutual funds that meet Conditions A, B and C are widely held, or have a wide spread of investments. And it is reasonable to suppose that such funds may be more likely to be set up in a way that would contradict the policy intention of the offshore funds tax regime.

16. Condition C in subsection (5) is the most important: in essence it requires that an investor in the arrangements, as participant, would expect to be able to realise the investment at, or very nearly at, net asset value (NAV). It also provides that a reasonable investor who would expect to be able to realise their investment on a basis calculated entirely or almost entirely by reference to an index of any description also meets Condition C.

17. A reasonable investor is not defined in the legislation but it is envisaged that HMRC guidance would be based upon existing regulatory guidance. It will be assumed that a reasonable investor has read the documentation that the offshore fund provides.

18. It is not necessary that the investor obtains NAV directly from the fund. Exchange traded funds (ETF) are usually operated in such a way that the quoted prices are 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, so as to keep a discount on the share price within a reasonable limit would not make the fund a mutual fund. It is not thought advisable to lay down any percentage limit of variation from NAV which would be acceptable. It all depends on what the arrangements are intended to provide – so if for example buy-back arrangements normally kick in if the discount exceeds say 20%, but may also be used in very exceptional circumstances to buy back at a very small discount or at NAV, that will not taint the fund.

19. This condition must be read in conjunction with section 40E(1), the main exception. It is the main factor that allows a distinction to be made between a mutual fund and a company organised in the way that e.g. an investment trust company in the UK is organised. Such a company is a closed-ended company, one which does not allow investors to redeem their shares on request, nor does it issue new shares on request. This contrasts with an open-ended investment company (OEIC) which is designed to enable investors to realise NAV whenever they wish to and does so through its ability to issue or redeem shares at any time.

20. An investor in a “normal” closed-ended company which otherwise meets Conditions A or B would only reasonably expect to be able to realise NAV on the liquidation of the company. So section

40E(1)(a) excludes from section 40B 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, except in the case where section 40E(1)(b) applies – see below.

21. It might be thought that Condition C and section 40E(1)(a) could instead have been stated in terms of whether the company (as a whole or in relation to any class of shares) was open-ended or not. However, it is considered that such a rule would enable arrangement to be set up which, though closed-ended in form, nonetheless would enable the participants to effectively obtain NAV at times of their choosing.

22. Subsection (6) of section 40B allows the Treasury to amend Condition C by regulations. Section 42A(2), inserted by paragraph 5 of the Schedule, makes it clear that any such regulations are to be made under the affirmative resolution procedure, allowing debate on them in the House of Commons. These regulations might widen or narrow the meaning of mutual fund. For example, they might provide that if there are arrangements seeking to circumvent Condition C but to give the investor NAV, such arrangements did not succeed.

New Section 40C FA 2008

23. Section 40C deals with umbrella arrangements. It is based on section 756B ICTA and defines umbrella arrangements in the same terms. Subsection (1) also provides, as section 756B does, that where there are such arrangements, each separate part is to be treated as separate arrangements so that the question whether or not each part is a mutual fund and an offshore fund is determined separately, and the overall arrangements are disregarded so it is never a question of whether the overall arrangements are a mutual fund or an offshore fund.

24. It would follow that each separate arrangement has the same residence status as the overall arrangement. In the case of a company each separate arrangements 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.

New Section 40D FA 2008

25. Section 40D is based on section 756C and deals with a case where there is more than one class of interest in any arrangements and includes the case where there is more than one class of interest in a part of umbrella arrangements, a point made clear by subsection (2). That subsection also provides that a part of umbrella arrangements in which there is only one class of interest is not itself a class of interest within section 40D. As with section 756C, and indeed section 40C(1), 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.

26. "Class of interest" is not limited to share classes. There may be other forms of interest which entitle an investor to NAV or an index. Certain types of loan may give a return which tracks NAV or is based on an index. An interest in a linked life assurance policy or capital redemption contract would

also be capable of being a class of interest that gave NAV. Exclusions of such types of interest is catered for in the regulation that replace section 759 ICTA.

27. The way sections 40A to 40D are structured means that 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.

New Section 40E FA 2008

28. Section 40E contains the exceptions. There are, in fact, only two, although section 40E(4) permits the Treasury, by regulations, to make further exclusions in specified circumstances or if the arrangements are of a specified description. These regulations, which are relieving in nature, are to be made under the negative resolution procedure and, by virtue of section 40E(5), may also be made to have effect in relation to the tax year or to accounting periods which are current on the day on which they are made, so as to give the earliest possible carve-out from the meaning of mutual fund.

29. The effect of section 40E(1)(a) has been explained above in relation to Condition C in section 40B. To reiterate, arrangements are not a mutual fund if the only occasion on which a reasonable investor would expect to be able to realise NAV is winding-up, dissolution or termination of the arrangements ("termination event"). This applies to parts of an umbrella fund and to each separate class in a section 40D case. "Termination" covers a case where there is a final redemption of a class of interest, such as a redeemable preference share.

30. However, there have been arrangements set up so as to get round the existing rules on the meaning of "material interest in an offshore fund" which are designed to operate over a short period and only to allow a participator to access funds on a termination event, but which, in fact, are ones where the value of the interest tracks NAV or produces an interest-like return for the investor. They, therefore, embody the policy intention of the offshore funds tax regime. Section 40E(1)(b) ensures that such arrangements are within the definition of a mutual fund and offshore fund, by adding further conditions to be met, apart from only being able to get NAV on termination, if a fund is not to be a mutual fund.

31. The first condition, Condition X, requires that the arrangements are not such that they terminate on a date that is stated or determinable under the arrangements. In this connection "arrangements" has a wide meaning and is not limited to the documents establishing the fund, but can include all agreements and understandings.

But even if that date of termination is stated or determinable, Condition Y is met, and so the arrangements are not a mutual fund, if none of the assets of the arrangement are "income-producing". This is designed to exclude arrangements which invest in assets intended to give a purely equity based capital growth. 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 40E(7) ensures that such assets so hedged are not regarded as income producing assets.

Section 40E(7) also contains, at paragraph (b) a blank space in which to add a further provision for income-producing assets. Chapter 2 of the policy document invites comments, with evidence, on a possible rule to cover unintentional and incidental income.

B Draft regulations

B.1 The draft regulations for the offshore funds tax regime have been drawn up on the basis of the powers provided by sections 41 and 42 of the Finance Act 2008.

B.2 The draft regulations have not incorporated the draft Finance Bill 2009 legislation contained in Annex A. These changes will be made following this consultation on the new definition of an offshore fund.

B.3 The numbering of these draft regulations is a temporary system and will be renumbered before being published in final form.

B.4 The Government invites comments on these draft regulations.

Draft Regulations laid before the House of Commons under section 41(4) of the Finance Act 2008 (c. 9) for approval by resolution of that House. Draft: December 08

D R A F T S T A T U T O R Y I N S T R U M E N T S

2009 No.

INCOME TAX

CORPORATION TAX

CAPITAL GAINS TAX

The Offshore Funds (Tax) Regulations 2009

Approved by the House of Commons

Made - - - - ***

Coming into force - - ***

CONTENTS

PART 1
INTRODUCTION
Preliminary provisions
1. Citation, commencement and effect [1.1.1]
2. Structure of these Regulations [1.1.2]
General provisions
3. Definition of “offshore fund” [2.1.1]
4. Classification of offshore funds [2.1.2]
Umbrella funds and funds comprising more than one class of interest
5. Treatment of umbrella funds [2.1.3]
6. Treatment of funds comprising more than one class of interest [2.1.4]
Interpretation
7. Definition of “participant” [1.1.3ZA]
8. Definition of “guaranteed return fund” [1.1.3ZAB]
9. Definition of “market value” [1.1.3ZB]
10. General interpretation [1.1.3]
11. Transitional provisions, abbreviations and general index [1.1.4]

PART 2
THE TREATMENT OF PARTICIPANTS IN NON-REPORTING FUNDS
CHAPTER 1
PRELIMINARY PROVISIONS
12. Structure of this Part [3.1.1]
13. Interpretation [3.1.2]

CHAPTER 2
THE CHARGE TO TAX ON PARTICIPANTS IN NON-REPORTING FUNDS
Charge to tax
14. The charge to tax [3.2.1]
15. Income treated as arising under regulation [3.2.1]: remittance basis [3.2.9A]
Exemptions from the charge
16. Long-term insurance funds of insurance companies [3.2.4ZA]
17. Charitable companies and charitable trusts [3.2.4]
Offshore funds and the transfer of assets abroad
18. Application if transfer of assets abroad [3.2.8A]
Application of TCGA 1992
19. Application of certain provisions of TCGA 1992 [3.2.2]
20. Application of section 10A of TCGA 1992 [3.2.6]
21. Application of section 13 of TCGA 1992 [3.2.7]
22. Application to gains of non-resident settlements [3.2.8]

CHAPTER 3
RELEVANT INTERESTS IN NON-REPORTING FUNDS
23. The general rule [3.3.1]
24. The realisation of the value of the interest [3.3.2]
25. Interests in certain offshore funds that are not relevant interests [3.3.3ZA]
26. Interests in non-reporting funds that are not relevant interests [3.3.3]

CHAPTER 4
DISPOSALS OF RELEVANT INTERESTS IN NON-REPORTING FUNDS
Basic provisions
27. Application of this Chapter [3.4.1]
28. Meaning of disposal of an asset: the basic rule [3.4.2]
Further provisions
29. Provisions applicable on death [3.4.3]
30. Application of section 135 of TCGA 1992 [3.4.4]
31. Application of section 136 of TCGA 1992 [3.4.5]
32. Exchange of interests of different classes [3.4.6]

CHAPTER 5
OFFSHORE INCOME GAINS AND THE CALCULATION OF OFFSHORE INCOME GAINS
33. General provisions [3.5.1]
34. The basic gain and its calculation [3.5.2]
35. Earlier disposal to which the no gain/no loss basis applies [3.5.3]
36. Modifications of TCGA 1992 [3.5.4]
37. Losses [3.5.5]

CHAPTER 6
THE DEDUCTION OF OFFSHORE INCOME GAINS IN CALCULATING CAPITAL GAINS
38. Ambit of this Chapter [3.6.1]
39. Treatment of the TCGA disposal: general rules [3.6.2]
40. Modification of section 162 of TCGA 1992 [3.6.3]
41. Application of section 128 of TCGA 1992 [3.6.4]

CHAPTER 7
THE CONVERSION OF A NON-REPORTING FUND INTO A REPORTING FUND
42. Consequences of conversion for participants [3.7.2]

PART 3
REPORTING FUNDS AND THE TREATMENT OF PARTICIPANTS IN REPORTING FUNDS
CHAPTER 1
PRELIMINARY PROVISIONS
43. Structure of this Part [4.1.1]
44. Meaning of “reporting fund” [4.1.2]

CHAPTER 2
ENTRY INTO THE REPORTING FUND REGIME
Applications for this Part to apply
45. Who may make an application [4.2.1]
46. Contents of an application [4.2.2]
47. Form and timing of application [4.2.3]
48. Conversion of non-reporting fund into reporting fund [4.2.2A]
Procedure on applications
49. Response by HMRC to application [4.2.4]
50. Appeal against rejection of application [4.2.5A]
51. Constant net asset value reporting funds [4.2.6]

CHAPTER 3
THE GENERAL DUTIES OF REPORTING FUNDS
52. Effects of entry into the reporting fund regime [4.3.1ZA (formerly [4.2.5])]
53. General duties of reporting fund [4.3.1]

CHAPTER 4
THE PREPARATION OF ACCOUNTS
54. Accounts to be prepared in accordance with acceptable accounting policy [4.4.1]
55. Change in accounting practice [4.4.2]
56. Change in accounting practice to a generally accepted accounting practice [4.4.4]

CHAPTER 5
THE CALCULATION OF REPORTABLE INCOME
General
57. Duty to provide calculation [4.5.1]
58. Calculation of reportable income: general [4.5.2]
Adjustments for capital items
59. Treatment of capital items following IMA SORP [4.5.3]
60. Treatment of other capital items [4.5.4]
Adjustments for special classes of income
61. Income from wholly-owned subsidiaries [4.5.5]
62. Income from other reporting funds [4.5.7]
63. Income from non-reporting funds: first case [4.5.8]
64. Income from non-reporting funds: second case [4.5.9]
65. Income from non-reporting funds if first case ceases to apply [4.5.10]
More than one class of interest
66. Different classes of interest [4.5.12]

CHAPTER 6

REPORTS TO PARTICIPANTS

67. Report to participants for a reporting period [4.6.1]
68. Meaning of "reporting period" [4.6.1A]
69. Contents of report to participants [4.6.2]
70. Lengthy periods of account where full information not available [4.6.3]

CHAPTER 7

THE TAX TREATMENT OF PARTICIPANTS IN REPORTING FUNDS

Tax treatment of the reported income of the fund in the hands of participants

71. Reported income: general provisions [4.7.1]
72. Participants chargeable to income tax: corporate funds [4.7.2]
73. Participants chargeable to income tax: certain unit trust schemes [4.7.2A]
74. Participants chargeable to corporation tax [4.7.3]

Disposals and deemed disposals of interests

75. Disposals of interests [4.7.6]
76. Deemed disposals of interests [4.7.7]

Charitable companies and charitable trusts

77. Special provisions applying to charitable companies and charitable trusts [4.7.9]

CHAPTER 8

THE PROVISION OF INFORMATION TO HMRC

78. Annual reporting requirements [4.8.1]
79. Information obligations of reporting funds [4.8.2]

CHAPTER 9

BREACHES OF REPORTING FUND REQUIREMENTS

80. Ambit of this Chapter [4.9.1]
81. Types of breaches [4.9.1A]
82. Consequences of minor breaches [4.9.2]
83. Differences between reported income and reportable income [4.9.4]
84. Provision of report that is incorrect or incomplete [4.9.3]
85. Cases where information is not provided [4.9.4A]
86. Serious breaches [4.9.4B]
87. Consequences of serious breaches [4.9.5]
88. Appeal against exclusion from the reporting fund regime [4.9.6]

CHAPTER 10

LEAVING THE REPORTING FUND REGIME

89. Termination by notice given by reporting fund [4.10.1]
90. Reporting fund becoming a bond fund [4.10.2]
91. Reporting fund not complying with requirements [4.10.3]

PART 4

CONSEQUENTIAL AMENDMENTS

92. Amendment of the Inheritance Tax Act 1984 [5.1.1]
93. Amendment of ICTA [5.1.2]
94. Amendment of TCGA 1992 [5.1.3]
95. Amendment of FA 1996 [5.1.4]

96. Amendment of ITTOIA 2005 [5.1.5]
97. Amendment of ITA 2007 [5.1.6]
98. Amendment of the Finance Act 2008 [5.1.7]

SCHEDULE 1 — Transitional Provisions
SCHEDULE 2 — Abbreviations and Defined Expressions
PART 1 — Abbreviations of Acts
PART 2 — Index of expressions defined or otherwise explained in these Regulations

The Treasury make the following Regulations in exercise of the powers conferred by sections 41(1) and 42 of the Finance Act 2008(**a**).

In accordance with section 41(4) of that Act, a draft of this instrument was laid before the House of Commons and approved by a resolution of that House.

PART 1

INTRODUCTION

Preliminary provisions

Citation, commencement and effect [1.1.1]

1.—(1) These Regulations may be cited as the Offshore Funds (Tax) Regulations 2009 and shall come into force on [day/month] 2009.

(2) These Regulations have effect—

(a) for the purposes of income tax—

(i) for the tax year [date] and subsequent years, and

(ii) for distributions made on or after [day/month] 2009;

(b) for the purposes of corporation tax—

(i) on income, for accounting periods ending on or after the day on which these Regulations come into force,

(ii) on chargeable gains, in relation to disposals made on or after the day on which these Regulations come into force, and

(iii) for distributions made on or after the day on which these Regulations come into force;

(c) for the purposes of capital gains tax, in relation to disposals made on or after the day on which these Regulations come into force.

Structure of these Regulations [1.1.2]

2. The structure of these Regulations is as follows—

this Part contains preliminary provisions of an introductory nature;

(**a**) 2008 c. 9.

Part 2 deals with the treatment of participants in non-reporting funds;

Part 3 deals with reporting funds and the treatment of participants in reporting funds;

Part 4 makes consequential amendments to primary legislation.

General provisions

Definition of "offshore fund" [2.1.1]

3. In these Regulations "offshore fund" has the same meaning as in Chapter 5 of Part 17 of ICTA (see sections 756A to 756C of that Act).

Classification of offshore funds [2.1.2]

4.—(1) Offshore funds consist of—

(a) non-reporting funds (see Part 2 of these Regulations), and

(b) reporting funds (see Part 3 of these Regulations).

(2) An offshore fund is a non-reporting fund unless it is a fund to which Part 3 of these Regulations applies for a period of account.

Umbrella funds and funds comprising more than one class of interest

Treatment of umbrella funds [2.1.3]

5.—(1) For the purposes of these Regulations "umbrella fund" has the meaning given by section 756B(1) of ICTA.

(2) For the purposes of these Regulations—

(a) each part of an umbrella fund is regarded as a separate offshore fund, and

(b) the umbrella fund as a whole is not regarded as an offshore fund.

(3) In these Regulations, in relation to a part of an umbrella fund—

(a) a reference to the assets of an offshore fund is to such of the assets of the umbrella fund as under the arrangements form part of the separate pool to which that part of the umbrella fund relates;

(b) a reference to the income of an offshore fund is to the income arising from those assets; and

(c) a reference to a participant in an offshore fund is to a person for the time being owning an interest in that separate pool.

Treatment of funds comprising more than one class of interest [2.1.4]

6.—(1) This regulation applies if there is more than one class of interest in an offshore fund (the "main fund").

(2) For the purposes of these Regulations—

(a) each class of interest is regarded as a separate offshore fund, and

(b) the main fund is not regarded as an offshore fund.

(3) In this regulation, references to a class of interest in an offshore fund do not include—

(a) a part of an umbrella fund which is regarded as an offshore fund by virtue of regulation [2.1.3], or

(b) a class of interest in an offshore fund which, by virtue of any provision of Chapter 3 of Part 2 of these Regulations, is not a relevant interest in the fund.

(4) In these Regulations, in relation to a class of interest in an offshore fund—

(a) a reference to the assets of an offshore fund is to the assets of the main fund;

(b) a reference to the income of an offshore fund is to such of the income of the main fund as is attributable to interests of that class under the arrangements constituting the main fund; and

(c) a reference to a participant in an offshore fund is to a person for the time being owning an interest of that class.

Interpretation

Definition of "participant" [1.1.3ZA]

7. In these Regulations references to participants in a fund are to persons taking part in the arrangements constituting the fund, whether by becoming the owner of, or of any part of, the property that is the subject of the arrangements or otherwise (and references to participation in a fund, however expressed, are to be read accordingly).

Definition of "guaranteed return fund" [1.1.3ZAB]

8.—(1) For the purposes of these Regulations an offshore fund is a guaranteed return fund if conditions A to C are met.

(2) Condition A is that the return on the shares or other interests in the fund is defined by reference to an index.

(3) Condition B is that the assets of the fund which are held to produce the return on the shares or other interests concerned cannot give rise to a return which, if it arose directly to an individual resident in the United Kingdom, would be chargeable to income tax.

(4) Condition C is that it is reasonable to assume that the main purpose, or one of the main purposes, of the arrangements constituting the offshore fund is or was the production for participants of a return that equates, in substance, to the return on an investment of money at interest.

Definition of "market value" [1.1.3ZB]

9.—(1) The market value of any asset for the purposes of these Regulations shall be determined in like manner as it would be determined for the purposes of TCGA 1992.

(2) But in the case of an interest in an offshore fund for which there are separate published buying and selling prices, section 272(5) of that Act (meaning of "market value" in relation to rights of unit holders in a unit trust scheme) shall apply with any necessary modifications for determining the market value of the interest for the purposes of this Chapter.

General interpretation [1.1.3]

10. In these Regulations—

a "bond fund", in relation to a period of account, means an offshore fund which fails to satisfy the non-qualifying investments test in paragraph 8 of Schedule 10 to FA 1996 at any time in the period of account;

"HMRC" means Her Majesty's Revenue and Customs;

"proposed prospectus" includes—

(a) any document supplementing or amending the proposed prospectus, and

(b) any document fulfilling the same function as a proposed prospectus having effect under the law of the territory in which the fund is situated;

"prospectus" includes—

(a) any document supplementing or amending the prospectus, and

(b) any document fulfilling the same function as a prospectus having effect under the law of the territory in which the fund is situated;

"tax year"—

(a) in relation to income tax, has the meaning given by section 4(2) of ITA 2007, and

(b) in relation to capital gains tax, has the meaning given by section 288(1ZA) of TCGA 1992(**a**);

"tribunal" means the First-tier Tribunal or, where determined by or under Tribunal Procedure Rules, the Upper Tribunal.

Transitional provisions, abbreviations and general index [1.1.4]

11.—(1) Schedule 1 to these Regulations (which contains transitional provisions) has effect

(2) Schedule 2 to these Regulations (which contains abbreviations and defined expressions that apply for the purposes of these Regulations) has effect.

(3) Part 1 of Schedule 2 gives the meaning of the abbreviated references to Acts used in these Regulations.

(4) Part 2 of Schedule 2 lists the places where expressions used in these Regulations are defined or otherwise explained—

(a) in these Regulations for the purposes of these Regulations, or

(b) in these Regulations for the purposes of a Part or Chapter of these Regulations.

PART 2

THE TREATMENT OF PARTICIPANTS IN NON-REPORTING FUNDS

CHAPTER 1

PRELIMINARY PROVISIONS

Structure of this Part [3.1.1]

12. The structure of this Part is as follows—

(a) this Chapter contains preliminary provisions;

(b) Chapter 2 deals with the charge to tax on participants in non-reporting funds;

(c) Chapter 3 deals with relevant interests in non-reporting funds;

(d) Chapter 4 deals with disposals of relevant interests in non-reporting funds;

(e) Chapter 5 deals with offshore income gains and the calculation of offshore income gains;

(f) Chapter 6 deals with the deduction of offshore income gains in determining capital gains;

(g) Chapter 7 deals with the conversion of a non-reporting fund into a reporting fund.

Interpretation [3.1.2]

13. In these Regulations a "material disposal" means a disposal to which this Part applies.

CHAPTER 2

THE CHARGE TO TAX ON PARTICIPANTS IN NON-REPORTING FUNDS

(**a**) Section 288(1ZA) was inserted by paragraph 101(3) of Schedule 2 to the Finance Act 2008 (c. 9).

The charge to tax [3.2.1]

14.—(1) There is a charge to tax if a person disposes of an asset and—

(a) at the time of the disposal either condition A or condition B is met, and

(b) as a result of the disposal an offshore income gain arises to the person making the disposal.

(2) Condition A is that the asset is a relevant interest in a non-reporting fund.

(3) Condition B is that the asset is an interest in a reporting fund and—

(a) the reporting fund was previously a non-reporting fund (becoming a reporting fund as the result of an application under regulation [4.2.2A]), and

(b) the person did not make the election mentioned in regulation [3.7.2](2).

(4) Chapter 5 of this Part deals with offshore income gains and the calculation of offshore income gains.

(5) The offshore income gain arising is treated for all the purposes of the Tax Acts as income which arises at the time of the disposal to the person making the disposal (or treated as making the disposal).

(6) The tax is charged on the person making the disposal (or treated as making the disposal).

(7) In the case of a person chargeable to income tax, tax is charged under Chapter 8 of Part 5 of ITTOIA 2005 (miscellaneous income: income not otherwise charged) for the year of assessment in which the disposal is made, but sections 688(1) and 689 of ITTOIA 2005 (income charged and person liable) do not apply.

(8) In the case of a person chargeable to corporation tax, tax is charged under Case VI of Schedule D for the accounting period in which the disposal is made.

(9) Paragraph (5) is subject to regulation [3.2.9A] and to regulations [3.2.8](4) and [3.2.7](6).

Income treated as arising under regulation [3.2.1]: remittance basis [3.2.9A]

15.—(1) This regulation applies to income treated as arising under regulation [3.2.1] to an individual in a tax year if—

(a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for that year, and

(b) the individual is not domiciled in the United Kingdom in that year.

(2) The income is treated as relevant foreign income of the individual.

(3) For the purposes of Chapter A1 of Part 14 of ITA 2007 (remittance basis)—

(a) any consideration obtained on the disposal of the asset is treated as deriving from the income, and

(b) unless the consideration so obtained is of an amount equal to the market value of the asset, the asset is treated as deriving from the income.

(4) In paragraph (3)—

(a) "the asset" means the asset the disposal of which causes the income to be treated as arising, and

(b) "the disposal" means the disposal mentioned in sub-paragraph (a) of that paragraph.

Exemptions from the charge

Long-term insurance funds of insurance companies [3.2.4ZA]

16.—(1) The charge to tax in regulation [3.2.1] does not apply to disposals of assets of an insurance company's long-term insurance fund.

(2) In paragraph (1) "insurance company" and "long-term insurance fund" have the same meaning as in section 431(2) of ICTA.

Charitable companies and charitable trusts [3.2.4]

17.—(1) A charitable company shall be exempt from corporation tax in respect of an offshore income gain if the gain is applicable and applied for charitable purposes.

(2) See section 535 of ITA 2007 for an exemption for income tax purposes for offshore income gains accruing to a charitable trust.

(3) Paragraphs (4) and (5) apply if—

(a) property held on charitable trusts ceases to be subject to charitable trusts, and

(b) that property represents directly or indirectly an offshore income gain.

(4) The trustees are treated as if they had disposed of and immediately reacquired that property for a consideration equal to its market value.

(5) An offshore gain accruing on the disposal arising under paragraph (4) is treated as an offshore income gain not accruing to a charity.

(6) In this regulation "charity" and "charitable company" have the same meaning as in section 506 of ICTA.

Offshore funds and the transfer of assets abroad

Application if transfer of assets abroad [3.2.8A]

18.—(1) Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) applies in relation to an offshore income gain arising to a person resident or domiciled outside the United Kingdom as if the offshore income gain were income becoming payable to the person.

(2) Income treated as arising under that Chapter by virtue of paragraph (1) is regarded as "foreign" for the purposes of section 726, 730 or 735 of that Act.

(3) Paragraph (1) does not apply to so much of the offshore income gain as is treated by any provision of Chapter 5 of Part 5 of ITTOIA 2005 as income of the settlor.

(4) Paragraph (1) does not apply in relation to an offshore income gain if (and to the extent that) it is treated, by virtue of regulation [3.2.7], as arising to a person resident or ordinarily resident in the United Kingdom.

(5) The following provisions apply if regulation [3.2.8] applies in relation to an offshore income gain (the "relevant offshore income gain").

(6) Regulation [3.2.8] does not apply to an OIG amount if, and to the extent that, the OIG amount has been charged to tax under—

(a) section 720 of ITA 2007 (charge where power to enjoy income), or

(b) section 727 of that Act (charge where capital sums received).

(7) Section 731 of ITA 2007 (charge where benefit received) applies only if the non-transferor receiving a benefit as a result of a relevant transaction is not charged to tax under regulation [3.2.8].

Application of TCGA 1992

Application of certain provisions of TCGA 1992 [3.2.2]

19.—(1) The following enactments have effect in relation to income tax or corporation tax in respect of offshore income gains as they have effect in relation to capital gains tax or corporation tax in respect of chargeable gains—

(a) section 2(1) of TCGA 1992 (persons chargeable to capital gains tax);

(b) section 10 of TCGA 1992 (non-resident with a United Kingdom branch or agency);

(c) section 10B of TCGA 1992 (non-resident company with United Kingdom permanent establishment).

(2) Paragraph (1) is subject to paragraphs (3) and (4).

(3) In the application of section 10 of TCGA 1992 in accordance with paragraph (1), paragraphs (a) and (b) of subsection (1) (assets on the disposal of which chargeable gains are taxable) have effect with the omission of the words “situated in the United Kingdom and”.

(4) In the application of section 10B of TCGA 1992 in accordance with paragraph (1), paragraphs (a) and (b) of subsection (1) (assets on the disposal of which chargeable profits arise for the purposes of corporation tax) have effect with the omission of the words “situated in the United Kingdom and”.

Application of section 10A of TCGA 1992 [3.2.6]

20.—(1) Section 10A of TCGA 1992 (temporary non-residents) applies for the purposes of this Part with the following modifications.

(2) The section applies as if, in subsection (2)—

(a) the reference to section 86A were omitted;

(b) for the reference to capital gains tax there were substituted a reference to income tax;

(c) in paragraph (a), for the reference to chargeable gains and losses there were substituted a reference to offshore income gains;

(d) in paragraph (b)—

(i) for the reference to chargeable gains there were substituted a reference to offshore income gains;

(ii) for the reference to section 13 or 86 there were substituted a reference to regulation [3.2.7];

(e) paragraph (c) were omitted; and

(f) for the reference to gains or, as the case may be losses there were substituted a reference to offshore income gains.

(3) The section applies as if, in subsection (3)—

(a) for the reference to gains and losses there were substituted a reference to offshore income gains; and

(b) for the reference to any gain or loss there were substituted a reference to any offshore income gains.

(4) The section applies as if subsection (4) were omitted.

(5) The section applies as if, in subsection (5)—

(a) for the reference to gains and losses there were substituted a reference to offshore income gains;

(b) for the reference to any chargeable gain or allowable loss there were substituted a reference to an offshore income gain; and

(c) for the reference to section 10 or 16(3) there were substituted a reference to regulation [3.2.2](1)(b).

(6) The section applies as if subsection (6) were omitted.

(7) The section applies as if, in subsection (7), for the reference to capital gains tax there were substituted a reference to income tax.

(8) The section applies as if, in subsection (9ZA)—

(a) for the reference to foreign chargeable gains there were substituted a reference to offshore income gains to which regulation [3.2.9A] applied;

(b) the second sentence of that subsection were omitted.

(9) The section applies as if, in subsection (9B)—

(a) in paragraph (a)—

(i) for the reference to section 87 or 89(2) there were substituted a reference to regulation [3.2.8];

(ii) for the reference to chargeable gains there were substituted a reference to offshore income gains; and

(b) in paragraph (b) the references to subsections (2)(c) and (6) were omitted.

(10) The section applies as if, in subsection (9C)—

(a) for the reference to capital gains tax there were substituted a reference to income tax; and

(b) for the reference to chargeable gains there were substituted a reference to offshore income gains.

Application of section 13 of TCGA 1992 [3.2.7]

21.—(1) Section 13 of TCGA 1992 (chargeable gains accruing to certain non-resident companies) applies for the purposes of this Part with the following modifications.

(2) The section applies as if—

(a) for any reference to a chargeable gain there were substituted a reference to an offshore income gain, and

(b) for any reference to anything accruing there were substituted a reference to it arising (with similar references being read accordingly).

(3) The section applies as if, in subsection (5), paragraphs (b) and (c) were omitted.

(4) The section applies as if, in subsection (7), for the reference to capital gains tax there were substituted a reference to income tax or corporation tax.

(5) The section applies as if subsection (8) were omitted.

(6) If this regulation applies, the person to whom the offshore income gain arises is treated as the person making the disposal.

(7) To the extent that an offshore income gain is treated, by virtue of this regulation, as having accrued to any person resident or ordinarily resident in the United Kingdom, that gain shall not be deemed to be the income of any individual for the purposes of Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad).

Application to gains of non-resident settlements [3.2.8]

22.—(1) If—

(a) offshore income gains arise to the trustees of a settlement in a tax year, and

(b) section 87 of TCGA 1992 (gains of non-resident settlements) applies to the settlement for that year,

the OIG amount for the settlement for that year is the amount of the offshore income gains.

(2) Sections 87, 87A, 87C to 90A and 96 to 98 of, and Schedule 4C to, TCGA 1992 apply in relation to OIG amounts as if—

(a) references to section 2(2) amounts (except those in paragraph 7B(2)(b) and (4) of Schedule 4C) were to OIG amounts,

(b) references to chargeable gains (except the one in paragraph 1(5) of Schedule 4C) were to offshore income gains,

(c) references to anything accruing were to it arising (and similar references, except the one in paragraph 1(5) of Schedule 4C, were read accordingly), and

(d) sections 87(4), 88(2) to (5), 89(4) and 97(6) and paragraphs 1(3A), 3 to 7, 8AA, 12 and 12 of Schedule 4C were omitted.

(3) Section 87A of TCGA 1992 applies for a tax year by virtue of paragraph (3) before it applies for that year otherwise than by virtue of that paragraph.

(4) If this regulation applies, the person to whom the offshore income gain arises is treated as the person making the disposal.

CHAPTER 3

RELEVANT INTERESTS IN NON-REPORTING FUNDS

The general rule [3.3.1]

23.—(1) The interest of a participant ("X") in a non-reporting fund is a relevant interest if, at the time when X acquired the interest, it could reasonably be expected that X would be able to realise the value of the interest at some time during the period of seven years beginning at the time of X's acquisition.

(2) Paragraph (1) is subject to the following provisions of this Chapter.

The realisation of the value of the interest [3.3.2]

24.—(1) For the purposes of regulation [3.3.1] a participant ("X") is at any time able to realise the value of an interest if at that time X can realise an amount which is reasonably approximate to that portion which the interest represents (directly or indirectly) of the market value at that time of the assets of the fund.

(2) For the purposes of regulation [3.3.1] the value of an interest may be realised by transfer, surrender or in any other manner.

(3) For the purposes of regulation [3.3.1] and of this regulation—

(a) a participant ("X") is able to realise a particular amount if X is able to obtain that amount either in money or in the form of assets to the value of that amount, and

(b) if at any time an interest in an offshore fund has a market value which is substantially greater than the portion which the interest represents of the market value at that time of the assets of the fund, the ability to realise such a market value of the interest shall not be regarded as an ability to realise such an amount as is referred to in paragraph (1).

Interests in certain offshore funds that are not relevant interests [3.3.3ZA]

25.—(1) An interest in an offshore fund is not a relevant interest in a non-reporting fund if condition A or B is met.

(2) Condition A is that the fund is within section 756A(1)(c) of ICTA.

(3) Condition B is that the fund is a unit trust scheme which—

(a) is within section 756A(1)(b) of ICTA, and

(b) is not a non-transparent scheme.

(4) Paragraph (2) of regulation [4.7.2A] applies to determine whether a scheme is a non-transparent scheme for the purposes of paragraph (3)(b) in the same way as it applies to determine that matter for the purposes of paragraph (1)(c) of that regulation.

(5) But such an interest is a relevant interest in a non-reporting fund if—

(a) the offshore fund holds an interest in another non-reporting fund, and

(b) the offshore fund's holdings of such interests amount to more than 5% by value of the offshore fund's assets throughout the fund's period of account.

Interests in non-reporting funds that are not relevant interests [3.3.3]

26.—(1) An interest in a non-reporting fund is not a relevant interest if the interest is—

(a) a right arising under a policy of insurance, or

(b) a participating loan.

(2) In paragraph (1)(b), a "participating loan" means a loan where the amount payable on redemption exceeds the issue price by an amount which is determined in whole or in part by reference to the income of the non-reporting fund.

CHAPTER 4

DISPOSALS OF RELEVANT INTERESTS IN NON-REPORTING FUNDS

Basic provisions

Application of this Chapter [3.4.1]

27. This Chapter applies if a participant disposes of an asset which, at the time of the disposal, is a relevant interest in a non-reporting fund.

Meaning of disposal of an asset: the basic rule [3.4.2]

28.—(1) There is a disposal of an asset for the purposes of these Regulations if there would be a disposal of an asset for the purposes of TCGA 1992.

(2) Paragraph (1) is subject to the following provisions of this Chapter,

Further provisions

Provisions applicable on death [3.4.3]

29.—(1) Notwithstanding anything in paragraph (b) of subsection (1) of section 62 of TCGA 1992 (general provisions applicable on death: no deemed disposal by the deceased), where a person dies and the assets of which the deceased was competent to dispose at the time of death include a relevant interest in a non-reporting fund, then, for the purposes of these Regulations—

(a) immediately before the acquisition referred to in paragraph (a) of that subsection, that interest shall be deemed to be disposed of by the deceased for such a consideration as is mentioned in that subsection; but

(b) nothing in this regulation affects the determination, in accordance with regulation [3.4.1] above, of the question whether that deemed disposal is one to which this Chapter applies.

(2) Subject to paragraph (1), section 62 of TCGA 1992 applies for the purposes of these Regulations as it applies for the purposes of that Act, and the reference in that paragraph to the assets of which a deceased person was competent to dispose shall be construed in accordance with subsection (10) of that section.

Application of section 135 of TCGA 1992 [3.4.4]

30.—(1) Section 135 of TCGA 1992 (exchange of securities for those in another company treated as not involving a disposal) does not apply for the purposes of this Part to the extent that—

(a) the interest in the entity that is company A for the purposes of that section that is exchanged is an interest in a non-reporting fund, and

(b) the interest in the entity that is company B for those purposes that is exchanged is not an interest in such a fund.

(2) In a case where section 135 of TCGA 1992 would apply apart from paragraph (1), the exchange in question shall for the purposes of this Part constitute a disposal of interests in the non-reporting fund for a consideration equal to their market value at the time of the exchange.

Application of section 136 of TCGA 1992 [3.4.5]

31.—(1) Section 136 of TCGA 1992 (scheme of reconstruction involving issue of securities treated as exchange not involving disposal) does not apply for the purposes of this Part to the extent that—

(a) the interest in the entity that is company A for the purposes of that section that is exchanged is an interest in a non-reporting fund, and

(b) the interest in the entity that is company B for those purposes that is exchanged is not an interest in such a fund.

(2) In a case where section 136 of TCGA 1992 would apply apart from paragraph (1), the deemed exchange in question shall for the purposes of this Part constitute a disposal of interests in the non-reporting fund for a consideration equal to their market value at the time of the deemed exchange.

Exchange of interests of different classes [3.4.6]

32.—(1) If conditions A to D are met, section 127 of TCGA 1992 (equation of original shares and new holding) does not prevent an exchange from constituting a disposal for the purposes of these Regulations.

(2) Condition A is that classes of interest in an offshore fund (the “main fund”) are treated as separate offshore funds by virtue of regulation [2.1.4].

(3) Condition B is that a participant exchanges an interest of one class (“class A”) in the main fund for an interest of another class (“class B”) in that fund as the result of—

(a) a reorganisation within the meaning of section 126 of TCGA 1992, or

(b) a conversion of securities within the meaning of section 132 of that Act.

(4) Condition C is that the interest of class A is at the time of the exchange an interest in a non-reporting fund.

(5) Condition D is that the interest of class B is at the time of the exchange an interest in a fund which is a reporting fund.

(6) Any disposal to which this regulation applies is to be treated as a disposal for a consideration equal to the market value of the rights at the time of the exchange.

(7) In this section “class of interest” has the same meaning as in regulation [2.1.4].

CHAPTER 5

OFFSHORE INCOME GAINS AND THE CALCULATION OF OFFSHORE INCOME GAINS

General provisions [3.5.1]

33.—(1) An offshore income gain arises to a person on the disposal of an asset if a basic gain arises on the disposal.

(2) The disposal gives rise to an offshore income gain of an amount equal to the basic gain on the disposal.

(3) The following provisions of this Chapter explain how the basic gain is calculated.

The basic gain and its calculation [3.5.2]

34.—(1) In the case of a participant chargeable to income tax, the basic gain is a gain of the amount which would be the gain on that disposal for the purposes of TCGA 1992 if the gain were calculated without regard to any charge to income tax arising under this Part.

(2) In the case of a participant chargeable to corporation tax, the basic gain is a gain of the amount which would be the gain on that disposal for the purposes of TCGA 1992 if the gain were calculated—

(a) without regard to any charge to corporation tax arising under this Part, and

(b) without regard to any indexation allowance on the disposal under TCGA 1992.

(3) The calculation of the basic gain is subject to—

(a) regulation [3.4.3] (provisions applicable on death);

(b) regulation [3.4.4] (application of section 135 of TCGA 1992);

(c) regulation [3.4.5] (application of section 136 of TCGA 1992);

(d) regulation [3.4.6] (exchange of interests of different classes;

(e) regulation [3.5.3] (earlier disposal to which the no gain/no loss basis applies);

(f) regulation [3.5.4] (modifications of TCGA 1992);

(g) regulation [3.5.5] (losses).

Earlier disposal to which the no gain/no loss basis applies [3.5.3]

35.—(1) This regulation applies if—

(a) a participant is chargeable to corporation tax, and

(b) the amount of any chargeable gain or allowable loss which would arise on the disposal would fall to be determined in a way which, in whole or in part, would take account of the indexation allowance on an earlier disposal to which section 56(2) of TCGA 1992 (disposals on a no gain/no loss basis) applies.

(2) The basic gain on the disposal is calculated as if—

(a) no indexation allowance had been available on any such earlier disposal, and

(b) subject to that, neither a gain nor a loss had arisen to the person making such an earlier disposal.

Modifications of TCGA 1992 [3.5.4]

36.—(1) If the disposal forms part of a transfer to which section 162 of TCGA 1992 (roll-over relief on transfer of business) applies, the basic gain arising on the disposal is calculated without regard to any deduction which falls to be made under that section in calculating a chargeable gain.

(2) If the disposal is made otherwise than under a bargain at arm's length and a claim for relief is made in respect of that disposal under section 165 or 260 of TCGA 1992 (relief for gifts), the claim does not affect the calculation of the basic gain arising on the disposal.

Losses [3.5.5]

37.—(1) If the effect of any calculation under regulations [3.5.2] to [3.5.4] would be to produce a loss, the basic gain on the disposal is nil.

(2) Paragraph (1) applies notwithstanding section 16 of TCGA 1992 (losses determined in like manner as gains).

(3) Accordingly, for the purposes of these Regulations, no loss is to be treated as arising on the disposal.

CHAPTER 6

THE DEDUCTION OF OFFSHORE INCOME GAINS IN CALCULATING CAPITAL GAINS

Ambit of this Chapter [3.6.1]

38.—(1) This Chapter applies if—

(a) a material disposal gives rise to an offshore income gain, and

(b) that disposal also constitutes the disposal of the interest concerned for the purposes of TCGA 1992.

(2) In this Chapter the disposal specified in paragraph (1)(b) is called the "TCGA disposal".

Treatment of the TCGA disposal: general rules [3.6.2]

39.—(1) This regulation applies for the purposes of the calculation of the chargeable gain arising on the TCGA disposal.

(2) The provisions of this regulation have effect in relation to the TCGA disposal in substitution for section 37(1) of TCGA 1992 (deduction of consideration chargeable to tax on income).

(3) In the calculation of the gain arising on the TCGA disposal, a sum equal to the offshore income gain shall be deducted from the sum which would otherwise constitute the amount or value of the consideration for the disposal.

(4) Paragraph (3) is subject to the following provisions of this Chapter.

(5) Paragraph (6) applies if the TCGA disposal is of such a nature that, by virtue of section 42 of TCGA 1992 (part disposals), an apportionment falls to be made of certain expenditure.

(6) No deduction is to be made by virtue of paragraph (3) in determining the amount or value of the consideration for the purposes of the fraction in section 42(2) of TCGA 1992.

Modification of section 162 of TCGA 1992 [3.6.3]

40.—(1) This regulation applies if the TCGA disposal forms part of a transfer to which section 162 of TCGA 1992 applies (roll-over relief on transfer of business in exchange wholly or partly for shares).

(2) For the purposes of subsection (4) of section 162 of TCGA 1992 (determination of the amount of the deduction from the gain on the old assets) "B" in the fraction in that subsection (the value of the whole of the consideration received by the transferor in exchange for the business) is to be taken to be what it would be if the value of the consideration other than shares so received by the transferor were reduced by an amount equal to the offshore income gain.

Application of section 128 of TCGA 1992 [3.6.4]

41.—(1) This regulation applies if there is a disposal to which this Part applies by virtue of—

(a) regulation [3.4.4] (application of section 135 of TCGA 1992),

(b) regulation [3.4.5] (application of section 136 of TCGA 1992), or

(c) regulation [3.4.6] (exchange of interests of different classes).

(2) TCGA 1992 has effect as if an amount equal to the offshore income gain to which that disposal gives rise were given (by the person making the exchange) as consideration for the new holding (within the meaning of section 128 of that Act (consideration given or received for new holding on a reorganisation)).

CHAPTER 7

THE CONVERSION OF A NON-REPORTING FUND INTO A REPORTING FUND

Consequences of conversion for participants [3.7.2]

42.—(1) This regulation applies if an offshore fund ceases to be a non-reporting fund and becomes a reporting fund.

(2) A participant in the fund may make an election to be treated—

(a) as disposing of the relevant interest owned by the participant in the non-reporting fund at its market value on the disposal date, and

(b) as acquiring a holding in the reporting fund at the beginning of the reporting fund's first period of account.

(3) Chapter 5 of this Part applies to determine the offshore income gain arising on the deemed disposal referred to in paragraph (2)(a).

(4) The deemed acquisition referred to in paragraph (2)(b) is treated as made for the same amount as the deemed disposal referred to in paragraph (2)(a).

(5) If the participant is chargeable to income tax, the election mentioned in paragraph (2) must be made by being included in a return made for the tax year which includes the disposal date.

(6) If the participant is chargeable to corporation tax, the election mentioned in paragraph (2) must be made by being included in the participant's company tax return for the accounting period which includes the disposal date.

(7) In this regulation—

"company tax return" has the same meaning as in Schedule 18 to the Finance Act 1998(**a**);

the "disposal date" means the final day of the last period of account before the fund becomes a reporting fund.

PART 3

REPORTING FUNDS AND THE TREATMENT OF PARTICIPANTS IN REPORTING FUNDS

CHAPTER 1

PRELIMINARY PROVISIONS

Structure of this Part [4.1.1]

43. The structure of this Part is as follows—

(a) this Chapter contains preliminary provisions;

(b) Chapter 2 contains provisions relating to entry into the reporting fund regime;

(c) Chapter 3 contains provisions relating to the general duties of reporting funds;

(d) Chapter 4 contains provisions relating to the preparation of accounts;

(e) Chapter 5 contains provisions relating to the calculation of reportable income;

(f) Chapter 6 contains provisions relating to reports to participants;

(g) Chapter 7 contains provisions relating to the tax treatment of participants in reporting funds;

(h) Chapter 8 contains provisions relating to the provision of information to HMRC;

(**a**) 1998 c. 36.

(i) Chapter 9 contains provisions relating to breaches of reporting fund requirements;

(j) Chapter 10 contains provisions relating to leaving the reporting fund regime.

Meaning of "reporting fund" [4.1.2]

44. In these Regulations a "reporting fund" means an offshore fund to which this Part applies for a period of account.

CHAPTER 2

ENTRY INTO THE REPORTING FUND REGIME

Applications for this Part to apply

Who may make an application [4.2.1]

45.—(1) The manager of an eligible offshore fund may make an application for this Part to apply to the fund.

(2) If it is proposed to establish an offshore fund, the person expected to become the manager of the fund on its establishment (the "applicant") may make an application for this Part to apply to the fund on its establishment.

(3) In this Part—

the "applicant" means the person referred to in paragraph (2),

an "application" means an existing fund application or a future fund application,

an "eligible offshore fund" means an offshore fund which is not a guaranteed return fund,

an "existing fund application" means an application made under paragraph (1),

a "future fund application" means an application made under paragraph (2), and

the "manager", in relation to an offshore fund, includes the manager or other person who has or is expected to have day to day control of the property of the fund.

Contents of an application [4.2.2]

46.—(1) An application must include the following—

(a) a statement of the first period of account for which it is proposed that this Part should apply to the fund;

(b) an undertaking that no period of account will exceed 18 months;

(c) a statement whether or not the fund intends to prepare its accounts in accordance with international accounting standards, and, if it does not, a statement of which generally accepted accounting practice it intends to use;

(d) in a case in which the fund does not intend to prepare its accounts in accordance with international accounting standards, a statement specifying the entries in the fund's accounts that are considered to equate to "total recognised income and expense for the period" as that expression is used in international accounting standards;

(e) an undertaking to meet the requirements relating to reports to participants in the fund (see Chapter 6);

(f) an undertaking to meet the requirements relating to the provision of information to HMRC (see Chapter 8).

(2) An existing fund application must be accompanied by the prospectus.

(3) A future fund application must be accompanied by the proposed prospectus.

(4) The application must be in English.

(5) If the prospectus or the proposed prospectus (as the case may be) is not in English, it must be accompanied by an English translation.

Form and timing of application [4.2.3]

47.—(1) An application must be made in writing to HMRC.

(2) The application must be received by HMRC before the expiry of a period of three months beginning on the first day of the first period of account for which it is proposed that this Part should apply to the fund.

(3) An application may be withdrawn within 28 days after it is made—

(a) by the manager (in the case of an existing fund application), or

(b) by the applicant (in the case of a future fund application).

Conversion of non-reporting fund into reporting fund [4.2.2A]

48. A non-reporting fund may make an application to become a reporting fund if it is an eligible offshore fund, and—

(a) it has never been a reporting fund, or

(b) it has been a reporting fund, but ceased to be such a fund because it gave notice under regulation [4.10.1].

Procedure on applications

Response by HMRC to application [4.2.4]

49.—(1) Within 28 days beginning with the day on which HMRC receive the application, HMRC must give notice to the person who made the application—

(a) accepting the application,

(b) rejecting the application, or

(c) asking for further information in order to consider the application.

(2) HMRC must not accept an application if any item mentioned in regulation [4.2.2] is not supplied.

(3) HMRC must not accept an application if they consider that there will be a significant difference, in calculating reportable income (see Chapter 5), between—

(a) the result given by the use of international accounting standards, and

(b) the result given by the use of the accounting practice specified in the application and by the use of the entries in the fund's accounts, specified in the application, that are considered to equate to "total recognised income and expense for the period" under international accounting standards (see regulation [4.5.2]).

(4) Paragraph (5) applies if—

(a) HMRC have given notice under paragraph (1)(c), and

(b) the person who made the application provides further information within a period of 28 days beginning with the day on which HMRC ask for further information, or within such longer period as is agreed by HMRC.

(5) Within 28 days beginning with the day on which HMRC receive the further information, HMRC must give notice to the person who made the application—

(a) accepting the application, or

(b) rejecting the application.

Appeal against rejection of application [4.2.5A]

50.—(1) If HMRC reject an application, the person who made the application may appeal.

(2) The notice of appeal must be given to HMRC within a period of 42 days beginning with the day on which the notice rejecting the application is given.

(3) On an appeal, the tribunal may uphold or quash the rejection of the application.

Constant net asset value reporting funds [4.2.6]

51. [Marker for provisions to provide simplified reporting rules for constant net asset value reporting funds.]

CHAPTER 3

THE GENERAL DUTIES OF REPORTING FUNDS

Effects of entry into the reporting fund regime [4.3.1ZA (formerly [4.2.5])]

52.—(1) If HMRC accept an application, the offshore fund becomes a reporting fund on whichever is the later of—

(a) the first day of the first period of account mentioned in regulation [4.2.2](1)(a), or

(b) the day on which the fund is established.

(2) This Part applies to the fund and to its participants on and after the date specified in paragraph (1).

(3) Once this Part has begun to apply to a fund, it shall continue to apply unless and until it ceases to apply in accordance with Chapter 10 of this Part.

General duties of reporting fund [4.3.1]

53. A reporting fund must—

(a) prepare accounts in accordance with the requirements of Chapter 4;

(b) provide a calculation of its reportable income in accordance with the requirements of Chapter 5;

(c) provide reports to participants in accordance with the requirements of Chapter 6; and

(d) provide information to HMRC in accordance with the requirements of Chapter 8.

CHAPTER 4

THE PREPARATION OF ACCOUNTS

Accounts to be prepared in accordance with acceptable accounting policy [4.4.1]

54. A reporting fund must prepare accounts—

(a) in accordance with international accounting standards, or

(b) in accordance with the generally accepted accounting practice specified in the application.

Change in accounting practice [4.4.2]

55.—(1) This regulation applies if—

(a) there is a change of accounting policy in drawing up a reporting fund's accounts from one period of account (in this Chapter called the "earlier period") to the next (in this Chapter called the "later period"), and

(b) the approach in each of those periods accorded with the law and practice applicable in relation to that period.

(2) If there is a difference between—

(a) the accounting value of an asset or liability of the offshore fund at the end of the earlier period, and

(b) the accounting value of that asset or liability at the beginning of the later period,

a corresponding debit or credit (as the case may be) must be brought into account for the purposes of these Regulations in the later period.

(3) In paragraph (2) "accounting value" means the carrying value of the asset or liability recognised for accounting purposes.

Change in accounting practice to a generally accepted accounting practice [4.4.4]

56.—(1) This regulation applies if—

(a) there is a change of accounting practice in drawing up a reporting fund's accounts from the earlier period to the later period, and

(b) the offshore fund prepares accounts for the later period in accordance with a generally accepted accounting practice.

(2) If the accounts for the later period are prepared in accordance with international accounting standards, the offshore fund must give notice to HMRC applying for approval of the generally accepted accounting practice, providing the statement mentioned in regulation [4.2.2](1)(d).

(3) If the accounts for the later period are not prepared in accordance with international accounting standards, the offshore fund must give notice to HMRC applying for approval of the generally accepted accounting practice.

(4) Within 28 days beginning with the day on which HMRC receive an application under paragraph (2) or (3), HMRC must give notice to the offshore fund—

(a) accepting the application, or

(b) rejecting the application.

(5) If HMRC reject an application, the offshore fund may appeal.

(6) The notice of appeal must be given to HMRC within a period of 42 days beginning with the day on which the notice rejecting the application is given.

(7) On an appeal, the tribunal may uphold or quash the rejection of the application.

CHAPTER 5

THE CALCULATION OF REPORTABLE INCOME

General

Duty to provide calculation [4.5.1]

57.—(1) This Chapter explains how reportable income is calculated.

(2) A reporting fund must provide a calculation of its reportable income for a period of account.

Calculation of reportable income: general [4.5.2]

58.—(1) The starting point for calculating the reportable income of a reporting fund for a period of account is—

(a) in a case in which the fund prepares its accounts in accordance with international accounting standards, the "total recognised income and expense for the period" as that expression is used in international accounting standards, or

(b) in any other case, the entries in the fund's accounts that are considered to equate to "total recognised income and expense for the period" as that expression is used in international accounting standards.

(2) The amount specified in paragraph (1) must be adjusted for—

(a) capital items (see regulations [4.5.3] and [4.5.4]), and

(b) special classes of income (see regulations [4.5.5] to [4.5.10]).

(3) In addition, there are provisions that apply if a reporting fund falls within regulation [2.1.4](2)(a) (see regulation [4.5.12]).

(4) In the case of any one item, an adjustment under paragraph (2) may be made only once (even if more than one of the regulations mentioned in that paragraph apply to that item).

(5) The reportable income of the reporting fund for the period of account is the amount calculated in accordance with the provisions of this Chapter.

(6) But if the calculation gives rise to a negative amount, the reportable income is nil.

Adjustments for capital items

Treatment of capital items following IMA SORP [4.5.3]

59.—(1) The capital items for which an adjustment is required are such profits, gains or losses as would, were the accounts to be prepared in accordance with the following definitions in IMA SORP, fall to be dealt with under—

(a) the heading "net gains/losses on investments during the period", or

(b) the heading "other gains/losses",

in the statement of total return for the accounting period.

(2) The amount specified in regulation [4.5.2](1) must be adjusted by—

(a) deducting gains that fall within the headings specified in paragraph (1), and

(b) adding losses that fall within those headings.

(3) A profit or loss from a trade may not be treated as a capital item for the purposes of this regulation.

(4) For the purposes of paragraph (1) "IMA SORP" means, in relation to any accounting period for which it is required or permitted to be used, the Statement of Recognised Practice relating to authorised investment funds issued by the Investment Management Association in November 2008, as from time to time modified, amended or revised.

Treatment of other capital items [4.5.4]

60.—(1) The amount specified in regulation [4.5.2](1) must also be adjusted by adding the amounts specified in paragraph (2).

(2) Those amounts are—

(a) expenses directly related to acquisition or disposal of investments (other than those taken into account in arriving at the amounts specified in sub-paragraph (a) or (b) of regulation [4.5.3](1)), and

(b) costs relating to the setting up, merger or dissolution of the fund.

Adjustments for special classes of income

Income from wholly-owned subsidiaries [4.5.5]

61.—(1) This regulation applies if an offshore fund has a wholly-owned subsidiary.

(2) For the purposes of this regulation, a company is a wholly-owned subsidiary of an offshore fund if and so long as the whole of the issued share capital of the company is—

(a) in the case of an offshore fund falling within paragraph (a) of the definition of "offshore fund" in section 756A(1) of ICTA, directly and beneficially owned by the fund;

(b) in the case of an offshore fund falling within paragraph (b) of the definition of "offshore fund" in that enactment, directly owned by the trustees of the fund for the benefit of the fund;

(c) in the case of an offshore fund falling within paragraph (c) of the definition of "offshore fund" in that enactment, owned in a manner which, as near as may be, corresponds either to paragraph (a) or paragraph (b) above.

(3) But in the case of a company which has only one class of issued share capital, the reference in paragraph (2) to the whole of the issued share capital shall be construed as a reference to at least 95% of that share capital.

(4) That percentage of the receipts, expenditure, assets and liabilities of the subsidiary which is equal to the percentage of the issued share capital of the company concerned which is owned as mentioned in paragraph (2) shall be regarded as the receipts, expenditure, assets and liabilities of the fund.

(5) There shall be left out of account—

(a) the interest of the fund in the subsidiary, and

(b) any distributions or other payments made by the subsidiary to the fund or by the fund to the subsidiary.

(6) The adjustments required under regulations [4.5.3] and [4.5.4] must be made to the amount determined under paragraph (4).

Income from other reporting funds [4.5.7]

62.—(1) This regulation applies if a reporting fund ("RF1") has an interest in another reporting fund ("RF2").

(2) The excess (if any) of the income reported by RF2 in respect of RF1's interest in RF2 over the amount distributed by RF2 to RF1 must be added by RF1 to the amount specified in regulation [4.5.2](1) after making the adjustments specified in regulations [4.5.3] and [4.5.4].

(3) The adjustment specified in paragraph (2) must be made in the calculation of the reportable income of RF1 for the period of account specified in paragraphs (4) and (5).

(4) The basic rule is that the period of account specified for the purposes of this regulation is the period of account in which the fund distribution date of RF2 falls.

The basic rule is subject to paragraph (5).

(5) If the fund distribution date of RF2 is determined in accordance with regulation [4.7.1](3)(b), RF1 must—

(a) include its best estimate of reported income from RF2 as an adjustment to the calculation of its reportable income for the period of account in which the latest possible fund distribution date for RF2 falls (to the extent that any such amount has not already been recognised in the calculation of RF1's reportable income for that or any earlier period of account), and

(b) make any necessary corrections to its best estimate in its calculation of reportable income for the first later period of account in which it has sufficient information to make those corrections.

Income from non-reporting funds: first case [4.5.8]

63.—(1) This regulation applies if—

(a) a reporting fund has an interest in a non-reporting fund, and

(b) the conditions in paragraph (2) are met for a period of account.

(2) The conditions are that—

(a) the non-reporting fund is not a bond fund;

(b) the main purpose or one of the main purposes of the investment in the non-reporting fund is not the deferral or avoidance of United Kingdom tax;

(c) the reporting fund has access to the accounts of the non-reporting fund;

(d) the reporting fund has sufficient information about the non-reporting fund to enable it to prepare a calculation of reportable income for the non-reporting fund; and

(e) the reporting fund can reasonably expect to be able to rely on continued access to that information for the period in which it will hold the investment in the non-reporting fund.

(3) Regulation [4.5.7] applies as if the reporting fund were RF1 and the non-reporting fund were RF2.

Income from non-reporting funds: second case [4.5.9]

64.—(1) This regulation applies if a reporting fund has an interest in a non-reporting fund, but the conditions in regulation [4.5.8](2) are not met for a period of account.

(2) No adjustments may be made under regulations [4.5.3] and [4.5.4] in respect of the interest in the non-reporting fund.

Income from non-reporting funds if first case ceases to apply [4.5.10]

65.—(1) The regulation applies if—

(a) a reporting fund has an interest in a non-reporting fund, and

(b) the conditions in regulation [4.5.8](2) have been met for an earlier period of account but are no longer met for a later period of account.

(2) Regulation [4.5.9] applies for the later period of account and for all subsequent periods of account.

More than one class of interest

Different classes of interest [4.5.12]

66.—(1) This regulation applies if a reporting fund falls within regulation [2.1.4](2)(a).

(2) The reportable income attributable to each fund is determined in accordance with the following rules—

First rule

Apportion the reportable income in the proportion that the share of capital attributable to the fund bears to the total capital of the main fund.

Second rule

Deduct those charges or expenses applying specifically to the fund.

CHAPTER 6

REPORTS TO PARTICIPANTS

Report to participants for a reporting period [4.6.1]

67.—(1) A reporting fund must make a report available to each participant for each reporting period.

(2) For the purposes of these Regulations a report is made available if the fund—

(a) sends the report to a participant by post,

(b) sends the report to a participant by means of an electronic communications service,

(c) makes the report available on a website accessible to relevant participants and to HMRC, or

(d) publishes the report in a newspaper which is published in English in the United Kingdom and readily available in all parts of the United Kingdom.

(3) In paragraph (2)(c) "relevant participants" means participants who—

(a) are resident in the United Kingdom, or

(b) are reporting funds,

during any part of the reporting period.

(4) If the fund does not provide the report to a participant by sending it to the participant by post, the fund must, if so required by the participant, make the report available to the participant in some further manner (whether or not that further manner is also specified in regulation [4.6.1](2)) as the fund and the participant may agree.

(5) The reporting fund must make the report available within a period of six months beginning on the day immediately following the final day of the reporting period.

(6) The report must be in English.

Meaning of "reporting period" [4.6.1A]

68. In these Regulations a "reporting period" of a reporting fund means a period determined in accordance with the following rules—

First rule

If the reporting fund's period of account is twelve months or less, the reporting period is the same as the period of account.

Second rule

If the reporting fund's period of account is more than twelve months, there are two reporting periods.

The first reporting period is a period consisting of the first twelve months of the period of account.

The second reporting period is a period consisting of the remainder of the period of account.

Contents of report to participants [4.6.2]

69.—(1) The report to participants for a reporting period must include the following information—

(a) the amount actually distributed to participants per unit of interest in the fund in respect of the reporting period;

(b) the excess of the amount of the reported income per unit of interest in the fund for the reporting period over the amount actually distributed to participants per unit of interest in the fund in respect of the reporting period;

(c) the dates on which distributions were made;

(d) the fund distribution date (see regulation [4.7.1](3);

(e) a statement whether or not the fund remains a reporting fund at the date the fund makes the report available.

(2) In these Regulations the "reported income" of a reporting fund for a reporting period means the reportable income of the fund for the reporting period, calculated by or on behalf of the fund, and provided, in the report for the reporting period, to the participants in the fund.

(3) For the purposes of paragraph (1)—

(a) the reported income per unit of a reporting fund for a report is calculated by dividing the reported income of the fund for the reporting period by the average number of units in the fund in issue during the reporting period,

(b) an amount actually distributed to participants per unit of interest in the fund in respect of the reporting period must be calculated at the time the distribution is made, and

(c) an amount per unit of interest in the fund must be expressed to at least four decimal places of a pound (or other currency unit) of value per unit.

(4) If the amount of the reported income per unit of interest in the fund for the reporting period is equal to, or less than, the amount actually distributed to participants per unit of interest in the fund in respect of the reporting period, the amount to be stated for the purposes of paragraph (1)(b) is nil.

(5) This regulation is subject to regulation [4.6.3].

Lengthy periods of account where full information not available [4.6.3]

70.—(1) This regulation applies if a reporting fund—

(a) has a period of account which is longer than twelve months, and

(b) has difficulty in calculating its reportable income for the reporting period constituting the first twelve months of that period of account (the "relevant reporting period").

(2) For the purpose of preparing its report to participants for the relevant reporting period, the fund may elect—

(a) to calculate its reportable income based on such information as is reasonably available, or

(b) to make a just and reasonable apportionment of the income of the period of account.

(3) The calculation of reportable income for the reporting period following the relevant reporting period must include all amounts not accounted for in the relevant reporting period.

CHAPTER 7

THE TAX TREATMENT OF PARTICIPANTS IN REPORTING FUNDS

Tax treatment of the reported income of the fund in the hands of participants

Reported income: general provisions [4.7.1]

71.—(1) The Tax Acts shall have effect as if the excess (if any) of the reported income of a reporting fund in respect of a reporting period over the distributions made by the fund in respect of the reporting period were additional distributions made to the participants in the fund in proportion to their rights.

(2) The excess specified in paragraph (1)—

(a) is treated as made to participants holding an interest in the fund at the end of the reporting period, and

(b) is treated as made on the fund distribution date.

(3) In these Regulations the "fund distribution date" for a reporting period of a reporting fund means—

(a) in a case where the reporting fund issues its report to participants within a period of six months beginning with the day immediately following the last day of the reporting period, the date on which the report is issued, and

(b) in any other case, the last day of the reporting period.

Participants chargeable to income tax: corporate funds [4.7.2]

72.—(1) This regulation applies if—

(a) a reporting fund makes a distribution to a participant chargeable to income tax in respect of a reporting period, and

(b) the fund is a company within section 756A(1)(a) of ICTA(**a**).

(2) This regulation also applies if some or all of the excess specified in regulation [4.7.1](1) is treated as made by such a fund to such a participant.

(3) Any amount to which paragraph (1) or (2) applies is charged to income tax under Chapter 4 of Part 4 of ITTOIA 2005 (savings and investment income: dividends from non-UK resident companies).

Participants chargeable to income tax: certain unit trust schemes [4.7.2A]

73.—(1) This regulation applies if—

(a) a reporting fund makes a distribution to a participant chargeable to income tax in respect of a reporting period,

(b) the fund is a collective investment scheme within paragraph (b) or (c) of section 756A(1) of ICTA, and

(c) the scheme is a non-transparent scheme.

(2) For the purposes of paragraph (1)(c) a scheme is a non-transparent scheme if, in the case of holders of interests in the scheme who are individuals domiciled and resident in the United Kingdom, any sums which form part of the income of the scheme are not of such a nature that those holders—

(a) are chargeable to tax under a provision specified in section 830(2) of ITTOIA 2005 in respect of such of those sums as are referable to their interests, or

(b) if any of that income is derived from assets within the United Kingdom, would be so chargeable had the assets been outside the United Kingdom.

(3) This regulation also applies if some or all of the excess specified in regulation [4.7.1](1) is treated as made by a fund to which that enactment applies to a participant in the fund.

(4) Any amount to which paragraph (1) or (3) applies is charged to income tax under Chapter 8 of Part 5 of ITTOIA 2005 (miscellaneous income: income not otherwise charged) for the year of assessment in which the distribution is made, but sections 688(1) and 689 of ITTOIA 2005 (income charged and person liable) do not apply.

Participants chargeable to corporation tax [4.7.3]

74.—(1) This regulation applies if some or all of the excess specified in regulation [4.7.1](1) is treated as made to a participant chargeable to corporation tax.

(2) The amount is charged to corporation tax under Case V of Schedule D.

Disposals and deemed disposals of interests

Disposals of interests [4.7.6]

75.—(1) If a participant has an interest in a reporting fund and disposes of the interest, the participant disposes of an asset for the purposes of tax in respect of chargeable gains.

(2) For the purposes of the disposal referred to in paragraph (1), an amount equal to the accumulated undistributed income is treated as expenditure—

(a) given for the acquisition of the asset, and

(b) falling within section 38(1)(a) of TCGA 1992 (acquisition and disposal costs).

(**a**) Section 756A was inserted by paragraph 3 of Schedule 26 to the Finance Act 2004 (c. 12).

(3) In paragraph (2) the "accumulated undistributed income" means the aggregate of amounts specified in regulation [4.7.1](1) on which the participant has been charged to tax under regulation [4.7.2], [4.7.2A] or [4.7.3].

(4) The expenditure mentioned in paragraph (2) is treated as incurred, in the case of each amount referred to in paragraph (3), on the fund distribution date for the reporting period in respect of which the amount is treated as distributed.

(5) But if the participant receives an amount in respect of the interest in the participating fund which is chargeable to income tax, and that amount is received (or treated as received) after the date of the disposal referred to in paragraph (1), the amount is treated as received immediately before that disposal for the purposes of tax in respect of chargeable gains.

Deemed disposals of interests [4.7.7]

76.—(1) This regulation applies in the case of an offshore fund which ceases to be a reporting fund and becomes a non-reporting fund.

(2) A participant in the fund may make an election to be treated for the purposes of TCGA 1992—

(a) as disposing of an interest in the reporting fund at the end of the reporting fund's final period of account, and

(b) as acquiring a relevant interest in the non-reporting fund at the beginning of the fund's next period of account.

This is subject to paragraph (3).

(3) The election mentioned in paragraph (2) may only be made if a report has been made available to the participant under regulation [4.6.1] for the period of account mentioned in paragraph (2)(a).

(4) The disposal referred to in paragraph (2)(a) is treated as made for a consideration equal to the net asset value of the participant's interest in the fund at the end of the period of account following that for which for which the final reported income is reported to and declared by the participant.

(5) The acquisition referred to in paragraph (2)(b) is treated as made for the same amount as the disposal referred to in paragraph (2)(a).

(6) If the participant is chargeable to income tax, the election mentioned in paragraph (2) must be made by being included in a return made for the tax year which includes the disposal date.

(7) If the participant is chargeable to corporation tax, the election mentioned in paragraph (2) must be made by being included in the participant's company tax return for the accounting period which includes the disposal date.

(8) In this regulation—

"company tax return" has the same meaning as in Schedule 18 to the Finance Act 1998;

"disposal date" means the final day of the reporting fund's final period of account.

Charitable companies and charitable trusts

Special provisions applying to charitable companies and charitable trusts [4.7.9]

77.—(1) This regulation applies if—

(a) a charitable company is a participant in a reporting fund, or

(b) the trustees of a charitable trust are participants in a reporting fund.

(2) No liability to tax arises in respect of any amount which, under regulation [4.7.1](1), is treated as distributed to a charitable company or the trustees of a charitable trust.

(3) Paragraph (2) of regulation [4.7.6] (read with paragraphs (3) and (4) of that regulation) does not apply to the disposal of an interest in a reporting fund by a charitable company or the trustees of a charitable trust.

(4) In this regulation "charity" and "charitable company" have the same meaning as in section 506 of ICTA.

CHAPTER 8

THE PROVISION OF INFORMATION TO HMRC

Annual reporting requirements [4.8.1]

78.—(1) A reporting fund must provide the following information to HMRC in relation to each period of account—

(a) its audited financial statements (see Chapter 4);

(b) its calculation of its reportable income for the period of account based on its audited financial statements (see Chapter 5);

(c) a copy of the report made available to participants for each reporting period falling within the period of account (including, for each reporting period, the information specified in regulation [4.6.2](1));

(d) the reported income of the fund for the reporting period;

(e) the amount actually distributed to participants in respect of the reporting period;

(f) the average number of units in issue during the reporting period;

(g) the amount of the reported income per unit of interest in the fund in respect of the reporting period;

(h) a declaration confirming that the fund has complied with the obligations specified in regulations [4.2.2] and [4.3.1].

(2) The information specified in paragraph (1) must be provided within six months of the end of the period of account.

Information obligations of reporting funds [4.8.2]

79.—(1) HMRC may give notice requiring a reporting fund or its managers, within such time, not being less than 42 days, as is specified in the notice, to provide any information, particulars or documents, in the possession or power of the reporting fund or its managers as HMRC may reasonably require for the purposes of determining whether the fund has met or continues to meet its obligations under Chapter 3 of this Part.

(2) Before a notice is given to a reporting fund by HMRC under paragraph (1), the fund must have been given a reasonable opportunity to deliver the information, particulars or documents, or to make them available (the "initial request"); and HMRC must not give notice under paragraph (1) until the initial request has been given to the fund.

(3) HMRC must give the initial request to the company within a period of one year beginning on the day that the fund provide information specified in regulation [4.8.1](1).

(4) HMRC may extend the time specified in paragraph (1) if they consider it reasonable to do so.

(5) A person to whom a notice under paragraph (1) is given may appeal.

(6) The notice of appeal must be given to HMRC within a period of 42 days beginning with the day on which the notice under paragraph (1) is given.

(7) On an appeal, the tribunal may uphold, vary or quash the notice.

CHAPTER 9

BREACHES OF REPORTING FUND REQUIREMENTS

Ambit of this Chapter [4.9.1]

80.—(1) This Chapter applies if a reporting fund is in breach of a requirement imposed in this Part.

(2) Those breaches include—

(a) a failure to make a report available to each participant within the specified period (see regulation [4.6.1]);

(b) a failure to provide a report to HMRC within the specified period (see regulation [4.8.1]);

(c) the making available or provision of a report that is incorrect or incomplete;

(d) the breaches specified in regulation [4.9.4B].

Types of breaches [4.9.1A]

81.—(1) A breach of a requirement imposed in this Part is—

(a) a minor breach, or

(b) a serious breach.

(2) For the purposes of these Regulations, a breach of a requirement imposed in this Part is a "serious breach" if it is—

(a) a breach specified as a serious breach in a provision of this Chapter, or

(b) a breach which is not a minor breach.

(3) For the purposes of these Regulations, a breach of a requirement imposed in this Part is a "minor breach" if it is a breach (other than a breach specified as a serious breach in a provision of this Chapter)—

(a) for which there is a reasonable excuse, or

(b) which is inadvertent and remedied as soon as reasonably possible.

This paragraph is subject to the following provisions of this regulation.

(4) For the purposes of this Chapter a minor breach is not regarded as a breach if the reporting fund corrects the breach without any HMRC intervention.

(5) For the purposes of these Regulations there is an "HMRC intervention" in relation to a reporting fund if HMRC request the fund to provide them with information relating to a requirement imposed in this Part.

This is subject to paragraph (6).

(6) There is no HMRC intervention in relation to a reporting fund if—

(a) the fund takes the initiative to correct a minor breach, and

(b) HMRC request the fund to provide them with information so that they may deal with the initiative taken.

(7) Regulation [4.9.2] deals with the consequences of minor breaches.

(8) Regulation [4.9.5] deals with the consequences of serious breaches.

Consequences of minor breaches [4.9.2]

82.—(1) If a reporting fund is in breach of a requirement imposed in this Part and the breach is a minor breach, the fund continues to be treated as an offshore fund.

(2) Paragraph (1) is subject to the following provisions of this Chapter.

(3) If paragraph (1) applies on four separate occasions in a period of ten years beginning with the first day of the period of account in which the first breach occurs, the fourth breach is a serious breach.

(4) If a single event results in more than one minor breach within a single period of account, there is only one minor breach in that period of account for the purposes of this Chapter.

Differences between reported income and reportable income [4.9.4]

83.—(1) This regulation applies if there is a difference between the reported income and the reportable income of a reporting fund for a period of account.

(2) If the difference between the reported income and the reportable income is less than 10% of the reportable income, there is no breach of a requirement imposed in this Part.

(3) If the difference between the reported income and the reportable income is between 10% and 15% of the reportable income, an amount equal to the difference must be added—

(a) to the reported income for the reporting period in which the error is established, or

(b) to the reported income for the following reporting period.

(4) If the difference between the reported income and the reportable income is more than 15% of the reportable income, the reporting fund must make a supplementary report to participants for the period of account in which the difference occurs before the end of the period of account in which the error is established.

(5) If paragraph (3) or (4) applies and the action specified in the applicable paragraph is taken as soon as reasonably possible, there is a minor breach.

(6) If paragraph (3) or (4) applies but the action specified in the applicable paragraph is not taken as soon as reasonably possible, there is a serious breach.

(7) For the purposes of paragraph (3) an error is established for a reporting period if, during that reporting period, HMRC conclude—

(a) that an error has been made in respect of an earlier reporting period, and

(b) that, as a result of the error, the difference between the reported income for the reporting period and the reportable income for the period of account in which the reporting period is comprised is between 10% and 15%; and

HMRC give notice of the matters specified in sub-paragraphs (a) and (b) to the reporting fund.

(8) For the purposes of paragraph (4) an error is established for a period of account if, during that period of account, HMRC conclude—

(a) that an error has been made in respect of an earlier period of account, and

(b) that, as a result of the error, the difference between the reported income and the reportable income for the period of account is more than 15%; and

HMRC give notice of the matters specified in sub-paragraphs (a) and (b) to the reporting fund.

Provision of report that is incorrect or incomplete [4.9.3]

84.—(1) This regulation applies if—

(a) a reporting fund provides a report specified in paragraph (2) that is incorrect or incomplete, and

(b) regulation [4.9.4] does not apply.

(2) The reports specified are—

(a) the report to participants in accordance with the requirements of Chapter 6 of this Part, and

(b) the report to HMRC in accordance with the requirements of Chapter 8 of this Part.

(3) If the reporting fund provides a correct report as soon as reasonably possible, there is a minor breach.

(4) If the reporting fund does not provide a correct report as soon as reasonably possible, there is a serious breach.

Cases where information is not provided [4.9.4A]

85.—(1) This regulation applies if, on the relevant date, a reporting fund has not provided—

(a) the information specified in regulation [4.8.1](1) to HMRC in relation to a period of account (the "requisite period of account"), and

(b) a report to each participant for each reporting period comprised in the requisite period of account.

(2) In paragraph (1) the "relevant date" means the day immediately following the expiry of the period of six months beginning immediately after the end of the requisite period of account.

(3) If the reporting fund provides the information mentioned in paragraph (1)(a) and the reports mentioned in paragraph (1)(b) within a period of [four] months beginning on the relevant date, the breach is not regarded as a breach for the purposes of this Chapter.

(4) If the reporting fund does not provide the information mentioned in paragraph (1)(a) and the reports mentioned in paragraph (1)(b) within a period of [four] months beginning on the relevant date but does provide that information and those reports within a period of [twelve] months beginning on the relevant date, there is a minor breach.

(5) If the reporting fund does not provide the information mentioned in paragraph (1)(a) and the reports mentioned in paragraph (1)(b) within a period of [twelve] months beginning on the relevant date, there is a serious breach.

Serious breaches [4.9.4B]

86.—(1) There is a serious breach if condition A, B or C is met.

(2) Condition A is that a period of account of a reporting fund exceeds 18 months.

(3) Condition B is that—

(a) a reporting fund fails, or its managers fail, to provide the information, particulars or documents within the time specified in a notice given under regulation [4.8.2](1), and

(b) there is no appeal against the notice within the time specified in regulation [4.8.2](6).

(4) Condition C is that—

(a) on an appeal against a notice given under regulation [4.8.2](1), the Commissioners vary the notice,

(b) a reporting fund fails, or its managers fail, to provide the information, particulars or documents within the time specified in the notice (as so varied), and

(c) there is no appeal against the decision of the Commissioners.

Consequences of serious breaches [4.9.5]

87.—(1) This regulation applies if conditions A and B are met.

(2) Condition A is that—

(a) a reporting fund is in breach of a requirement imposed in this Part, and

(b) the breach is a serious breach.

(3) Condition B is that HMRC give notice to the fund—

(a) stating that the fund is in breach of a requirement imposed in this Part and that the breach is a serious breach, and

(b) specifying the serious breach.

(4) The fund is treated as a non-reporting fund for the reporting period in which HMRC give the notice and for all subsequent reporting periods.

(5) Paragraph (4) is subject to the following provisions of this regulation.

(6) If regulation [4.9.4B](3) applies, the fund is treated as a non-reporting fund for the reporting period in which the notice is given and for all subsequent reporting periods.

(7) If regulation [4.9.4B](4) applies, the fund is treated as a non-reporting fund for the reporting period in which the notice as varied is given and for all subsequent reporting periods.

Appeal against exclusion from the reporting fund regime [4.9.6]

88.—(1) If HMRC give notice to a fund under regulation [4.9.5](3) (an "exclusion notice"), the fund may appeal.

(2) The notice of appeal must be given to HMRC within a period of 42 days beginning with the day on which the exclusion notice is given.

(3) On an appeal, the tribunal may uphold or quash the exclusion notice.

CHAPTER 10

LEAVING THE REPORTING FUND REGIME

Termination by notice given by reporting fund [4.10.1]

89.—(1) If a reporting fund gives a notice under this regulation specifying a day (the "specified day") at the end of which this Part is to cease to apply to the fund, this Part shall cease to apply to the fund at the end of that day.

(2) The specified day must be the last day of a period of account of the reporting fund.

(3) A notice under paragraph (1) must be given in writing to HMRC before the specified day.

(4) If the fund gives a notice under paragraph (1), the fund must also make the notice available to each participant before the specified day.

(5) Paragraphs (2) to (4) of regulation [4.6.1] apply to determine whether the notice is made available to a participant in the same way as they apply to determine whether a report for a reporting period is made available to a participant.

(6) This regulation is subject to regulations [4.10.2] and [4.10.3].

Reporting fund becoming a bond fund [4.10.2]

90.—(1) This regulation applies if a reporting fund gives a notice under regulation [4.10.1] with the intention of becoming a bond fund after the specified day.

(2) In the case of a participant chargeable to income tax, HMRC may still treat the fund as a reporting fund after the specified day.

(3) After the specified day, a participant chargeable to corporation tax is charged to that tax in accordance with the provisions of Schedule 10 to FA 1996.

(4) In this regulation the "specified day" has the same meaning as in regulation [4.10.1].

Reporting fund not complying with requirements [4.10.3]

91.—(1) This regulation applies if—

(a) a reporting fund gives a notice under regulation [4.10.1], and

(b) the fund has not complied with all requirements imposed in this Part for all periods during which it was a reporting fund.

(2) For the purposes of these Regulations the fund is treated as a fund to which regulation [4.9.5] has applied and not as a fund to which regulation [4.10.1] has applied.

PART 4

CONSEQUENTIAL AMENDMENTS

Amendment of the Inheritance Tax Act 1984 [5.1.1]

92. In section 174(1)(a) of the Inheritance Tax Act 1984 (income tax and unpaid inheritance tax) for “Chapter V of Part XVII of the Taxes Act 1988, arising on a disposal which is deemed to incur on the death by virtue of section 757(3) of that Act” substitute “regulations made under section 41(1) of the Finance Act 2008, arising on a disposal which is deemed, under such regulations, to occur on the death (as at [date], see [Part 2] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))”.

Amendment of ICTA [5.1.2]

93.—(1) ICTA is amended as follows.

(2) In section 396(2) (Case VI losses) for “Chapter 5 of Part 17 applies” substitute “regulations made under section 41(1) of the Finance Act 2008 apply (as at [date], see [Chapter 4 of Part 2] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))”.

(3) In section 505(3)(b)(iii) (charitable companies) for “section 761(6) below” substitute “regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.4] of the Taxation of Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))”.

(4) In section 842(3A) (meaning of investment trust) for “section 761(1)(a)” substitute “regulations made under section 41(1)of the Finance Act 2008 (as at [date], see [regulation 3.2.1(2)] of the Taxation of Offshore Funds Regulations 2009 (S.I. 2009/[Y]))”.

Amendment of TCGA 1992 [5.1.3]

94.—(1) TCGA 1992 is amended as follows.

(2) In section 108(1)(c) (identification of relevant securities)—

(a) omit “, or have at any time been,”, and

(b) for “material interests in a non-qualifying offshore fund, within the meaning of Chapter V of Part XVII of that Act” substitute “relevant interests in a non-reporting fund, within the meaning of regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [Chapter 3 of Part 2] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))”.

(3) In section 212 (annual deemed disposal of holdings of unit trusts, etc.)—

(a) in subsection (5)(a) for “a material interest in an offshore fund for the purposes of Chapter V of Part XVII of the Taxes Act” substitute “a relevant interest in a non-reporting fund, within the meaning of regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [Chapter 3 of Part 2] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))”, and

(b) in subsection (6A)(a) for “subsections (6) and (8) of section 759 of that Act” substitute “regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulations 3.3.4 and 3.3.5] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))”.

(4) In paragraph 7 of Schedule 7AD (gains of insurance company from venture capital investment partnership: disposal of partnership asset giving rise to offshore income gain)—

(a) in sub-paragraph (1) for “Chapter 5 of Part 17 of the Taxes Act (offshore funds)” substitute “regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [Chapter 3 of Part 2] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))”, and

(b) in sub-paragraph (2) for “that Chapter” substitute “such regulations”.

Amendment of FA 1996 [5.1.4]

95. In paragraph 7(1)(a) of Schedule 10 to FA 1996 (loan relationships: collective investment schemes: meaning of offshore funds) for "a material interest in an offshore fund for the purposes of Chapter V of Part XVII of the Taxes Act 1988" substitute "a relevant interest in a non-reporting fund for the purposes of regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [Chapter 3 of Part 2] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))".

Amendment of ITTOIA 2005 [5.1.5]

96.—(1) ITT01A 2005 is amended as follows.

(2) In section 632 of ITTOIA 2005 (offshore income gains)—

(a) in subsection (2) for "section 761(1) of ICTA (charge to income tax of offshore income gain)" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.1] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))", and

(b) in subsection (3) for "Chapter 5 of Part 17 of ICTA (charge to income tax of offshore income gains)" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [Chapter 5 of Part 2] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))".

(3) In section 830(4) (meaning of "relevant foreign income") for paragraph (aa) substitute—

"(aa) regulations made under section 41(1) of the Finance Act 2008 (as at [date] see regulation [3.2.9A] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y])), ".

Amendment of ITA 2007 [5.1.6]

97.—(1) ITA 2007 is amended as follows.

(2) In section 152(8) (losses from miscellaneous transactions) for "section 761(1)(b)(i) of ICTA" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.1] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))".

(3) In section 482 (types of amount to be charged at special rates for trustees), in the description of "*Type 3*" for "section 761(1) of ICTA (offshore income gains)" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.1] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))".

(4) In section 535 (exemption for offshore income gains)—

(a) in subsection (3) for "Chapter 5 of Part 17 of ICTA (offshore funds) (see section 758 of, and Schedule 28 to, that Act)" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [Chapter 3 of Part 2] of the Offshore (Tax) Funds Regulations 2009 (S.I. 2009/[Y]))", and

(b) for subsection (4) substitute—

"(4) See also any provision of regulations made under section 41(1) of the Finance Act 2008 which—

(a) apply where property held on charitable trusts ceases to be subject to charitable trusts (as at [date], see [regulation 3.2.4(3)] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y])), and

(b) provide for any gain accruing in such circumstances to be treated as an offshore income gain not accruing to a charity (as at [date], see [regulation 3.2.4(3)] of those Regulations).".

(5) In section 734(5)(**a**) (reduction in amount charged: previous capital gains tax charge) for "section 762 of ICTA" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date] see regulation [3.2.8] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))".

(6) In section 1016(2) (table of provisions to which this subsection applies), in Part 3 of the Table, for "Section 761(1)(b)(i) of ICTA" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see regulation [3.2.1] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))".

Amendment of the Finance Act 2008 [5.1.7]

98.—(1) The Finance Act 2008(**b**) is amended as follows.

(2) In paragraph 99 of Schedule 7 (remittance basis: offshore income gains: commencement)—

(a) in paragraph (c)(i) for "section 762(2) of ICTA" where it first appears substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.8](1) of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))",

(b) in paragraph (c)(i) for "section 762(2) of ICTA" where it secondly appears substitute "that provision of those Regulations", and

(c) in paragraph (c)(ii) for "section 762(3) of ICTA" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.8](2) of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))".

(3) In paragraph 100 of Schedule 7, in sub-paragraph (1)(a)—

(a) for "section 762 of ICTA" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.8] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))",

(b) for "section 761 of ICTA" substitute "such regulations (as at [date], see [regulation 3.2.1] of those Regulations".

(4) In paragraph 101 of Schedule 7, in sub-paragraph (1)(b)—

(a) for "section 761 of ICTA" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.1] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))",

(b) for "section 762 of ICTA" substitute "such regulations (as at [date], see [regulation 3.2.8] of those Regulations".

(5) In paragraph 102 of Schedule 7, in sub-paragraph (1)(d)—

(a) for "section 762 of ICTA" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.8] of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))",

(b) for "section 761 of ICTA" substitute "such regulations (as at [date], see [regulation 3.2.1] of those Regulations"

(6) In paragraph 122(4) of Schedule 7 (remittance basis: attribution of gains to beneficiaries: commencement) for "section 762(3) of ICTA" substitute "regulations made under section 41(1) of the Finance Act 2008 (as at [date], see [regulation 3.2.8](2) of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/[Y]))".

[abc]
[def]

[day] [month] 2009 — Two of the Lords Commissioners of Her Majesty's Treasury

---

(**a**) Section 734(5) was inserted by paragraph 97 of Schedule 7 to the Finance Act 2008 (c. 9).
(**b**) 2008 c. 9.

SCHEDULE 1

Partial Transitional Provisions

1. In this Schedule—

"distributing fund" is to be construed in accordance with Chapter 5 of Part 17 of ICTA;

"existing fund" means an offshore fund which is in existence on the day these Regulations come into force;

"non-qualifying fund" is to be construed in accordance with Chapter 5 of Part 17 of ICTA.

2. A participant begins to have a relevant interest in a non-reporting fund at the beginning of the first period of account of the non-reporting fund to begin on or after [day/month 2009].

3. If an existing fund becomes a non-reporting fund, an offshore income gain arising to a person on the disposal of an asset must be calculated in accordance with Part 2, but is to have regard to the entirety of the period of the person's ownership of the asset.

4. An existing fund may make an application under Part 3 which is received by HMRC on whichever is the later of—

(a) The expiry of a period of three months beginning on the first day of the first period of account for which it is proposed that Part 3 should apply to the fund, or

(b) [day/month] 2009.

5.—(1) This paragraph applies if—

(a) an existing fund is a non-qualifying fund on the day these Regulations come into force, and

(b) becomes a reporting fund.

(2) Regulation [3.7.2] applies as if the existing fund were the non-reporting fund.

(3) Chapter 5 of Part 17 of ICTA applies to determine the offshore income gain referred to in regulation [3.7.2](2).

6. Regulations [4.7.2] and [4.7.3] do not apply to the extent that a distribution is made (or treated as made) before [day/month 2009].

SCHEDULE 2

Abbreviations and Defined Expressions

PART 1

Abbreviations of Acts

TMA 1970	The Taxes Management Act 1970 (c. 9)
ICTA	The Income and Corporation Taxes Act 1988 (c. 1)
TCGA 1992	The Taxation of Chargeable Gains Act 1992 (c. 12)
FA 1994	The Finance Act 1996 (c. 9)
FA 1996	The Finance Act 1996 (c. 8)
FISMA 2000	The Financial Services and Markets Act 2000 (c. 8)
FA 2002	The Finance Act 2002 (c. 23).
ITEPA 2003	The Income Tax (Earnings and Pensions) Act 2003 (c. 1)
ITTOIA 2005	The Income Tax (Trading and Other Income) Act 2005 (c. 5)
FA 2006	The Finance Act 2006 (c. 25)
ITA 2007	The Income Tax Act 2007 (c. 3)
FA 2008	The Finance Act 2008 (c. 9)

PART 2

Index of expressions defined or otherwise explained in these Regulations

Applicant (in Part 3)	Regulation [4.2.1](3)
Application (in Part 3)	Regulation [4.2.1](3)
Basic gain	Chapter 5 of Part 2
Bond fund	Regulation [1.1.3]
Eligible offshore fund (in Part 3)	Regulation [4.2.1](3)
Existing fund application (in Part 3)	Regulation [4.2.1](3)
Fund distribution date	Regulation [4.7.1](3)
Future fund application (in Part 3)	Regulation [4.2.1](3)
Guaranteed return fund	Regulation [1.1.3ZAB]
HMRC	Regulation [1.1.3]
HMRC intervention	Regulation [4.9.1A](5)
Main fund	Regulation [2.1.4]
Manager (in Part 3)	Regulation [4.2.1](3)
Market value	Regulation [1.1.3ZB]
Material disposal	Regulation [3.1.2]
Minor breach	Regulation [4.9.1A](3)
Non-reporting fund	Regulation [2.1.2](2)
Offshore income gain	Chapter 5 of Part 2
Offshore fund	Regulation [2.1.1]
Participant	Regulation [1.1.3ZA]
Proposed prospectus	Regulation [1.1.3]
Prospectus	Regulation [1.1.3]
Relevant interest (in a non-reporting fund)	Chapter 3 of Part 2
Reportable income	Chapter 5 of Part 3
Reported income	Regulation [4.6.2](2)
Reporting fund	Regulation [4.1.2]
Reporting period	Regulation [4.6.1A]
Serious breach	Regulation [4.9.1A](2)
Tax year	Regulation [1.1.3]
TCGA disposal (in Chapter 6 of Part 2)	Regulation [3.6.1](2)
Tribunal	Regulation [1.1.3]
Umbrella fund	Regulation [2.1.3](1)

EXPLANATORY NOTE

(This note is not part of the Regulations)

[To follow]

SCHEDULE 2

Abbreviations and Defined Expressions

PART 1

Abbreviations of Acts

TMA 1970	The Taxes Management Act 1970 (c. 9)
ICTA	The Income and Corporation Taxes Act 1988 (c. 1)
TCGA 1992	The Taxation of Chargeable Gains Act 1992 (c. 12)
FA 1994	The Finance Act 1996 (c. 9)
FA 1996	The Finance Act 1996 (c. 8)
FISMA 2000	The Financial Services and Markets Act 2000 (c. 8)
FA 2002	The Finance Act 2002 (c. 23).
ITEPA 2003	The Income Tax (Earnings and Pensions) Act 2003 (c. 1)
ITTOIA 2005	The Income Tax (Trading and Other Income) Act 2005 (c. 5)
FA 2006	The Finance Act 2006 (c. 25)
ITA 2007	The Income Tax Act 2007 (c. 3)
FA 2008	The Finance Act 2008 (c. 9)

PART 2

Index of expressions defined or otherwise explained in these Regulations

Applicant (in Part 3)	Regulation [4.2.1](3)
Application (in Part 3)	Regulation [4.2.1](3)
Basic gain	Chapter 5 of Part 2
Bond fund	Regulation [1.1.3]
Eligible offshore fund (in Part 3)	Regulation [4.2.1](3)
Existing fund application (in Part 3)	Regulation [4.2.1](3)
Fund distribution date	Regulation [4.7.1](3)
Future fund application (in Part 3)	Regulation [4.2.1](3)
Guaranteed return fund	Regulation [1.1.3ZAB]
HMRC	Regulation [1.1.3]
HMRC intervention	Regulation [4.9.1A](5)
Main fund	Regulation [2.1.4]
Manager (in Part 3)	Regulation [4.2.1](3)
Market value	Regulation [1.1.3ZB]
Material disposal	Regulation [3.1.2]
Minor breach	Regulation [4.9.1A](3)
Non-reporting fund	Regulation [2.1.2](2)
Offshore income gain	Chapter 5 of Part 2
Offshore fund	Regulation [2.1.1]
Participant	Regulation [1.1.3ZA]
Proposed prospectus	Regulation [1.1.3]
Prospectus	Regulation [1.1.3]
Relevant interest (in a non-reporting fund)	Chapter 3 of Part 2
Reportable income	Chapter 5 of Part 3
Reported income	Regulation [4.6.2](2)
Reporting fund	Regulation [4.1.2]
Reporting period	Regulation [4.6.1A]
Serious breach	Regulation [4.9.1A](2)
Tax year	Regulation [1.1.3]
TCGA disposal (in Chapter 6 of Part 2)	Regulation [3.6.1](2)
Tribunal	Regulation [1.1.3]
Umbrella fund	Regulation [2.1.3](1)

EXPLANATORY NOTE

(This note is not part of the Regulations)

[To follow]

ISBN 978-1-84532-505-3