
EXPLANATORY NOTE

(This note is not part of the Regulations)

Sections 41 and 42 of the Finance Act 2008 (c. 9), (which have since been amended and supplemented by provisions contained in Part 1 of Schedule 22 to the Finance Act 2009 (c. 10)), make provision for the tax treatment of participants in offshore funds. Section 41(1) of the Finance Act 2008 provides that the Treasury may by regulations make provision about the treatment of participants in an offshore fund for the purposes of enactments relating to income tax, capital gains tax or corporation tax; and section 42(3) of the Finance Act 2008 (as amended) envisages that the previous legislation relating to offshore funds (to be found in Chapter 5 of Part 17 to the Income and Corporation Taxes Act 1988 (c. 1)) may be repealed. These Regulations make provision accordingly.

These Regulations are in four Parts, with Parts 2 and 3 being divided into Chapters.

Part 1 of these Regulations contains introductory provisions. Regulation 1 deals with citation, commencement and effect; and regulation 2 sets out the structure of these Regulations. Regulation 3 defines the expression “offshore fund” by reference to the definition in section 40A(2) of the Finance Act 2008. Regulation 3 divides offshore funds into non-reporting funds (dealt with in Part 2 of these Regulations) and reporting funds (dealt with in Part 3 of these Regulations). 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. Regulation 5 is concerned with the treatment of umbrella arrangements; regulation 6 with funds comprising more than one class of interest; and regulations 7 to 12 with interpretation. Regulation 13 introduces the three Schedules to these Regulations. Schedule 1 contains transitional provisions and savings; and Schedule 2 contains repeals. The repeals in Schedule 2 have effect subject to any savings provisions in Schedule 1. Schedule 3 contains abbreviations and defined expressions that apply for the purposes of these Regulations.

Part 2 of these Regulations is concerned with the treatment of participants in non-reporting funds.

Chapter 1 of Part 2 contains preliminary provisions. Regulation 14 sets out the structure of this Part; and regulation 15 contains the definition of “material disposal”.

Chapter 2 of Part 2 deals with charges to tax on the participants in non-reporting funds. Regulation 16 provides for a charge to tax on certain amounts treated as distributions. Regulation 17 provides that there is a charge to tax if a person disposes of an asset; the asset is an interest in a non-reporting fund (or, in certain circumstances, an interest in a reporting fund) at the time of the disposal; and an offshore gain arises to the person making the disposal. Regulation 18 contains further provisions relating to this charge to tax, and regulation 19 is concerned with the application of the remittance basis. Regulation 20 deals with the position if an offshore income gain arises to a non-resident settlor in a tax year; and regulation 21 with the application of Chapter 2 of Part 13 of the Income Tax Act 2007 (c. 3) (transfer of assets abroad) if an offshore gain arises to a person resident or domiciled outside the United Kingdom. Regulations 22 to 24 deal with the application of provisions in the Taxation of Chargeable Gains Act 1992 (c. 12) (“TCGA 1992”) in the context of this Part.

Chapter 3 of Part 2 provides for various exceptions from the charge to tax in regulation 17.

Chapter 4 of Part 2 deals with the disposal of an interest in a non-reporting fund (and, in certain circumstances, of an interest in a reporting fund). Regulation 32 sets out the ambit of this Chapter. Regulation 33 sets out the basic rule: 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. The basic rule, however, applies subject to the following provisions of this Chapter, set out in regulations 34 to 37.

Chapter 5 of Part 2 is concerned with offshore income gains and the computation of offshore income gains. Regulation 38 provides that an offshore income gain arises to a person on the disposal of an asset if a basic gain arises on the disposal; and that the disposal gives rise to an offshore income gain on an amount equal to the basic gain on the disposal. Regulation 39 explains how the basic gain is computed. The computation of the basic gain, however, is subject to a number of other provisions: some of these have been set out in regulations 34 to 37; the others are set out in regulations 40 to 43.

Chapter 6 of Part 2 deals with the case which arises if a material disposal gives rise to an offshore income gain, and that disposal also constitutes the disposal of the interest concerned for the purposes of TCGA 1992 (the “TCGA disposal”). Regulation 44 sets out the ambit of this Chapter. Regulation 45 sets out the general rules that apply: a sum equal to the offshore income gain is deducted from the gain arising on the TCGA disposal. The general rules, however, need to be qualified in various respects; and the qualifications are set out in regulations 46 and 47.

Chapter 7 of Part 2 (consisting of regulation 48) is concerned with the situation arising if an offshore fund ceases to be a non-reporting fund and becomes a reporting fund. A participant in the fund may elect to be treated as disposing of an interest in the non-reporting fund and as acquiring an interest in the reporting fund.

Part 3 of these Regulations is concerned with the treatment of participants in reporting funds.

Chapter 1 of Part 3 contains preliminary provisions. Regulation 49 sets out the structure of this Part; and regulation 50 contains the definition of “reporting fund”.

Chapter 2 of Part 3 deals with entry into the reporting fund regime. Regulation 51 specifies the persons who may make an application for this Part to apply to an offshore fund; and regulation 52 with the position arising if a non-reporting fund wishes to make an application to become a reporting fund. Regulation 53 deals with the contents of an application; and regulation 54 with the form, timing and withdrawal of an application. The next two regulations deal with procedure on applications: Her Majesty’s Revenue and Customs (“HMRC”) must respond to the application (regulation 55); and, if HMRC reject the application, the person who made the application may appeal (regulation 56).

Chapter 3 of Part 3 is concerned with the general duties of reporting funds. Regulation 57 deals with the effects of entry into the reporting fund regime, and regulation 58 with general duties of reporting funds.

Chapter 4 of Part 3 is concerned with the preparation of accounts. A reporting fund must prepare accounts in accordance with international accounting standards, or in accordance with the generally accepted accounting practice specified in the application (regulation 59). Special rules apply if there is a change in accounting practice (regulations 60 and 61).

Chapter 5 of Part 3 deals with the computation of reportable income. Regulation 62 provides that a reporting fund must provide a computation of its reportable income for a period of account. Regulation 63 provides that the starting point for this computation is the “total comprehensive income for the period” in a case where the fund prepares its accounts in accordance with international accounting standards (or the entries equivalent to that expression in any other case). But this starting point may need to be adjusted having regard to various matters specified in the remainder of this Chapter and in Chapter 6 of Part 3. Adjustments may be needed to deal with capital items (regulations 64 and 65); with special classes of income (regulations 66 to 71); and with reporting funds operating equalisation arrangements (regulation 72).

Chapter 6 of Part 3 deals with transactions by certain offshore funds which are not treated as trading. If a transaction falls within the ambit of this Chapter, the transaction will not fall within the starting point for the computation of reportable income specified in regulation 63, but will be classified as a capital item within regulation 64: the consequence, accordingly, is that a transaction falling within the ambit of this Chapter will not form part of the offshore fund’s reportable income. The Chapter begins (in regulation 73) by specifying the two conditions which an offshore fund must meet before this Chapter can apply: a fund which meets these conditions is referred to as a “diversely owned fund”. The conditions are the “equivalence condition” (regulation 74) and the

“genuine diversity of ownership condition” (regulations 75 and 76). Clearance that the fund meets the two conditions may be applied for (regulation 77) and the procedure for obtaining clearance is specified (regulation 78). There are circumstances in which a clearance may not be relied upon (regulation 79). Regulation 80 provides that if a diversely owned fund carries out an investment transaction in an accounting period, the investment transaction is treated as a non-trading transaction. Regulation 81 defines the expression “investment transaction”; and regulations 82 to 89 provide for the interpretation of component parts of that expression.

Chapter 7 of Part 3 deals with reports to participants. Regulation 90 provides that a reporting fund must make a report available to each participant for each reporting period. Regulation 91 deals with the meaning of the expression “reporting period” and regulation 92 with the contents of the report. Regulation 93 makes further provision if the relevant period of account is lengthy and the reporting fund does not have full information available for the relevant reporting period.

Chapter 8 of Part 3 deals with the tax treatment of participants in reporting funds. Provision is first made in relation to the tax treatment of the reported income of the fund in the hands of participants. Regulation 94 provides for any excess of the reported income of the offshore fund over the income of the fund actually received by participants in the fund in respect of a reporting period to be attributed to the participants in proportion to their rights. Regulations 95 to 97 make provision for participants to be charged to income tax in the case of various different types of offshore fund; and regulation 98 makes provision for participants to be charged to corporation tax. Provision is then made in relation to disposals and deemed disposals of interests. Regulation 99 provides that 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. Regulation 100 provides that if an offshore fund ceases to be a reporting fund and becomes a non-reporting fund, a participant in the fund may elect to be treated as disposing of an interest in the reporting fund and as acquiring an interest in the non-reporting fund. Further provision is then made: regulation 101 contains special provisions applying to charitable companies and charitable trusts, while regulations 102 to 105 are anti-avoidance provisions applying to financial traders.

Chapter 9 of Part 3 deals with the provision of information to HMRC. Regulation 106 specifies the information which a reporting fund must provide to HMRC in relation to each period of account, and regulation 107 provides HMRC with powers to obtain information.

Chapter 10 of Part 3 applies if a reporting fund is in breach of a requirement imposed in this Part. Regulation 108 deals with the various types of breach, distinguishing between a serious breach and a minor breach; and regulation 109 deals with the consequences of minor breaches. Regulation 110 applies if there is a difference between the reportable income of a reporting fund for a period of account, and the reported income of the fund for all reporting periods comprised in the period of account: the classification of any resulting breach depends on the amount of the difference, and whether the error is corrected as soon as reasonably possible. Regulation 111 applies if the reporting fund provides an incorrect report and regulation 110 does not apply: the classification of the breach depends on whether the error is corrected as soon as reasonably possible. Regulation 112 applies if a reporting fund has not provided information to HMRC in relation to a period of account and a report to each participant for each reporting period comprised in that period of account: the classification of the breach (if any) depends upon how quickly the information is provided. Regulation 113 deals with serious breaches and regulation 114 with the consequences of serious breaches: HMRC may give notice to the fund excluding it from the reporting fund regime (so that the fund is treated as a non-reporting fund). Regulation 115 provides that the fund may appeal against the notice.

Chapter 11 of Part 3 deals with leaving the reporting fund regime. Regulation 116 provides that a reporting fund may give notice to HMRC specifying a date from which this Part will cease to apply to the fund. But if the fund has not complied with all requirements imposed in Part 3, regulation 117 provides that the fund is treated as a fund to which regulation 114 has applied and not as a fund to which regulation 116 has applied.

Draft Legislation: This is a draft item of legislation. This draft has since been made as a UK Statutory Instrument: The Offshore Funds (Tax) Regulations 2009 No. 3001

Chapter 12 of Part 3 deals with constant NAV funds. Regulation 118 defines “constant NAV fund”. Regulation 119 provides that, in the case of a constant NAV fund, Chapters 2 to 11 of Part 3 apply with modifications; and regulations 120 to 124 specify those modifications.

Part 4 of these Regulations (consisting of regulations 125 to 131) makes provision for consequential amendments to primary legislation.

Schedule 1 to these Regulations contains transitional provisions and savings.

Schedule 2 to these Regulations provides for repeals. Chapter 5 of Part 17 of the Income and Corporation Taxes Act 1988 is repealed, together with provisions in later legislation amending that Chapter. This Schedule also includes the repeals made in Part 4 of these Regulations.

Schedule 3 to these Regulations lists abbreviations and defined expressions. Part 1 gives the abbreviated references to Acts used in these Regulations; and Part 2 consists of an Index of expressions defined or otherwise explained in these Regulations.

A full impact assessment of the effect that the new legislation relating to offshore funds (including this instrument) will have on the costs of business and the voluntary sector is annexed to the Explanatory Memorandum which is available alongside this instrument on the OPSI website.