



Interest distributions from Authorised Investment Funds paid without deduction of tax

Consultation document

Publication date: 22 July 2013

Closing date for comments: 16 September
2013

Subject of this consultation:	The conditions under which interest distributions from Authorised Investment Funds may be paid without deduction of tax.
Scope of this consultation:	The Government announced at Budget 2013 that it would consult on a proposal to remove the requirement to withhold tax on interest distributions on UK domiciled bond funds when sold via reputable intermediaries and marketed only to non –UK investors. HM Revenue & Customs (HMRC) are asking for views on the proposals set out in this document.
Who should read this:	HMRC would like to hear in particular from tax practitioners, fund managers, representative bodies, administrators and other interested parties.
Duration:	22 July to 16 September 2013.
Lead official:	John Buckeridge
How to respond or enquire about this consultation:	Please send responses by email to: John.buckeridge@hmrc.gsi.gov.uk or by post to: John Buckeridge CTISA Financial Products & Services Team Room 3C/06 100 Parliament Street London SW1A 2BQ Enquiries about this consultation should be directed to - John Buckeridge Tel 020 7147 2560 or Wayne Strangwood Tel 020 7147 2545
Additional ways to be involved:	HMRC will consider holding further meetings with interested parties to discuss the proposals in this consultation. The timing, format and venue of meetings will be informed by expressions of interest received.
After the consultation:	A summary of responses together with draft regulations and guidance will be published in Autumn 2013, with a view to legislating by statutory instrument around the end of the year.
Getting to this stage:	This consultation follows an announcement at Budget 2013. This is the first stage in the formal consultation process.
Previous engagement:	HMRC has held informal discussions with interested stakeholders to identify the key issues that need to be addressed, and the proposals for change.

Contents

1	Introduction	4
2	The Proposal and Consultation Questions	5
3	Assessment of Impacts	7
4	The Consultation Process: How to Respond	8

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1. Introduction

1.1 Introduction

This consultation relates to the implementation of one of the tax elements of the UK Investment Management Strategy announced at Budget 2013, namely to:

“Allow UK domiciled bond funds to pay gross interest where they are marketed to non UK residents.”

The full HMT document outlining the Strategy is available on the gov.uk¹ website.

1.2 Background

Authorised Investment Funds (AIFs) can, in certain circumstances pay interest distributions instead of (or, in some cases, in addition to) dividend distributions.

Such interest distributions are treated as deductible for the purposes of Corporation Tax but are taxed as interest in the hands of investors. In the case of UK resident investors within the charge to income tax the AIF must deduct basic rate income tax from the payment and account for the amount deducted to HMRC. Individual investors must then meet any higher rate tax liability directly.

The origin of interest distributions paid by a UK domiciled fund could be from interest bearing investments anywhere in the world and, where such distributions are paid to non-resident investors, to deduct UK income tax may be considered to be inappropriate and it deters non-residents from holding investments in UK funds which have interest bearing investments.

Existing tax regulations therefore permit an interest distribution paid by an AIF to a non-resident investor to be paid without deduction of Income Tax subject to certain conditions designed to ensure that the investor is actually non-resident.

This rule should, at least in theory, permit UK funds paying interest distributions ('bond' funds) to be freely available to foreign investors without deduction of UK basic rate income tax from interest distributions.

In practice, however, because a holding in an investment fund is typically sold and maintained through an intermediary (a distributor), the fund administrator may have no direct knowledge of the investors holding units in the fund. A distributor based offshore may be unwilling to handle holdings of units in UK funds where that would require them to take on the administrative burden of establishing whether each of their clients is resident in the UK.

1

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/188368/uk_investment_management_strategy.pdf.pdf

This has the effect of preventing UK domiciled bond funds from competing freely with similar non-UK based funds as offshore distributors which sell a range of funds to international investors will be less willing to market UK bond funds.

2. The Proposal

2.1 The intended result of the change

As set out in the Government's Investment Management Strategy, published at Budget 2013, the Government is determined to improve the competitiveness of UK domiciled bond funds.

It is therefore proposed that a UK domiciled fund should be permitted to make available units in the fund from which interest distributions will be paid without deduction of basic rate income tax provided that the units are sold through distributors who will market the units exclusively outside the UK. There would be no requirement on the distributors to establish the tax residence of investors who approach them from addresses outside the UK.

It is sensible, however, to retain the withholding tax requirements for interest distributions paid from units marketed to UK residents. Otherwise recipients will be faced with a different tax treatment than the generality of taxpayers in receipt of interest income (while still having the same total tax liability) which may result in more taxpayers having to complete tax returns.

This measure is not expected to lead to either a tax loss or gain to the Exchequer.

Any UK residents who, exceptionally, obtain internationally distributed units in a UK domiciled fund making interest distributions will need to ensure that tax is accounted for on the full amount of the distribution (as none will have been deducted). This is the same rule as currently applies for any UK residents receiving distributions from offshore funds which are treated as interest and where no UK tax is deducted.

There will be no change for UK residents holding units in UK funds which have been marketed in the UK or to UK residents.

Following legislation in Schedule 46 to the Finance Act 2013 which removes the concept of 'ordinary residence' from primary legislation for most tax purposes, it is also intended, at the same time, to remove corresponding references to being 'ordinarily' resident from the tax Regulations for AIFs. In the details that follow reference is therefore made only to a person being either resident or not-resident in the UK.

2.2 How it might work

Under current rules an AIF can make interest distributions without deduction of tax to a company (receiving the distribution on behalf of the beneficial owner) provided that the company itself meets certain criteria with respect to money laundering and that the

AIF has reasonable grounds for believing that the beneficial owner is not resident in the UK.

It is proposed to replace (or possibly provide an alternative to) the existing requirement for the AIF to have reasonable grounds for believing that the beneficial owner is not resident with a new requirement as follows:

- the units/ shares of that class are marketed exclusively outside the UK with no marketing that is specifically targeted to investors resident in the UK,
- the units are marketed and sold with clear information that:
 - no UK income tax will be deducted from interest distributions, and
 - if the investor is resident or becomes resident in the UK then they must account to HMRC for tax due on the full amount of any interest distributions received or accumulated while they are UK resident.

This could replace or be an alternative to the existing condition (“...that the legal owner has reasonable grounds for believing that the participant is not resident in the United Kingdom.”).

It is intended that this provision will apply equally to units marketed by UK or international distributors provided that the units are only marketed to investors not resident in the UK.

Other regulations which remove the requirement to withhold tax when the AIF makes an interest distribution to a participant for which there is a declaration of non-residence would remain unchanged (except to remove references to ordinary residence).

2.3 Technical Note

An AIF is normally required to deduct tax from an interest distribution. Chapter 2 of Part 4 (regulations 26 to 33) of The Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) set out the circumstances in which an AIF is not required to deduct tax from an interest distribution. The proposal above is likely to involve making changes to regulation 27 while leaving the other regulations in this section unchanged.

Draft Regulations to remove references to ordinary residence and which will now be included with this proposal to the extent they remain relevant have previously been published and can be found at: <http://www.hmrc.gov.uk/drafts/draft-leg-fb-2013.htm>

2.4 Specific Questions for Consultation

1. Will the proposed conditions enable the objective of enabling UK domiciled bond funds to be marketed outside the UK to non-UK residents to be met?
2. Is the existing condition (providing for gross payment to a reputable intermediary when the fund has a reasonable belief that the participant is not UK resident) still required as an alternative? (Or will the new conditions always be met in such cases so that the current rule becomes otiose)?

- Will the proposed approach provide a level playing field for UK based and for offshore distributors marketing to individual investors resident outside the UK?

Other comments on the proposals outlined in this consultation paper are also welcome and will be considered.

3. Assessment of Impacts

Summary of Impacts

Exchequer impact (£m)	2013-14	2014-15	2015-16	2016-17	2017-18
	Negligible	Negligible	Negligible	Negligible	Negligible
Economic impact	The measure is not expected to have any significant economic impacts.				
Impact on individuals and households	It is not expected that there will be any significant impact on individuals and households generally, as relatively few UK resident individuals invest in share classes of UK funds which are marketed only outside the UK.				
Equalities impacts	There is no evidence to suggest that the measure will have any adverse equalities impacts for any particular groups.				
Impact on businesses and Civil Society Organisations	This measure is expected to have a negligible impact on businesses and civil society organisations.				
Impact on HMRC or other public sector delivery organisations	This measure is not expected to have significant effect on any operational area of HMRC or any effect in other public sector organisations.				
Other impacts	<p><u>Small firms impact test:</u> small firms will be affected to the extent that they form part of the population of affected fund managers.</p> <p>Other impacts have been considered and none have been identified.</p>				

4. The Consultation Process

4.1 Framework

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals.

4.2 How to respond

Responses should be sent by 16 September 2013

by e-mail to: john.buckeridge@hmrc.gsi.gov.uk

or by post to: John Buckeridge
Room 3c/06, Third Floor, CTISA
HMRC, 100 Parliament Street
London SW1A 2BQ

Telephone enquiries: 020 7147 2560

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC Inside Government](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

4.3 Next Steps

Subject to consultation responses HMRC expects to issue a draft Statutory Instrument for comment for a short period following this consultation. Following this period the Government will decide upon a final version to be laid before the House of Commons to come into force shortly thereafter.

4.4 Confidentiality

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 HM Revenue and Customs (HMRC).

HMRC 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.

4.5 Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles

The Consultation Principles are available on the Cabinet Office website: <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

Amy Burgess, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.