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Taxation of investments in funds

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Agenda

1. Overview
2. UK funds
3. Offshore funds
4. Non-resident capital gains

1. Overview

Overview

Types of funds

UK Traditional

Open Ended Investment Company
Authorised Unit Trust
Investment Trust
Real Estate Investment Trust
Exchange Traded Fund
Authorised Contractual Scheme

Offshore Traditional

Mutual Funds (USA)
Unit Investment Trusts (USA)
Common Contractual Fund (Ire)
SICAV/SICAF (Lux/France)
BEVAK/BEVEK (NL/Belgium)
VCIC/ICAV (Ire)
Exchange Traded Fund

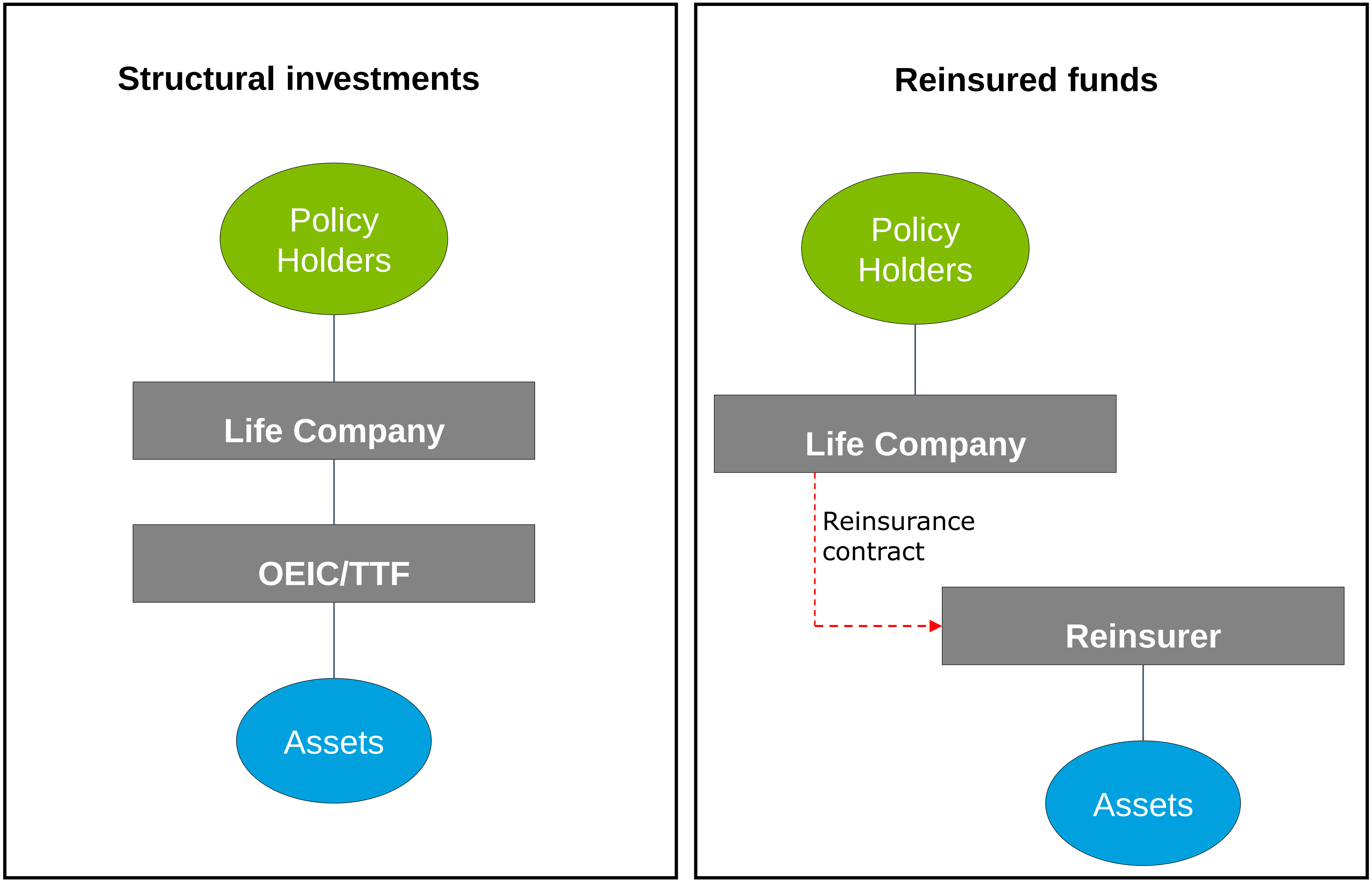
UK Alternative

UK Limited Partnership
Unauthorised Unit Trust
Venture Capital Trust

Offshore Alternative

Hedge Fund (typically Cayman Islands)
Jersey (/G) Property Unit Trust
Exchange Traded Fund

Overview
Investment by life companies



2. Taxation of UK Funds

Taxation of UK Funds
Regulated Funds

In the UK, regulated funds are typically established as:

- **Open-Ended Investment Company ("OEIC")**, also known as an Investment Company with Variable Capital ("ICVC")

- **Authorised Unit Trust ("AUT")**

- **Authorised Contractual Scheme ("ACS")**

In the UK, these entities are typically authorised and regulated by the Financial Conduct Authority ("FCA") and, if so, are also known as Authorised Investment Funds ("AIFs") – which can be confused with Alternative Investment Funds.

Taxation of UK Funds
OEIC – Open Ended Investment Companies

Characteristics

- A company
- Shareholding
- Open ended/variable capital
- Depository
- Legal owner of investments
- Beneficial owner of investments

Taxation in the fund

- Taxed at a basic rate income tax rate of 20%
- Exempt from tax on gains
- Management expenses are deductible
- In practice, dividends fall within the dividend exemption
- For bond funds distributions are treated as tax deductible

Taxation of UK Funds

AUT – Authorised Unit Trust

Characteristics

- A trust
- Units
- Trustees
- Trustee legally owns investments
- Investors beneficially own investments

Taxation in the fund

- Treated as a company for tax purposes
- Taxed at a basic income tax rate of 20%
- Exempt from tax on gains
- Management expenses are deductible
- In practice, dividends fall within the dividend exemption
- For bond funds distributions are treated as tax deductible

Taxation of UK Funds
Corporate streaming

Streaming splits the distribution between:

Franked -	taxed as dividend (usually exempt)
Unfranked -	grossed up at basic rate of income tax
	taxed as annual payment
	UK source – reclaim income tax
	Non-UK source – treat income tax credit as overseas tax and claim double tax relief

The relevant calculation is:

$$U = \frac{A \times C}{D}$$

U = the unfranked part of the dividend distribution (taxed as annual payment)

A = the amount of the dividend distribution

C = gross income derived from income that has been subject to corporation tax reduced by the legal owners net liability to corporation tax

D = gross income as reduced by the legal owner’s net liability to corporation tax

Tax Transparent Funds (TTF)
Introduction

Most common form of tax transparent funds used within the investment management industry, include:

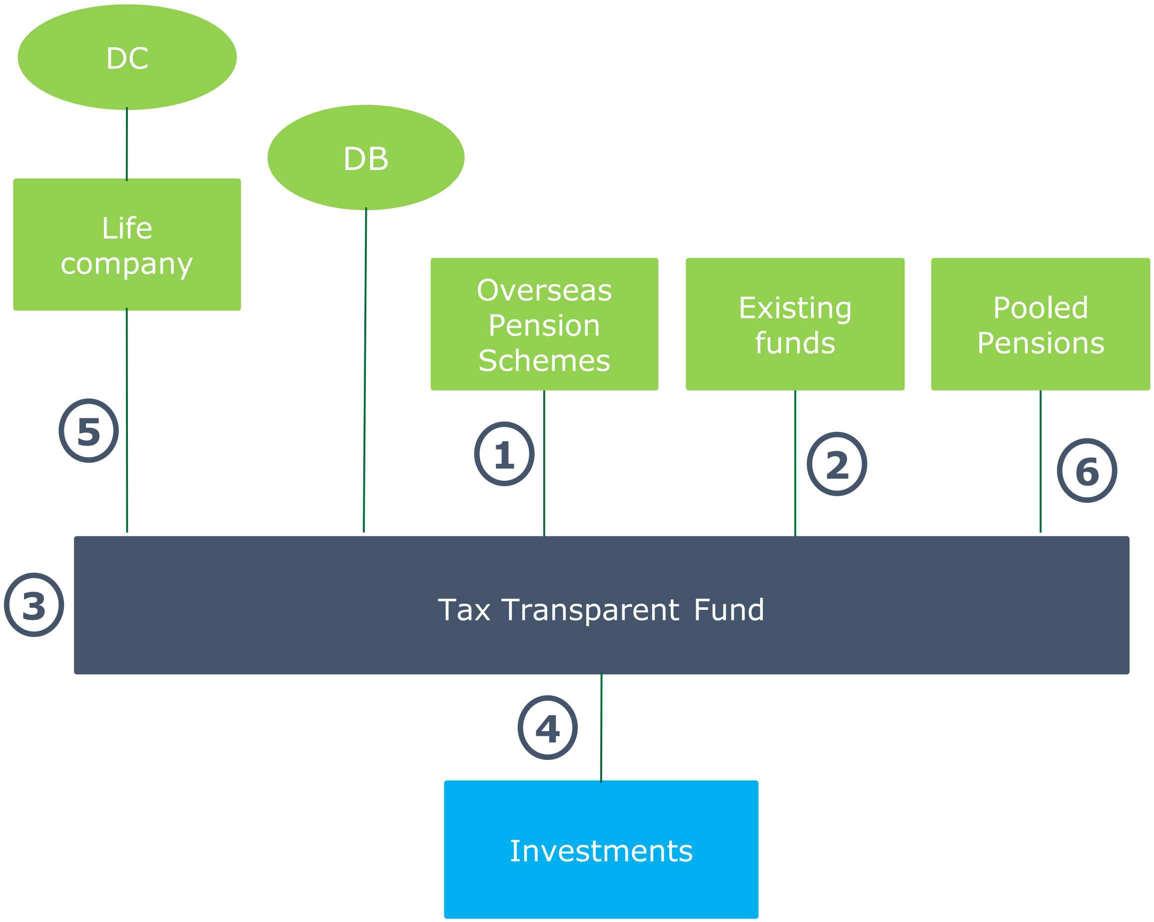
- **UK** Authorised Contractual Schemes (“ACS”)
- **Irish** Common Contractual Funds (“CCF”)
- **Luxembourg** Fonds Commun de Placement (“FCP”)
- **Dutch** Fondsen Voor Gemene Rekening (“FGR”)

All of the above can be regulated as UCITS fund.

Tax Transparent Funds

Reasons for establishing a tax transparent fund

There are a number of reasons groups are considering establishing tax transparent funds. Some of these examples are set out below. Both and ACS and CCF can be used in most of these scenarios:



1: Increased distribution

2: Fund rationalisation programs

3: VAT savings on management fees

4: Tax efficiencies

5: Solvency II

6: Access to pooled pension investors

Tax Transparent Funds

UK ACS co-ownership schemes

Chargeable gains

- Opaque for chargeable gains purposes
- S212 TCGA 1992 applies
- Transfers of assets from a life assurance company seeding a co-ownership scheme – nil gain / nil loss treatment:
  - But anti-avoidance rules apply to prevent gains from being spread where seeder units are sold within 3 years of transfer
- Amounts already taxed (e.g. loan relationship gains) treated as incidental costs of acquisition and disposal of units
- Existing rules which apply to AIFs on disposal of assets to a connected manager extended to apply to ACSs (i.e. no connected party loss)

Summary – Taxation of UK funds by UK lifeco

Type of fund	Tax in fund	Income	Gain
AUT/OEIC (bond fund)	Yes – investment income less expenses of management (gains exempt) taxed at basic rate of income tax	Taxed as loan relationship	
AUT/OEIC (when not a bond fund)		FII – dividend (Part 9A of CTA 09) UFII – gross-up by BRIT, tax as annual payment; if UK source, reclaim BRIT, if non-UK source, tax credit is overseas tax for DTR	Subject to s212 TCGA
ACS CS	No	Transparent	CG assets treated as single asset, subject to s212 disposals
ACS LP			Transparent
LP/LLP			Transparent (though for venture capital investment partnerships treat CG assets as a single asset)
REIT	Income, profits and gains of qualifying property rental business is exempt	Property income dividend - treated as property income Non-property income dividend – dividend (Part 9A of CTA 2009)	Subject to s212 TCGA
Unauthorised unit trust (UUT)	Yes (gains exempt for exempt UUTs)	EUUTs – income treated as received is taxed NEUUTs – income likely to be exempt	Taxed – s212 TCGA does not apply
Investment trust company (ITC)	Yes (gains exempt)	Dividend (Part 9A of CTA 2009)	Taxed – s212 TCGA does not apply

3. Offshore Funds

Offshore Funds

Types and locations

Offshore funds (funds not domiciled in the UK) may generally be established as:

- Mutual Funds
- Hedge Funds
- Société d'investissement à capital variable (SICAV)/Sistema de Cadastramento Unificado de Fornecedores (SICAF)
- Investment company with variable capital (ICVC)/Irish Collective Asset Management Vehicle (ICAV)

Common locations include:

- Cayman Islands
- Ireland
- Jersey
- Luxembourg

Offshore Funds

Investor Taxation

- The offshore fund regime distinguishes between reporting and non-reporting funds.
  - **Non-reporting** – Entire investment return is taxed as income on distribution / exit / redemption (“offshore income gain”)
  - **Reporting funds** – Requirements to report income annually which will be taxed in the hands of UK investors each year. Subsequent profit on disposal is treated as a capital gain.

Summary – Taxation of offshore funds by UK lifeco

Type of fund	Income	Gain
Bond fund	Taxed as loan relationship	
Reporting fund (non-transparent fund)	Actual and reported income treated as dividend (Part 9A of CTA 09)	Subject to s212 TCGA
Non-reporting fund (non-transparent fund)	Actual income treated as dividend (Part 9A of CTA 2009)	Subject to s212 TCGA (offshore income gain rules are disapplied for assets in the long-term insurance fund)
Tax transparent funds	As per ACS co-ownership schemes	

Also need to check CFC rules, though likely either not to apply, or for their to be provisions mitigating double taxation

4. Non-resident capital gains

Other Recent Tax Developments in the UK

Non Resident Capital Gains

- From April 2019 **UK tax will be charged on gains made by non-residents on disposals of all types of UK property**
- **Indirect property disposals will also be within the charge to UK tax** where there is a sale of an entity (or group) where greater than 75% of the gross asset value derives from UK land, triggered by the sale of an interest by any owner who has held at least 25% interest in the entity over the last 5 years prior to disposal.
- The 75% test will be assessed on a gross asset market value basis. Non-UK land is excluded when calculating the 75%.
- Additionally, the Government is consulting on bringing non-resident landlords within scope of UK corporation tax from April 2020.
- All of the above changes are subject to consultation.