

THE NEW OFFSHORE FUNDS RULES

What are the offshore funds rules and why are they changing?

► **A CHANGE IN THE OFFSHORE FUND RULES MEANS THAT, WITHOUT TAKING ACTION NOW, INVESTORS IN OFFSHORE FUNDS COULD BE TAXED ON SALES OF THEIR UNITS AS INCOME RATHER THAN MORE FAVOURABLY AS CAPITAL GAINS.**

The offshore funds rules aim to prevent the tax-free roll up of income in an offshore fund. Without these rules, the investor's return on a sale of fund units would be taxed under the favourable capital gains tax rules.

Where the offshore funds rules apply any gains on the sale of fund units are taxed as income rather than capital gains. And, the rules apply whether the fund's property is in the UK or overseas.

Until 1 December 2009, funds which distributed at least 85 per cent of their income were exempted from these rules and profits on sales of units in such funds were capital gains. On 1 December 2009 the rules changed. There is now no requirement for a fund to distribute income, but instead, the fund can opt to be a 'Reporting' or 'Non-reporting Fund'. There are transitional rules dealing with funds already in existence on 1 December.

A Reporting Fund must report to each investor their share of the income of the fund (calculated according to the rules). A UK resident investor must include this amount on his own tax return, and is taxed as if it were his income, regardless of whether he has actually received any distribution from the fund. Subsequent sales of units remain within the capital gains rules. For Non-reporting Funds, sales of units are taxable as income.

Investors in a Reporting Fund may face a tax charge even though they have not received a distribution from the fund. Since a 'dry' tax charge is possible, fund managers need to think carefully about whether their funds should be reporting or non-reporting.

WHAT FUNDS ARE CAUGHT BY THE OFFSHORE FUND RULES?

The definition of 'offshore fund' under the rules is wide and encompasses most overseas entities or co-ownership arrangements, other than partnerships, where the investors:

- do not have day-to-day control over the fund's assets
- where the investor can realise his interest in the fund at a price calculated by reference to the net assets of the fund.

The definition normally catches funds which are 'open ended', that is, which allow investors to redeem their units, for example a Jersey Open Ended Investment Company (OEIC) or a Luxembourg SICAV.

For a normal close-ended company, such as a Luxembourg SICAF or SOPARFI, an investor would expect to realise his investment only on liquidation. The offshore fund rules do not usually apply, unless the fund is designed to wind up on a specified date.



ABOUT BDO

BDO LLP is the UK Member Firm of BDO, the world's fifth largest accountancy network, with more than 1,000 offices in over 100 countries*. In the UK we have offices in Birmingham, Bristol, Cambridge, Chelmsford, Epsom, Gatwick, Glasgow, Hatfield, Leeds, London, Manchester, Northern Ireland, Reading and Southampton.

There is an exemption for 'tax transparent funds', whose investors are in any event subject to UK tax on their share of fund income. Provided the fund makes sufficient information available to investors to meet their UK tax obligations, it is not required to report under the offshore funds rules. The investor is taxed on unit sales as capital.

SHOULD A FUND BE REPORTING OR NON-REPORTING?

Capital gains treatment on unit sales is normally better than income, because of lower tax rates and more available reliefs. In most cases then, reporting status will be beneficial, especially where capital growth is an important part of the investor's return. Exceptions are:

- if a fund has no, or few UK investors, the cost of reporting may outweigh any tax benefit to UK investors
- where a fund's investors are taxed as income on unit sales (for example traders)
- where an investor's tax treatment under income or capital gains rules is similar (for example for UK corporates).

UK resident investors in Reporting Funds which do not distribute all their income, are nevertheless liable to UK tax on the reported income, which may be unattractive. The costs of complying with the reporting regime also needs to be considered.

WHAT INCOME IS REPORTED TO INVESTORS?

The income reported under the offshore fund rules is the figure of income shown in the fund's accounts, after adjusting for capital items. There are special rules for calculating reported income where a fund owns interests in other funds.

PROVISION OF INFORMATION TO INVESTORS AND HMRC

A Reporting Fund must provide to investors and to HMRC details of the amount of reportable income and other supporting information and documents. To be accepted into the Reporting Fund regime, the Fund manager must undertake to HMRC that:

- it will provide to investors and HMRC the information required under the rules
- it will either prepare its accounts under international accounting standards ('IAS'); or if not, show how IAS equivalent figures can be computed from its accounting results.

HOW CAN BDO HELP?

BDO can help investors and fund managers understand their tax position and reporting obligations under the new rules, and to decide what status their funds should opt for. Opting for the wrong status can lead to investors paying tax earlier than they should do, or paying too much tax on eventual sale of their units. BDO has an extensive list of fund clients, and has considerable experience in advising both funds and investors on tax issues arising.



'Tax Team of the Year' 2009 and 2008
'Audit Team of the Year' 2008
'Corporate Finance Deal of the Year' 2008

For more information please contact your usual BDO Adviser or:

Philip Spencer

Tax Partner
philip.spencer@bdo.co.uk
020 7893 2483

Angela Foyle

Tax Partner
angela.foyle@bdo.co.uk
020 7893 2475

Andrew Levene

Tax Principal
andrew.levene@bdo.co.uk
020 7893 2045

Thomas Story

Tax Director
thomas.story@bdo.co.uk
020 7893 3964

www.bdo.co.uk

*Including exclusive alliances of BDO Member Firms.

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO LLP to discuss these matters in the context of your particular circumstances. BDO LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

BDO LLP, a UK limited liability partnership registered in England and Wales under number OC305127, is a member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. A list of members' names is open to inspection at our registered office, 55 Baker Street, London W1U 7EU. BDO LLP is authorised and regulated by the Financial Services Authority to conduct investment business.

BDO is the brand name of the BDO network and for each of the BDO Member Firms.

In Northern Ireland, BDO is represented by BDO Northern Ireland, a separate and independent member of the BDO International network.

BDO LLP is the Data Controller for any personal data that it holds about you. We may disclose your information, under a confidentiality agreement, to a Data Processor (Shamrock Marketing Ltd). To correct your personal details or if you do not wish us to provide you with information that we believe may be of interest to you, please contact Amanda Bunney on 020 7893 2104 or email amanda.bunney@bdo.co.uk

Copyright © February 2010. BDO. All rights reserved.

This document is printed on 9lives 80, a paper containing 80 per cent recycled fibre and 20 per cent virgin Totally Chlorine Free (TCF) fibre sourced from sustainable forests. 9lives 80 is produced by an ISO 14001 accredited supplier.