

Asset Management – The Calm Amidst The Storm

Introduction

In the harshest economic environment most of us have witnessed it is not surprising that the Government's focus in this PBR is not on tax measures for the esoteric legislation that impacts pooled funds. Given that the once relatively simple regime for UK funds now has separate regimes for QIS and PAIFs with further regimes such as TEFs in the pipeline, and that the offshore funds rules and investment management exemption rules have been substantially amended in recent times, that may be just as well.

Taxation of Foreign Profits

The Government will bring forward reforms to the taxation of foreign profits in the Finance Bill 2009 enabling exemption from tax for eligible foreign dividends received by large and medium sized groups.

One potential issue is if AIFs were to 'qualify for' that exemption. It may lead to the loss of access to double tax treaties and so increase the tax cost in the fund. Opinion is divided in the industry; for some this would be a step closer to the exempt model they have sought, for others this would substantially reduce the attractiveness of UK funds - this could lead to the global players merging their UK ranges into their offshore ranges.

VAT Rate Reduction

We welcome the temporary VAT rate reduction from 17.5% to 15%. This should benefit managers of AIFs, life companies and certain 'retail offshore funds sold into the UK,' as the associated VAT they suffer on their own costs (which is irrecoverable) will be reduced. It will also benefit certain clients such as pension funds and investors in UUTs, which suffer VAT on management fees.

VAT registered businesses should focus on ensuring that accounts receivable and accounts payable systems are able to manage the changes i.e. can the systems adequately deal with the issue and receipt of invoices at the 17.5% rate and 15% rate at the same time.

PAIFs

There were 3 minor clarificatory amendments to the PAIF regime:

- i. Where a 'feeder fund' is used to comply with the '10% rule' it will be exempt from Schedule 19 SDRT on unit transactions to ensure a double charge does not apply, (though the feeder fund will have to 'satisfy certain conditions' which are not stipulated).
- ii. Flexibility for PAIFs to make net payments to unit trusts which may be administratively simpler e.g. if all other investors obtain such payments net.
- iii. Distributions will be subject to the manufactured dividends rules so they are treated in the same way as comparable payments on other securities normally paid net of WHT.

Ongoing Consultations

There are a number of ongoing consultations that are mentioned in PBR, albeit without any significant progress being announced:

QIS

The QIS regime has been amended to replace the 10% substantial holding rule with a 'genuine diversity of ownership' condition which will apply to all investors. For most providers this is likely to make QIS more attractive as the draconian tax regime for certain investors breaching the 10% rule has gone. However, it will no longer be possible for pension funds or life companies to use

QIS as vehicles for captive funds. Guidance is awaited on how the 'genuine diversity of ownership' rule will apply.

TEFs

The proposed TEFs regime is designed to leave no tax sticking at the fund level. Such a regime may be of interest to:

- The few AIFs that pay UK tax (e.g. balanced funds) and have significant exempt investors (e.g. pension funds and ISA investors)
- AIF providers who wish to distribute the funds to e.g. European investors who may prefer 'the exempt fund model'.

We believe that income streaming is commercially undesirable & administratively complex and would result in little or any take up of TEFs. Additionally we believe it is crucial that the Government considers any impact a TEF regime would have on ordinary AIFs access to tax treaties, (which will be impacted by the application of the foreign profits changes outlined above.)

ITCs

It is proposed that ITCs will have an optional tax streaming regime under which income from bonds, cash etc is deductible from taxable profits. Whilst this is a minor improvement it remains likely that many such funds will continue to locate offshore where a roll up of income can be achieved and there can be an associated VAT benefit for the manager.

SDRT - Schedule 19

The Schedule 19 regime remains under review. Whilst it seems unrealistic to expect abolition in current market conditions, we believe it is important that an (Exchequer neutral) flat n.a.v. tax is not introduced. This would move the burden of the tax from retail to institutional funds and be another reason for fund managers to locate such funds outside the UK.

The offshore fund regime

No further announcements were made today regarding the ongoing overhaul of the UK's offshore funds regime. The industry awaits the Government's plans for changes to the definition of 'offshore fund' – in particular whether it will seek to equate the treatment of investments into offshore closed-ended funds with onshore closed-ended funds and open-ended funds both on and offshore. It will be interesting to see if the independent review of the UK's offshore financial centres announced today has any impact on this.

IME – definition of 'investment transactions'

The Government has announced that it will release draft regulations regarding the new approach to defining 'investment transactions' in early December this year. The changes are expected to cover the definition of debt and derivatives that fall within the IME, but are not expected to extend the scope of the IME to include commodities or land.

Trading versus investment for AIFs

The Government announced their intention to discuss with industry the potential for introducing legislative changes to provide further certainty on the distinction between trading and investment transactions carried out by AIFs.

For further information on the PBR visit the Deloitte website at www.ukbudget.com

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