

Authorised investment funds technical release

September 2009

TEF regime regulations

Further to ongoing consultation between the Government and the asset management industry, final regulations introducing the Tax Elected Funds (TEF) regime have been released.

The TEF regime is an elective regime and open to authorised investment funds (AIF) meeting certain conditions. The regime moves the point of taxation from the fund to the investor and as such investors in a TEF will broadly be taxed in the same way as if they owned the underlying assets directly.

Following the first phase of the introduction of the taxation of foreign profits regime on 1 July 2009, overseas dividends will not normally be subject to corporation tax for an AIF. As such, where a fund receives predominately UK and overseas dividend income, there may be limited benefit in entering the TEF regime as such a fund is now unlikely to have a UK tax liability. However, the TEF regime will still be of particular interest to mixed funds receiving both dividend and interest income where they would otherwise have a UK tax liability, notwithstanding the recent changes to the taxation of foreign profits.

Under the regime the fund will be required to identify the income received as being dividend income (including overseas dividends), property income or other income. The fund will make either dividend or non dividend distributions with non dividend distributions i.e. interest distributions being deductible from taxable profits and subject to a deduction of income tax as appropriate.

There are a number of conditions which must be satisfied in order for a fund to enter into the regime and some points to bear in mind. The conditions for entry include a property condition which prohibits the fund from having a UK or overseas property business and the genuine diversity of ownership (GDO) condition.

The regulations have introduced a standard GDO condition for all AIFs and equivalent offshore funds which need to rely on this condition, for example the investment 'white list', the Qualified Investor Scheme (QIS) and the Property Authorised Investment Fund (PAIF) regime. On the basis that private funds are unlikely to be able to meet the GDO condition they may not be eligible for entry into the regime.

The definition of an equivalent offshore fund has not yet been released by the Government and is eagerly awaited as it will have important implications for the proposed new reporting fund regime.

While the new regime for the taxation of dividends includes an election to opt to tax dividends which would otherwise be exempt as a result of the changes to the taxation of foreign profits, this would be of no benefit to a TEF as the dividend would not be taxable at the fund level anyway. As such, where dividend income is received from countries with a double taxation treaty containing a condition that dividends must be 'subject to tax', a TEF may not be able to access the reduced withholding tax rate. Although the number of treaties with a 'subject to tax' clause in the treaty is quite small, it is important to review this carefully before taking the decision to enter the TEF regime, particularly if the fund would not have a UK tax liability whether within or outside the TEF regime, as in these circumstances electing to be a TEF could in fact be disadvantageous.

The TEF regime comes into force on 1 September 2009 and is available for accounting periods beginning after that date. The application for entry into the regime must be made in advance of the accounting period for which the application is made. For a fund wishing to enter the TEF regime, it may be beneficial to consider shortening the current accounting period to accelerate the date at which the fund may join the regime. It is worth bearing in mind though that, having left the regime, a fund may not then rejoin it for a period of six years.



Summary

While the regime may not be advantageous to all AIFs and investors, the potential benefits should be considered in respect of each individual fund. The TEF regime may offer substantial tax benefits to certain funds, providing the conditions for entry can be met and essentially means that for most AIFs, they should be able to operate in a way which results in no UK tax charge. In conjunction with other recent changes to the taxation of AIFs therefore, the UK is becoming a much more competitive and attractive location for funds.

Contact us

If you would like to discuss any of the matters raised in this release further, please contact Anne Stopford or Dana Ward on the details below.



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