

Revenue & Customs Brief 04/13 - Additional guidance for collective investment scheme holdings

Following publication of Revenue & Customs Brief 04/13 HMRC has received a number of questions. Common questions and HMRC's answers are summarised below. This guidance covers collective investment scheme holdings that are not held as part of a policy of life insurance. Where investments in a collective investment scheme are held within a policy of life insurance please see the additional guidance relating to life insurance policies:

[Additional guidance: life insurance companies](#)

Glossary

For the purposes of this note:

- 'Funds' are Authorised Unit Trusts (AUTs), Open Ended Investment Companies (OEICs), or Offshore Funds
- 'Financial Intermediaries' are all parties between the investor and the underlying investment vehicle and include Fund Managers (Unit Trust Managers or Authorised Corporate Directors), Platform Operators, and Financial Advisers

1. What type of payments does Revenue & Customs Brief 04/13 cover?

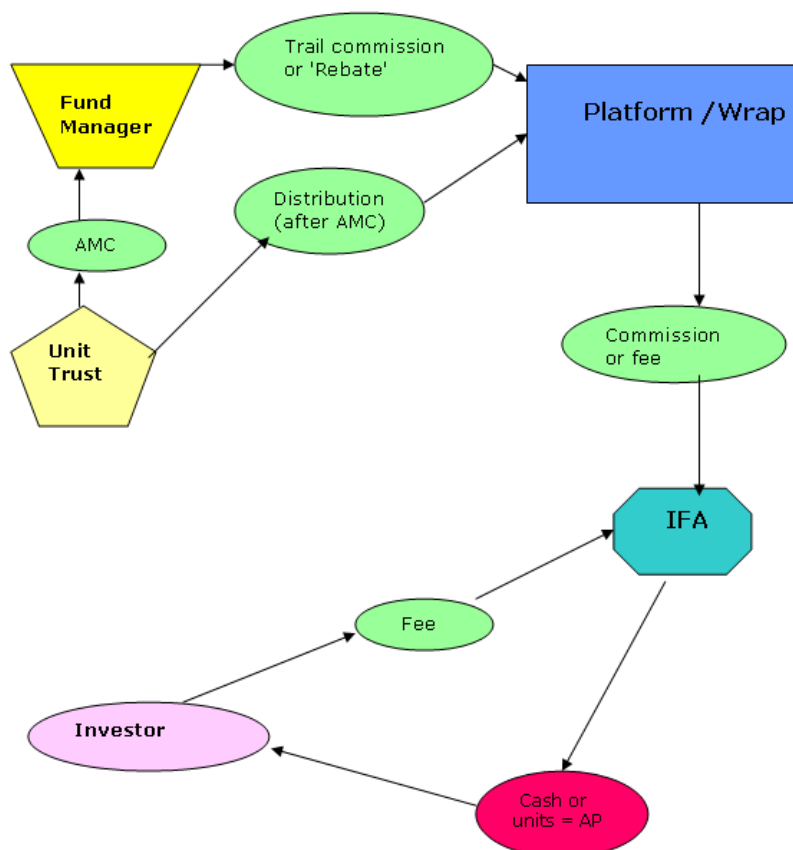
Payments made by funds to financial intermediaries are trading income of the intermediary and so not annual payments.

Where a financial intermediary makes a payment to the investor under an agreement and such payments will or could recur, that amount will be treated as an annual payment in line with the technical analysis set out in Revenue & Customs Brief 04/13. For the purposes of this analysis it is not relevant how the financial intermediary making the payment to the investor has funded those payments.

The situations in which a payment in this context will be made include the return by a financial intermediary of an amount of money to the investor, the payment by the intermediary of a monetary obligation or liability on the investor's behalf and the situation in which the financial intermediary acquires and pays for additional units that are added to the investor's holding.

Please see the next page for an example.

An example of when an annual payment (AP) will occur:



Where the investor has agreed financial advice costs with a financial adviser and redeems units from the investment (fund) to pay for the advice to pay this cost then this is not an annual payment for tax purposes. The redemption from the fund will be dealt with under the rules relating to the chargeable gains.

If there is no entitlement or agreement for the investor to receive any payment from a financial intermediary and instead a financial intermediary charges a lower fee to the investor because the financial intermediary also receives remuneration from the fund manager or platform then no annual payment arises. However, where payment is made to the client's cash account and the client then uses the payment to offset the advice fee or instructs the financial intermediary to use it to offset the fee then an annual payment will arise.

If the financial intermediary agrees to make payments to the investor whenever the trail commission or fee paid to the financial intermediary by the fund manager or other intermediary exceeds the fees chargeable to the investor then these payments will be annual payments (even if they do not occur every year).

An annual payment is not necessarily linked to any particular 'rebate' received by the intermediary. For example, if an intermediary agrees with a client a composite annual fee to the intermediary in respect of ongoing advice given and the total of 'rebates' or 'commissions' received by the intermediary exceeds this leading to a payment of the excess to the client then that would be an annual payment even though the amount or the fact of the payment is not directly linked to receipt of a particular commission or rebate by the intermediary.

Where the amount received by the investor is taxed under another provision of the Taxes Acts then the payments cannot be taxed as annual payments. S683 ITTOIA

2005 taxes as annual payments only those amounts that are not charged to Income Tax elsewhere in the Income Tax Acts. So, for example, if the commission or 'rebate' is a trading receipt in the hands of the investor then it cannot be taxed as an annual payment.

References to 'rebates', 'trail commission', 'annual management charge' or 'fees' below are used in the context of questions that have been referred to HMRC. These terms are used interchangeably and all refer to payments which may be received by an investor. The principles set out above apply equally to these payments (no matter what they are called).

2. Is rebated 'Trail Commission' or an annual management charge (AMC) paid directly to a financial intermediary an 'annual payment'?

No - where a fund manager pays a financial intermediary amounts such as a percentage of their AMC or annual commission payable for the retention of an investment in a fund the payment will be trading income of the financial intermediary and, as set out above, will not be taxable as an annual payment.

However, where the financial intermediary agrees to pass on all, or part, of the rebated trail commission to the investor, the rebated amount will be a business expense for the financial intermediary and an annual payment for the investor.

For the avoidance of doubt, amounts paid to the investor are not equivalent to those set out in SP 4/97 as they are not a discount from the cost of an investment or the provision of a service at arm's length.

3. Are payments in lieu of Trail Commission 'annual payments'?

Yes - where the fund manager agrees to pay the trail commission which would otherwise have been due to a financial intermediary directly to an investor the trail commission will be an annual payment for the investor.

4. For an amount to be an 'annual payment' there has to be a legal obligation to pay an amount - what does this mean?

In this context a legal obligation means a binding arrangement or an agreement which creates a liability to pay a specified (although not necessarily fixed) amount or to do a certain thing for a person or group of persons on which the person/s entitled to the payment can rely (ie sue for).

The agreement may be oral or in writing and could include an offer in an advertisement relating to the product or to products held on a particular platform.

More details of this can be found at hmrc.gov.uk/manuals/saimmanual/SAIM8020.htm

5. What are the rules for deducting tax from an 'annual payment'?

Tax should be deducted by the entity making the payment to the investor at the basic rate of Income Tax in force for the tax year in which the payment is made. Further details can be found in HMRC's Savings and Income Manual (SAIM) at SAIM9120.

hmrc.gov.uk/manuals/saimmanual/SAIM9120.htm

So the fund manager may be required to deduct tax from amounts which are paid in lieu of trail commission.

Nominee holdings

Wrap platforms hold units in underlying investments in the name of a nominee company on behalf of all their clients. Fund managers will pay aggregated rebates to the platform. Where the investor has an agreement with an intermediary platform to

receive trail commission then the obligation to deduct tax falls on the platform when they pay the disaggregated rebates to their clients. Indeed, in this situation, it is possible that the fund manager will not be aware of the agreement or the clients for which they are making the investments.

For nominee accounts the position depends on the contractual relationship. Provided the recipient nominee has no obligation to pass on the amount to the ultimate beneficiary then the payer does not need to look through the nominee to establish the status of the ultimate beneficiary. The payer just considers the status of the nominee in establishing whether there is a requirement to withhold tax.

6. How do I pay over the tax I have deducted?

The method for paying over the tax deducted is set out in HMRC's COTAX Manual at COM23135.

hmrc.gov.uk/manuals/commanual/COM23135.htm

In cases where the tax is deducted by an individual or a partnership then please see also SAIM9170:

hmrc.gov.uk/manuals/saimmanual/saim9170.htm

7. Does it make a difference if the investor is not a UK resident?

Yes - there is now no requirement to withhold tax from annual payments made to non-residents where these annual payments are made on the basis of the holding by the non-resident in an authorised investment fund or an offshore fund and are related to (and not more than) the proportion of the management fees charged to that fund and attributable to that holding.

Please see Statutory Instruments 2013 Nos. 1770 (relating to Offshore Funds) and 1772 (relating to Authorised Investment Funds)

8. What is the process for claiming repayment of tax deducted?

Where the recipient of a payment is entitled to a repayment of tax deducted then, the process for repaying the tax is the same as that for any person who wishes to reclaim tax. Where an individual completes a Self Assessment tax return they can claim for repayment of the tax paid on the return. Where an individual does not complete a Self Assessment tax return they should use form R40 to reclaim the tax.

9. Can 'annual payments' to individuals be made gross?

For individuals resident in the UK there is no equivalent for annual payments to the provision which allows interest to be paid gross. However, certain non-individuals may receive annual payments gross and details of these entities can be found in HMRC's Company Taxation Manual at CTM35215.

hmrc.gov.uk/manuals/ctmanual/CTM35215.htm

As explained at question 7 above it is also now the case that non-residents may receive certain annual payments without tax having been deducted.

10. Can the Intermediary/Fund Manager pay the tax on behalf of the investor?

Yes. In some cases there may only be a short period following 6 April 2013 in which amounts which will fall to be treated as annual payments will arise because, for instance, a fund manager has moved to "clean" share classes. The payer of the rebate may choose to bear the cost of the tax deducted to ensure that the investor receives the full rebate amount. So for example if the rebate amount is £100 the payer could choose to pass the full £100 onto the investor and pay £20 in tax to

HMRC. HMRC has no objection to this arrangement.

In such a case the investor will receive a 'gift' of the extra £20. The make up of the amount received being the net of tax annual payment of £80 plus the 'gift' of £20, totalling the £100 received. The investor would need to record gross income of £100 on his tax return, from which tax of £20 has been deducted. The 'gift' of £20 should not be shown on the tax return.

Where higher rate or additional rate tax liabilities are paid on behalf of the investor then the same rationale applies. Where the payer settles the investor's full tax liability then the investor will not need to enter these payments on their tax return.

11. Are payments arising from non-taxable investments taxable?

The treatment for ISA and SIPP investors is set out in Revenue & Customs Brief 04/13. Amounts of rebated commission that continue to be held within the ISA or SIPP investment and do not leave the control of the ISA manager or the SIPP trustee or administrator do not count towards the investor's annual ISA or SIPP contribution nor are they taxable as annual payments.

Platforms may also operate accounts to allow investment by external registered pension schemes. Such accounts are often called 'Trustee Investment Plans' (TIP). A registered pension plan's TIP is likely to be exempt from tax and, provided the rebate is retained within the TIP account, no annual payment will arise.

For other non-taxable investors holding accounts on a platform, for example charitable trusts, UK pension trusts other than registered pension schemes such as EFRBs or offshore pension schemes provided the rebates remain within the relevant trust or scheme and are not paid out to the beneficiary no annual payment will arise.

12. Pension rules - is a rebate of trail commission an 'unauthorised distribution'?

Whether a rebate of commission is an unauthorised distribution will depend on the facts and circumstances. There is guidance about commission paid by registered pension schemes in the Registered Pension Schemes Manual, at hmrc.gov.uk/manuals/rpsmmanual/index.htm

Although this guidance refers to 'commission' payments the underlying principles will apply equally to rebated trail commission.

13. Will there be additional tax liability as a result of switching to 'Clean' Share Classes

Under new regulations (SI 2013/1400) it is made clear that switches to 'clean' share classes will not create a liability to Capital Gains Tax.

Prior to 8 June 2013 most switches took place as part of a reorganisation or reconstruction and would also not create a liability to capital gains tax. The new regulations provide further clarification on the matter and widen the treatment to cover cases of switching that might not have fallen within the previous rules including switches undertaken on behalf of and at the instance of an individual investor.

To fall within the new provision any switch or exchange undertaken at the behest of the investor must require only a single instruction from the investor and if the mechanics of the switch require a notional redemption of the old unit reissue of a new unit by an intermediary on behalf of the investor then there must be no time interval between the two events beyond the minimum necessary to achieve the transaction - normally expected to be no more than one to two working days.