

Technical Note: background to Revenue & Customs Brief 04/13

Collective Investment Schemes

Payments by fund managers, platforms or other intermediaries to investors in funds (in cash or fund units)

1. By 'intermediary' this note means any person or entity that stands between an investor and the Collective Investment Scheme in which they hold an investment. Specifically this includes fund managers platforms and advisers.
2. This note covers cases where the Collective Investment Scheme is itself taxable (either in its own right as a company or through its trustees) to corporation tax or Income Tax in the UK or is a taxable person in its own jurisdiction elsewhere.
3. HMRC was initially asked for information about the treatment of possible 'facilitation payments' to be made by fund managers following the Financial Services Authority's Retail Distribution Review (RDR) and comparisons were made with the treatment of payments currently made to investors out of (or in lieu of) adviser commission (trail commission) which were considered by industry players not to be taxable.
4. What follows is a consideration of the tax treatment that should apply, under existing legislation, to payments made to investors from trail commission paid by fund managers (or in lieu of such trail commission). The note also goes on to consider the effects of a ban on commission payments under RDR, although it should be noted that the tax treatment of such payments made to investors, whether in cash or units, has not changed as a result of the RDR.

Trail commission payments

5. HMRC has no record that the tax position of payments made to investors by intermediaries to investors had ever been considered by it. It has therefore had to consider the fundamental nature of such payments.
6. In doing so it is aiming to be as clear as possible on the tax treatment of such payments paid by fund managers, platforms or advisers to investors whether in cash or in kind (for example additional units or shares).

7. HMRC is aware that following an investor's initial investment an investor sometimes receives an amount from the fund manager, platform or adviser in relation to the investment made in the fund. That amount must be deducted by the investor from the initial amount invested in arriving at the cost of their investment for capital gains purposes. This is because any amount received by the investor as a 'cashback' or discount from initial charges clearly does not form part of the cost of the initial investment. Being a return of part of the initial fee paid by the investor this amount is not itself a taxable receipt in the investors hands. Such payments are covered by a publication of the then Inland Revenue - Statement of Practice 4/97 (SP4/97). SP4/97 does not cover payments to investors from (or in lieu of) trail commission (see paragraph 5 of the SP4/97).
8. A practice has developed over a number of years where part or all of the trail commission paid by the fund manager to other intermediaries is passed on to investors. Trail commission is a payment made to other intermediaries by the fund manager on a regular basis for commercial reasons. The payment is business income in the hands of the intermediary receiving it.
9. Similarly, for commercial reasons, for example; to attract clients or because the client requires it, an intermediary may pass on payments to the investor. These will be a business expense for the intermediary.
10. It is also possible that the payment may be made by the fund manager to the client in lieu of paying trail commission (possibly using a platform or adviser as a paying agent). In such a case the platform or adviser would never have any right to the payment which would flow through a client account.
11. HMRC considers that such payments of (or in lieu of) trail commission to an investor are income in the hands of the investor and taxable as an annual payment. Such an amount may be funded directly by the fund manager from the fund manager's own resources (which include any amounts received by the fund manager from the fund such as the annual management charge).
12. Annual payments are taxable by virtue of S683 ITTOIA 2005. Case law has established four essential characteristics for a payment to be an annual payment:
 - The amounts must be paid under a legal obligation. Trail commission is paid in accordance with the agreement between the platform and the investor (or possibly between the fund manager or adviser and the investor). The agreement does not necessarily have to be in an individual or written form. For example if a platform was to include in advertising material applicable to the relevant investment, a statement that a proportion of any trail commission received from the fund manager would be passed on, then there would be such an obligation.
 - The payments must be capable of recurrence. They clearly are - apart from any element of the initial investment charge which may reach the investor and would be a one-off sum - as stated above these initial payments are covered by SP4/97.

- The payments must be income, as opposed to capital, in the hands of the investor. Apart from any initial amount, the sums would be part of the investor's income. The obligation to make the payment arises purely from the agreement referred to in the 1st bullet. These are also not, for example, instalments of a capital sum.
 - The payments must represent 'pure income profit' of the recipient. In other words, they come to the recipient without them having to do anything in return (over and above the making of an investment). The words also mean that there are no deductions for expenses which relate to the amounts received. Interest and annuity payments are examples of 'pure income profit'. Again, this condition is met.
13. Basic rate Income Tax should be deducted by the payer under existing legislation as trail commission is taxable as an annual payment. The obligation on the payer to deduct tax is found at Chapter 6 Part 15 ITA 2007 (see sections 900 and 901).
14. It follows from above that in existing arrangements where trail commission paid by fund managers to platforms or advisers is passed on to investors then the amounts passed on to investors are taxable in investor's hands (and that the payer should be deducting tax at the basic rate). It would appear that this is not current industry practice.
15. With regard to past payments, our conclusion is set out in paragraph 4 of Revenue and Customs Brief 04/13

Impact of RDR

16. The intention of RDR is to regularise the position of investors in the context of services they receive from the fund platform or adviser. A principle is that payment for such services should be the responsibility of the investor. If the investors bear the responsibility for making payments to advisers and platforms there are no complex tax consequences. If, as a result, lower annual management charges are levied by fund managers on funds then investors will receive a better return on their investment, (which will be free of tax for investments in an ISA wrapper or in a self invested personal pension (SIPP)), but investors will have to bear the cost of advice and platform services¹.
17. HMRC does not think that the effect of the RDR as described in the paragraph above would pose any particular difficulty in tax terms and the Financial Services Authority does not intend to allow the payment of cash amounts of commission to investors.
18. Given that commission payments will be prohibited by RDR rules (and there will therefore be no commission for platforms or advisers to pass on to investors) then, going forward, it may appear that it will not be necessary to put in place arrangements to ensure that the tax legislation is complied with in this respect for the future.

¹ The cost of advice for the investments in a SIPP may be chargeable to that SIPP, in which case the cost will be borne within the tax privileged vehicle.

19. However trail commission will still be paid for a period in respect of legacy business and it is also possible that the Financial Services Authority will permit some payments (possibly in the form of units) to investors following RDR. Therefore it will be necessary for many payers to make (at least temporary) arrangements to deduct tax.
20. HMRC understands that, in some cases, intermediaries may wish to offer investors the possibility of receiving additional units in the fund purchased on their behalf by the fund manager or fund platform. In such a case the tax consequences would be the same as for cash payments to investors, for example, trail commission.
21. This means that any agreement to provide additional units to the investor, funded by the fund manager or other intermediary, will constitute an annual payment in the same way as a payment of trail commission.

Investments in Offshore Funds

22. Where an investor receives payments from an intermediary with respect to their investment in an offshore fund then the tax analysis will be the same as for payments received from intermediaries in respect of an investment in a UK fund. In particular payments (other than in respect of the initial investment) will normally be taxable as an annual payment in the same way as described above.
23. Where a taxable annual payment is received directly from an offshore intermediary then it will not have been subject to deduction of basic rate Income Tax at source. The investor must therefore account to HMRC for all of any tax due at the investor's marginal rate for Income Tax.