HM Revenue & Customs

Authorised contractual schemes: reducing tax complexity for investors

Summary of Responses
December 2016

Contents

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1. Introduction

What is an Authorised Contractual Scheme (ACS) and who can invest?

1.1 An ACS is a UK tax transparent collective investment scheme. It has no legal personality and does not constitute an entity in its own right. It is essentially a pool of assets held and managed on behalf of a number of **participants** (the investors) who are co-owners of the assets.

1.2 The scheme has an **operator** (or manager) who is responsible for running the scheme. The operator is also responsible for decisions about the investment of participants' funds in accordance with the terms of the scheme. The scheme also has a **depositary** who is responsible for holding and safeguarding assets in the scheme. The depositary will acquire and dispose of assets on behalf of the participants on the instructions of the operator.

1.3 An ACS must be authorised by the Financial Conduct Authority (FCA) and the operator and depositary must also be FCA-authorised persons.

1.4 An ACS may take one of two legal forms:

- a partnership ACS, formed as a limited partnership; or
- a co-ownership ACS (CoACS), formed under contracts agreed by the depositary, operator and participants.

1.5 It is a regulatory requirement that investors in an ACS must be either:

- a professional investor, such as an institution or feeder fund; or
- any other person who invests a minimum of £1m.

1.6 An ACS is not a taxable entity and is not within the charge to direct taxes. Each participant is responsible for tax arising on their own share of income (and gains, for partnership ACS) at their own rates of tax. It is the participant who is entitled to claim any available capital allowances. For this reason an ACS is described as "tax transparent".

Consultation purpose, scope and progress

1.7 A consultation document was published on 9 August 2016. It sought industry views on the following:

- Clarifying and formalising how capital allowances rules apply to taxable investors in ACS;
- New requirements on ACS operators to report tax information to investors and to HM Revenue & Customs; and
- Any other improvements that might be made to the tax rules in other areas.

Response to consultation

1.8 HMRC received a total of 20 formal responses: seven from representative bodies, six from professional advisory firms ("advisers"), six from businesses which are investors and/ or fund administrators, and one from an individual. Given the

complexity of the issues in connection with capital allowances, HMRC convened a meeting of a wide range of interested parties with specialist knowledge and experience in that area to discuss the issues raised by the consultation document.

1.9 Responses to the questions raised in the consultation document are outlined in Chapter 2 together with the government's response. It became clear during consultation that the issues raised by the consultation document were relevant to CoACS and not to partnership ACS.

1.10 Several respondents also addressed issues not directly raised by the consultation document:

- There were a number of comments in relation to the calculation of capital gains arising from the disposal of units in a CoACS, including the special rules for gains arising to life insurance companies. These comments were taken into account in preparing draft legislation published alongside this summary of responses.
- One respondent asked HMRC to clarify the tax treatment of investors where an ACS has investments in an offshore fund. Draft legislation published alongside this summary of responses also addresses that issue.
- There were a number of issues on which respondents sought additional guidance. HMRC will update its guidance in this area in due course and will review comments received during the consultation as that time.

2. Responses

Capital allowances: application to partnership ACS

Question 1 – Do you agree that the existing capital allowances rules so far as they apply to partnerships generally also work appropriately for partnership ACS? If you do not, please explain the difficulties that arise.

2.1 Respondents who answered this question agreed that in theory current capital allowances rules ought to work appropriately for partnership ACS, but in practice they were not aware that any partnership ACS currently exist.

Capital allowances: matters to be clarified in legislation

Question 2 – Do you believe that legislation should clarify, for capital allowances purposes: (a) what is a qualifying activity for investors in a CoACS; and (b) what is an investor's interest in land held by a CoACS?

Question 3 – Do you believe that providing legislative certainty resolves the problem? In doing so, would that create any further problems?

2.2 Around half of the respondents who addressed this question thought it would be helpful to clarify in legislation how these terms apply to CoACS, and one respondent thought "qualifying activity" should be clarified.

2.3 A significant minority thought that the current tax and regulatory framework meant that the terms were clear enough, though they requested that HMRC guidance clarify its views. Some were particularly concerned that legislation should not undermine tax transparency in the eyes of overseas jurisdictions.

2.4 A few advisers emphasised that the government should aim to produce a simple, clear scheme which reduced or limited the administrative burden on CoACS.

Capital allowances: computation of allowances by Co-ACS

Question 4 –What are the pros and cons of legislation enabling the CoACS to compute capital allowances on behalf of investors? Would the administrative burden be prohibitive?

Question 5 – Are there any other options to address the problems outlined in this chapter? What are the pros and cons for those options?

2.5 Most respondents said that enabling a CoACS to compute capital allowances on behalf of investors was beneficial overall. One administrator said that would be commercially desirable. An adviser outlined the problems with current legislation:

> "…each and every unit transaction represents a part disposal of every asset in the portfolio leading to a need for a very significant number of s198 elections to be made… This creates an administration burden which is not in the interests of taxpayers nor HMRC. Well-designed legislation should reduce this burden."

2.6 Another adviser observed:

> "The administrative burden could be further reduced by statutory recognition that changes in the proportionate ownership share in the ACS do not trigger a part disposal that requires a capital allowances election. Instead such changes would automatically occur at tax written down value. Elections would however still be required as assets are acquired or sold by the ACS."

2.7 Several respondents said that the rules would also need to address the value of assets on acquisition and disposal by the CoACS.

2.8 One investor said that the benefits of this approach are that it would:

> "• enable capital allowances to be claimed
>
> • make capital allowances simpler to administer
>
> • make it possible to report to investors in a clear and consistent fashion
>
> • not be open to manipulation
>
> • have an appropriate level of record keeping
>
> • clarify what tax written down value (TWDV) an ACS would inherit from purchases
>
> • clarify what TWDV or other qualifying value can be passed on to a purchaser of a property from an ACS"

2.9 There was broad agreement to those points, though some pointed out the following drawbacks:

- It is potentially inconsistent with transparency.
- It creates an administrative burden for CoACS with exempt investors if there is no option not to apply the regime.
- Taxable investors might not get full value for their share of qualifying expenditure as the written down allowance reduces and if there is no balancing allowance.
- It might not be the most tax efficient arrangement where there is a mix of taxable and exempt investors and the operator of the CoACS may not be able to optimise the tax position for all investors simultaneously.

2.10 Several respondents outlined other potential models. The pros and cons of those models were discussed extensively at the consultation meeting referred to in paragraph 1.8. The main preference in both the meeting and written responses was for the model outlined above, although there was a strong general view that the new rules should only apply where the operator of the CoACS elected to apply them.

2.11 CoACS which did not elect into the regime would apply the existing rules whereby they would need to pass information on to investors to enable them to calculate their own allowances. One administrator said that CoACS would favour that

where there were only a small number of investors or where all investors are exempt investors (such as pension funds).

2.12 One respondent cautioned that scheme administrators might prefer that all CoACS they administered elected into the regime (or not) to simplify their systems – potentially negating the value of the election.

Government response on capital allowances

2.13 The government acknowledges that there are practical difficulties with applying the capital allowances rules to CoACS and those difficulties will multiply as the number of CoACS increase. The best way of addressing these difficulties is by permitting the operator of the CoACS to compute capital allowances and allocate them to investors. The government notes that is the less burdensome approach where investors in a CoACS may claim capital allowances but it would make unnecessary requirements on CoACS with exempt investors (who cannot claim capital allowances). For that reason, the government accepts that an elective regime would be most appropriate and considers that this does not alter the tax transparent nature of a CoACS.

2.14 The government is publishing draft legislation and welcomes comments on its effectiveness in delivering its policy.

Information requirements

Question 6 – What would be the impact of introducing a legal requirement on ACS operators to provide sufficient information to investors to enable them to meet their tax obligations (as outlined in paragraphs 3.5 to 3.8)?

Question 7 – Is there an alternative option which is both effective in ensuring that investors can meet their tax obligations and proportionate?

2.15 Respondents who addressed these questions agreed that a requirement on CoACS operators to provide sufficient information to investors to enable them to meet their tax obligations would have no impact as CoACS operators already provide this information as a matter of commercial necessity. One adviser suggested that a requirement should specify that the operator should provide information that enables investors to make claims. One respondent said that there should be clarity on what constitutes 'sufficient' information and on timing.

2.16 Several respondents said that that the any requirement should not be more onerous than those applicable to tax transparent offshore reporting funds. One said:

> "…such a requirement should mimic the transparent offshore fund rules to offer the flexibility to accommodate existing ACS systems as well as new system set ups."

2.17 A few respondents noted that a requirement to provide a partnership return to HMRC would be an effective alternative, but considered it would be less flexible and possibly disproportionate.

Question 8 – What would be the impact of introducing a legal requirement on ACS operators to provide HMRC with an annual list of ACS investors and other information on HMRC's request (as outlined in paragraphs 3.12 and 3.13)?

Question 9 – Is there an alternative option which is both effective in ensuring that HMRC has sufficient information to carry out its statutory function and proportionate?

2.18 Most respondents thought there should be no significant impact if there were a requirement on operators of CoACS to provide a list of investors. One respondent said that the list should be restricted to direct investors in the CoACS. Two respondents observed there may be concerns about privacy if the operator was required to provide client-specific information to HMRC.

2.19 Respondents broadly agreed that that requests from HMRC for further information should not be onerous. A trade body emphasised this point, pointing out that most investors in CoACS are exempt investors. One respondent thought they should be limited to questions about the operating systems and controls used to administer the CoACS. Another said that HMRC ought to obtain other information from investors, not the operator.

2.20 One adviser observed that providing further information would be an additional burden to operators of CoACS but would provide HMRC the opportunity to cross-check against investors' tax returns. It emphasised that HMRC should seek to minimise the additional compliance burden and only request information which had already been prepared by the operator (a point also made by another adviser). It said that existing powers to request information from third parties provides a further backup in case of serious problems.

2.21 One adviser queried the need to provide a list of investors and said there was no similar requirement in other jurisdictions, such as Luxembourg. It also pointed that there is no such requirement in UK legislation for authorised investment funds or unauthorised unit trusts. However, another respondent said that Ireland has similar requirements for its Common Contractual Fund. A further respondent said HMRC should consider the approaches taken in other jurisdictions and ensure the rules for CoACS were not more onerous.

2.22 One operator said that, because system changes may be needed, HMRC should say in guidance what kind of information might be required.

2.23 Respondents did not favour alternative options. Two advisers said that the proposed option would be effective and proportionate and another respondent said that a limited requirement to provide information would be acceptable, but like others opposed any requirement to provide a partnership return (or similar).

Information requirements: penalties for non-compliance

Question 10 – Is there a need for a sanction should an ACS fail to provide information to investors or to HMRC? If so, what sanction should apply and when? If not, please explain how an ACS would otherwise be obliged to comply with this requirement.

2.24 Several respondents acknowledged the need for some form of sanction on the operator of a CoACS if they materially failed to comply with the requirements. One adviser drew a comparison to the rules for tax transparent offshore funds, which provide for different types of sanction depending on the seriousness of the failure. Another respondent said that the operator should have the opportunity to correct and investigate the actions of its contractors before a penalty could be considered.

2.25 However, the majority of respondents thought that sanctions were not necessary. One administrator expressed a common view in this way:

> "We believe that the commercial terms between investor and CoACS operator should be sufficient to impose the appropriate sanction on the CoACS operator in the event that there is a failure… Were HMRC to impose a separate sanction on the CoACS operator… there is a risk of doubling the sanction".

2.26 A few respondents also thought there may be regulatory consequences for the CoACS and/ or the operator if proper information were not being provided to investors. One respondent expressed the concern that sanctions might impinge on the transparency of the CoACS.

Government response on information requirements

2.27 Existing legislation requires other types of collective investment scheme to report tax information – typically by making a tax return of some kind to HMRC – to ensure tax due is paid and assist HMRC in ensuring taxpayer compliance. CoACS are not subject to any of the current requirements to submit a tax return and are not themselves subject to tax. However, the government believes it is necessary to have requirements which ensure that information the operator of a CoACS holds is passed to investors to help them comply with their own tax obligations and to HMRC. In proposing light requirements the government acknowledged the contractual obligations placed on operators of CoACS and the relatively low tax risk associated with many of the current investors in CoACS. The government believes that targeted requirements and sanctions are needed in line with the usual tax framework and to act as a deterrent against non-compliance.

2.28 The government proposed information requirements that broadly reflected those applicable to tax transparent offshore funds and notes that this approach received some support. Several respondents acknowledged that the requirement to provide information to HMRC was substantially less burdensome than potential alternatives, such as a partnership return (applicable to partnership ACS) or routine submission of information provided to investors (applicable to offshore reporting funds). Some respondents encouraged HMRC to look at the requirements of

comparable tax transparent funds in other jurisdictions: HMRC have noted Ireland's approach in particular in developing final proposals.

2.29 The government therefore plans to legislate to require the operator of a CoACS to provide sufficient information to investors to enable them to meet their tax obligations. This requirement matches the equivalent rule for tax transparent offshore reporting funds and the government believes this is a proportionate approach.

2.30 Having considered Ireland's approach, the government will require the following information to be provided to HMRC annually:

- A list of all investors in the CoACS at any stage in that accounting period;
- A list of classes of unit in the CoACS in that accounting period; and
- The amount of income per unit in respect of each class.

2.31 The government will retain the proposed power of HMRC to request further information as necessary. That is necessary to enable HMRC to ensure taxpayer compliance.

2.32 Finally, the government will introduce sanctions to address:

- Minor (and uncorrected) failures to provide required information; and
- Serious failures, such as failing to take reasonable care in providing information.

2.33 The government is publishing draft legislation and welcomes comments on its effectiveness in delivering its policy.

3. Next steps

3.1 The government is publishing draft legislation and welcomes comments on its effectiveness in delivering its policy. Draft legislation will address the two issues dealt with in this consultation (capital allowances and information requirements) as well as the two areas mentioned in paragraph 1.10 of this summary of responses (capital gains and investments in offshore funds).

3.2 The government is also publishing a Tax Information and Impact Note which outlines the proposed changes, whether they will be contained in primary or secondary legislation and when they are expected to take effect. Any primary legislation will be included in Finance Bill 2017.

Annex A: List of stakeholders consulted

We are grateful to the following organisations for their written responses:

- Association of British Insurers
- Association of Real Estate Funds
- Aviva plc
- BlackRock Inc
- British Property Federation
- Deloitte LLP
- Depositary and Trustee Association
- Ernst & Young LLP
- Eversheds LLP
- FTI Consulting
- Grant Thornton UK LLP
- HSBC Securities Services
- Investment Association
- Investment and Life Assurance Group
- KPMG UK
- Lloyds Banking Group
- Northern Trust
- State Street Global Services
- Tax Transparent Fund Forum

One individual also submitted a written response.