





## Steering Group Meeting PAIFs & TEFs



BNP Paribas Securities Services  
 PAIFs and TEFs – Next Steps  
 Obstacles to Affect PAIFs and TEFs  
 on Platforms  
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### Authorised Investment Funds

#### Tax Regime

UK authorised unit trusts and open ended investment companies have a special tax regime; the Authorised Investment Fund regulations.

TEFs and PAIFs are really an extension of that regime.

#### Distributions paid by Authorised Funds

- Authorised Funds can pay:-
  - dividend distributions
  - interest distributions
- Dividend distributions are treated in the same way as all dividends from shares in UK Companies, with a 10% non reclaimable tax credit.
- Interest distributions are treated in the same way as interest on bank and building society accounts, normally received net of 20% income tax deducted at source but can be paid gross.

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### Other Distributions

#### TEFs

TEFs pay part dividends and part non dividends which are treated as dividends and interest distributions respectively

#### PAIFs

PAIFs pay

- Property income <sup>1</sup>
- Other taxable income (interest) <sup>2</sup>
- UK dividend income <sup>3</sup>

<sup>1</sup> and <sup>2</sup> taxed as interest

<sup>3</sup> taxed as UK dividends

Must be reported in three streams.

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### Basic tax regime that applies within the fund

- AIFs are subject to 20% Corporation Tax on unfranked income such as interest or property income after deduction for expenses
- AIFs are not taxed on most dividend income whether from UK companies , or since 1 July 2009, on those from overseas companies
- Most equity funds do not pay any UK Corporation Tax as they have no taxable income after expenses, and even before the 2009 changes, most overseas AIFs paid no UK corporation tax as double taxation relief covered the liability.
- If an AIF pays UK corporation tax it makes it a very unattractive investment for UK pension funds and other exempt investors
- Interest distributions were introduced to make AIFs bond funds more attractive to investors, by allowing funds with 60% plus in such investments to pay interest distribution (an expense in the fund). However, this meant that when received by the investor the distribution was treated as interest and not a dividend.
- AIFs still did not work for funds receiving property income, if they had substantial bond income but did not meet the 60% test, and some funds holding derivatives.
- TEF and PAIF regime attempts to address these issues, at the expense of complexity

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### The Position of UK Individual Investors

- UK individual investors are taxed on all **dividend** type distributions as follows:
  - Non tax payer - no refund
  - Starting rate - no further liability
  - Basic rate - no further liability
  - Higher rate 32.5% (25% on the net dividend)
  - Additional rate 42.5% (36.11% on the net dividend)
- UK individual investors are taxed on all **interest** type distributions as follows:
  - Non tax payer - refund 20%
  - Starting rate - refund 10%
  - Basic rate - no further liability
  - Higher rate 40% (20% deducted at source)
  - Additional rate 50% (20% deducted at source)



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### Equalisation

- Equalisation is a means of ensuring that creations and redemptions from a fund do not adversely impact pre-existing holders
- When units/shares are created during a distribution period, the price includes elements representing the income earned since the start of the period. When units/shares are redeemed, the exit price includes an element of income earned in the period to date but it is paid out as capital.
- Group 1 holdings are shares / units held for the whole of the current distribution period.
- Group 2 holdings are shares / unit purchased during the current period, which will be transferred to Group 1 at the end of the distribution period.
- Both sets of holders are paid same amount of net distribution, but for Group 2 holders, part of the distribution is equalisation, which is the total on the income element of the units/shares sold in the distribution period.
- The lower figure of income on Group 2 is taxable, as the equalisation is deducted from the acquisition cost of the holding, to give a revised cost for CGT purposes.



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### Reporting to Holders

- Most nominees will effectively have a bulk amount of income for a number of holders but with one tax voucher.
- Most nominees will have numerous amounts of income, from different holdings, for each investor.
- Subsidiary vouchers deal with numerous holders receiving payments in bulk.
- Consolidated tax vouchers deal with many dividends being received by one individual.
- Normally a consolidated / subsidiary tax voucher is received from each tax year ended 5 April, giving totals for holders to put onto their self assessment tax returns.
- H.M.R.C. believe that there is no statutory authority in the tax legislation for subsidiary /consolidated tax vouchers, and they effectively "police" the system by giving formal approval of formats and issue a reference number (and also setting out conditions for their use).

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### H.M.R.C.'s Requirement

Approval by H.M.R.C.

H.M.R.C. contact for obtaining approval is:

Sandra Palmer (Tel 0114 2969 755)

HM Revenue & Customs

Collective Investment Schemes Centre  
1st Floor  
Concept House  
5 Young Street  
Sheffield  
S1 4LB

The requirements are:

- Original vouchers stamped "subsidiary voucher issued"
- Vouchers to be retained for inspection
- Schedule of receipts including holding, no of shares/units held, ex' dividend date, payment date, rate, tax credit (if appropriate), income tax suffered, overseas tax suffered, net dividend, equalisation, amount payable
- A summary voucher with boxes detailing the different types of income and the figures from the backing page approximately matching the boxes on the self assessment regime.
- If a duplicate subsidiary/ consolidated tax voucher has to be requested, the system must automatically print the word "duplicate" on the voucher.
- The system has been subject to an H.M.R.C. Audit!

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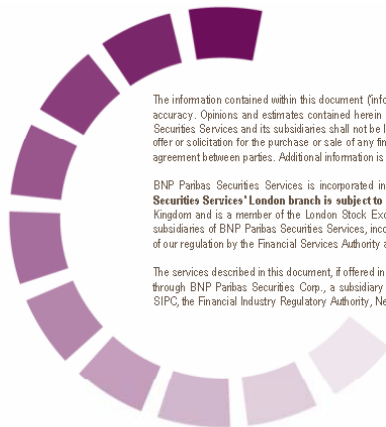
### Current Issues

- PAIFs and TEFs do provide an administrative burden that other jurisdictions do not.
- In the UK a large proportion of funds are held via nominees and supermarkets which increases the complexity.
- Custody, administration systems and nominees systems have been set up to process each distribution as one item (dividend or interest) and have not been set up to easily split distributions. This potentially doubles the workload.
- TEF and PAIF - to ensure that holders pay the appropriate amount of tax - need to operate equalisation on all income streams because of the different tax rules that apply. Normally this distortion may not make very much difference to the amount of tax paid, but it could be significant.
- All nominees are likely to have Group 1 and Group 2 holdings in each bulk payment.
- Holders may well have both Group 1 and Group 2 holdings.
- H.M.R.C. Guidance Notes do not address equalisation and different amounts of equalisation for different pools.
- H.M.R.C. procedures on subsidiary / consolidated tax vouchers are not as defined or set out in H.M.R.C.'s website and their specimen voucher does not appear to deal with the complexities for TEFs and PAIFs.

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