Investment Management Association
ima

16 February 2011

Rt. Hon. George Osborne MP
Chancellor of the Exchequer
Her Majesty's Treasury
1 Horseguards Road
London SW1A 2HQ

REPRESENTATIONS FOR BUDGET REPORT 2011

I enclose the Investment Management Association's[1] representations for the 2011 Budget Report. The representations cover three areas and we seek five specific action points:

- The immediate laying of the "protected cell" legislation for OEICs.
- Commitment to a clear timetable for amendment of the Financial Services & Markets Act 2000 to enable the introduction of tax-transparent funds, in order to facilitate the launch of UK master-feeder structures.
- Abolition of the fund-specific Schedule 19 Stamp Duty Reserve Tax regime.
- Firm proposals to ensure there will be no adverse UK tax consequence for a foreign UICTS as a result of having a UK management company.
- Adoption, as a long-term aspiration, a commitment to abolition the Stamp Duty Reserve Tax primary charge, which is a tax on ordinary savers and pension funds.

1. The competitiveness of the UK fund management industry

Over recent years, IMA has had a series of positive discussions with your officials on a number of technical tax and regulatory issues that impact the competitiveness of the UK as a centre for the location of funds. The objective is to maximise the level of economic activity in the UK industry, to the benefit of the UK and UK investors. A series of reforms have already been introduced, but EU regulatory changes – the UCITS IV Directive, the Alternative Investment Fund Managers Directive ("AIFMD") and the Solvency II Directive – mean that some further changes to the tax regime are necessary for the UK to capitalise on new business opportunities.

We were, therefore, pleased to note the commitment of the Government to continue work to enhance further the competitiveness of the UK as a fund domicile, and in particular the statement that:

> *"The Government is committed to taking all available measures, within the current fiscal constraints, to maintain and build on the UK's position as a major global centre for the asset management industry...."* [2]

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[1] IMA represents the asset management industry operating in the UK. Our Members include independent investment managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of over £3.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

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Specifically, we welcome:

- the reform of the Schedule 19 Stamp Duty Reserve Tax regime to treat investments made by funds in other funds as exempt assets, subject to certain conditions being met;
- the announcement on 23 November 2010 by the Financial Secretary that the Government will launch a tax transparent vehicle in 2012; and
- the statement that *"The Government will consult with industry to find an appropriate way of ensuring that there will be no adverse UK tax consequences for a foreign UCITS fund as a result of having a UK management company."* [3]

However, welcome as these announcements are, the UK fund-specific Schedule 19 SDRT charge remains a significant impediment to the UK being able to compete as a fund domicile. The medium to long term benefits of abolishing this charge will far outweigh the initial, small tax loss of c£70 million. Indeed, if it is not abolished, not only will the UK not gain business, it will lose even more, and therefore more employment and tax revenues.

2. Savings policy

A key policy goal should be to stimulate saving. An example of a current disincentive in the current tax system is the imposition of stamp duty on the purchase of shares. Abolishing this would increase returns to investors.

The demographic shift underway in the UK and elsewhere in Europe is resulting in a welfare settlement that is likely to see a significant amount of responsibility placed on individuals for their economic well-being in retirement. Yet it is clear that many millions of individuals and households in the UK are not saving sufficiently for their long-term needs. We therefore welcome the recent announcements regarding the introduction of NEXT, the changes to the annuitisation rules and the continuation of fiscal incentives to save for retirement. We shall comment further on this area in our response to the Treasury's call for evidence on early access to pension savings.

We also welcome, and are party to the current discussions on, a replacement for the Child Trust Fund. We believe that fiscal incentives are an essential tool in savings policy and therefore urge the Government to re-introduce as soon as possible some form of initial government contribution to encourage the widest possible range of families to use the new vehicle.

3. The UK as a place to do business

The tax regime is a key factor in maintaining the UK's pre-eminent position as a global financial services centre. The most important feature is predictability, which has been lacking in recent years. It is essential that the direction of tax policy should be stable and clear, and rule changes subject to proper consultation and debate. We appreciate that the UK cannot engage in a race to the bottom on tax rates. But it needs to provide a predictable tax environment in which firms can make business plans and have sufficient confidence that they will not be suddenly and unexpectedly

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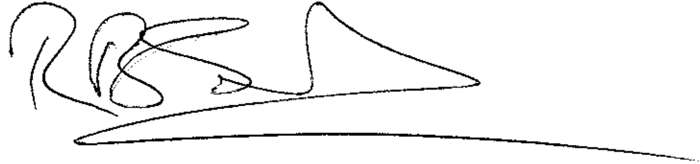
[2] In paragraph 9.1 of the joint HM Treasury/FSA consultation document on the Transposition of the UCITS IV Directive ("the UCITS IV Consultation Document").

[3] In paragraph 9.4 of the UCITS IV Consultation Document.

disrupted. The attached discusses the necessary balancing act between the principles of equity, simplicity and certainty.

We are of course at your disposal and that of your officials to discuss any of these points.



RB Saunders
Chief Executive

INVESTMENT MANAGEMENT ASSOCIATION

REPRESENTATIONS FOR THE CHANCELLOR'S BUDGET REPORT 2011

1. The Competitiveness of the UK fund management industry

The UK should be able to attract funds from non-UK investors as well as being attractive as a fund domicile for UK investors. But Ireland and Luxembourg have drawn UK investors away from UK funds and out-compete the UK internationally. We have worked closely with officials on the recommendations made in the 2006 report we published in conjunction with KPMG, entitled "Taxation and the Competitiveness of UK Funds", with the aim of reversing the outflow of funds from the UK.

The majority of suggested reforms from this report have been implemented, including: tax-efficient securities and property fund regimes; legislative certainty that UK authorised funds will not be treated as trading; and a reformed regime for institutional funds. These developments represent a major step forward and to a large extent succeed in producing a "level playing field" between the UK and competitor jurisdictions, at least under the current EU regulatory framework.

However, there is a danger that this major improvement in the UK's position may be short-lived if, as a matter of urgency, further action is not taken to facilitate the dynamic changes to the regulatory and competitive framework that will shortly occur. The advent of the UCITS IV, AIFM and Solvency II Directives, combined with the prompt response of competitor jurisdictions to these regulatory reforms, may result once again in the UK falling behind. Outflows of business seen in the past decade will increase unless the UK acts now.

We were therefore pleased to see the statement that:

> *"The Government recognises the opportunities that UCITS IV presents for the UK funds industry and its investors. It believes that tax policy should be aligned with modern business practice and that commercial decisions should not result in adverse tax consequences. The Government is committed to taking all available measures, within the current fiscal constraints, to maintain and build on the UK's position as a major global centre for the asset management industry, and to ensure that UK businesses can take full advantages of opportunities created by EU legislation such as UCITS IV."* [4]

a) Why fund domicile matters

The tax system for UK authorised funds is designed to take a minimal yield from the taxation of the funds themselves, so that it is the circumstances of the investor alone that determine the tax treatment. It is the economic impact (and the resulting taxation of the fund management industry itself) from which the Exchequer derives benefit. We share the Government's objective to maximise the level of economic activity of the industry in the UK.

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[4] In paragraph 9.1 of the UCITS IV Consultation Document.

In 2007, we issued a second report in conjunction with KPMG[5], which found that ***for every £1bn of funds under management located offshore, the UK Exchequer would receive £720,000 [6] in direct tax receipts each year were these funds located in the UK***. This is the direct consequence of the fact that fund administration will generally be located where the fund is located, so if funds are located offshore the Government loses any employment and yields associated with both taxation of corporate profits and employment taxes arising from these administrative and related functions.

The IMA's eighth annual survey[7] found that as at 31 December 2009, our members provided investment management services to non-UK funds totalling £503 billion. On the prudent assumption that the funds under management have increased at the same rate as UK-domiciled funds, we estimate this figure is at least £600 billion as at 31 December 2010. ***Had these funds been domiciled in the UK, the Government would have received over £400 million of additional tax revenue per annum [8] from the industry***.

b) EU Regulatory Changes for Funds

The **UCITS IV Directive**, which comes into force on 1 July 2011, is designed to lead to an improved Single Market for UCITS. It aims to simplify the regulatory environment, to create cost savings through economies of scale, to give greater choice of investment funds to investors, and to increase investor protection by ensuring that retail investors receive clear, easily understandable and relevant information.

Two measures in particular need to be considered in the context of the evaluation of the competitive opportunities and threats for the UK:

(i) allowing Master-Feeder funds as a pooling technique; and
(ii) the introduction of a Management Company Passport, which is likely to result in a smaller number of management companies ("Mancos").

Under the Master-Feeder proposals, a manager will be able to pool the investments of its EU-based funds into one Master UCITS. UCITS domiciled in different Member States ("Feeders") will be able to invest into the Master, and an individual Feeder will be able to satisfy the reporting requirements of its home and other States. The logic behind the Master–Feeder arrangement is to encourage efficient asset pooling in a single EU jurisdiction. Investment managers will therefore want to decide first, where to locate the domicile of the Master, and second, in which jurisdictions to locate its Feeders.

It is expected that many Feeders will be domiciled in the jurisdiction where they are sold, given the cultural bias of individual investors to purchase UCITS domiciled in their home jurisdiction. Moreover, Feeders may be designed for a particular type of investor, e.g. in order to deliver double tax treaty preferential rates for pension funds. But this might well change over time given the new dynamics introduced into

[5] The Value to the UK Economy of UK-Domiciled Authorised Investment Funds, 30 November 2007.
[6] Assumes no Schedule 19 SDRT charge.
[7] Asset Management in the UK 2009-2010 – The IMA Annual Survey.
[8] Calculated assuming that GDP generated by funds is 0.2% of funds under management and that 36% of that GDP is paid as tax (from IMA/KPMG report 'The Value to the UK Economy of UK Domiciled Authorised Investment Funds'). Therefore £600bn x 0.2% x 36% = £430m.

the market by UCITS IV, especially if a home country Feeder is seen to be not tax-efficient. Therefore, UK-domiciled Feeders will be at risk as sterling-denominated Feeders are created elsewhere.

Moreover, as a result of the quantitative requirements of the **Solvency II Directive** (such as the valuation standard for liabilities to policyholders), even UK insurance companies are considering re-organising their balance sheets and creating Masters that are at risk of being domiciled elsewhere. On the basis of initial indications from a small sample of our members, ***we estimate that somewhere in the region of £500 billion of assets under management could leave the UK in the short term if it is not attractive as a domicile for Masters***.

UK jobs, employment taxes, corporation tax and VAT receipts will therefore be at risk if the UK fails to become a domicile of choice for Masters.

As noted in the joint HMT/industry report[9], both the **AIFMD** and changes to the approach of tax authorities internationally to offshore centres have resulted in hedge fund managers looking to relocate funds from current domiciles into the EU, or at least to launch new funds here. Given that so much hedge fund investment management takes place in the UK, this represents a chance for the UK also to secure the fund domicile here. Ireland has already gained a good proportion of this relocation business. The UK should be able to do the same.

The UK will lose out on potential jobs, employment taxes, corporation tax and VAT receipts if the UK fails to be attractive as a domicile of choice for alternative investment funds.

Therefore, remaining barriers to the competitiveness of the UK as a fund domicile need to be tackled. An important non-fiscal barrier is the UK's lack of "protected cell" legislation for sub-funds within an umbrella. Legislation is already drafted but there has been an unacceptable delay in it being laid.

We urge that the protected cell legislation be laid immediately.

In relation to tax, we have welcomed the announcement that the Government will launch a tax-transparent vehicle in 2012.

We now ask for a public commitment to a clear and more specific timetable for amendment of FSMA 2000.

Also, we are engaged in positive discussions with your officials on clarification to HMRC guidance in certain areas. The main remaining tax barrier to UK competitiveness is Schedule 19 SDRT. Time is of the essence as firms are already taking decisions about future fund domicile.

c) Abolition of Schedule 19 SDRT

The Schedule 19 SDRT regime is a serious barrier to the UK becoming a domicile of choice for Masters and for alternative investment funds. Schedule 19 imposes an

[9] Asset management: the UK as a global centre: November 2009

additional SDRT charge on UK-authorised funds and is administratively burdensome for the industry to calculate and for HMRC to inspect, due to the complicated formula. It thereby acts to make them less competitive than their European counterparts because such a tax does not exist in other European jurisdictions. Ireland does not have a similar tax charge. Luxembourg's *taxe d'abonnement* is an annual tax on net assets, which varies between 0.01% and 0.05% depending on the type of fund. The *taxe d'abonnement* is an administratively simple tax and does not add materially to operational costs. The Luxembourg charge is 0.05% on ordinary SICAVs and FCPs. This is close to the true cost of Schedule 19 SDRT, estimated in a 2007 HM Treasury consultation paper[10] to be only 0.05% of relevant UK funds under management. Luxembourg is otherwise a tax-free jurisdiction, allowing for the rolling up of gross income.

Moreover, Luxembourg has already shown itself ready to amend this tax as a result of competitive pressure. It reduced the rate to 0.01% for "special investment funds" in direct response to the perceived threat from Irish QIF funds. Also, from June 2004, an FCP (as well as a SICAV) is exempt from the *taxe d'abonnement* if its units are "reserved" for pension providers where the ultimate beneficiaries are employees belonging to the same multinational group. Although Luxembourg has stated that there are no current plans to reduce the *taxe d'abonnement* further, or to abolish it, Luxembourg's past track record in responding to competitive pressure means that it would be unwise for the UK to presume no further reduction in the scope and/or rate charged.

Potential investors in UK funds fix upon the headline Schedule 19 SDRT rate of 0.5% and assume it is applied to the total value of any purchase of fund units. Given the computational complexity of Schedule 19 SDRT, it is hard to explain to anyone not immersed in Schedule 19 SDRT compliance the difference between the headline and the actual rate, a difficulty which the UK's competitors are able to exploit, and do.

Of particular concern is that a UK-domiciled Master would be within the charge to Schedule 19 SDRT, whereas Masters in other EU jurisdictions would not. Moreover, Schedule 19 SDRT would affect UK-domiciled Feeders. This will impact UK competitiveness: a UCITS Feeder domiciled elsewhere, but with a sterling share class to remove currency risk for UK investors, will become more attractive.

At present, only a handful of UK investment managers export UK funds cross-border, and some of these are re-considering their business strategy. Many other managers are considering marketing only non-UK funds to UK investors in future. Abolition of the Schedule 19 SDRT regime would send a very clear signal to the market that the Government is serious about making the UK a more attractive fund domicile. ***In the short term, we expect that such a change would cause UK managers to reconsider any current proposals to move funds outside the UK.*** In the longer term it could help make the UK a serious competitor to Ireland and Luxembourg. New entrants into the EU could be more confident about basing their funds in the UK.

Also, significant opportunities could arise for the UK out of the AIFMD, which will provide a European passport for funds marketed to professional investors. The UK should aim to be the domicile of choice for such funds and for the related administration activities. Yet, such funds are most unlikely to consider the UK as

[10] Stamp duty reserve tax – Schedule 19: a discussion paper, November 2007

their domicile of choice while the Schedule 19 SDRT regime continues to exist. Indeed, Ireland has already gained momentum in attracting such funds.

Abolition of Schedule 19 SDRT would strongly reinforce the message to the market that the UK Government is serious about the competitiveness of UK funds and the UK fund industry. The "PR" benefits of abolition should not be underestimated. The benefits will far outweigh the initial, minimal tax loss of c£70 million.

If the concern is potential tax avoidance, Government might consider adopting more widely the Genuine Diversity of Ownership ("GDO") condition already introduced in respect of direct taxation for Qualified Investor Schemes ("QIS"), Tax-Elected Funds ("TEFs"), Property Authorised Investment Funds ("PAIFs") and those funds wishing to secure an investment (rather than trading) tax treatment.

We call for the complete abolition of Schedule 19 SDRT.

d) EU Regulatory Changes for Management Companies

The UCITS IV Manco proposals will allow UCITS authorised in one Member State to be managed remotely by a Manco established in another Member State and authorised by that Member State's regulatory body. This proposal, like the introduction of Master-Feeder structures, is designed to stimulate economies of scale.

Whilst tax is only one factor amongst many in the decision-making process, it will be an important factor. If the UK is to retain and attract Mancos, it is vital a UK Manco managing a foreign UCITS does not cause the foreign UCITS to be subject to UK tax. The firm statement at paragraph 9.4 of the UCITS IV Consultation Document was therefore a very welcome signal to the market that tax barriers that could frustrate the UK being considered as the location of choice for a Manco are to be dealt with.

Firms are already beginning to factor into their strategic business plans the ability to consolidate the number of management companies they operate around Europe.

We call for further detailed proposals to be issued as soon as possible to ensure that there will be no adverse UK tax consequences for a foreign UCITS as a result of having a UK management company.

2. Savings policy

The encouragement of savings by UK citizens should be a key policy goal. The demographic shift underway in the UK and elsewhere in Europe is resulting in a welfare settlement that is likely to see a significant amount of responsibility placed on individuals for their economic well-being in retirement. The expectation among policymakers is that in the UK, beyond baseline support provided by the state, the claims on future output that are at the heart of any pension system will be managed through individual saving rather than collective redistribution through the tax system or through employer schemes.

It is clear that many millions of individuals and households in the UK are not saving sufficiently for their long-term needs, particularly retirement. With respect to shorter-term precautionary saving, it is also striking how poor provision appears to be in this area, perhaps reflecting a period of easy accessibility of credit. The Family Resources Survey (2007-08) estimated that almost half of households had savings of less than £1,500, with just over a quarter having no savings at all.

The tax rules that apply to savers have developed in recognition of the fact that investors of modest means cannot easily access capital markets given the transaction costs, and the difficulty of producing a diversified portfolio when the amount available to invest is small. The range of financial products available on the market to assist in the objective of encouraging savings is wide and includes authorised funds, ISAs, and pension and life products. However, much more needs to be done to stimulate saving and we suggest that fiscal incentives are an essential tool.

An example of a current disincentive in the current tax system is the imposition of SDRT on the purchase of shares, which reduces returns to savers. We recognise that in the current fiscal environment, abolition of the SDRT primary charge is not a realistic request.

We therefore call on the Government to adopt as a long-term aspiration the abolition of SDRT.

3. The UK as a place to do business

In our experience, in the last decade or so, officials have spent much time and energy on the question of **equity**. In fact, so over-riding has been the concern to cap potential loopholes, that resulting legislation has too often imposed considerable additional complexity and administrative burden on the vast majority of ordinary savers and the industry. Moreover, in many cases the additional complexity has been found not to have fully closed down the identified loophole or has been found to have resulted in the creation of new loopholes.

Certainty will always prove to be a chimera where the rules are highly complex, but not all complexity is necessary. Frequent changes in the rules are a major contributor to complexity, and we agree with the Office of Tax Simplification ("OTS") that:

> *".....a complex system can become simple (or at least simpler) if it is left in place for many years so that taxpayers can learn it, devise ways of complying and become comfortable with requirements."*[11]

Simplicity is widely regarded as a sub-set of the issue of certainty, since it is difficult to conceive of a tax system that can be regarded as certain if the rules are so oblique and complex that it is beyond the wit of all but a small group of specialists to understand them. Most citizens do not have the income or wealth to justify engaging tax professionals to assist them in their tax affairs; it is important that taxation does not remain a "closed book" to all but the tax professional. We recognise that complexity is partly created by the need to minimise the possibility of abuse of the system by those searching for technical loopholes, but, as noted above,

[11] Page 9 of the Office of Tax Simplification's Review of Tax Reliefs interim report

complexity is very likely to create loopholes. It has been argued that the volume of the tax legislation is, in itself, an indicator of complexity. IMA does not agree, and supports the position of the OTS that a major factor of increased length has been the rewriting of the legislation in simpler language.[12]

Predictability is a critically important feature of a stable and attractive tax regime, and is crucial to UK competitiveness. It is thus important in the development of a tax policy to support growth. Currently, the perspective is that the UK rates poorly on predictability compared to many other tax jurisdictions. This is important for economic activities that are potentially mobile, such as significant parts of the financial services sector (see the recent report prepared for the City of London Corporation by CRA International).[13]

The Government should aim to develop tax policy within existing established frameworks and administrative structures, to increase significantly the certainty of the tax regime as a whole. Moreover, as part of the development of taxation policy, all areas should be consulted upon, including anti-avoidance policy. Anti-avoidance policy has greatly exacerbated unpredictability in the development and application of tax policy in recent years. The manner in which highly complex anti-avoidance legislation is introduced has been problematic, with many changes being made piecemeal and without notice. This produces uncertainty and adds considerably to compliance costs, especially where legislation supposedly targeted at a specific mischief has unintended consequences on "innocent bystanders".

We call on the Government to consult fully and openly on all changes to the tax regime, including anti-avoidance measures.

[12] Pages 8 – 9 of the Office of Tax Simplification's Review of Tax Reliefs interim report
[13] Pages 5, 26 and 59 of "Taxation of the Financial Services Sector in the UK, October 2010"