



10 DOWNING STREET

From the Private Secretary

15 November 1983

Offshore and Overseas Funds: Offshore Life Assurance

The Prime Minister has seen your letter to me of 14 November which reported the Chancellor's wish to tighten up the tax treatment of overseas life assurance policies. This would be announced at the same time as the details of the measures on offshore roll up funds originally announced in September. The Prime Minister has also seen your letter of 16 November which explains the reasons for extending legislation to offshore life assurance and explains that these measures would satisfy the so-called "Rees rules". In the light of this information she is content with the Chancellor's proposals.

Andrew Turnbull

Miss Margaret O'Mara,
H.M. Treasury.

HL

Just



Prime Minister^①

(i) Ch/Ex wishes to announce details of action on offshore vol-up funds originally announced in September

(ii) He feels it is necessary to stop life assurance being used as an alternative

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Agree his proposals?

AT 15/11

14 November 1983

Andrew Turnbull Esq
No 10 Downing Street
LONDON SW1

Have we consulted about this - a few the same warnings? If not then I think it should wait until the Finance Bill. It is ModI unusual

Dear Andrew,

OFFSHORE AND OVERSEAS FUNDS

The Chancellor announced on 15 September, with the Prime Minister's agreement, that he intended to propose legislation in the 1984 Finance Bill to ensure that an appropriate amount of income and corporation tax was paid when an investor disposed of a holding in an offshore or overseas fund. (Judith Simpson's letter to Michael Scholar of 5 September sets out the background.) The announcement promised a subsequent statement giving full details of the new rules.

I now enclose a copy of the further announcement which the Chancellor has agreed should be made on Wednesday 16 November. It takes the form of a brief reply to a Parliamentary Question, and a more detailed Inland Revenue statement.

You will see that the announcement also gives details of the measures proposed to correct a potentially serious anomaly in the tax treatment of offshore life assurance policies held by UK residents. The present rules are almost as attractive as the regime which has applied for offshore funds. There were preliminary indications that some UK life companies were preparing a marketing campaign for policies issued by their offshore subsidiaries (usually located in tax havens) and that money in offshore funds might therefore simply have been diverted into offshore life assurance. This would have rendered the offshore funds legislation largely ineffective and the Chancellor felt it essential to act quickly in order to block this loophole before it was too late.

Yours sincerely,

Margaret O'Mara

MISS M O'MARA



INLAND REVENUE Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 6692 OR 6706

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November 1983

OFFSHORE AND OVERSEAS FUNDS; LIFE ASSURANCE POLICIES ISSUED BY NON-RESIDENT LIFE OFFICES

In a Written Answer to a Parliamentary Question, Mr John Moore MP, Financial Secretary to the Treasury, today

- i. outlined the shape of the proposed legislation on offshore and overseas funds, and
- ii. announced that legislation would be included in next year's Finance Bill to amend the present tax treatment of life assurance policies issued to UK residents by non-resident life offices. The provisions will apply from midnight tonight.

The Financial Secretary's statement, and a more detailed statement which he has authorised the Inland Revenue to issue, are reproduced below.

NOTE TO EDITORS

Offshore and Overseas Funds

The Chancellor of the Exchequer announced on 15 September his intention to propose legislation in the 1984 Finance Bill to ensure that an appropriate amount of income or corporation tax is paid when an investor disposes of a holding in an offshore or overseas fund. The statement was published as an Inland Revenue press release.

WRITTEN PARLIAMENTARY QUESTION AND ANSWER

In reply to the following Parliamentary Question:-

"To ask Mr Chancellor of the Exchequer what will be the details of his proposed legislation for taxing disposals of holdings in offshore and overseas funds, and whether, in addition to proposing legislation on investments in such funds, he intends to change the tax treatment of life assurance policies issued by non-resident life offices to UK residents,"

the Financial Secretary to the Treasury said today:-

"I have authorised the Inland Revenue to issue today a statement giving the details of the new provisions for investments in offshore and overseas funds and of changes we intend to introduce in the tax rules for life assurance policies issued by non-resident life offices.

"The overall shape of the new provisions relating to the funds will be as follows:-

(i) they will apply to disposals after 1 January 1984 of interests in funds held by investors resident or ordinarily resident in the United Kingdom;

(ii) they will apply to all funds not resident in the United Kingdom, irrespective of the type of investment they undertake - they will not be confined to specific types of fund such as money funds;

(iii) the new rules will not apply where it is established that a fund genuinely distributes all its income. For this purpose, funds will be able to obtain regular clearance as "distributors" from the Inland Revenue;

(iv) except for any gain accruing before 1 January 1984, the whole of the investor's gain on disposal will be taxed as income;

(v) as at present, the capital gains regime will apply to gains accruing before 1 January 1984: the new rules will not apply retrospectively to such gains.

"As regards life assurance policies issued by non-resident life offices to UK residents, there are a number of anomalies in the present rules. We propose to make the following changes in their tax treatment:-

(i) policies issued in respect of insurances made after midnight tonight will not satisfy the qualifying conditions unless issued or administered in the course of UK branch business.

(ii) UK residents will be liable to income tax in full on their profits from non-qualifying policies issued after midnight tonight.

The provisions will also apply to existing policies in certain circumstances; but special measures will be taken to safeguard the bona fide expatriate business of non-resident life companies. Fuller details are given in the Inland Revenue statement.

It is proposed to legislate in the 1984 Finance Bill. Draft Clauses will be published in due course.

OFFSHORE AND OVERSEAS FUNDS; LIFE ASSURANCE POLICIES ISSUED BY NON-RESIDENT LIFE OFFICES

As announced in a Written Answer today, the Financial Secretary to the Treasury has authorised the Inland Revenue to issue the following statement.

I. OFFSHORE AND OVERSEAS FUNDS

Introduction

1. On 15 September, the Chancellor of the Exchequer announced that in the 1984 Finance Bill he would be proposing to Parliament provisions to ensure that an appropriate amount of income or corporation tax was paid when a United Kingdom investor disposed of an interest in an offshore or overseas fund.

2. The paragraphs that follow describe the basic shape of the new provisions. They do not cover all the fine detail of the new rules and their application in the more complex cases. Draft Clauses giving full details will be published in due course.

The Tax Charge

3. There will be a charge to income tax or corporation tax under Case VI of Schedule D on an investor when he makes a gain on the disposal of an interest in an offshore or overseas fund after 1 January 1984.

4. Broadly, the computation of the gain chargeable as income will follow the capital gains tax rules. The major exceptions to this will be as follows:-

(i) Death will be an occasion of charge under the new rules, with the gain calculated by reference to the market value of the interest in a fund at that date.

(ii) Claims to roll over gains under Section 79 Finance Act 1980 (gifts etc) will not be possible.

(iii) The indexation allowance will not be available.

(iv) Some restrictions will be imposed on the working of the company reorganisation provisions (Section 77 et seq Capital Gains Tax Act 1979). These restrictions will not apply where the reorganisation is only within one company.

Persons chargeable

5. The rules on persons chargeable will broadly follow those for capital gains tax and corporation tax on capital gains.

6. The provisions will apply to an investor who, in the chargeable period, is a person (including a company or body of persons) resident or ordinarily resident in the United Kingdom. They will also apply to disposals by a non-resident company of interests held in connection with a branch or agency carrying on a trade in the United Kingdom.

7. Individuals resident or ordinarily resident but domiciled overseas will be charged only in respect of amounts received in the United Kingdom.

Definition of Offshore and Overseas funds

8. Offshore and overseas funds will be defined as non-resident concerns whose investors have, at the time of acquiring their interest in the concern, a reasonable expectation of being able to dispose of that interest to the issuer or some other person, within ten years of the investment, for a consideration substantially equivalent to their proportionate share of the fund's net assets.

9. The non-resident concern may be a non-resident company or a unit trust scheme with non-resident trustees or a similar arrangement governed by foreign law. For this purpose companies and trustees will be treated as non-resident if they were not resident

(i) at the time the investor disposes of a holding, or

(ii) at any time between 1 January 1984 or (if later) the investor's acquisition of the interest and the date of disposal.

However, gains on disposals of interests in companies and unit trusts which become resident in the United Kingdom before 1 January 1985, and remain so resident up to the date of disposal, will be excluded from the new rules.

10. The new provisions will apply to interests in all types of fund: they will not be confined to "money funds". But they will not apply to:-

(i) rights under life assurance contracts;

(ii) rights in respect of loans made in the ordinary course of a banking business;

(iii) interests held by managers of a fund which entitle the holder only to repayment of the original consideration; and

(iv) interests which entitle the holder to have a fund wound up and to receive on the winding-up more than half the assets.

Funds which Distribute their Income

11. The new charge on the disposal of an interest in a fund will not apply where it is established that the fund distributed all its income throughout the period for which the investment was held. A disposal of such an interest will continue to be chargeable under the capital gains tax regime.

12. To this end there will be a clearance procedure under which funds will be able to establish "distributor" status. The clearance procedure will operate separately for each period of account of a fund. To obtain clearance, funds will have to demonstrate to the Inland Revenue that:-

(i) they distribute all their net income as computed in their accounts, and

(ii) the accounts figure of income is at least 85 per cent of the taxable income, computed broadly in accordance with corporation tax principles, which they would have if they were resident in the UK.

13. To protect the Exchequer, it will be necessary to impose some restrictions on the pattern of funds' investments if "distributor" status is to be established. A fund will not qualify as a distributing fund if

(i) more than 5 per cent by value of its portfolio consists of investments in other funds, or

(ii) more than 10 per cent by value of its portfolio consists of investment in a single company, or it holds more than 10 per cent of a class of share in a single company (there are similar restrictions for authorised unit trusts in the UK and for comparable institutions in other European Community countries).

14. A fund will not be able to establish "distributor" status where income is distributable to some investors but not to others.

15. Where a fund which meets the criteria does not seek clearance as a "distributor" the investor will have an opportunity to establish that the conditions were met during the period for which the interest was held.

Gains Accruing before 1 January 1984

16. Gains accruing before 1 January 1984 will continue to be chargeable to capital gains tax or corporation tax on chargeable gains. They will not be treated as income.

Computation of the Tax Charge

(a) Interests acquired on or after 1 January 1984

17. Where the investor acquired his interest in the fund on or after 1 January 1984, the whole of his gain on disposal will be charged as income.

(b) Interests acquired before 1 January 1984

18. Where the interest was acquired before 1 January 1984, the amount to be treated as income will normally be that part of the investor's gain on disposal attributable to the period commencing 1 January 1984 (broadly the difference between the value of his interest at 1 January 1984 and its value on disposal). Where the value at 1 January 1984 is less than the value on acquisition, the charge will be limited to the actual gain on disposal.

Indirect Holdings

19. Provisions may need to be included to ensure that a UK investor cannot avoid the new rules by investing via an intermediate entity, wherever resident.

II. LIFE ASSURANCE POLICIES ISSUED BY NON-RESIDENT LIFE OFFICES

20. Life assurance policies issued by non-resident life offices to UK residents may at present be qualifying or non-qualifying. If a policy is qualifying, no tax relief will be given in respect of premiums paid (unless paid to the UK branch of a non-resident life office) but the profits on maturity will be entirely tax free, as is the case with such policies issued by UK companies. But, because the life office is non-resident, it will generally pay no UK tax on its investment income. If a policy is non-qualifying, the UK investor will be liable to income tax at the higher and additional rates (if relevant) on any profits but, as with such policies issued in the UK, there will be no basic rate income tax liability. Again, the life office will generally pay no UK tax on its investment income.

21. The Chancellor regards the present tax treatment of policies issued by non-resident life offices as anomalous and he proposes to change it. Legislation to this effect will be included in next year's Finance Bill. Policies issued in respect of insurances made after midnight tonight by non-resident life companies will not satisfy the qualifying conditions unless such policies remain, throughout the policy holder's period of residence in the UK, a liability of a UK branch of that life office, and are either issued or administered by that branch. Existing policies issued by non-resident companies will come within the new provisions if, after midnight tonight, they are varied so as to increase the benefits secured (by injecting further capital) or to extend the term of the insurance.

22. The Chancellor also proposes to change the rules for computing the tax charge on profits received by UK investors from non-qualifying policies issued by non-resident life companies. Since such companies will generally pay no UK tax on their investment income, there is no justification for waiving investor's basic rate liability in respect of such profits. UK residents will therefore be liable to income tax in full on profits arising from new

non-qualifying policies issued after midnight tonight, or existing policies into which further capital is injected after midnight tonight.

23. In order to ensure that bona fide expatriate business carried on by non-resident life companies is not penalised, the computational and top-slicing rules for non-qualifying policies will be amended to cater for cases in which the policy holder is non-UK resident for any part of the period over which the policy runs.

24. Draft clauses on these new rules will be published in due course.

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