

M19 GUERNSEY RESIDENTS – INVESTMENTS IN FUNDS (sections 17, 19 and 67)

Income will always be taxable, the only variation being the time it is brought into charge:

- (a) distributions in cash form are income of the year in which the distribution is declared;
- (b) where a fund offers the investor the alternative of receiving distributions of income or a "roll-up/reinvestment" (or a mixture of both of these), then a tax charge will arise whether or not the distribution is taken in cash form;
- (c) where under the terms of the fund income is not distributed but is accumulated (usually by enhancing the share or unit value), referred to here as an "accumulation fund", then a tax charge will not arise until the holding is disposed of, unless the 'alternative approach' is adopted as set out below. On disposal the element of the proceeds relating to accumulated income will have to be determined and declared on the relevant tax return.

Cases will also be reviewed to consider whether any charge to tax arises on death or leaving the island.

Any other gains arising from the holding of an investment in a fund will give rise to a charge to income tax if:

- (a) in the opinion of the Director, section 67 of the Income Tax Law applies (general provision against legal avoidance); or
- (b) the disposal forms a business or part of a business (section 19(a) of the Income Tax Law).

Information to be declared relating to investments in accumulation funds

Where an investor holds an interest in an accumulation fund, this fact should be noted on the tax return for the year in which it is held, regardless of whether any disposals of units/shares have been made.

The holding should be recorded for each relevant tax year up to and including the year of final disposal. It should be noted in the section of the tax return entitled 'Additional information'.

When a disposal has taken place, the investor should include the total accumulated income relating to the disposal on their tax return, unless the 'alternative approach' has been adopted as set out below. The income should be declared in the section entitled 'Any Other Income'.

The accumulated income that has been received on disposal should be declared in full as soon as reasonably practicable. In many cases the amount of accumulated income that arose in the actual year of disposal (but not the previous years) will not be known until a subsequent tax year (the timing will depend on the date of the disposal and the fund's year-end).

An investor may incur late payment surcharges if the accumulated income is not declared as soon as reasonably practicable. Investors may therefore wish to include the accumulated income that they are aware of, on their tax return for the year of disposal, and include a best estimate of the additional income up to the date of disposal. In that case the Director would not seek to collect late payment surcharges, so long as the best estimate of the final income has been made in good faith. Any adjustment could be made on the tax return in the following year, once the actual final accumulated income is known.

The investor should make it clear on their tax return what amount of the accumulated income has been estimated and when they expect to receive the final amount to declare. Again, such disclosure should be made in the 'Additional Information' section.

Example

An investor holds units in an accumulation fund until they are disposed of in the sixth year. In the year of disposal (i.e. year six) the investor knows how much accumulated income has arisen in the previous five years but is not yet aware of the accumulated income for year six. The investor should include the previous five years of accumulated income on their 'year six' tax return and also estimate the amount that arose in year six and disclose this as a best estimate. That best estimate should then be amended on the next tax return following the determination of the actual year six accumulated income.

Alternative approach

As an alternative to declaring the total income on disposal, if the fund or its manager provides the investor with details of the accumulated income on a regular (at least annual) basis, the investor can choose to include this amount on their tax return each year and be assessed accordingly.

Where an investor takes this approach, any subsequent disposal will not be subject to income tax to the extent that the accumulated income has already been declared, the only amount to be declared would be the accumulated income in the final period up to disposal.

Investors should clearly set out in the 'Additional Information' section of their tax return if this alternative approach is being taken.

What constitutes a disposal?

A sale/redemption/liquidation of interests amounts to a disposal for income tax purposes, whether or not proceeds are received and in what form.

Transfers and gifts of shares may also be treated as disposals depending on the circumstances, as may be the case on the death of an investor or if they were to leave the island.

However, the Director would not treat the following as a disposal so long as **each** of the following conditions is met:

- (a) the investor holds interests in an accumulation share class/unit ('class A') of a fund;
- (b) those interests are transferred/switched into a new accumulation share class/unit ('class B') of the same fund;
- (c) the investment portfolio of Class A is also transferred to Class B;
- (d) Class A and Class B provide the investor with an identical right to share in the profits of the accumulation class/unit. For this purpose, where Class B provides for a lower fee structure such as a lower management fee, this will not be treated as a different right; and
- (e) the Class A and Class B interests are managed by the same fund manager.

Where this treatment applies, as there is no disposal the accumulated income/(deficit) from Class A will carry over to Class B. That is, the Class B shares/units stand in the shoes of the Class A shares/units.

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