

Further consultation on amendments to the CIS border for property transactions

August 2007



HM TREASURY



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FOLLOW UP TO THE INITIAL CONSULTATION AND NEW PROPOSALS

1.1 HM Treasury's consultation of 1 February 2007 sought views on proposals to amend paragraph 9 of the Schedule to the Financial Services and Markets Act 2000 Collective Investment Schemes Order 2001¹ (henceforth "paragraph 9"). We received 16 responses which we have considered carefully. Those responses authorised for publication will be made available at www.hm-treasury.gov.uk alongside this further consultation.

1.2 A revised draft for the new paragraph 9 is at Annex A. We hope that it addresses the majority of issues raised by respondents. Given that the draft has changed substantially since the first consultation we decided to consult again before finalising the proposals. We welcome further comments. A revised regulatory impact assessment is at Annex B. Further background on the proposals is available in the original consultation document which is available at www.hm-treasury.gov.uk/media/3/0/consult_cis010207_107.pdf.

1.3 This earlier consultation proposed an alternative option of a specific exemption for certain organisations regularly involved in property transactions. This option received very little support in responses so the Treasury is no longer considering this.

RESPONSE TO THE CONSULTATION

Effect on existing schemes

1.4 Ten responses supported the principle of reforming paragraph 9 to deliver greater certainty and flexibility for property and other joint ventures. One response explicitly opposed reform and others were broadly neutral. However, 14 responses highlighted potential unintended consequences for certain types of collective investment scheme (CIS). They pointed to the large number of CISs which have been set up with a special purpose vehicle (SPV) as a participant in order to fail to qualify for the exemption in paragraph 9 and thus maintain CIS status. This CIS status is important to them as it has a consequential impact on their tax treatment since certain parts of tax law refer back to the FSMA definition of a CIS.

1.5 The Treasury does not wish to disrupt the operation of such schemes unnecessarily. However, we remain committed to our original objective of granting greater certainty and flexibility in the setting up of property and other commercial joint ventures. We therefore propose:

1. to preserve the status quo for pre-existing CIS-exempt arrangements by providing for the continuation of their exempt status provided that at all times after the date of the proposed Order all participants are "permitted participants" (see paragraph 9(1)(a) and definition of "permitted participant" in paragraph 9(4) of the revised draft);

¹ The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062), as amended by article 2(1) and (2) of the Financial Services and Markets Act 2000 (Miscellaneous Provisions) Order 2001 (SI 2001/3650) and other amending instruments not directly relevant to paragraph 9.

2. to preserve the status quo for pre-existing arrangements which did qualify as CISs by providing that such arrangements may only qualify for the redrafted exemption in paragraph 9 where all the participants irrevocably agree that the arrangements do not constitute a CIS and all participants are permitted participants (see paragraph 9(1)(b) and definition of permitted participant in paragraph 9(4) of the revised draft); and
3. to exempt new arrangements where all participants are permitted participants (see sub-paragraphs 9(2) and (4) of the revised draft) but to allow them to agree irrevocably not to benefit from the exemption.

1.6 Opting in to the exemption (see sub-paragraph 2 above) would require an irrevocable agreement in writing from all the participants who or which were participants under the pre-existing arrangements immediately before the coming into force of the proposed Order. Later participants (if any) would therefore have no part in the agreement which would remain effective. Opting out of the exemption (see sub-paragraph 3 above) would require an irrevocable agreement in writing from all those who or which are the first participants to enter into the arrangements. The proposed new paragraph 9(2) also requires that the participants so agree at the time the arrangements are first entered into. Here too, later participants (if any) would have no part in the agreement which would remain effective.

1.7 We propose to require the agreements from all participants as described above because, given the diversity of schemes affected by the CIS border, it was impossible to identify a single type of person who or which would have a central role in all arrangements. We propose to make the agreements irrevocable as there would be a risk (albeit limited) of abusive tax and regulatory practices were we to allow schemes frequently to opt in and out of CIS status. Additionally, given that agreement is required from all participants, if we did wish to allow the agreement to be revoked, we would have to make specific provisions as to how that revocation could collectively be made. However, we would be interested to hear from respondents if there are circumstances where revocability would bring significant benefits.

1. Do you agree that the status quo for pre-existing arrangements should be preserved as proposed?
2. Do you agree that provision should be made to opt in and out of the exemption as proposed? Do you agree that opting in and out should be by irrevocable agreement in writing by all participants as proposed?

SPVs as participants

1.8 Some respondents pointed out that providing that SPV participants were not participants for the purposes of the revised paragraph 9 was unnecessarily circular and confusing. As suggested in some responses, we therefore propose to introduce the new concept of a ‘permitted participant’. Permitted participants would fall into two categories – persons acting in connection with an existing and non-specified business (essentially as per the existing paragraph 9) and SPVs set up for the purposes of the transaction. In order to benefit from the exemption, all participants must be permitted participants. There is thus no need to disregard certain types of participant. This also clarifies the issue of how to treat arrangements where all the participants are SPVs –

under the new proposal such arrangements would be able to benefit from the exemption.

Form of SPVs

1.9 Some respondents also pointed out that SPVs are not always bodies corporate and that the new law should not discriminate against other forms of SPV. We therefore propose to include “a body corporate, unincorporated association, partnership, or trustee of a trust (unless that trustee is an individual)” within the definition of a permitted participant.

3. Do you agree that the proposed list of permitted SPV forms is appropriate and sufficient?

Participation in arrangements through SPVs

1.10 The earlier consultation set out the Government’s concern that the freedom to include SPVs should not allow arrangements to include retail investors without failing the paragraph 9 exemption by having them invest through an SPV. We said that if an arrangement were set up with SPVs used purely to shield retail investors from holding a direct interest in the arrangements, it would be possible to consider those retail investors as participants alongside the SPVs. However, it is important to emphasise that we did not in any way seek to imply that there should be a presumption in favour of ‘looking through’ corporate participants to their underlying owners and controllers.

1.11 Many respondents stated that they did not believe the law could be interpreted as allowing owners and controllers of bodies corporate to be considered participants alongside those bodies corporate. Although it would not be possible through this consultation to provide a final interpretation on this issue, it does appear clear that there would be at least some risk of the type of arrangements described in the previous paragraph qualifying for the exemption unless specific provision was made to avoid it.

1.12 As was suggested by some respondents, we therefore propose that an SPV should only be a permitted participant where it “only ever has as its members, partners or trust beneficiaries persons who themselves qualify, or would qualify if they participated in the arrangements” as permitted participants. To allow multi-layered SPVs, the members etc of the SPV may themselves be SPVs provided those SPVs also meet the requirements. Although this provision is technically circular, we believe that the meaning and interpretation are sufficiently clear.

4. Do you agree that SPVs should only be permitted participants where their members etc are permitted participants?

Carrying on business in addition to a specified business

1.13 As set out in the previous consultation, we propose to allow firms which have a specified business but which enter into arrangements in connection with another non-specified business to be permitted participants. We have maintained this provision in the new draft although the drafting has been clarified slightly based on feedback from respondents.

2

RESPONDING TO THE CONSULTATION

2.1 The Government would welcome responses on whether the Schedule to the Collective Investment Schemes Exemption Order should be amended to clarify its application to certain types of property transaction.

How to respond

2.2 The Government would welcome the views of all stakeholders on the issues raised in the document. The consultation begins with the publication of this document and will last for a period of 6 weeks. The reason for the shorter consultation period is that, while we want to ensure the revised proposals do not have further unintended consequences, we believe we have addressed the concerns raised in the previous consultation. Please respond by 12 September 2007. Responses to the consultation should be sent to:

Tom Springbett
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HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4356

Email: tom.springbett@hm-treasury.gov.uk

2.3 This document can be found on the Treasury's website at www.hm-treasury.gov.uk. When responding, please state whether you are responding as an individual or as part of an organisation. If responding on behalf of a larger organisation, please make it clear whom the organisation represents and, where applicable, how the members' views were assembled.

Confidentiality

2.4 All written responses may be made public on HM Treasury's website unless the author specifically requests otherwise. In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response. If you wish, part, but not all, of your response to remain confidential, please supply two versions – one for publication on the website with the confidential information deleted, and other confidential version for the team managing the consultation.

2.5 Even where confidentiality is requested, if a request for disclosure of the consultation response is made in accordance with the freedom of information legislation, and the response is not covered by one of the exemptions in the legislation, the Government may have to disclose the response in whole or in part.

Partial regulatory impact assessment

2.6 As highlighted above, the Partial Regulatory Impact Assessment (Partial RIA) is published with this document and should be read in conjunction with it.

2.7 The Partial RIA lays out implementation options for the areas highlighted above and considers qualitative, and where possible, quantitative costs and benefits for the options.

2.8 A copy of the Partial RIA can be found on HM Treasury's website - www.hm-treasury.gov.uk - or requested through HM Treasury's correspondence and enquiry unit. Contact details can be found at http://www.hm-treasury.gov.uk/contact/contact_index.cfm.

CABINET OFFICE CODE OF PRACTICE FOR WRITTEN CONSULTATIONS

2.9 The Cabinet Office has published a Code of Practice for Written Consultations to guide Departments' activities in this area which sets down the following criteria:

- Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy;
- Be clear about what the proposals are, who may be affected, what questions are being asked, and the timescale for responses;
- Ensure the consultation is clear, concise and widely accessible;
- Give feedback regarding the responses received and how the consultation process influenced the policy;
- Monitor the department's effectiveness at consultation, including through the use of a designated consultation coordinator;
- Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

2.10 If you feel that this consultation does not fulfil the criteria please contact:

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CONFIDENTIALITY DISCLOSURES

2.11 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily) the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of

the information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department. The Department will process your personal data in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

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2007 No.

FINANCIAL SERVICES AND MARKETS

The Financial Services and Markets Act 2000 (Collective Investment Schemes) (Amendment) (No 2) Order 2007

<i>Made</i>	- - - -	2007
<i>Laid before Parliament</i>		2007
<i>Coming into force</i>	- -	2007

The Treasury make the following order in exercise of the powers conferred by section 235(5) of the Financial Services and Markets Act 2000⁽²⁾:

Citation and commencement

1.—(1) This Order may be cited as the Financial Services and Markets Act 2000 (Collective Investment Schemes) (Amendment) (No 2) Order 2007.

(2) This Order comes into force on [] 2007.

Amendment of the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001

2.—(1) The Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001⁽³⁾ (arrangements not amounting to a collective investment scheme) is amended as follows.

(2) For paragraph 9 (schemes entered into for commercial purposes related to existing business), substitute—

“Schemes entered into for commercial purposes wholly or mainly related to existing business

9.—(1) Arrangements first entered into before [*date of commencement of this Order*] do not amount to a collective investment scheme if—

- (a) by virtue of paragraph 9 of the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 as it had effect immediately before [*date of commencement of this Order*] they did not then do so provided that at all times on or after [*date of commencement of this Order*] all participants are and have been permitted participants; or
- (b) in the case of arrangements which amounted to a collective investment scheme immediately before [*date of commencement of this Order*] each person who or which was then a participant irrevocably agrees in writing that they do not do so and at all times on or after [*date of commencement of this Order*] all participants are and have been permitted participants.

⁽²⁾ 2000 c. 8.

⁽³⁾ S.I. 2001/1062, amended by S.I. 2001/3650; there are other amending instruments but none is relevant.

(2) Arrangements first entered into on or after [*date of commencement of this Order*] do not amount to a collective investment scheme if at all times into on or after [*date of commencement of this Order*] all participants are and have been permitted participants unless at the time the arrangements are first entered into each person who or which is then a participant irrevocably agrees in writing that the exclusion in this sub-paragraph shall not apply to the arrangements.

(3) For the purposes of this paragraph—

“permitted participant” means a participant who or which—

- (a) at the time of entering into the arrangements carries on a business which is not specified business (the “first business”) but which may be in addition to any specified business carried on by that participant at that time and—
 - (i) does not carry on that first business by virtue of being a participant in the arrangements, and
 - (ii) enters into the arrangements for commercial purposes wholly or mainly related to that first business; or
- (b) is a body corporate, unincorporated association, partnership, or trustee of a trust (unless that trustee is an individual) which—
 - (i) does not carry on any business other than participating in the arrangements; and
 - (ii) only ever has as its members, partners or trust beneficiaries persons who themselves qualify, or would qualify if they participated in the arrangements, as participants of the kind mentioned in paragraph (a) or this paragraph; and

“specified business” means the business of engaging in any regulated activity of the kind specified by any of articles 14, 21, 25, 25D, 37, 40, 45, 51 to 53 or, so far as relevant to any of those articles, article 64 of the Regulated Activities Order.

(4) [*Only necessary if Order comes into force before 01.11.07*] In sub-paragraph (3), the reference to article 25D of the Regulated Activities Order in the definition of “specified business” has effect in accordance with regulation 1(2) of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment No 3) Order 2006⁽⁴⁾.”.

[Name]

[Name]

Two of the Lords Commissioners of Her Majesty’s Treasury

[] 2007

EXPLANATORY NOTE

(This note is not part of this Order)

This Order amends the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (S.I. 2001/1062) which sets out arrangements which are not to be regarded as a collective investment scheme (“CIS”) for the purposes of the Financial Services and Markets Act 2000 (c. 8). It substitutes paragraph 9 of that Schedule (the “former paragraph 9”).

Sub-paragraph (1) provides for arrangements first entered into before the date on which this Order comes into force (the “commencement date”). Paragraph (a) provides for the circumstances in which arrangements which, by virtue of the former paragraph 9, did not amount to a CIS continue not to amount to a CIS on and after the commencement date. Paragraph (b) provides for the circumstances in which arrangements which did amount to a CIS immediately before the commencement date no longer do so from that date onwards.

Sub-paragraph (2) provides for the circumstances in which arrangements first entered into on or after the commencement date do not amount to a CIS and a mechanism for the first participants to agree that they do.

⁽⁴⁾ S.I. 2006/3384.

Sub-paragraph (3) sets out the definitions of “permitted participant” and “specified business” on which the tests in sub-paragraphs (1) and (2) as to whether arrangements do not amount to a CIS depend.

B

PARTIAL REGULATORY IMPACT ASSESSMENT

Title of proposal

B.1 Amendment of the Schedule to the FSMA Collective Investment Schemes Order 20015 (henceforth the Exemption Order) to clarify its application to certain types of property transaction involving Special Purpose Vehicles (SPVs) or where there are multiple transactions.

Purpose and intended effect

B.2 Section 235(1) of the Financial Services and Markets Act 2000 (FSMA) defines a Collective Investment Scheme (CIS) as “any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income”. There is a general prohibition on establishing, operating or winding up a CIS without prior authorization from the Financial Services Authority (FSA)⁶. The Schedule to the Exemption Order lists certain cases in which arrangements which would otherwise be considered CISs under section 235 of FSMA are exempt and can therefore be established without FSA authorisation.

B.3 Certain types of property transactions may qualify as CISs under the definition in section 235. They therefore rely on the exemptions in the Schedule to the Exemption Order to avoid the requirement for FSA authorization. Paragraph 9 of the Schedule to the Exemption Order exempts certain arrangements entered into for commercial purposes related to an existing business. This paragraph would usually be expected to exempt commercial transactions between businesses. However, for transactions involving SPVs in many cases the paragraph 9 exemption may not apply. This may prevent transactions from being structured in the most commercially efficient way or force participants to pay an FSA authorised operator to oversee the arrangements. However, certain arrangements also use SPVs specifically in order to fail the exemption in paragraph 9 and so maintain CIS status and secure the tax treatment afforded to CISs.

B.4 The proposed redrafting of paragraph 9 aims to allow the use of SPVs in new transactions while avoiding disruption to arrangements set up under the current rules. It is intended that this should:

- clarify and extend the scope of the exemption for eligible arrangements wishing to avoid CIS status, permitting greater certainty, reduced legal and administrative expenditure and greater freedom to structure transactions according to commercial imperatives;
- reduce the probability of arrangements being designed inadvertently in a way which does not benefit from the exemption, implying a risk of legal challenge by one of the participants or enforcement action by the FSA.

⁵ SI 2001/1062.

⁶ See sections 19 and 22 of FSMA and article 51(1) of the FSMA (Regulated Activities) Order 2001 (SI 2001/544).

Consultation

B.5 The drafting of this consultation and the development of the options for reform have been informed by informal consultation with stakeholders in and outside Government and by a previous formal consultation process. The Government welcomes further responses to this consultation.

OPTIONS

Option 1: amend paragraph 9 of the Schedule to the Exemption Order to clarify application to SPVs and multiple transactions

B.6 Option 1 is to redraft paragraph 9 so that arrangements involving SPVs may benefit from the exemption. The freedom to include SPVs would apply by default to new arrangements. Arrangements first entered into before the date of the amending statutory instrument would continue to be assessed under existing rules. There would be provision to opt out of the exemption and so maintain CIS status where arrangements meet the CIS definition in s235 of FSMA and do not qualify for any other exemption. There would also be provision for participants in arrangements which did not qualify for the current paragraph 9 exemption but which would qualify under the revised exemption to agree to benefit from the new exemption.

B.7 The proposed amending Statutory Instrument is at Annex A.

Option 2: do nothing

B.8 The Government could leave the legislation unamended.

COSTS AND BENEFITS

Sectors and groups affected

B.9 The proposal would affect mainly participants in property transactions which can be both businesses and individuals. However, it could also affect participants in other arrangements which currently benefit from the exemption in paragraph 9. However, the Government believes that the proposed draft does not materially narrow the scope of the exemption or adversely affect the treatment of pre-existing arrangements so there should be no additional costs for these groups.

Benefits

B.10 There are 3 main benefits from Option 1:

- greater legal certainty over the interpretation of paragraph 9;
- greater freedom to design property transactions according to commercial imperatives rather than in order to fit in with legal definitions; and
- less legal advice required in designing arrangements.

B.11 The first two benefits are hard to quantify. However, it is possible to estimate a range of quantitative benefits from the third. Assuming the price of an hour of a commercial lawyer's time is £250 and that on average under the new proposed

arrangements 50 fewer lawyer hours would be required for each transaction, the benefits from the proposals would be £12,500 per transaction. Of course in practice the costs and time saved for every transaction will be different. However, the Government believes this is a reasonable estimate of the average. The Government does not have access to accurate statistics on the number of affected transactions. Assuming there are between 5 and 50 per year, the annual benefits could be between £62,500 and £625,000. Given the lack of central data on arrangements of this type, the range of possible benefits is necessarily very broad. The Government would welcome any feedback on the validity of the assumptions used. However, the Government is confident that the benefits would be large enough to be material.

Costs

B.12 The Government does not believe that there would be any additional costs once the new arrangements were bedded down – the new exemption is not designed to prevent any arrangements from benefiting which would have benefited under the existing arrangements. There may be some small transitional costs in law firms and other market participants coming to grips with the new arrangements. However these are likely to be small. There is some risk – as highlighted in responses to the earlier consultation – of unintended consequences causing further costs. However, we believe that the insertion of provisions to preserve the status quo for pre-existing schemes along with provision for opting in and out should minimise this risk.

Small Firms Impact Test

B.13 The proposal is unlikely to have any significant impact on small firms as participants in the types of arrangements discussed tend to be larger firms or other organisations.

Competition assessment

B.14 Any impact on competition should be positive since the proposal would permit greater flexibility in the design of joint ventures allowing a greater focus on commercial and competitive, rather than legal, issues.

Enforcement, sanctions and monitoring

B.15 The CIS border will continue to be enforced and monitored by the Financial Services Authority under any of the options.

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