AIMA

Transparent, sophisticated, tax neutral

The truth about offshore alternative investment funds

Executive Summary

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Myth: Investing in offshore alternative investment funds avoids tax.

Truth: Investing in an offshore alternative investment fund does not confer a tax advantage over investing in an onshore fund, because investment funds (and "collective investment schemes" in general) are tax neutral, whether registered offshore or onshore. That means that investors in the funds remain liable to tax on their gains but the fund itself does not incur tax which would be an additional cost to the investors.

Tax neutrality thus is not unique to the offshore world. All developed economies with funds industries, such as the US, France, Germany and the UK, have tax neutral fund structures in their regulatory and tax regimes. The reason hedge funds, private credit funds and private equity funds tend to be set up in offshore jurisdictions such as the Cayman Islands is that the regulatory regimes of those financial centres permit much more flexibility over the investing and risk-management tools the funds may use as well as being more suited to an international institutional investor base.

Myth: The identity of investors in offshore alternative investment funds is a secret.

Truth: The identity may be private, but it is not secret. Under the Common Reporting Standard (CRS), a set of global tax transparency rules that were drawn up by the OECD and have been implemented by more than 90 countries, including all the main offshore alternative investment fund jurisdictions, the identities and financial details of beneficial owners (such as investors in offshore alternative investment funds) are shared with tax authorities in the investors' home countries. These reports are sent automatically - there are no legal hoops for tax authorities to jump through first.

The offshore alternative investment fund jurisdictions also have or are establishing registries of beneficial ownership from which details can be provided to official agencies on request. The information is treated as private and confidential by tax and law enforcement agencies, meaning the data may not enter the public domain without good reason. The wider public interest is served by official agencies having access to the data.

Myth: Offshore alternative investment funds are based in countries that don't have any regulations.

Truth: Offshore alternative investment funds are set up in offshore jurisdictions such as the Cayman Islands, Bermuda, the British Virgin Islands, Jersey and Guernsey, many of which have regulatory and supervisory regimes that have been comprehensively and positively assessed by the European Securities Markets Authority from the point of view of investor protection and systemic risk monitoring. All of the mentioned jurisdictions have implemented global anti-money laundering standards, comply with US and global tax information exchange rules and meet global transparency standards.

Myth: Offshore alternative investment funds serve no useful social purpose.

Truth: Money invested in offshore alternative investment funds is not kept in a bank account offshore but is invested in financial markets around the world. This activity helps to provide additional sources of financing to businesses and infrastructure projects in developing and developed economies, creating significant jobs and generating tax revenues around the world.

WHY ANY FUND SHOULD BE TAX NEUTRAL – THE THREE LAYERS OF TAX

Investment through any alternative fund or other collective investment scheme adds a potential layer of tax over and above that which would be payable were the investors to own the underlying assets themselves.

Ideally, alternative funds will be established with tax neutral status to prevent "Layer 2" tax being applied to the fund in addition to the taxes incurred (i) by the investors at "Layer 1" and (ii) on the investments at "Layer 3", as illustrated in the table.

Layer of tax	Description	Comment
Layer 1 - Investors	Tax in investors' own jurisdictions on investment income and realised capital gains, either as these arise to the fund or when investors receive proceeds from their interests in the fund.	The investors do not cease to be liable to domestic tax, even if they invest in an offshore fund. Offshore fund investors are visible to their tax authorities, which automatically receive information on their holdings.
Layer 2 - Fund	Tax in the jurisdiction where the fund is registered on the fund's investment income and realised capital gains.	This would be an additional tax charge to be borne by the investors as it arises in respect of the same amounts as in Layer 1 and Layer 3. Onshore, as well as offshore, tax neutral funds are not taxed at this level.
Layer 3 - Investments	Tax in the jurisdiction where the fund invests on income and realised capital gains from the fund's investments, e.g. on an equity stake that the fund has taken in a company or bonds that the fund holds.	Some jurisdictions charge tax on non-resident investors, unless they benefit from a double tax treaty or other relief. Offshore tax neutral funds are not exempt from this layer.