

Property Authorised Investment Funds: a discussion paper

July 2007



HM TREASURY



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**Property Authorised
Investment Funds:
a discussion paper**

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INTRODUCTION

1.1 The Government has continued to consider the taxation position for Authorised Investment Funds (AIF) investing in property further to the development of Real Estate Investment Trusts (UK-REITs).¹ In the 2006 Pre-Budget Report, the Government announced that in taking this issue forward, it had identified a number of significant challenges and committed to continuing dialogue with stakeholders to establish how best to address them.²

1.2 The issue of the taxation of Property AIFs was also raised in an Investment Management Association commissioned report published in October 2006.³ Following publication of that report, the Economic Secretary announced on 14th December 2006 the creation of a joint Investment Management Association, HM Treasury and HM Revenue & Customs Working Group to consider its recommendations.

1.3 Budget 2007 announced that, following constructive discussions with the Working Group, industry and other representative bodies, a framework had been developed for taking this issue forward.⁴ The framework moves the point of taxation from the AIF to the investor, with the result that investors face broadly the same tax treatment as they would have, had they owned real property or UK-REIT shares directly. The framework takes account of many of the same international tax issues that had a bearing on the discussions about, and eventual design of, the UK-REIT.

1.4 A supplementary document released at Budget 2007 laid out the key features of the proposed framework and highlighted areas that the Government and the Working Group would continue to discuss.⁵

1.5 The purpose of this Discussion Paper is to:

- provide partial draft Regulations which deliver certain parts of the framework as set out in the Budget document; and
- set out how the Government intends to take forward the remaining parts of the framework.

1.6 Subject to the successful resolution of the issues which remain, the Government remains committed to launching a new tax regime for Property AIFs by April 2008.

¹ *UK Real Estate Investment Trusts: a discussion paper*, HM Treasury and Inland Revenue, March 2005; *2005 Pre-Budget Report: Britain meeting the global challenge: Enterprise, fairness and responsibility*, HM Treasury, December 2005

² *2006 Pre-Budget Report: Investing in Britain's potential: Building our long-term future*, HM Treasury, December 2006

³ *Taxation and the Competitiveness of UK Funds*, KPMG, October 2006

⁴ Representative bodies consulted to date include the Investment Management Association, British Property Federation, Association of Real Estate Funds, Royal Institution of Chartered Surveyors and the Investment Property Forum

⁵ *Property Authorised Investment Funds*, HM Treasury, March 2007

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KEY FEATURES

2.1 Chapter 2 covers the key features of the proposed tax regime for Property AIFs and directs stakeholders to a number of points on which the Government would welcome comments. Draft Regulations can be found in Annex A. The sections relevant to each feature are referred to in the text, however, the regulations for certain features will depend on further discussions with industry. Regulations for these will therefore be published later in the year.

LEVEL OF PROPERTY HOLDING

(draft Regulations 4A.2.2 to 4A.2.6)

2.2 As set out in the Budget framework, access to any new Property AIF tax regime will be available only to AIFs whose investment portfolio comprises predominantly real property or shares in UK-REITs.

2.3 AIFs need to maintain sufficient liquidity to allow investors to redeem their holding within a reasonable period. The Government therefore believes that a property holding of 60 per cent or greater is a suitable threshold. As set out in the draft Regulations the intention is for this property holding to include real property and shares in UK-REITs. The definition of real property will be the same as that used for UK-REITs. The Government is currently exploring the inclusion of REITs established in other European Economic Area member states in the property holding requirement.

2.4 In addition, the UK-REIT regime has specific regulations that apply to circumstances when the UK-REIT indirectly owns property (for example, property owned through Special Purpose Vehicles (SPV)). The Government has considered whether similar regulations are required for a Property AIF. However as the current Non-UCITS Retail Scheme and Qualified Investor Scheme (QIS) regulations do not allow for indirect holdings of this type, the Government is satisfied that no additional rules to address this issue are required at this time. It may however, be necessary to consider this issue further in conjunction with the Financial Services Authority's (FSA) Quarterly Consultation (CP07/13) which includes proposals that would enable AIFs to invest in SPVs provided they meet certain due diligence criteria.

2.5 In the case of a QIS only, the draft regulations include a restriction on financing costs relative to income from property which parallels that in the UK-REIT legislation. The draft regulations covering financing limits are likely to be revised before final regulations are published, in the light of changes to this aspect of the UK-REIT regime made in Finance Bill 2007.

Point 1 for discussion:

Do the draft regulations deliver the policy intention as set out above? The Government would welcome comments on the proposals in respect of the property holding requirement.

TYPE OF AUTHORISED INVESTMENT FUND

(draft Regulations 4A.1.1)

2.6 AIFs can be constituted either as Authorised Unit Trusts (AUT) or as Open-ended Investment Companies (OEIC). Many of the UK's double taxation treaties deal differently with these two legal entities. As set out in the Budget framework, to help ensure that the UK retains a fair proportion of tax on income from UK land and property, any new Property AIF regime will only be available to those established as OEICs. Existing Property AUTs will have to convert to OEICs if they wish to take advantage of the Property AIF regime.

2.7 Under the current tax rules, on conversion OEICs face a Stamp Duty Land Tax charge on the property that they hold. The Government intends to give a 100 per cent relief to the OEIC from this charge if they have converted from an AUT in order to elect into the Property AIF tax regime. Draft regulations to achieve this SDLT relief will be published later in the year.

ELECTIVE REGIME

(draft Regulations Chapter 2, 4A.2.1 to 4A.2.8)

2.8 The Budget framework also set out that AIFs meeting the property-holding requirement would be able to elect into any new tax regime for Property AIFs, i.e. any new regime would not be mandatory simply because an AIF met the property-holding requirement. Regulations 4A.2.7 to 4A.2.8 set out the details for an AIF wishing to elect into the regime. Under the draft Regulations, an AIF would give notice to HMRC in writing before joining the regime.

Point 2 for discussion:

The Government would welcome comments on the suggested process for electing into the Property AIF regime.

2.9 Regulations 4A.3.5 to 4A.3.9 of the draft Regulations, which are similar to those of UK-REITs, will apply where a Property AIF breaches the conditions of the regime. In addition, regulations 4A.7.1 to 4A.7.5 set out the detail where a Property AIF wishes to leave the scheme or is removed from the scheme for consistent breaching of conditions.

Point 3 for discussion:

The Government would welcome comments as to whether any changes are required to the draft regulations for Property AIFs with regard to breaches, voluntary removal or being forcibly removed.

RING-FENCING OF DIFFERENT TYPES OF INCOME

(draft Regulations 4A.3.2 and 4A.3.3)

2.10 As set out in the Budget framework, as for UK-REITs, it is necessary to ring-fence property income so that it remains identifiable as it passes through a Property AIF and out to its investors, who are taxed as if they owned the real property or UK-REIT shares directly.

2.11 However, unlike UK-REITs, FSA regulations require AIFs to value their fund bi-monthly, although in practice many are priced daily. This includes a precise allocation of fund income and expenses between property and other income to calculate the impact of tax on the value of the fund. To enable Property AIFs to price daily while ring-fencing property income, the Budget framework proposed a ring-fencing of three types of income. These are:

- “Property Income”
- “Other Taxable Income” (primarily interest and non-UK dividends); and
- “UK Dividend Income”

2.12 The intention is that the “Other Taxable Income” pool will operate in much the same way as a “bond fund”, with deductions given for distributions that relate to that pool.

2.13 This will allow a Property AIF to offset expenses efficiently without having to factor tax into its pricing calculation. Investors will receive up to three types of distribution each year – a ‘property income’ distribution, an ‘interest’ distribution, and a UK dividend. Each of these distributions will be subject to the UK tax rules applicable to that form of income in the hands of the recipient. For example, individuals and corporate investors would be taxable on the property income or interest distribution at their normal rates. If the investment is held via a tax wrapper such as an ISA or self invested personal pension scheme, or the investor is exempt from tax on property or interest, the tax would be nil.

2.14 The FSA currently allow the authorised fund manager and the depositary to agree a de minimis amount in respect of which a distribution of income is not required. The Government envisages that this provision encompasses the three types of distribution rather than separate de minimis provisions for each category of ring-fenced income.

2.15 It is anticipated that a Property AIF’s accounting procedures should be such that qualifying property for the purpose of the holding and income tests is clearly identifiable.

2.16 The Government envisages that where a Property AIF invests into a UK-REIT it will receive the REIT’s property income distribution without deduction of withholding tax.

Point 4 for discussion:

The Government would particularly welcome comments on regulations 4A.3.2 and 4A.3.3 which are intended to achieve the ring-fencing of different types of income for the model. Although not included in the attached partial draft regulations, the Government is interested to hear industry's views on the *de minimis* provision, in particular whether three separate provisions are desired or needed.

TEN PER CENT CORPORATE OWNERSHIP TEST

(draft Regulations to be published at a later date)

2.17 As for UK-REITs, in order to help ensure that the UK retains the ability to tax investors fairly on income from UK land and property, a rule is required for any corporate investor that owns ten per cent or more of a Property AIF.

2.18 To address this issue for UK-REITs, there is a requirement for a UK-REIT to take “reasonable steps” to ensure that dividends are not paid to, and for the benefit of, corporate investors with a ten per cent or greater interest in the vehicle. The Government believes that a similar approach can be applied to Property AIFs, with the fund manager being required to take certain “reasonable steps”.

2.19 The “reasonable steps” might include:

- implementing a mechanism that can identify investors with a certain level of holding. The Government envisages that this level would be at the discretion of the fund manager, and, to the extent that it is possible, would provide sufficient warning that the investor was approaching a ten per cent holding. The mechanism should also take into account holdings by intermediaries;
- a requirement for the fund manager to obtain information from any investor as to their beneficial entitlement to distributions;
- the fund manager requesting an investor to reduce their holding, if necessary;
- if the investor does not reduce their holding, the fund manager could forcibly sell down the shares, or transfer the holding to a separate share class.

2.20 The Government intends that investors should have certain obligations which should be explicit in the Property AIF's prospectus and instruments of incorporation. The FSA has additional disclosure requirements which funds must comply with. Such obligations might include a requirement that the corporate investor will not seek to obtain, or intentionally maintain, a holding of ten per cent or more. A further requirement is that the investor must notify the fund manager if they hold more than an agreed level of holding in the Property AIF and, in any event, if the ten per cent holding has been breached.

2.21 The Government intends to apply penalties to the fund if it has been identified that “reasonable steps” were not taken. If this occurs repeatedly it is intended that the Property AIF be removed from the scheme.

2.22 If it is identified that the fund manager has not taken the “reasonable steps” and an investor received a distribution in respect of their holding of ten per cent or more, the intention is to levy both a penalty and a tax charge, equal to the rate of withholding tax on that distribution, on the fund.

2.23 The Government will work with the FSA to ensure that the “reasonable steps” required of the fund manager operate within regulatory requirements.

2.24 The Government anticipates that a corporate investor which would otherwise be entitled to receive dividend distributions as a result of a ten per cent or more holding would put in place arrangements to transfer the rights to dividends. There are a number of legal arrangements that can be used, including a dividend strip, under which the legal ownership of the shares is not transferred at the same time as the right to the dividend is transferred. Transfers can also happen under stock lending or repo arrangements, where the legal (but not the economic) ownership of the shares is transferred. Discussions with the Working Group have made clear that for commercial reasons such transactions may not be practical for some investors.

2.25 One alternative solution may be for investment to take place via a taxable, opaque, non-corporate collective investment scheme (e.g. a ‘captive’ of a life insurer subject to FSA rules). It is not envisaged that additional provisions for this will be required in regulations.

Point 5 for discussion:

The Government is interested in industry’s views in relation the “reasonable steps”, in particular how these could work in practice.

Point 6 for discussion:

The Government is interested to know whether the proposed solution for corporate investors via another vehicle, described in paragraph 2.25 would work in practice, and would welcome further views from industry on this.

GENUINE DIVERSITY OF OWNERSHIP

(Preliminary Partial draft Regulations 4A.2.3 and 4A.2.6A)

2.26 The Budget framework made clear that, to avoid Property AIFs being used to obtain unintended tax advantages, it is necessary to include a test based on “genuine diversity of ownership”. This is achieved for UK-REITs by limiting access to the regime to companies that are not ‘close’ (i.e. not controlled by five or fewer participators), which is a long-established concept of company taxation. Both Government and industry have agreed that while this principle needs to be carried across to Property AIFs, applying the concept in an open-ended environment is challenging.

2.27 Following further discussions with the Working Group, the Government believes that the following approach offers a possible way forward. A fund that wishes to take advantage of the Property AIF tax regime will have to demonstrate that it passes the

“genuine diversity of ownership” test. It is envisaged that regulations would set out the purpose of this test. Indicators will be provided in guidance setting out the characteristics that will be considered in determining whether or not the Property AIF passes this test.

2.28 It is envisaged that a fund will be able to do this by having statements in its prospectus and instrument of incorporation making clear that it will be available to a wide range of investors, including (for example):

- access to investment in the fund should be easily available through similar channels to widely available non-property funds
- the minimum investment is not unreasonably high in view of the risk profile of the fund
- charges for smaller investors will not be greater (in comparison to those for large investors) than is commercially reasonable and normal for widely available non-property funds.

2.29 In addition, it is intended that the Property AIF can, if desired, apply for advance clearance as to whether HMRC will accept that the fund passes the test (see draft regulations 4A.2.6A). The Government envisages that the Property AIF would submit its prospectus and other appropriate supporting documentation to HMRC who would confirm or otherwise that, provided it acts within the intentions of that documentation, it will be considered to have passed the test. The Property AIF would be able to re-apply for clearance following any subsequent relevant revisions to its prospectus.

Point 7 for discussion:

The Government is interested in industry’s views on this approach and on the factors to be taken into account in determining whether the fund is a genuine diversity of ownership, as well as comments on the proposed clearance procedure.

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NEXT STEPS

3.1 This discussion paper sets out the Government's latest thinking on the new tax regime for Property AIFs, contains draft Regulations on many parts of the framework, and describes some of challenges that remain in developing a regime that fulfils the stated objectives.

3.2 The Government invites stakeholders to comment on the issues set out in this paper and the attached partial regulations. The Working Group announced by the Economic Secretary will continue to provide a focus for this work. Interested parties can also send additional comments by 28 September 2007 to:

Sue Harper
Assets, Savings and Wealth Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 0207 270 6031

Email: sue.harper@hm-treasury.gov.uk

3.3 The next step in the process will be for the Government to issue a complete set of draft regulations for the proposed tax regime for Property AIFs. These will include draft Regulations for the full SDLT relief for funds converting from AUTs to OEICs to take advantage of the regime. Subject to responses to this discussion paper, the Government intends to issue the complete set of draft Regulations later in the year. These will be accompanied by an impact assessment.

DISCLOSURE OF RESPONSES

3.4 Information provided in response to this discussion paper, 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 1998 (DPA) and the Environmental Information Regulations 2004).

3.5 If you ask us to treat the information that you provide 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 can 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.

3.6 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.

A

PARTIAL DRAFT REGULATIONS

The draft Regulations have been drawn up on the basis of a provisional analysis of the powers provided by sections 17(3) and 18 of the Finance (No. 2) Act 2005. This analysis is subject to confirmation by HMRC solicitors. Should further consideration result in a change to that analysis, then significant changes in the form of the Regulations may be required.

These draft Regulations work by inserting new Regulations in the AIF (Tax) Regulations 2006. The numbering of these draft Regulations is a temporary system and will be renumbered before being published in final form.

Consultation Draft

STATUTORY INSTRUMENTS

2007 No.

INCOME TAX

CORPORATION TAX

CAPITAL GAINS TAX

The Authorised Investment Funds (Tax) (Amendment No. [x])
Regulations 2007

<i>Made</i>	- - - -	***
<i>Laid before the House of Commons</i>		***
<i>Coming into force</i>	- -	***

The Treasury make the following Regulations in exercise of the powers conferred by sections 17(3) and 18 of the Finance (No. 2) Act 2005.

1. Citation and commencement

These Regulations may be cited as the Authorised Investment Funds (Tax) (Amendment No. [x]) Regulations 2007 and shall come into force on [6th April 2008].

2. Amendment of the Authorised Investment Funds (Tax) Regulations 2006 (S.I. 2006/964)

The Authorised Investment Funds (Tax) Regulations 2006 are amended as follows.

3. Amendment of regulation 2

In regulation 2 (structure of Regulations), after “participants in authorised investment funds;” insert–

“Part 4A deals with Property AIFs;”.

4. Insertion of Part 4A

After regulation 69 insert the following Part–

**“PART 4A
PROPERTY AIFS
CHAPTER 1
PRELIMINARY PROVISIONS**

4A.1.1 Property AIFs

- (1) This Part enables an open-ended investment company which meets the conditions in regulations [4A.2.1] to [4A.2.6]–
 - (a) to benefit from the exemption from corporation tax in accordance with regulation [4A.3.2], and
 - (b) to have liabilities to tax imposed on the company and on participants in accordance with [Chapters 4 and 5].
- (2) In these Regulations an open-ended investment company to which this Part applies may be referred to as a “Property AIF”.

4A.1.2 Structure of this Part

The structure of this Part of these Regulations is as follows–

This Chapter contains preliminary provisions;

Chapter 2 contains provisions relating to an open-ended investment company’s entering the Property AIF regime;

Chapter 3 deals with the tax treatment of Property AIFs;

Chapter 4 deals with distributions made by Property AIFs;

Chapter 5 deals with the treatment of participants in Property AIFs; and Chapter 7 contains provisions relating to an open-ended investment company's leaving the Property AIF regime.

4A.1.3 Key Concepts

- (1) In this Part "entry" means the time when this Part begins to apply to an open-ended investment company.
- (2) In this Part "cessation" means the time when this Part ceases to apply to an open-ended investment company.
- (3) In this Part, in relation to an open-ended investment company—
 - (a) "F (pre-entry)" means the open-ended investment company before this Part begins to apply to it,
 - (b) "F (tax-exempt)" means the open-ended investment company in so far as it carries on property investment business (within the meaning of regulation [4A.2.2]) while this Part applies to it,
 - (c) "F (residual)" means the open-ended investment company in so far as it carries on business other than property investment business while this Part applies to it, and
 - (d) "F (post-cessation)" means the open-ended investment company after this Part has ceased to apply to it.
- (4) For the purposes of this Part the income arising to F (residual) consists of—
 - (a) distributions qualifying for exemption under section 208 of ICTA, and
 - (b) other income ("F other").

4A.1.4 Meaning of "net income"

- (1) In this Part the "net income" of an open-ended investment company for an accounting period means, in the case of an open-ended investment company that prepares accounts in accordance with UK generally accepted accounting practice, the amount falling to be dealt with under the heading "Net income/(expense) before taxation" in the company's statement of total return for the accounting period.
- (2) For the purposes of paragraph (1), the statement of total return for an accounting period is the statement of total return which, in accordance with the Statement of Recommended Practice used for the accounting period, must be included in the accounts contained in the annual report of the open-ended investment company which deals with the accounting period.
- (3) For the purposes of paragraph (2), "Statement of Recommended Practice" means, in relation to any accounting period for which it is required or permitted to be

used, the Statement of Recommended Practice relating to authorised investment funds issued by the Investment Management Association in December 2005, as from time to time modified, amended or revised.

CHAPTER 2

ENTERING THE PROPERTY AIF REGIME

Conditions of membership of the Property AIF regime

4A.2.1 Conditions for this Part to apply to company

- (1) An open-ended investment company may give notice for this Part to apply to it in accordance with regulation [4A.2.7] if it meets–
 - (a) the property investment business condition (see regulation [4A.2.2]), and
 - (b) the genuine diversity of ownership condition (see regulation [4A.2.3]).
- (2) In order for this Part to apply to an open-ended investment company in respect of an accounting period, the conditions mentioned in paragraph (1) must be met in relation to the company throughout the accounting period.

4A.2.2 The property investment business condition

- (1) The property investment business condition is that the open-ended investment company must carry on property investment business throughout the accounting period.
- (2) In this Part “property investment business” means business consisting of any one or more of–
 - (a) property rental business, and
 - (b) owning shares in UK-REITs.This is subject to paragraph (3).
- (3) To the extent that income arising from shares in UK-REITs falls within regulation 4A.1.3(4)(a), the income is income of F (residual).
- (3) In these Regulations–

“property rental business” has the meaning given by section 104 of the Finance Act 2006;

“UK-REIT” means a Real Estate Investment Trust which–

 - (a) is resident in the United Kingdom, and

- (b) is not resident in another place in accordance with the law of that place relating to taxation;

“Real Estate Investment Trust” means a company or group to which Part 4 of the Finance Act 2006 applies.

- (5) For the purposes of this Part an asset is involved in property investment business if–
 - (a) it is an estate, interest or right in or over land by the exploitation of which property rental business is conducted, or
 - (b) it consists of shares owned by the open-ended investment company in a UK-REIT.
- (6) For the purposes of this Part references to property (or an asset) being involved in property rental business are reference to an estate, interest or right in or over land by the exploitation of which property rental business is conducted.

4A.2.3 The genuine diversity of ownership condition

- (1) The genuine diversity of ownership condition is that the open-ended investment company must meet conditions A to D throughout the accounting period.
- (2) Condition A is that the company’s instrument of incorporation and prospectus in issue for the time being (including any supplements to that prospectus) contains a statement that shares in the company will be widely available to a wide range of investors.
- (3) Condition B is that a person–
 - (a) may easily buy shares in the company, and
 - (b) may buy the shares in the same way as a person may buy shares or units in other authorised investment funds that are widely available.
- (4) Condition C is that the minimum investment is not unreasonably high in view of the risk profile of the company.
- (5) Condition D is that, in comparison with charges imposed on larger investors, charges imposed on smaller investors will not be greater than is commercially normal and reasonable than the charges imposed by other authorised investment funds that are widely available.

4A.2.4 The loan creditor condition

- (1) The loan creditor condition is that the open-ended investment company must meet conditions A to C throughout the accounting period in the case of any loan relationship to which the company is party.

- (2) Condition A is that, in the case of a debtor relationship of the company, the person standing in the position of a creditor as respects the debt in question is not entitled to an amount by way of interest which depends to any extent on—
 - (a) the results of all or part of the open-ended investment company's business, or
 - (b) the value of any of the company's assets.
- (3) Condition B is that, in the case of a debtor relationship of the company, the person standing in the position of a creditor as respects the debt in question is not entitled to an amount by way of interest which exceeds a reasonable commercial return on the consideration lent.
- (4) Condition C is that, in the case of a debtor relationship of the company, the person standing in the position of a creditor as respects the debt in question is entitled on repayment to an amount which—
 - (a) does not exceed the consideration lent or
 - (b) is reasonably comparable with the amount generally repayable (in respect of an equal amount of consideration) under the terms of issue of securities listed on a recognised stock exchange.
- (5) In this regulation "loan relationship" and "debtor relationship" shall be construed in accordance with Chapter 2 of Part 4 of FA 1996 (loan relationships).

4A.2.6 Conditions for balance of business

- (1) In order to be an open-ended investment company to which this Part applies in respect of an accounting period, conditions A and B must be met in respect of the company.
- (2) Condition A is that the net income of F (tax-exempt) (determined in accordance with regulation [4A.3.3]) is at least 60% of the open-ended investment company's total net income in the accounting period.
- (3) Condition B is that the value of the assets involved in property investment business is at least 60% of the total value of assets held by the open-ended investment company at the end of the accounting period.
- (4) For the purposes of condition B—
 - (a) assets must be valued in accordance with generally accepted accounting practice,
 - (b) where generally accepted accounting practice offers a choice of valuation between cost basis and fair value, fair value must be used, and
 - (c) no account shall be taken of liabilities secured against or otherwise relating to assets (whether generally or specifically).

Clearance applications

4A.2.6A Clearance in relation to the genuine diversity of ownership condition

- (1) The manager of an open-ended investment company may apply to HM Revenue and Customs for clearance that the company meets the genuine diversity of ownership condition.
- (2) An application for clearance must-
 - (a) be in writing, and
 - (b) be accompanied by the company's proposed instrument of incorporation and its proposed prospectus (including any supplements to that prospectus).
- (3) The officer of Revenue and Customs dealing with the application for clearance may require the manager of the company to provide further particulars if the officer thinks that full particulars of the company have not been provided.
- (4) HM Revenue and Customs may-
 - (a) give clearance that the company meets the genuine diversity of ownership condition,
 - (b) give that clearance subject to conditions, or
 - (c) refuse to give that clearance.
- (5) HM Revenue and Customs must give notice to the company of their decision on the application for clearance within [xx] days after the date on which the manager of the company provides full particulars of the company to the officer of Revenue and Customs dealing with the application for clearance.
- (6) The company may not rely on a clearance given under this regulation if-
 - (a) the company acts in contravention of a relevant statement in its instrument of incorporation or prospectus in issue for the time being (including any supplements to that prospectus), or
 - (b) the company amends a relevant statement in its instrument of incorporation or prospectus in issue for the time being (including any supplements to that prospectus).

Giving notice for this Part to apply

4A.2.7 Notice

- (1) This regulation applies if-
 - (a) an open-ended investment company meets the conditions mentioned in regulation [4A.2.1(1)], and

- (b) the manager of the company gives a notice under this regulation specifying an accounting period from the beginning of which this Part is to apply to the company (the “specified accounting period”).
- (2) This Part shall apply to the open-ended investment company from the beginning of the specified accounting period.
- (3) A notice under this regulation–
 - (a) must be given in writing to the Commissioners,
 - (b) must be given at least [xx] days before the beginning of the specified accounting period,
 - (c) must be accompanied by a statement by the open-ended investment company that the conditions specified in regulations [4A.2.2] to [4A.2.6] are reasonably expected to be met in respect of the company throughout the specified accounting period, and
 - (d) must be accompanied by [documents to be specified].

4A.2.7A Notice: further provisions

- (1) This regulation applies if an open-ended investment company–
 - (a) gives a notice under regulation [4A.2.7], but the notice is not accompanied by the documents specified in regulation [4A.2.7(3)(d)], or
 - (b) gives a notice under regulation [4A.2.7] in circumstances in which the genuine diversity of ownership condition is not met.
- (2) HM Revenue and Customs may give notice to the company quashing the notice given under regulation [4A.2.7] (a “quashing notice”).
- (3) HM Revenue and Customs must give a quashing notice–
 - (a) not earlier than [aa] days beginning with the day on which the company gave notice under regulation [4A.2.7], and
 - (b) not later than [bb] days beginning with the day on which the company gave notice under regulation [4A.2.7].
- (4) HM Revenue and Customs must not give a quashing notice until–
 - (a) they have given notice to the company (a “preliminary notice”) that the company’s notice under regulation [4A.2.7]–
 - (i) was not accompanied by the documents specified in regulation [4A.2.7(3)(d)], or
 - (ii) was given in circumstances in which the genuine diversity of ownership condition was not met; and
 - (b) they have given the company a period of [qq] days to rectify the matter specified in sub-paragraph (a).

- (5) The period of [qq] days mentioned in paragraph (4)(b) is a period beginning with the day on which HM Revenue and Customs give the preliminary notice to the company.

Consequences of entry

4A.2.8 Effects of entry

- (1) Property rental business of F (pre-entry) shall be treated for the purposes of corporation tax as ceasing at entry.
- (2) Assets which immediately before entry are involved in property rental business of F (pre-entry) shall be treated for the purposes of corporation tax as being sold by F (pre-entry) immediately before entry and reacquired by F (tax-exempt) immediately after entry.
- (3) For the purposes of corporation tax, on entry one accounting period of the open-ended investment company shall end and another shall begin.
- (4) For the purposes of tax in respect of chargeable gains in respect of the sale and re-acquisition deemed under paragraph (2)-
- (a) no chargeable gain or allowable loss shall accrue to F (pre-entry), and
 - (b) F (tax-exempt) shall be treated as if F (pre-entry's) acquisition of the asset had been its acquisition of it.
- (5) For the purposes of CAA 2001, the sale and re-acquisition deemed under paragraph (2)-
- (a) shall not give rise to allowances or charges, and
 - (b) shall not make it possible to make an election under section 198 or 199 of that Act (apportionment).
- (6) For the purposes of CAA 2001, anything done by or to F (pre-entry) before entry in relation to an asset which is deemed under paragraph (2) to be sold and reacquired shall be treated after entry as having been done by or to F (tax-exempt).

4A.2.9 Duration

Once this Part has begun to apply to an open-ended investment company it shall continue to apply unless and until it ceases to apply in accordance with Chapter 7 of this Part.

CHAPTER 3

THE TAX TREATMENT OF PROPERTY AIFS

Categories of business

4A.3.1 Ring-fencing of tax-exempt business

- (1) For the purposes of corporation tax, the business of F (tax-exempt) shall be treated as a separate business (distinct from—
 - (a) any business carried on by F (pre-entry),
 - (b) any business carried on by F (residual), and
 - (c) any business carried on by F (post-cessation)).
- (2) For the purposes of corporation tax, F (tax-exempt) shall be treated as a separate company (distinct from—
 - (a) F (pre-entry),
 - (b) F (residual), and
 - (c) F (post-cessation)).
- (3) In particular—
 - (a) a loss incurred by F (tax-exempt) may not be set off against the net income of F (residual),
 - (b) a loss incurred in respect of F (residual) may not be set off against the net income of F (tax exempt),
 - (c) a loss incurred in respect of F (pre-entry) may not be set off against the net income of F (tax-exempt) (but this regulation does not prevent a loss of that kind from being set off against profits of F (residual)),
 - (d) a loss incurred by F (tax-exempt) may not be set off against profits arising to F (post-cessation) (in respect of business of any kind), and
 - (e) receipts accruing after entry but relating to business of F (pre-entry) shall not be treated as receipts of F (tax-exempt).
- (4) In paragraph (3) a reference to a loss includes a reference to a deficit, expense, charge or allowance.
- (5) Section 392B of ICTA (ring-fencing of losses from overseas property business) shall not apply to business of F (tax-exempt).
- (6) Paragraphs 5B and 5C of Schedule 28AA to ICTA (transfer pricing: exemption for small and medium enterprises) shall not apply to an open-ended investment company to which this Part applies (whether to F (tax-exempt) or to F (residual)).

Chargeability to tax

4A.3.2 Corporation tax

- (1) The net income of F (tax-exempt) shall not be charged to corporation tax.

- (2) The net income of F (residual) shall be charged to corporation tax at the rate applicable for open-ended investment companies (see section 468A(1) of ICTA).

4A.3.3 Calculation of net income

- (1) This regulation applies to determine the net income of F (tax-exempt) for the purposes of this Part.
- (2) Section 21A of ICTA (calculation of profits of Schedule A business) shall apply to–
 - (a) income arising from the business of F (tax-exempt), and
 - (b) income arising from the business of F (residual).
- (3) Paragraph 2(3) of section 15(1) of ICTA (Schedule A: disregard of credits and debits from loan relationships and derivative contracts) shall not apply in respect of–
 - (a) a loan relationship if or in so far as it relates to tax-exempt business,
 - (b) a hedging derivative contract if or in so far as it relates to tax-exempt business, or
 - (c) embedded derivatives if or in so far as the host contract is entered into for the purposes of tax-exempt business.
- (4) For the purposes of paragraph (3)–
 - (a) a derivative contract is hedging in relation to a company if or in so far as it is acquired as a hedge of risk in relation to an asset by the exploitation of which tax-exempt business is conducted,
 - (b) a derivative contract is hedging in relation to a company if or in so far as it is acquired as a hedge of risk in relation to a liability incurred in connection with tax-exempt business,
 - (c) a designation of a contract as wholly or partly hedging for the purposes of a company's accounts shall be conclusive, and
 - (d) "embedded derivatives" and "host contract" shall be construed–
 - (i) in accordance with section 94A of FA 1996 in relation to loan contracts with embedded derivatives,
 - (ii) in accordance with paragraph 2A of Schedule 26 to FA 2002 in relation to non-financial contracts with embedded derivatives,
 - (iii) in accordance with paragraph 2B of Schedule 26 to FA 2002 in relation to hybrid derivatives
- (5) In paragraph (4)(a) the reference to an asset includes a reference to–
 - (a) the value of an asset, and
 - (b) profits attributable to it.

- (6) Net income shall be computed without regard to items giving rise to credits or debits which would be within Schedule 26 to FA 2002 (derivative contracts) but for paragraph 4(2)(b) of that Schedule (exclusion of share-based and unit-trust-based contracts).
- (7) Income and expenditure relating partly to tax-exempt business and partly to non-tax-exempt business shall be apportioned reasonably.
- (8) Section 3(1) of CAA 2001 (claims for capital allowances) shall not apply; and any allowance which the company could claim under that section shall be made automatically and reflected in the calculation of net income.

Breaches of conditions

4A.3.5 Breach of the genuine diversity of ownership condition

- (1) This regulation applies if an open-ended investment company to which this Part applies is in breach of the genuine diversity of ownership condition.
- (2) HM Revenue and Customs may give notice to the company—
 - (a) giving details of the condition breached, and
 - (b) specifying the period within which the company must rectify the breach.
- (3) For the purposes of paragraph (2)(b) the period specified must not be less than a period of [xx] days beginning with the day on which HM Revenue and Customs give the notice to the company.
- (4) If the company rectifies the breach within the period specified in the notice given under paragraph (2), this Part shall continue to apply to the company despite the breach (but see regulation [4A.3.9]).
- (5) If the company does not rectify the breach within the period specified in the notice given under paragraph (2), the Commissioners may give a termination notice to the company.
- (6) If the company is given three separate notices under paragraph (2) in three different accounting periods in a period of ten years beginning with the day on which HM Revenue and Customs give the first of those notices to the company, the Commissioners may give a termination notice to the company.

4A.3.6 Breach of the loan creditor condition

- (1) This regulation applies if an open-ended investment company to which this Part applies is in breach of the loan creditor condition.
- (2) If HM Revenue and Customs think that the company is inadvertently in breach of the loan creditor condition, they may give notice to the company—

- (a) giving details of the condition breached, and
 - (b) specifying which of the conditions set out in regulation [4A.2.4] HM Revenue and Customs thinks has been breached.
- (3) This Part shall continue to apply to the company despite the breach (but see paragraphs (5) and (6) and regulation [4A.3.9]).
- (4) If HM Revenue and Customs think that the company is intentionally or negligently in breach of the loan creditor condition, the Commissioners may give a termination notice to the company.
- (5) If the company is given two separate notices under paragraph (2) specifying breaches of the same condition set out in regulation [4A.2.4] in two different accounting periods in a period of ten years beginning with the day on which HM Revenue and Customs give the first of those notices to the company, the Commissioners may give a termination notice to the company.
- (6) If the company is given three separate notices under paragraph (2) in three different accounting periods in a period of ten years beginning with the day on which HM Revenue and Customs give the first of those notices to the company, the Commissioners may give a termination notice to the company.

4A.3.8 Breach of conditions for balance of business

- (1) This regulation applies if an open-ended-investment company to which this Part applies—
 - (a) is in breach of condition A set out in regulation [4A.2.6(2)] in an accounting period, or
 - (b) is in breach of condition B set out in regulation [4A.2.6(3)] at the beginning of an accounting period.
- (2) If the conditions specified in paragraph (3) are met, this Part shall continue to apply to the company despite the breach (but see paragraph (5) and regulation [4A.3.9]).
- (3) The conditions are that—
 - (a) property investment business is at least 50% of the company's net income in the accounting period,
 - (b) the value of the assets involved in property investment business is at least 50% of the total value of assets held by the company at the beginning of the accounting period, and
 - (c) the accounting period is not the third consecutive accounting period in which this regulation has applied.
- (4) If the conditions specified in paragraph (3) are not met, the Commissioners may give a termination notice to the company.

- (5) If this regulation applies to a company in three different accounting periods in a period of ten years, the Commissioners may give a termination notice to the company.

4A.3.9 Multiple breaches of separate conditions

- (1) This regulation applies in relation to an open-ended investment company to which this Part applies if-
- (a) there has been a breach of at least two of the conditions in regulations [4A.2.2] to [4A.2.6]],
 - (b) at least one of the conditions breached is contained in a different regulation from that containing another of those breached, and
 - (c) there have been five breaches in the specified ten year period.
- (2) In paragraph (1)(c) the “specified ten year period” means a period of ten years beginning-
- (a) in a case where the earliest breach was a breach of a condition set out in regulation [4A.2.6], on the first day of the accounting period in which that breach was committed, and
 - (b) in any other case, on the day on which HM Revenue and Customs gave notice to the company in relation to the earliest breach.
- (3) The Commissioners may give a termination notice to the company.

Further provisions

4A.3.10 Profit/financing costs in the case of a Property AIF that is a qualified investor scheme

- (1) This regulation applies if conditions A and B are met.
- (2) Condition A is that an open-ended investment company to which this Part applies is a qualified investor scheme.
- (3) Condition B is that the result of the following calculation is less than 1.25 in respect of an accounting period-

$$\frac{\text{Income} + \text{Financing Costs}}{\text{Financing Costs}}$$

- (4) In paragraph (3)-
- “Income” means the amount of the net income of F (tax-exempt) arising in the accounting period (before the offset of capital allowances, of losses from a previous accounting period, and

“Financing Costs” means the amount of the financing costs incurred in that period in respect of the business of F (tax-exempt).

- (5) An amount shall be charged to tax.
- (6) That amount is determined as follows–

Step One

Determine the financing costs which, given the actual income, would produce the result of 1.25 in the calculation specified in paragraph (3) (the “theoretical financing costs”).

Step Two

Determine the amount by which the actual financing costs exceed the theoretical financing costs (the “excess financing cost”).

Step Three

Divide the main rate at which corporation tax is charged for the accounting period by the rate at which corporation tax is charged on an open-ended investment company for the accounting period (see section 468A(1) of ICTA) to determine the multiplier.

Step Four

Multiply the excess financing cost by the multiplier.

The result is the amount charged to tax.

- (7) In paragraphs (3) and (4) “financing costs” means the cost of debt finance; and in calculating the costs of debt finance in respect of an accounting period the matters to be taken into account include–
 - (a) costs giving rise to debits in respect of debtor relationships of the company under Chapter 2 of Part 4 of FA 1996 (loan relationships), other than debits in respect of exchange losses from such relationships (within the meaning of section 103(1A) and (1B) of that Act),
 - (b) any exchange gain or loss from a debtor relationship within the meaning of that Chapter in relation to debt finance,
 - (c) any credit or debit falling to be brought into account under Schedule 26 to FA 2002 (derivative contracts) in relation to debt finance,
 - (d) the financing cost implicit in a payment under a finance lease, and
 - (e) any other costs arising from what would be considered, in accordance with generally accepted accounting practice, to be a financing transaction.

4A.3.11 Cancellation of tax advantage

- (1) This regulation applies if the Commissioners think that a company to which this Part applies has tried to obtain a tax advantage for itself or another person.

- (2) The Commissioners may give a notice to the company specifying the tax advantage.
- (3) If the Commissioners give a notice to the company under paragraph (2) a tax advantage obtained by the company shall be counteracted, in accordance with the notice, by an adjustment by way of—
 - (a) an assessment;
 - (b) the cancellation of a right of repayment;
 - (c) a requirement to return a repayment already made;
 - (d) the computation or recomputation of profits or gains, or liability to tax, on a basis specified by the Commissioners in the notice.
- (4) The Commissioners may (in addition to the adjustment under paragraph (3)) assess the company to such additional amount of income tax under Case VI of Schedule D as they think is equivalent to the value of the tax advantage.
- (5) For the purposes of this regulation “tax advantage” has the meaning given by section 709 of ICTA.
- (6) But a company does not obtain a tax advantage by reason only of this Part applying to it, unless it does anything (whether before or during the application of this Part) which in the Commissioners’ opinion is wholly or principally designed to create or inflate or apply a loss, deduction or expense (whether or not suffered or incurred by the company).
- (7) If a notice is given to a company under paragraph (2), the company may appeal to the Special Commissioners.
- (8) An appeal must be instituted by notice to the Commissioners during the period of 30 days beginning with the date on which the notice under paragraph (2) is given to the company.

4A.3.12 Charge to tax in case of distribution to a company with more than the maximum permitted shareholding

[Please see the discussion paper issued with this partial draft of Regulations.]

CHAPTER 4

DISTRIBUTIONS MADE BY PROPERTY AIFS

4A.4.1 Attribution of distributions

The total amount shown in the distribution accounts of an open-ended investment company to which this Part applies as available for distribution to participants shall be attributed—

- (a) first, to property income distributions up to the amount of the net income of F (tax-exempt) (determined in accordance with regulation [4A.3.3]),
- (b) secondly, to PAIF distributions (interest) up to the amount of the net income of F (other), and
- (c) finally, to PAIF distributions (dividends).

4A.4.2 Property income distributions

- (1) This regulation applies if-
 - (a) an open-ended investment company to which this Part applies makes a distribution, and
 - (b) the amount distributed includes sums attributed to property income distributions.
- (2) The Tax Acts shall have effect as if the sums were payments made on the distribution date by the company to the participants in proportion to their rights.
- (3) Regulation [4A.5.1] (property income distributions: liability to tax of participants) explains how a property income distribution received by a participant is treated.
- (4) In these Regulations a “property income distribution” means a sum attributed to property income distributions which is distributed (including a payment made to a participant who is not chargeable to income tax or corporation tax).
- (5) This regulation is subject to-
 - (a) regulation [4A.4.5] (prohibition on distributions to corporate shareholders with substantial holdings), and
 - (b) regulation [4A.4.6] (treatment of de minimis amounts).

4A.4.3 PAIF distributions (interest)

- (1) This regulation applies if-
 - (a) an open-ended investment company to which this Part applies makes a distribution, and
 - (b) the amount distributed includes sums attributed to PAIF distributions (interest).
- (2) The Tax Acts shall have effect as if the sums were payments of yearly interest made on the distribution date by the company to the participants in proportion to their rights.

- (3) In this Part a “PAIF distribution (interest)” means a sum attributed to PAIF distributions (interest) which is distributed (including a payment made to a participant who is not chargeable to income tax).
- (4) This regulation is subject to–
 - (a) regulation [4A.4.5] (prohibition on distributions to corporate shareholders with substantial holdings), and
 - (b) regulation [4A.4.6] (treatment of de minimis amounts).

4A.4.4 PAIF distributions (dividends)

- (1) This regulation applies if–
 - (a) an open-ended investment company to which this Part applies makes a distribution, and
 - (b) the amount distributed includes sums attributed to PAIF distributions (dividends).
- (2) The Tax Acts shall have effect as if the sums were dividends on shares paid on the distribution date by the company to the participants in proportion to their rights.
- (3) In this Part a “PAIF distribution (dividends)” means a sum attributed to PAIF distributions (dividends) which is distributed (including a dividend treated as paid to a participant who is not chargeable to corporation tax).
- (4) This regulation is subject to–
 - (a) regulation [4A.4.5] (prohibition on distributions to corporate shareholders with substantial holdings), and
 - (b) regulation [4A.4.6] (treatment of de minimis amounts).

4A.4.5 Prohibition on distributions to corporate shareholders with substantial holdings

[Please see the discussion paper issued with this partial draft of Regulations.]

4A.4.6 De minimis amounts

[Please see the discussion paper issued with this partial draft of Regulations.]

CHAPTER 5

THE TREATMENT OF PARTICIPANTS IN PROPERTY AIFS

Treatment of distributions: liability to tax of participants

4A.5.1 Property income distributions: liability to tax of participants

- (1) A property income distribution received by a participant in an open-ended investment company to which this Part applies shall be treated—
 - (a) in the case of a participant within the charge to corporation tax, as profits of a Schedule A business, and
 - (b) in the case of a participant within the charge to income tax, as the profits of a UK property business (within the meaning of section 264 of ITTOIA 2005).
- (2) A distribution received by a participant who is not resident in the United Kingdom—
 - (a) if the participant is a company within the charge to corporation tax, shall be chargeable to tax as profits of a Schedule A business,
 - (b) if the participant is a person other than a company within the charge to corporation tax, shall be chargeable to tax as profits of a UK property business (within the meaning of section 264 of ITTOIA 2005), and
 - (c) in either case shall not be chargeable to tax by virtue of section 42A of ICTA (non-resident landlords).
- (3) Paragraph (1) shall not apply in relation to a participant if and in so far as the participant—
 - (a) is a dealer in respect of distributions (within the meaning of section 95 of ICTA),
 - (b) is a dealer in securities who is charged to tax under Part 2 of ITTOIA 2005 (trading income) in respect of distributions made by companies,
 - (c) is an individual member of Lloyd’s (within the meaning given by section 184(1) of FA 1993) and the distribution is made in respect of assets forming part of—
 - (i) a premium trust fund of his (within the meaning given by section 174 of FA 1993), or
 - (ii) an ancillary trust fund of his (within the meaning given by section 176 of FA 1993), or
 - (d) is a corporate member of Lloyd’s (within the meaning given by section 230(1) of FA 1994) and the distribution is made in respect of assets forming part of—
 - (i) a premium trust fund of his (within the meaning given by section 222 of FA 1994), or
 - (ii) an ancillary trust fund of his (within the meaning given by section 223 of FA 1994).

- (4) Section 114(1)(a) of ICTA (partnerships with companies as members) does not disapply paragraph (1).
- (5) Sections 231 of ICTA and 397 of ITTOIA 2005 (tax credits in respect of qualifying distributions) shall not apply to property income distributions.
- (6) Property income distributions received by one participant acting in one capacity shall be treated, for the purposes of paragraph (1), as the profits of a single business which is separate from—
 - (a) any other Schedule A business carried on by the participant,
 - (b) any other UK property business (within the meaning of section 264 of ITTOIA 2005) carried on by the participant,
 - (c) any overseas property business (within the meaning of section 70A(4) of ICTA) carried on by the participant, and
 - (d) any overseas property business (within the meaning of section 265 of ITTOIA 2005) carried on by the participant.
- (7) In the case of a participant which is a partnership, paragraph (6) applies to receipts by a partner of a share of any distribution as it applies to receipts by a participant.

4A.5.2 PAIF distributions (interest): liability to tax of participants

- (1) A PAIF distribution (interest) received by a participant in an open-ended investment company to which this Part applies shall be treated as if it were a payment of yearly interest.
- (2) Sections 231 of ICTA and 397 of ITTOIA 2005 (tax credits in respect of qualifying distributions) shall not apply to PAIF distributions (interest).

4A.5.3 Property distributions (dividends): liability to tax of participants

- (1) A PAIF distribution (dividends) received by a participant in an open-ended investment company to which this Part applies shall be treated as if it were a dividend on shares.
- (2) If a PAIF distribution (dividends) is made for a distribution period to a participant chargeable to corporation tax, regulations 48 to 52A shall not apply to the distribution.

4A.5.4 Distributions made after cessation

- (1) This regulation applies if an open-ended investment company—

- (a) is a company to which this Part applies in respect of an accounting period,
 - (b) makes a distribution in respect of that accounting period, and
 - (c) the distribution is made after cessation.
- (2) Regulations [4A.5.1] to [4A.5.3] apply in relation to the distribution.

Deduction of tax from distributions

4A.5.5 Deduction of tax from property income distributions

- (1) On making a property income distribution, an open-ended investment company to which this Part applies must deduct a sum representing income tax at the basic rate in force for the tax year in which the distribution date falls.
- (2) A property income distribution shall be treated as having been received by the participant after deduction of income tax at the basic rate for the year of assessment in which the distribution date falls, from a corresponding gross amount.
- (3) The sum is accordingly taken into account under sections 59B and 59D of TMA 1970 (see also paragraph 8 of Schedule 18 to the Finance Act 1998) in determining the income tax or corporation tax payable by, or repayable to, the participant.
- (4) This regulation is subject to regulation [4A.5.7] (distribution payments to be made without deduction of tax).

4A.5.6 Deduction of tax from PAIF distributions (interest)

- (1) On making a PAIF distribution (interest), an open-ended investment company to which this Part applies must deduct a sum representing income tax at the savings rate in force for the tax year in which the PAIF distribution (interest) is made.
- (2) Accordingly, the sum is one to which section 874 of ITA 2007 applies.
- (3) In paragraph (1) the “savings rate” means the rate of income tax specified in section 7 of ITA 2007.
- (4) This regulation is subject to regulation [4A.5.7] (distribution payments to be made without deduction of tax).

4A.5.7 Distribution payments to be made without deduction of tax

- (1) On making a distribution, an open-ended investment company to which this Part applies must not deduct any sum representing income tax if the company reasonably believes that conditions A and B are met.

- (2) Condition A is that if the distribution were made by a UK-REIT out of the profits of C (tax-exempt), the distribution would be required to be made without any deduction representing income tax.
- (3) Condition B is that if the distribution were a distribution of yearly interest, the distribution would be required to be made without any deduction representing income tax.
- (4) If at the time it makes a distribution the company reasonably believes that conditions A and B are met, but in fact those conditions are not both met, these Regulations shall apply to the distribution as if it were never one which could be made without deduction of tax.
- (5) In paragraph (2) “profits of C (tax-exempt)” shall be construed in accordance with Part 4 of FA 2006.

CHAPTER 7

LEAVING THE PROPERTY AIF REGIME

4A.7.1 Termination by notice: company

- (1) This regulation applies if an open-ended investment company to which this Part applies gives a notice under this regulation specifying a date at the end of which this Part is to cease to apply to the company.
- (2) This Part shall cease to apply to the company at the end of that date.
- (2) A notice under paragraph (1) must be given in writing to the Commissioners.
- (4) The date specified under paragraph (1) must be after the date on which the Commissioners receive the notice.

4A.7.2 Termination by notice: Commissioners

- (1) This regulation applies if the Commissioners give a notice in writing under this paragraph to an open-ended investment company to which this Part applies (a “termination notice”).
- (2) This Part shall cease to apply to the company.
- (3) The Commissioners may give a termination notice only if-
 - (a) a provision contained in this Part provides that the Commissioners may give a termination notice, or
 - (b) the Commissioners think that a breach of a condition in Chapter 2, or an attempt by the company to obtain a tax advantage (see regulation 4A.3.11)), is so serious that this Part should cease to apply to it.

- (4) A termination notice must state the reason for it.
- (5) If a termination notice is given to an open-ended investment company, this Part shall be taken to have ceased to apply to the open-ended investment company at the end of the accounting period before the accounting period during which the event occurs (or the last event occurs) which caused the Commissioners to give the notice.
- (6) If a termination notice is given to an open-ended investment company, the company may appeal to the Special Commissioners.
- (7) An appeal must be instituted by notice given in writing to the Commissioners during the period of 30 days beginning with the day on which the notice is given to the company.

4A.7.3 Company ceasing to be authorised etc.

- (1) This regulation applies if an open-ended investment company to which this Part applies—
 - (a) ceases to be authorised by the Financial Services Authority,
 - (b) ceases to be an open-ended investment company, or
 - (c) ceases to carry on property investment business.
- (2) This Part shall cease to apply to the company.
- (3) This Part shall cease to apply to the company at the end of the date on which the company ceases to be authorised by the Financial Services Authority, to be an open-ended investment company, or to carry on property investment business (as the case may be).

4A.7.4 Mergers

- (1) This regulation applies if—
 - (a) there is a transaction under which an open-ended investment company to which this Part applies (“entity A”) merges with, is taken over by, or takes over, another open-ended investment company (“entity B”), and
 - (b) the merged entity (“entity C”) does not itself become an open-ended investment company to which this Part applies at the date of the transaction (the “merger date”).
- (2) This Part shall cease to apply to entity A.
- (3) An accounting period of entity A shall end on the merger date.
- (4) This Part shall be taken to have ceased to apply to entity A at the end of the accounting period mentioned in paragraph (3).

4A.7.5 Effects of cessation

- (1) The business of F (tax-exempt) shall be treated for the purposes of corporation tax as ceasing immediately before cessation.
- (2) Assets which immediately before cessation are involved in the business of F (tax-exempt) shall be treated for the purposes of corporation tax as being sold by F (tax-exempt) immediately before cessation and reacquired immediately after cessation by F (post-cessation).
- (3) For the purposes of corporation tax, on cessation one accounting period of F (residual) shall end and an accounting period of F (post-cessation) shall begin.
- (4) For the purposes of tax in respect of chargeable gains, on cessation—
 - (a) no chargeable gain or allowable loss shall accrue to F (residual), and
 - (b) F (post-cessation) shall be treated as if F (residual's) or F (tax-exempt's) acquisition of the asset had been its acquisition of it.
- (5) For the purposes of CAA 2001, the sale and re-acquisition deemed under paragraph (2)—
 - (a) shall not give rise to allowances or charges, and
 - (b) shall not make it possible to make an election under section 198 or 199 of that Act (apportionment).
- (6) For the purposes of CAA 2001, anything done by or to F (tax-exempt) before cessation in relation to an asset which is deemed under paragraph (2) to be sold and re-acquired shall be treated after cessation as having been done by or to F (post-cessation).”.

5. Amendment of Part 5

- (1) Amend Part 5 (compliance) as follows.
- (2) Make the existing Part Chapter 1 of that Part; and insert before the italic cross-heading preceding regulation 70—

**“CHAPTER 1
GENERAL”.**

- (3) After regulation 75 insert the following Chapter—

“CHAPTER 2

COMPLIANCE IN RELATION TO THE PROPERTY AIF REGIME

Conditions of membership of the Property AIF regime

4A.6.1 [75A] Information to be provided

- (1) This regulation applies if an open-ended investment company to which Part 4A applies—
 - (a) does not meet a condition set out in Chapter 2 of that Part (entering the Property AIF regime), and
 - (b) becomes aware that it does not meet the condition.
- (2) As soon as reasonably practicable, the company must provide the Commissioners with the following information—
 - (a) the date on which the condition first ceased to be met and the date (if any) on which the condition was satisfied again;
 - (b) details of the condition that was breached;
 - (c) the nature of the breach; and
 - (d) what (if anything) the company has done to avoid the breach recurring.

Persons with more than maximum permitted shareholding

4A.6.2 [75B] Information relating to persons with more than maximum permitted shareholding

[Please see the discussion paper issued with this partial draft of Regulations.]

Accounting for tax deducted from property income distributions

4A.6.3 [75D] Payments in an accounting period

- (1) This section applies if—
 - (a) an open-ended investment company to which Part 4A applies makes a distribution in an accounting period of the company, and
 - (b) the distribution includes sums attributed to property income distributions or to PAIF distributions (interest) (or to both) (a “relevant distribution”).
- (2) The company must deliver a return to an officer of Revenue and Customs for each return period—
 - (a) which falls within the accounting period, and

- (b) in which the company makes a relevant distribution.
- (3) The return periods are –
- (a) the quarters ending on 31st March, 30th June, 30th September and 31st December (the “quarter days”); and
 - (b) any shorter period which –
 - (i) starts on the first day of an accounting period and ends with the first or only quarter day in that accounting period;
 - (ii) begins immediately after the last or only quarter day in that accounting period and ends on the last day of that accounting period; or
 - (iii) is an accounting period which starts and ends within a quarter.
- (4) The company must deliver the return during a period of 14 days beginning with the day immediately following the end of the return period.
- (5) The return must show the amount of –
- (a) any relevant distributions made by the company in the return period, and
 - (b) the tax (if any) payable by the company in respect of those payments.
- (6) The company must deliver, with the return for the return period which ends on the last day of an accounting period, a reconciliation statement showing, in relation to any distribution made during the accounting period, the amounts (if any) which are attributable to each of paragraphs (a) to (c) of regulation [4A.4.1] (attribution of distributions).

4A.6.4 [75E] Collection and payment of tax

- (1) Tax in respect of a relevant distribution is due, from the company making it, at the time by which the return on which the distribution must be included is required to be delivered.
- (2) The tax due is equal to the sum which the company is required to deduct from the relevant distribution under–
 - (a) regulation [4A.5.5(1)] (deduction of tax from property income distributions), and
 - (b) regulation [4A.5.6(1)] (deduction of tax from PAIF distributions (interest)).
- (3) The tax is payable without an officer of Revenue and Customs making any assessment.

4A.6.5 [75F] Certificates of deduction of tax

- (1) A company making a relevant distribution which is subject to deduction of tax by virtue of regulation [4A.5.5(1)] must furnish the recipient with a statement in writing showing—
 - (a) the gross amount of the payment,
 - (b) the amount of tax deducted, and
 - (c) the actual amount paid.
- (2) The duty imposed by subsection (1) is enforceable at the suit or instance of the recipient.

4A.6.6 [75G] Company's duty to deliver amended return

- (1) This section applies if an open-ended investment company to which Part 4A applies makes a distribution, and then becomes aware that—
 - (a) anything which should have been included in a return delivered by the company under these Regulations has not been so included,
 - (b) anything which should not have been included in a return delivered by the company under these Regulations has been so included, or
 - (c) any other error has occurred in a return delivered by the company under these Regulations.
- (2) The company must deliver an amended return correcting the error to an officer of Revenue and Customs without delay.
- (3) If the company delivers an amended return such assessments, adjustments, setoffs or payments or repayments of tax as are necessary for achieving the objective mentioned in paragraph (4) must be made.
- (4) The objective is that the resulting liabilities to income and corporation tax (including interest on unpaid or overpaid tax) of the company or any other person are the same as they would have been if a correct return had been delivered.”.

6. Amendment of Part 1 of the Schedule

In Part 1 of the Schedule (abbreviations of Acts) insert at the appropriate place—

“FA 1993	The Finance Act 1993 (c. 34)”
“FA 1994	The Finance Act 1994 (c. 9)”
“FA 2006	The Finance Act 2006 (c. 25)”
“ITA 2007	The Income Tax Act 2007 (c. 3)”.

7. Amendment of Part 2 of the Schedule

In Part 2 of the Schedule (index of defined expressions) insert at the appropriate place–

“Cessation (in Part 4A)	4A.1.3(2)”
“Entry (in Part 4A)	4A.1.3(1)”
“F (other) (in Part 4A)	4A.1.3(4)(b)”
“F (post-cessation) (in Part 4A)	4A.1.3(3)(d)”
“F (pre-entry) (in Part 4A)	4A.1.3(3)(a)”
“F (residual) (in Part 4A)	4A.1.3(3)(c)”
“F (tax-exempt) (in Part 4A)	4A.1.3(3)(b)”
“Genuine diversity of ownership condition (in Part 4A)	4A.2.3”
“Loan Creditor condition (in Part 4A)	4A.2.4”
“Net income (in Part 4A)	4A.1.4(1)”
“PAIF distribution (dividends) (in Part 4A)	4A.4.4(3)”
“PAIF distribution (interest) (in Part 4A)	4A.4.3(3)”
“Property AIF	4A.1.1(2)”
“Property income distribution	4A.4.2(4)”
“Property investment business (in Part 4A)	4A.2.2(2)”
“Property rental business	4A.2.2(4)”
“Real Estate Investment Trust	4A.2.2(4)”
“Termination notice (in Part 4A)	4A.7.2(1)”
“UK-REIT	4A.2.2(4)”.

[xx/yy/zz]

Two of the Lords Commissioners of Her Majesty’s Treasury

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