

STATUTORY INSTRUMENTS

2006 No. 964

The Authorised Investment Funds (Tax) Regulations 2006

[^{F1}PART 4A

PROPERTY AIFS

[^{F1}CHAPTER 3

THE TAX TREATMENT OF PROPERTY AIFS

Textual Amendments

F1 Pt. 4A inserted (6.4.2008) by [The Authorised Investment Funds \(Tax\) \(Amendment\) Regulations 2008 \(S.I. 2008/705\)](#), regs. 1, 5

Categories of business

Ring-fencing of tax-exempt business

69X.—(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

Chargeability to corporation tax

- 69Y.**—(1) The net income of F (tax-exempt) (see regulation 69Z1) shall not be charged to corporation tax.
- (2) The net income of F (residual) (see regulation 69Z3) shall be charged to corporation tax at the rate applicable for open-ended investment companies (see section 468A(1) of ICTA).

Meaning of “net income”

- 69Z.**—(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 [^{F2}net revenue/(expense) before taxation] in the company’s statement of total return for the accounting period.
- (2) In paragraph (1) “the company’s statement of total return for the accounting period” is to be construed in accordance with regulation 12.

Textual Amendments

- F2** Words in reg. 69Z(1) substituted (1.1.2009) by [The Authorised Investment Funds \(Tax\) \(Amendment No. 3\) Regulations 2008 \(S.I. 2008/3159\)](#), regs. 1(1), **23**

Calculation of net income of F (tax-exempt)

- 69Z1.**—(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 income arising from the business of F (tax-exempt).
- (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.

Components of income arising to F (residual)

69Z2.—(1) 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) income arising from the business of F (residual).

(2) Section 21A of ICTA (calculation of profits of Schedule A business) shall apply to income arising from the business of F (residual) if and to the extent that income arising from the business of F (residual) is chargeable to corporation tax under Schedule A.

Calculation of net income of F (residual)

69Z3. Use this regulation to determine the net income of F (residual) for the purposes of this Part.

First rule

Determine the amount of the income arising to F (residual).

Second rule

Deduct any amounts whose deduction is required or allowed under the Corporation Tax Acts (including any distributions qualifying for exemption under section 208 of ICTA).

In this Part the amount so found is called the "pre-distribution amount".

Third rule

Deduct the amount attributed to PAIF distributions (interest) under regulation 69Z14(b).
The result is the net income of F (residual).

Breaches of conditions

Breach of the genuine diversity of ownership condition

69Z4.—(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) Within 28 days of becoming aware of the breach, the company must provide the following information to the Commissioners—

- (a) the date on which the condition first ceased to be met;
- (b) the date on which the company became aware of the breach;
- (c) details of the condition that was breached;
- (d) the nature of the breach;
- (e) the steps the company proposes to take to rectify the breach; and
- (f) the date by which the company proposes to rectify the breach.

(3) The date referred to in paragraph (2)(f) must be the earliest date by which the objective of complying with the genuine diversity of ownership condition may reasonably be achieved.

(4) The Commissioners may give a termination notice to the company if—

- (a) the steps that the company proposes to take will not rectify the breach, or
- (b) the date by which the company proposes to rectify the breach is not the earliest date by which the objective of remedying the genuine diversity ownership condition may reasonably be achieved.

(5) If there are three different breaches of the genuine diversity of ownership condition in three different accounting periods in a period of ten years beginning with the first day of the accounting period in which the company becomes aware of the first of those breaches, the Commissioners may give a termination notice to the company.

Breach of the corporate ownership condition

69Z5.—(1) This regulation applies if an open-ended investment company to which this Part applies is in breach of the corporate ownership condition.

(2) If there is a breach which is caused by the action of a shareholder in the company and the company has not taken reasonable steps to prevent the breach (so that, accordingly, there is a charge to corporation tax under regulation 69Z12) (a “specified breach”), this Part shall continue to apply to the company despite the breach (but see paragraph (3) and regulation 69Z8).

(3) If there are three specified breaches in a period of ten years beginning with the first day of the accounting period in which the first specified breach occurs, the Commissioners may give a termination notice to the company.

Breach of the loan creditor condition

69Z6.—(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 the company is inadvertently in breach of the loan creditor condition but rectifies the breach within a period of 28 days beginning with the day on which the company first becomes aware of

the breach, this Part shall continue to apply to the company despite the breach (but see paragraphs (5) and (6) and regulation 69Z8).

(3) If the company is inadvertently in breach of the loan creditor condition but does not rectify the breach within a period of 28 days beginning with the day on which the company first becomes aware of the breach, the Commissioners may give a termination notice to the company.

(4) If 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 in breach of the same condition specified in paragraphs (2) to (5) of regulation 69M in two different accounting periods in a period of ten years beginning with the first day of the accounting period in which the company becomes aware of the first of those breaches, the Commissioners may give a termination notice to the company.

(6) If the company is in breach of the conditions specified in paragraphs (2) to (5) of regulation 69M in three different accounting periods in a period of ten years beginning with the first day of the accounting period in which the company becomes aware of the first of those breaches, the Commissioners may give a termination notice to the company.

Breach of balance of business conditions

69Z7.—(1) Paragraph (2) applies if a newly qualified company—

- (a) is in breach of condition A set out in regulation 69N(2)(a) in its first accounting period, or
- (b) is in breach of condition B set out in regulation 69N(3)(a) at the end of its first accounting period.

(2) This Part shall cease to apply to the company at the end of its first accounting period and regulation 69Z41 shall apply.

(3) Paragraphs (4) to (7) apply if an open-ended-investment company to which this Part applies—

- (a) is in breach of condition A set out in regulation 69N(2)(b) in an accounting period, or
- (b) is in breach of condition B set out in regulation 69N(3)(b) at the end of an accounting period.

(4) If the conditions specified in paragraph (6) are met, this Part shall continue to apply to the company despite the breach (but see paragraph (7) and regulation 69Z8).

(5) If the conditions specified in paragraph (6) are not met, the Commissioners may give a termination notice to the company.

(6) 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 end of the accounting period.

(7) If this regulation applies to a company in three different accounting periods in a period of ten years beginning with the first day of the accounting period in which the company becomes aware of the first of those breaches, the Commissioners may give a termination notice to the company.

Multiple breaches of separate conditions

69Z8.—(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 [^{F3}regulation 9A or] regulations 69E to 69N,

- (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 a period of ten years beginning with the first day of the accounting period in which the first breach occurs.
- (2) The Commissioners may give a termination notice to the company.

Textual Amendments

- F3** Words in reg. 69Z8(1)(a) inserted (1.9.2009) by The Authorised Investment Funds (Tax) (Amendment) Regulations 2009 (S.I. 2009/2036), regs. 1, 22

Further provisions

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

69Z9.—(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—

Income / Financing Costs

IncomeFinancing 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 of amounts taken into account under regulation 69Z1(3)), 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 corporation 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) For the purposes of paragraphs (3) and (4) “financing costs” are the costs 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.

(8) No loss, deficit, expense or allowance may be set off against the amount charged to tax by paragraph (5).

Cancellation of tax advantage

69Z10.—(1) This regulation applies if 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; or
- (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 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).

Appeal against notice under regulation 69Z10

69Z11.—(1) If a notice is given to a company under regulation 69Z10, the company may appeal^{F4}

(2) The notice of appeal must be given to HM Revenue and Customs within a period of 28 days beginning with the day on which the notice under regulation 69Z10 is given.

(3) On an appeal [^{F5}that is notified to the tribunal, the tribunal] may—

- (a) affirm, vary or cancel the notice, and

- (b) affirm, vary or quash an assessment made under regulation 69Z10(4).

Textual Amendments

- F4** Words in reg. 69Z11(1) omitted (1.4.2009) by virtue of The Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 (S.I. 2009/56), art. 1(2), **Sch. 2 para. 157(2)**
- F5** Words in reg. 69Z11(3) substituted (1.4.2009) by The Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 (S.I. 2009/56), art. 1(2), **Sch. 2 para. 157(3)**

Distribution to holder of excessive rights: charge to tax

69Z12.—(1) This regulation applies if an open-ended investment company to which this Part applies—

- (a) makes a distribution to, or in respect of, a holder of excessive rights (see regulation 69Z13), and
- (b) the company has not taken reasonable steps to prevent the possibility of such a distribution being made.

(2) The company is treated as having received an amount of income calculated in accordance with paragraph (3).

(3) The amount of the income is determined by the formula—

$$I \times P$$

(4) In paragraph (3)—

I is the net income of F (tax-exempt) distributable in accordance with regulation 69Z14(a);

P is the percentage of the rights to the net asset value of the company held by, or on behalf of, the holder of excessive rights.

(5) The amount determined in accordance with paragraph (3) shall be charged to corporation tax as if it were income of F (residual) chargeable under Case VI of Schedule D arising in the accounting period in which the distribution mentioned in paragraph (1) was made by the company.

(6) No loss, deficit, expense or allowance may be set off against the amount charged to tax by paragraph (5).

Meaning of “holder of excessive rights”

69Z13.—(1) In this Part a “holder of excessive rights” means a body corporate which—

- (a) is a participant in an open-ended investment company to which this Part applies, and
- (b) is beneficially entitled to shares representing rights to 10% or more of the net asset value of the company.

(2) Paragraphs (4) and (5) of regulation 69L apply for the purposes of paragraph (1) as they apply for the purposes of regulation 69K.

(3) In this Part an “excessive holding” means the holding of a holder of excessive rights.]

Changes to legislation:

There are currently no known outstanding effects for the The Authorised Investment Funds (Tax) Regulations 2006, CHAPTER3.