

Consultation on draft guidance relating to The Authorised Investment Funds (Tax) (Amendment) Regulations 2009 (SI2009/2036)

The following draft guidance explains new regulations contained in SI 2009/2036, which take effect from 1 September 2009 and makes amendments to The Authorised Investment Funds (Tax) Regulations 2006 (AIF regulations). The draft guidance is divided into three distinct parts to cover the subject matter contained in the regulations. The draft guidance includes the following:

PART A OF DRAFT GUIDANCE FOR CONSULTATION: General genuine diversity of ownership condition (GDO).

The GDO aims to ensure that authorised investment funds (AIFs) are genuine pooled investment schemes rather than arrangements designed to take advantage of the tax benefits of an AIF that may in reality be closely held investments for the benefit of a few individuals.

The new general GDO has been introduced so that a single condition can apply to most AIFs that rely on the GDO being met. This should simplify compliance, particularly in cases where the condition applies to an AIF for more than one reason.

The only variation to the new provisions is that the rules that allow specific types of unit trust schemes known as feeder funds to be taken into account in applying the test to the GDO has been restricted to Property AIFs only (including Property AIFs that are also QIS).

A GDO advance clearance form is available from the Collective Investment Schemes Centre web page at www.hmrc.gov.uk/collective/cis-centre.htm.

The draft guidance will be inserted into the Company Taxation Manual at CTM48150. It covers pages from CTM48155 to CTM48175.

As a result of the new GDO provisions, the guidance that was issued on qualified investor schemes in CTM48700 has been amended accordingly and is also included in the draft guidance below for information purposes only. We will not be consulting on this part of the guidance as a consultation exercise was already undertaken earlier this year. The guidance will be inserted directly into the Company Taxation Manual in due course.

PART B OF DRAFT GUIDANCE FOR CONSULTATION: Trading or investment.

New provisions allow defined financial transactions carried out by AIFs that meet certain conditions (diversely owned AIFs) from being characterised as trading transactions for tax purposes. This rule gives diversely owned AIFs certainty that gains on the realisation of certain types of investments, which would not be chargeable gains, cannot be re-characterised as profits arising from a trade which would then be taxable as income. A diversely owned AIF is one that carries out an "investment transaction" in an accounting period and meets the genuine diversity of ownership condition throughout that period.

The draft guidance will be inserted into the Company Taxation Manual at various pages ie CTM48200 - covering pages from CTM48280 to CTM48295, CTM48500 – covering pages CTM48530 to CTM48540 and CTM48550 – covering pages CTM48570 – 48580.

PART C OF DRAFT GUIDANCE FOR CONSULTATION: Tax elected funds (TEFs).

The regulations introduce a new tax regime called tax elected funds that applies to authorised investment funds that have a mixed portfolio of assets.

The intention of the TEF regime is to move the point of taxation from the TEF to the investor so that the investor is taxed as though they had invested in the underlying assets directly. This is achieved by requiring the TEF to make two types of distribution, a dividend distribution and a non-dividend distribution. In general all dividend income received by the TEF will be distributed as a dividend distribution and all other income will be distributed as a non-dividend distribution.

Investors are then taxed as though they have received a dividend, including the non-payable dividend tax credit and a payment of yearly interest and will allow the TEF to be an appropriate investment fund for a variety of investors, including those not subject to tax in the UK.

A TEF application form is available from the Collective Investment Schemes Centre web page at www.hmrc.gov.uk/collective/cis-centre.htm.

The draft guidance will be inserted into the Company Taxation Manual at CTM48900. It covers pages from CTM48910 to CTM48972.

Consultation period

The draft guidance for Parts A to C (apart from the guidance on the QIS rules) is open for consultation until the **16 October 2009**. If you have any comments on the draft guidance please send them, via email, to:

[Angela Nagarajah](#) regarding the GDO and the TEF regime, or

[Lee Harley](#) regarding the trading or investment rules.

Please note the links in this draft guidance do not work but will do so when the guidance is finally inserted into the Company Taxation Manual.

**PART A OF DRAFT GUIDANCE FOR CONSULTATION: GENERAL GENUINE DIVERSITY
OF OWNERSHIP CONDITION**

CTM48150 – AIFs: Genuine diversity of ownership condition (GDO): contents

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CTM48155 AIFs: Genuine diversity of ownership condition (GDO): Introduction

What is the genuine diversity of ownership condition (GDO)?

The GDO aims to prevent small groups of investors from taking advantage of the tax treatment available to investors in widely pooled schemes using closely held arrangements that may in reality be for the benefit of a tightly restricted group, for example a group of family members or a group of companies in common ownership. The concept of the GDO was first introduced in 2008 for Property AIFs.

When will the new GDO apply?

A new general GDO was introduced by The Authorised Investment Funds (Tax) (Amendment) Regulations 2009, SI 2009/2036, to take effect from the 1 September 2009. The SI introduces the new GDO condition into the Authorised Investment Funds (Tax) Regulation (SI 2006/964) by inserting a new Part 1A after regulation 9 of SI 2006/964. It also includes an advance clearance procedure which is explained in [CTM48165](#).

The new GDO will apply to authorised investment funds (AIFs) that are (or will be applying to be):

- Property AIFs (see [CTM48800](#) to CTM48882)
- Tax Elected Funds (see [CTM48900](#) to CTM48972)
- Qualified investor schemes (QISs) (see [CTM48700](#) to CTM48785)
- Diversely owned AIFs under Part 2B SI 2006/964, as inserted by SI 2009/2036. (See [CTM48280](#) onwards)

Why has a new GDO been introduced?

The new general GDO has been introduced so that a single condition can apply to most AIFs that rely on the GDO being met. This should simplify compliance, particularly in cases where the condition applies to an AIF for more than one reason. For example, where a diversely owned AIF has received pre-clearance that it has met the GDO and then decides to join the TEF regime, which requires a GDO to be met as one of the conditions of the regime, it would not need to gain further approval as it had already met the general GDO for the purposes of being a diversely owned AIF.

The only variation is to allow specific types of unit trust schemes known as feeder funds to be taken into account in applying the test to Property AIFs (including Property AIFs that are also QIS). This is because the regulations applying to Property AIFs place restrictions on the investments held directly by corporate participants (see CTM48160 for further information).

Optional advance clearance application form

An optional [GDO advance clearance application form](#) is available for any AIF that wants to gain an advance clearance from HMRC that they have met the GDO, which they can then rely on unless the fund's circumstances change, as explained in [CTM48165](#).

CTM48160 - AIFs: Genuine diversity of ownership condition (GDO): criteria required to meet the GDO

In order for an authorised investment fund (AIF) to meet the genuine diversity of ownership condition (GDO) under regulation 9A SI 2006/964 (as inserted by SI 2009/2036), it must meet Conditions A to C (which are explained below), throughout the whole accounting period.

Criteria required to meet the GDO

The fund documents (Regulation 9A (3) SI 2006/964)

The purpose of Condition A is to ensure that the fund has undertaken, in a manner which is both public and binding, a commitment to target the categories of investor specified.

Terms and conditions of the fund (Regulation 9A(4) & (5) SI 2006/964)

The purpose of Condition B is to exclude funds which are 'private' or only available to specific individual or corporate investors, whether such a limitation is achieved by a specific rule set out in the fund documentation or by the imposition of terms and conditions that would have the effect of deterring investors outside such a limited group.

It follows that the terms and conditions of the fund should not be set in such a way as to deter a reasonable investor within the target market from investing in the fund. For example, Condition B may not be met where charges differ according to categories of investors and the charges for one or more categories are such that it could not reasonably be expected that a potential investor in a category, acting rationally, would choose to invest.

Connected party in this context takes its meaning from ICTA88/S839.

While there is no objection to fund documentation covering future extension to its target market, such hypothetical extensions will not be taken into account in determining whether Condition B is met. Provided that all originally targeted investors remain within the target market, then any later extension to the target market cannot then cause a fund to fail Condition B.

Marketing requirements, providing information and selling units (Regulation 9A (6) SI 2006/964)

The purpose of Condition C is to allow the exclusion of any fund that, despite meeting Conditions A and B, then (contrary to the statements in its own documentation) fails to act in a way that supports the statements it has made as to the intended categories of investor.

It is recognised by HMRC that marketing to institutional and sophisticated investors may be more narrowly targeted than the marketing required for a retail fund, especially where a qualified investor scheme (QIS) is aimed at a particular type of institutional investor, for example life insurance companies. Any activity designed to attract the specified category of investor will constitute marketing for this purpose, for example, presentations to or meetings with institutional investors or their consultants, direct contact or advertisements in specialist or financial publications to attract sophisticated investors or their advisers.

HMRC also recognises that marketing is not necessarily a continuous activity and may not begin immediately on launch of a fund because, for example, there is a need to establish a short term performance record. However, if this is the case then there must be a clear and continuing intention to make the fund available to its target market (or wind it up if the fund is found at the initial stages to be unsuccessful). HMRC would not seek to exclude a case where a fund starts out being seeded by a single corporate investor such as a single life insurer, as long as there is a clear and continuing intention at later stages to market and make available the scheme to all categories of investors specified in the target market.

Temporary circumstances where Condition C will still be met (Regulation 9A(7) SI 2006/964)

With Condition C it is recognised that there will be times where a fund reaches a limit on its capacity to absorb further investments, in which case it will be treated as meeting these conditions even though the scheme may not be marketed or made available temporarily, until there is further capacity to do so. (Regulation 9A (7) SI 2006/964.)

This derogation from Condition C will not apply if a fund limits investment to pre-determined investors who buy all or substantially all of the units in the fund at, or shortly after, the fund's launch which denies the opportunity for other investors in the target market to obtain information and buy units in the fund. (Regulation 9A (7)(b) SI 2006/964.) This is not intended to prevent pre-launch marketing of a fund but in such circumstances the fund should retain evidence that a range of investors in the target market could invest.

HMRC also recognises that the manager of the fund may not be able to accept investment for regulatory or legal reasons, for example having been unable to complete customer due diligence under the money laundering regulations or because in the case of a QIS the intending investor does not meet the 'Qualified Investor' test. Exclusion of an investor in such circumstances will not cause condition C to be failed.

Property AIFs and associated unit trust schemes (Regulation 9A(8) SI 2006/964)

The (optional) provision allows HMRC to take into account the intended categories of investors in an associated unit trust scheme of a Property AIF (see [CTM48817](#)), described as a feeder fund, in establishing whether the GDO is met. However, to do so, the feeder fund and the fund must have the same manager. Therefore, HMRC would not seek to exclude a Property AIF where the only beneficial investor was a unit trust scheme (feeder fund) providing that the unit trust scheme would, itself or together with the Property AIF, satisfy the GDO and the two entities have the same manager.

The optional provision for feeder funds applies **only** to Property AIFs. Where a fund is a Property AIF and meets the GDO by relying on the feeder fund then it will only continue to meet the GDO for any other purposes as long as it remains a Property AIF.

CTM48165 - AIFs: Genuine diversity of ownership condition (GDO): advance clearance procedure

Under regulation 9B SI 2006/964 (as inserted by SI 2009/2036), a manager or proposed manager of a fund can apply in writing for a clearance from HMRC that the fund meets the genuine diversity of ownership condition (GDO) ([CTM48610](#)). The manager or proposed manager is advised to use the [GDO advance clearance application form](#) that has been prepared for the advance clearance procedure. The form provides a 'checklist' which it is hoped will, when followed, reduce the chance of an application being refused.

If there is no doubt that a fund has or is intended to have a wide range of unconnected investors then it will clearly have no difficulty in meeting the GDO and thus advance clearance will not be necessary.

Once clearance is given by HMRC, the manager or proposed manager will be able to rely on this clearance unless there is any material change to the original fund documents, or they have acted contrary to relevant statements in fund documents. This is explained in further detail below.

To gain advance clearance, the manager (or proposed manager) must apply in writing to HMRC and send the following documents that apply, or are proposed to apply, at the beginning of the first accounting period for which clearance is sought:

- the instrument constituting the fund (that is the instrument of incorporation for an open-ended investment company or the trust deed for an authorised unit trust, as defined in regulation 6(7) SI 2006/964), and
- the current prospectus or proposed prospectus (including any supplements to the prospectus).

In the case of a Property AIF, which has an associated feeder fund structure, then in accordance with regulation 9B(3) SI 2006/964, the manager must submit the fund documents of the feeder fund (that is the trust deed and the prospectus), in addition to the fund documents stated above.

HMRC will consider the application within 28 days of its receipt and will respond in writing either to:

- request further information, in which case the 28 day period to respond will re-start once all the relevant information has been received
- give clearance (which may be subject to stated conditions), or
- deny clearance.

The fund will not be able to rely on any clearance given, if:

- the documents submitted to the FSA are, in any relevant respect, not in accordance with the documents considered when clearance was given by HMRC or are subsequently amended in any relevant way (that is in such a way that it is possible to consider that the GDO may no longer be satisfied)
- the fund later acts in contravention of any relevant statement in the relevant documents provided (that is it is subsequently found that condition C is not met), or
- there is a material change made to the documents that may reasonably cause doubt as to whether the GDO may fail in relation to any accounting period. (Hence, any changes to the fund documents that has no impact on whether the GDO is met or not, will not constitute a material change in this case.)

The points stated above also refer to fund documents submitted by a Property AIF that has an associated feeder fund structure under regulation 9B(7) SI 2006/964.

If there are any such changes then any clearance that was given by HMRC may no longer be relied upon. It is open to the manager to inform HMRC of the changes that have been made and request a further clearance. If the changes do lead to a fund failing to comply with the GDO then the consequences set out in the various regimes that rely on this condition will apply appropriately.

Applications for clearances should be submitted to:

Julie Norton (A to L) or Andy Nutbrown (M to Z)

HM Revenue & Customs

Collective Investment Schemes Centre

Concept House

5 Young Street

Sheffield

S1 4LB

e-mail address: Julie.norton@hmrc.gsi.gov.uk or andy.nutbrown@hmrc.gsi.gov.uk

Benefits of gaining an advance clearance

If an advance clearance for the GDO has been received, then as long as there have been no changes as described above, the clearance can be relied upon for other regimes that may require the GDO to be met. For example, if a qualified investor scheme (see [CTM48700](#) onwards) has obtained pre-clearance for the GDO it can also benefit from being treated as a diversely owned AIF if it carries out investment transactions (see [CTM48280](#)).

The only exception to this is where a clearance has been obtained by a Property AIF by relying on a feeder fund (see [CTM48160](#)), the clearance can **only** be relied upon by the fund while it is a Property AIF. However, while it is a Property AIF the clearance can be used for all purposes for which the GDO is relevant, (that is qualified investor schemes and diversely owned AIFs).

CTM48170 - AIFs: Genuine diversity of ownership condition (GDO): what information should HMRC consider to check that the GDO has been met

Initial checks by HMRC

Initial checks can be carried out by HMRC in two instances:

- when a fund applies for a genuine diversity of ownership condition (GDO) clearance using the advance clearance application; or
- when a fund makes an application for a particular regime in which the GDO has to be met.

The GDO requirements in [CTM48160](#) are designed to ensure that the shares or units are actually made available and marketed to a range of investors and is not limited to only specified persons.

In determining whether these conditions have been met, HMRC should consider:

- the fund documents, to ensure that they contain a statement that the units in the fund will be marketed and made widely available and that they clearly specify the categories of investor,
- the specified categories of investor and whether these are sufficiently wide so that the fund is not limited to a few specific persons named or implied by the given categories. (A group of connected persons will be regarded as one person.)
- whether any terms or conditions may deter or limit investors within the target market from buying units in the fund, by reviewing the fund documents and any other sources of information about the fund, such as its website. For instance whether the minimum investment(s) and charges are set at different levels according to categories of investors, in such a way that would clearly deter a potential investor in a category within the target market, acting reasonably, from investing in a fund, and
- whether there is any evidence of pre-determined limits to specific persons or groups of connected persons that would unfairly limit the number of units available to other categories of investors which remains fixed for a significantly longer period of time than would otherwise be expected.

Continuing requirements under Condition C of the GDO

In the case where a fund is already established then HMRC would not normally expect the fund documents (or draft fund documents) supplied, to be in conflict with the funds normal practice of marketing and making available the units or shares in the fund, but if there is any conflict then the fund should include an explanation as to why this is the case and where necessary set out proposed changes in practices (to comply with condition C), with their application. See also [CTM48175](#).

Recommended practice where a GDO advance clearance procedure has not been adopted

If an advance clearance of the GDO is not gained by the fund manager it is recommended that the fund documents (that is the prospectus and any supplements together with the instrument constituting the fund) are submitted with the first tax return for the fund so that HMRC can determine whether the GDO has been met or not. For subsequent years, if there has been no change to fund documentation then this should be stated, and reference should be made to the fund documents that were submitted with the relevant tax return. If advance clearance has been obtained then it is also recommended that this is specified when submitting the tax return.

CTM48175 - AIFs: Genuine diversity of ownership condition (GDO): what information should HMRC consider in respect of the continuing requirement under Condition C of the GDO

Where the fund documents meet Conditions A and B (see [CTM48160](#)) (and clearance has been given to a newly established fund on the basis of meeting these two conditions) then it is expected that Condition C will normally be met as well, since the fund's own documentation will require this in accordance with Condition A.

If there is any doubt that Condition C has been met then an officer should check all public documentation available on the fund to determine the practices of marketing and making available the fund and if it still believed that the fund has not satisfied Condition C in accordance with the relevant statements in the fund documents then full details of the case should be submitted to CT&VAT, who will advise on further steps.

GUIDANCE FOR QUALIFIED INVESTOR SCHEMES

(Updated guidance as result of new provisions for the genuine diversity of ownership condition introduced in SI 2009/2036. This guidance is not for consultation.)

CTM48700 - Authorised investment funds: qualified investor schemes: contents

- [CTM48705](#) Qualified investor schemes (QIS): introduction
 - [CTM48710](#) Qualified investor schemes (QIS): The genuine diversity of ownership condition
 - [CTM48715](#) Qualified investor schemes (QIS): timing and transitional arrangements for the genuine diversity of ownership condition
 - [CTM48720](#) Qualified investor schemes (QIS): consequences of breaching the genuine diversity of ownership condition
 - [CTM48725](#) Qualified investor schemes (QIS): the genuine diversity of ownership condition and HMRC enquiry powers
 - [CTM48730](#) Substantial QIS holding: meaning
 - [CTM48735](#) Substantial QIS holding: tax treatment: introduction
 - [CTM48740](#) Substantial QIS holding: tax treatment: calculation
 - [CTM48745](#) Substantial QIS holding: measuring dates and market value
 - [CTM48750](#) Substantial QIS holding: tax calculation: example 1
 - [CTM48755](#) Substantial QIS holding: tax calculation: example 2
 - [CTM48760](#) Substantial QIS holding: 'inadvertent breach'
 - [CTM48765](#) Substantial QIS holding: 'inadvertent breach': time limit
 - [CTM48770](#) Substantial QIS holding: 'inadvertent breach': example - rectified
 - [CTM48775](#) Substantial QIS holding: 'inadvertent breach': example - not rectified
 - [CTM48780](#) Substantial QIS holdings: disposals
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CTM48705 - Authorised investment funds: qualified investor schemes: introduction

A qualified investor scheme (QIS) is a type of authorised investment fund (AIF) which can take on for more sophisticated investors. Like other AIFs, a QIS is subject to regulation by the Financial Services Authority (FSA).

A QIS has wider investment and borrowing powers than other AIFs but is subject to lighter regulation because investment in a QIS is open only to 'qualified investors'. The definition of qualified investors can be found in the FSA 'COLL' handbook which is accessible through the FSA website at www.fsa.gov.uk.

Investors in a QIS will be corporates, other institutional investors (such as pension funds and charities) or sophisticated individual investors who regularly invest significant sums and can be expected to understand the risks involved in a wide range of investments.

Such investors may be in a position to have significant influence over the investment strategy of a fund in which they have a significant holding. The tax rules for QISs therefore stipulate conditions designed to ensure that the tax benefits that apply to AIFs generally only apply to QISs which constitute a genuine collective investment rather than closely held for the benefit of a few individuals. Prior to 2009 this was achieved through a 'substantial holding' rule, designed to prevent an investor owning more than 10% of a fund. This was however too blunt an instrument, inhibiting the development of QIS funds in the UK. From 1 January 2009 the substantial holding rule is replaced by the 'genuine diversity of ownership condition' (GDO), applying to the fund rather than the investor.

Tax treatment of a QIS (the taxation of the fund)

From 1 January 2009 the taxation rules that apply to AIFs (apart from property AIFs) also apply to a QIS that meets the GDO. This condition applies to any QIS established (that is authorised by the FSA) on or after the 1 January 2009 but is also deemed to be met for QISs established before this date, which are subject to transitional arrangements explained in [CTM48715](#).

Where the GDO is not met, the tax consequence for the QIS is that it will be treated as a close investment holding company (see [CTM48720](#)).

General tax treatment of investors in an AIF

The general treatment of investors in an AIF is designed to recognise that they have bought units in a pooled investment scheme where the investors have no control over the decisions of the fund manager over when and what investments to buy and sell. Instead of being charged to tax on their share of the income and gains of the scheme they are liable to tax (IT or CT) on the distributions they receive and to CGT (or to CT on chargeable gains) on the gains made when they sell their units. This treats their holding of units in a fund (that is units in an authorised investment fund or shares in an open-ended investment company) in a similar way to a holding of shares in a normal company (but not exactly the same – see [CTM48500](#) onwards for CT payers and [CTM48550](#) onwards for IT payers).

Tax treatment of investors in a QIS

From the 1 January 2009 the tax treatment for all investors in a QIS, which meets (or is deemed to meet) the GDO, is the same as if they had invested in an ordinary AIF. Prior to this date a different tax treatment applied to any investor with a 'substantial QIS holding' (as defined in [CTM48730](#)) and guidance on the substantial holding rule can be found in pages [CTM48735](#) to [CTM48780](#). Transitional arrangements that apply to substantial holders to 31 December 2008 are explained in [CTM48715](#).

Where the GDO is not met, the tax consequences for the investor is that they will be treated as having invested in a close investment holding company (see [CTM48720](#)).

CTM48710 – Authorised investment funds: qualified investor schemes: genuine diversity of ownership condition

Introduction

From the 1 January 2009, the genuine diversity of ownership condition (GDO) (regulation 14C SI2006/964) applies to all qualified investor schemes (QISs). However, from the 1 September 2009 this GDO is replaced by a general GDO introduced via SI2009/2036 into regulation 9A SI2006/964. See [CTM48155](#) to CTM48170 for details of the new general GDO.

The GDO was introduced as a tax requirement to prevent investors from gaining tax advantages by using a QIS in a way which did not represent a genuine pooling of investors' funds. The rule is similar to that adopted for Property Authorised Investment Funds (Property AIFs).

Unlike the previous substantial holding rule (explained in [CTM48730](#) to CTM48785) that applies to the investor and exempts certain investors from the requirement to comply with the 10% limit, the genuine diversity of ownership condition applies to the QIS itself and so the exceptions set out in regulation 53 SI 2006/964 will not apply under this condition.

If an advance clearance of the GDO (see [CTM48160](#)) is not gained by the fund manager it is recommended that the fund documents (see regulation 9A(9) SI2006/964) is submitted with the first tax return for the QIS so that HMRC can determine whether the GDO has been met or not. For subsequent years, if there has been no change to fund documentation then this should be stated, and reference should be made to the fund documents that were submitted with the relevant tax return. If advance clearance has been obtained then it is also recommended that this is specified when submitting the tax return.

Criteria required to meet the GDO condition

For a QIS that is established on or after 1 January 2009, the terms of the GDO that were introduced on the 1 January specifically for QISs are very slightly different to the general GDO that comes into force on the 1 September 2009 and the terms of the former condition can be found in regulation 14C SI2006/964.

If there are any QISs that were established between the 1 January 2009 to the 31 August 2009 that have relied upon meeting the specific GDO in regulation 14C then, in general, the QIS should be considered to meet the conditions set out in the general GDO in regulation 9A. If this is not considered to be the case, that is the general GDO will not be met, then advice should be sought from CT&VAT.

For detailed guidance on the general GDO, including how to apply for an advance clearance from HMRC that the GDO has been met, please refer to [CTM48155](#) to 48170.

Any QIS established before the 1 January must meet the general GDO from the beginning of the second AP starting after the 1 January 2009 and all subsequent APs, which is explained more fully in [CTM48715](#).

CTM48715 - Authorised investment funds: qualified investor schemes: timing and transitional arrangements for the genuine diversity of ownership condition

When does the genuine diversity of ownership condition come into affect?

The genuine diversity of ownership condition (GDO) replaces the substantial holding rule from the 1 January 2009 and should be applied to all **new** qualified investor schemes (QISs) that are established on or after that date.

Transitional arrangements for existing QISs

For a QIS that is already established before the 1 January 2009, the GDO is deemed to be met from this date to the end of the first accounting period (AP) beginning on or after the 1 January 2009. For any subsequent accounting period the QIS will need to satisfy the general GDO conditions set out in regulation 9A SI2006/964 (as inserted by SI2009/2036). For example if an existing QIS has a 12 month AP that begins on the 1 February 2008, then it will be deemed to meet the GDO from the 1 January 2009 till the 31 January 2010. However, it will be able to use the clearance provisions in regulation 9B during this period of grace to determine whether the fund documents have been adequately amended to fulfil the GDO (see [CTM48165](#)). In this example, and taking into account the timetable for clearances, an application for clearance would need to be made by 30 November 2010.

If an existing QIS does not fulfil the GDO after the end of the first AP beginning on or after the 1 January 2009, then the QIS will be treated as a close investment holding company from the beginning of the following AP and the tax consequences are explained in [CTM48720](#).

Transitional arrangements for substantial holders

Where a QIS is established before the 1 January 2009 and has substantial holders ([CTM48730](#)), then these investors will have been required to calculate the change in 'market value' ([CTM48740](#)) of their holdings between the last pair of adjacent measuring dates, which is explained in [CTM48745](#). However, under regulation 31 SI2008/3159 a final measuring date of the 31 December 2008 was added to regulation 56 SI2006/964. This means that a substantial holder will need to fair value their holdings according to the calculation set out in [CTM48740](#) ie from the last measuring date that was used under the substantial holding rules to the 31 December 2008.

From the 1 January 2009, no further fair value calculations need to be undertaken by a former substantial holder. Therefore, where the QIS is deemed to meet the GDO any such investor will be treated in the same way as an investor in an ordinary AIF. Any disposal of units by a former substantial holder on or after the 1 January 2009 will become liable to tax on any capital gains if the investor is an individual or chargeable to corporation tax (CT) if a corporate but any sums charged to income tax or CT under the substantial holding rules can be deducted from the disposal consideration on the sale of the holdings, to avoid a double charge to tax, as explained in the Capital Gains Manual, page CG10260 "Interaction with Income Tax".

CTM48720 - Authorised investment funds: qualified investor schemes: consequences of breaching the genuine diversity of ownership condition

Where the genuine diversity of ownership condition (GDO) is not met in relation to an accounting period then the qualified investor scheme (QIS) will be taxed as though it is a close investment - holding company (CIC) under section 13A of the Income and Corporation Taxes Act 1988 (ICTA) (regulation 14B(3) SI2006/964).

The tax consequences of breaching the genuine diversity of ownership condition

Where a QIS is treated as a CIC, it will be chargeable to corporation tax (CT) at the full rate irrespective of the level of its profits or the number of associated companies and ICTA88/S468 (1A) and 468A (1) for authorised unit trusts and open-ended investment companies respectively, will cease to apply (regulation 14B (2)(c) and (d) SI2006/964). The total profits should be calculated in the normal way for a company. There will be no special restrictions for CICs, for example, on the deduction of interest payments, annual payments or (if it is also an 'investment company' as defined in ICTA88/S130) management expenses under ICTA88/S75.

However, as a CIC any capital gains accruing to the QIS will become chargeable to CT and so the exemptions under TCGA92/S100 and the exception to TCGA92/S99 (1)(both as modified by SI2006/964 Regulation 100) will not apply under regulation 14B(2)(e) and (f) SI2006/964.

For further guidance on the taxation of CICs, please refer to [CTM60700](#).

Normal tax rules that apply to distributions from UK resident companies will apply to an investor in a QIS that is treated as a CIC.

When do the tax consequences apply?

Where a newly established QIS fails to meet the GDO from the outset, it will in general, be subject to tax as though it was a CIC as soon as it was established.

Where an existing QIS fails to meet the GDO after the end of the first accounting period (AP) ending on or after 1 January 2009, then it will be treated as a CIC from the beginning of the second AP beginning after the 1 January 2009.

In the case of a QIS that subsequently fails to meet the GDO then it will be subject to the CIC rules from the start of the accounting period in which it failed to meet the conditions. (Regulation 14B(1) SI2006/964.)

CTM48725 - Authorised investment funds: qualified investor schemes: the genuine diversity of ownership condition and HMRC enquiry powers

Enquiry powers

Normal HMRC enquiry powers will apply to returns submitted by a qualified investor scheme (QIS).

For example, HMRC may undertake an enquiry and find that a QIS has made tax returns on the basis that it believed it had fulfilled the genuine diversity of ownership condition but in fact it had not met the required criteria. If so, then HMRC will amend the QIS's self assessment tax return, after issuing a closure notice, on the basis that it should have been taxed as a close investment holding company. However, any assessments will be subject to a right of appeal in the normal way.

CTM48730 - Authorised investment funds: qualified investor schemes: substantial QIS holding: meaning

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Introduction

A person (including a corporate body) who, together or with associates or connected persons, owns units representing rights to 10% or more of the net asset value of the fund constituting the qualified investor scheme (QIS) owns a 'substantial QIS holding', as defined in regulation 54 SI 2006/964.

- Associates are as defined at ICTA88/S417, ([CTM60150](#)).
- Connected persons are as defined at ICTA88/S839 (for guidance see CG14580 onwards which deals with similarly worded legislation).

The charge to tax on substantial QIS holdings in a QIS is covered in chapter 4, part 4 SI 2006/964.

However, from the 1 January 2009 the substantial QIS holding rule (explained in this page to [CTM48980](#)) ceases to apply and the charge to tax in chapter 4 of part 4 only has effect until 31 December 2008 for investors with a substantial holding in a QIS that was established before this date. See [CTM48745](#) for further guidance on these transitional arrangements.

Exceptions (SI 2006/964 Regulation 53)

However the holding is not a 'substantial QIS holding' if it is held by any of the following (as defined in Regulation 53):

- a charity,
- a registered pension scheme (or one so treated by Schedule 36 to FA1994),
- an insurance company holding the units as part of its long-term insurance fund,
- a friendly society,
- any person for whom a profit on sale of the units would be taxed as part of its trade (note that will covers most other holdings by insurance companies and also by the fund manager), or
- another QIS.

Holding becoming a 'substantial QIS holding'

A holding which is not initially a 'substantial QIS holding' may become substantial as a result of:

- the investor acquiring additional units, or
- connected or associated investors acquiring or increasing holdings, or
- other investors reducing their holding.

Once a person's holding is treated as a 'substantial QIS holding' then it continues to be treated as such a holding until the person completely disposes of it, even if it is subsequently reduced to a level below that which would have made it a 'substantial QIS holding' (SI2006/964 Regulation 54(4)).

However, in cases where the holding becomes substantial, other than as a result of additional units in the scheme being acquired (whether by the investor or others) then the investor can,

if so desired, avoid classification of the holding as a 'substantial QIS holding' by reducing it within a time limit (Regulation 54(5) – [CTM48760](#)).

CTM48735 - Authorised investment funds: qualified investor schemes: substantial QIS holding: tax treatment: introduction

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Taxation of an investor with a 'substantial QIS holding'

Distributions

The investor is charged to tax (IT or CT depending on the type of investor) on all types of distribution in exactly the same way as any other investor and as investors in any other type of authorised investment fund. See [CTM48500](#) (CT payers) or [CTM48550](#) (IT payers) onwards for details.

Gains in the market value of the holding

The investor is also chargeable to IT or to CT on any gain in the value of the holding. The method by which the charge is calculated and the treatment of a fall in value, is explained at [CTM48740](#). The value used is 'market value' as defined in the regulations (SI2006/964) – see [CTM48745](#) for more details.

Chargeable gains

As the investor will already have paid tax on any gain in value of the holding then, provided that the holding was treated as a 'substantial QIS holding' from the outset, there will be no chargeable gain on disposal.

In cases where the investor's holding was initially below that required to be treated as substantial but subsequently became substantial then a chargeable gain is calculated when the holding becomes substantial but is not treated as accruing until a partial or complete disposal of the holding of units is made ([CTM48780](#)).

CTM48740 - Authorised investment funds: qualified investor schemes: substantial OIS holding: tax treatment: calculation

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Calculation (participants chargeable to IT) – SI2006/964 Regulations 55 to 57

The participant must calculate the change in 'market value' ([CTM48745](#)) of their holding between each pair of adjacent measuring dates ([CTM48725](#)) where the second date falls during the tax year (taking the size of the holding after any transactions on the first measuring date and before any transactions on the second date in each case).

They must then aggregate the gains and losses so calculated to arrive at a total gain or loss in value for the year.

If this gives a gain then the amount of gain is then treated as 'other income' chargeable to IT under Chapter 8 Part 5 ITTOIA 2005 (SI2006/964 Regulation 57(3)).

There are examples covering different situations at [CTM48750](#) onwards.

Note that this charge is in addition to the charge arising from any distributions made to the participant.

If the aggregate amount is a loss then this may be deducted from any net income arising from transactions within the table at section 836B ICTA 1988 (see regulation 57(4) and also section 392 ICTA 1988) or may be carried forward and deducted from any future net gain or other income arising from transactions within the table at section 836B ICTA 1988.

Calculation (participants chargeable to CT) – SI2006/964 Regulation 58

A participant chargeable to CT must calculate the change in 'market value' of their holding between each pair of adjacent measuring dates ending during the participant's accounting period (taking the size of the holding after any transactions on the first measuring date and before any transactions on the second date in each case).

They must then aggregate the gains and losses so calculated to arrive at a total gain or loss in value for the accounting period.

If this gives a gain then the amount of gain is charged to CT under Case VI of Schedule D (Regulation 58(3)).

The examples given from [CTM48750](#) onwards cover participants within the charge to IT but the same principles apply for participants within the charge to CT except that the period for which a calculation is required will be an accounting period rather than the tax year.

Note that this charge is in addition to that which may arise from any distributions made to the participant.

If the aggregate amount is a loss then this is treated as a loss under Case VI of Schedule D.

CTM48745 - Authorised investment funds: qualified investor schemes: substantial QIS holding: measuring dates and market value

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Measuring dates – SI2006/964 Regulation 56

The calculation of gains and losses in value is based on measuring dates as defined at Regulation 56.

Measuring dates occur whenever:

- a holding of units in a qualified investor scheme (QIS) first becomes substantial (or is first acquired and is immediately substantial),
- a substantial QIS holding is added to by the acquisition of further units,
- a disposal is made of units from a substantial QIS holding (including total disposal of the holding),
- there is a 'reporting date' (a reporting date is the final day of each annual and each half-yearly accounting period of the authorised fund).

Measuring dates applied after the 1 January 2009 – SI2006/964 Regulation 56

In accordance with transitional arrangements outlined in [CTM48715](#) the dates specified above cease to have effect from the 1 January 2009 (as the substantial holding rules come to an end on that date). They are replaced by the two measuring dates below to ensure that any substantial holders fair value their holdings from:

- the earlier measuring date - that is date that was the later measuring date on the last occasion that the value was calculated in accordance with the dates used before the 1 January 2009 under this regulation, to
- the later measuring date which is 31 December 2008.

(Both these measuring dates were inserted by regulation 31 SI 2008/3159)

Market value – SI2006/964 Regulation 55(4) and 55(5)

In cases where there is a single published unit price then 'market value' is the price as published on the measuring date (or most recently before if none were published on that date). A single price is normal practice with all open-ended investment companies and with some authorised unit trusts.

In cases where separate buying and selling prices are published regularly then 'market value' is the buying price (the lower price) as published on the measuring date (or most recently before if none were published on that date). Dual pricing is currently used by most authorised unit trusts.

CTM48750 - authorised investment funds: qualified investor schemes: substantial QIS holding: tax calculation: example 1

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Simple case – no acquisitions or disposals of units

Mrs B needs to complete her Self Assessment for tax year 2007/08.

Mrs B has a holding of units amounting to 6% of the net asset value of a qualified investor scheme (QIS) in which her husband also has a holding of 4% so that she has a 'substantial QIS holding' after taking into account the holdings of associated or connected persons.

The QIS fund has reporting dates of 30 June and 31 December each year. Mrs B makes no acquisitions or disposals of units between 31 December 2006 and 5 April 2008.

She must:

1. Calculate the value of her holding as at the end of 31 December 2006 at the 'bid price' or single price ruling on 31 December 2006 – this is the last measuring date before the start of the tax year 2007/08.
2. Calculate the value of her holding as at the start of 30 June 2007 at the 'bid price' or single price ruling on 30 June 2007 – this is the first measuring date in the tax year 2007/08.
3. Subtract the value calculated at (1) above from the value calculated at (2) above.
4. Calculate the value of her holding (as at the end of 30 June 2007) at the 'bid price' or single price ruling on 30 June 2007. In this example this value will be the same as that reached at point (2) above but this will not always apply (see example 2).
5. Calculate the value of her holding (as at the start of 31 December 2007) at the 'bid price' or single price ruling on 31 December 2007 - this is the last measuring date in the tax year.
6. Subtract the value calculated at (4) above from the value calculated at (5) above.
7. Add together the values calculated at points (3) and (6) above. This amount should be reported as 'other income' in Mrs B's Self Assessment. (If the result is negative it may be carried forward and set against a future positive result from QIS holdings.)
8. Amounts received as distributions in the tax year 2007/08 should be reported as dividends or interest as the case may be showing the tax credit or tax deducted in the normal way.

Notes

For a CT payer with an accounting period matching the above the same calculation would apply except that the amount calculated at point (7) would be reported as Schedule D Case VI income and distributions would be either treated as dividend distributions ([CTM48510](#)) or interest distributions ([CTM48515](#)) as appropriate.

Whilst in this example it is true that the correct sum of 'other income' could be reached by ignoring the measuring date at 30 June 2007 this is not always the case as will be seen from other examples. Treating each pair of adjacent measuring dates separately and aggregating the results afterwards is the approach prescribed in the legislation (SI2006/964 Regulation 58) and is the only way to reach the correct result consistently.

CTM48755 - authorised investment funds: qualified investor schemes: substantial QIS holding: tax calculation: example 2

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Holding becomes substantial during the tax year (2007/08)

The qualified investor scheme (QIS) has reporting dates of 30 June and 31 December. All units in the QIS have equal rights to the net asset value.

At 30 June 2006 Mr X has a holding of 6% of the units in the fund. On 31 January 2007 he purchases further units so that his holding now amounts to 10% of the new net asset value of the fund.

On 1 June 2007 he sells units reducing his holding to 3% of the fund and on 1 April he sells further units reducing his holding to 1% of the fund.

The following thirteen steps set out the calculation which Mr X will need to do to find the amount of 'other income' he will need to include on his tax return in respect of his QIS holding. As in previous examples distributions received from the QIS should be reported as dividends or as interest (as the case may be) in the normal way.

Please see also the notes which follow.

1. Calculate the value of his holding as at the **end** of 31 January 2007 (that is after the purchase of units made on that day) at the 'bid price' or single price ruling on that date - this is the last measuring date before the tax year.
2. Calculate the value of his holding (as at the **start** of 1 June 2007 (before the sale made on that day) at the 'bid price' or single price ruling on that date - this is the first measuring date in the tax year.
3. Subtract the result of the calculation at (1) from that at (2).
4. Calculate the value of his holding as at the **end** of 1 June 2007 (after the sale made on that day) at the 'bid price' or single price ruling on that date. Note that, due to the sale of units during that day this will be lower than the value calculated at (2) above.
5. Calculate the value of his holding as at the **start** of 30 June 2007 at the 'bid price' or single price ruling on that date.
6. Subtract the result of the calculation at (4) from that at (5).
7. Calculate the value of his holding as at the **end** of 30 June 2007 at the 'bid price' or single price ruling on that date. (This will be the same as the result at point 5 above.)
8. Calculate the value of his holding as at the **start** of 31 December 2007 at the 'bid price' or single price ruling on 31 December 2007.
9. Subtract the result of the calculation at (7) from that at (8).
10. Calculate the value of his holding as at the **end** of 31 December 2007 at the 'bid price' or single price ruling on 31 December 2007. (The same result as at point 8 above.)
11. Calculate the value of his holding as at the **start** of 1 April 2008 (that is before the sale of units made on that day) at the 'bid price' or single price ruling on 1 April 2008. This is the last measuring date in the year.
12. Subtract the result of the calculation at (10) from that at (11).

13. Add together the results obtained at (3), (6), (9) and (12) above. This total should be reported as 'other income' in Mr X's Self- Assessment. (If the result is negative it may be carried forward and set against a future positive result.)
14. As in the previous example amounts received as distributions should also be reported as dividends or interest in the normal way.

Notes

Note that Mr X's holding remains substantial for as long as he holds any units in the fund. However if Mr X sells his entire holding and then repurchases units in the same fund then the new purchase is treated as an entirely different holding and will not necessarily be a 'substantial QIS holding'. The rules set out at [CTM48730](#) apply to determine its status.

For a CT payer with an accounting period matching the above the same calculation would apply except that the amount calculated at point (13) would be reported as Schedule D Case VI income and distributions would be either treated as dividend distributions ([CTM48515](#)) or interest distributions ([CTM48520](#)) as appropriate.

CTM48760 - Authorised investment funds: qualified investor schemes: substantial QIS holding: 'inadvertent breach'

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

SI2006/964 Regulation 63

In most cases, when a participant in a qualified investor scheme (QIS) acquires a holding of 10% or more of the net asset value of a QIS, either alone or together with associates or connected persons ([CTM48730](#)), then the holding will be treated as a 'substantial QIS holding' from the day it reaches or exceeds 10% of the net asset value. The 10% is calculated after aggregating the holding with those of associates or connected persons.

However it is recognised that this could lead to some participants in a fund who never intended to become substantial holders breaching this 10% limit through the actions of other unconnected persons.

In particular, if a major holder in a QIS were to sell all their units and if these units were then to be cancelled the net asset value of the fund would be reduced. This would have the effect of increasing the proportion held by each of the remaining unit (or share) holders.

A participant whose proportionate holding is thus increased (without the number of units being increased) to 10% or more of the net asset value of the fund may continue to receive the same tax treatment given to other participants (who do not have substantial QIS holdings) provided that their holding is reduced to below 10% of net asset value within a time limit ([CTM48765](#)).

Provided that:

- a. the holding did not become substantial as a result of the purchase of units (whether by the participant or by connected or associated persons ([CTM48710](#))), and
- b. the participant reduces their holding to below 10% of the net asset value of the fund. (note that this must be less than 10% after aggregation with holdings of associated or connected persons), and
- c. that this is done within the time limit ([CTM48745](#)),

then the participant will not be treated as having a substantial QIS holding at any time.

CTM48765 - Authorised investment funds: qualified investor schemes: substantial QIS holding: 'inadvertent breach': time limit

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Time limit for disposal to retain normal tax treatment

(Note that references to units in any authorised investment fund include references to shares in an open-ended investment company.)

If a participant has 'inadvertently acquired' ([CTM48760](#)) a 'substantial QIS holding' then:

- provided that the size of the holding is reduced to less than 10% of the net asset value of the qualified investor scheme (QIS) fund, and
- that this is done by the second reporting date ([CTM48745](#)) following the date when the holding became substantial,

the participant can retain normal tax treatment in respect of their holding in that QIS, (SI2006/964 Regulation 63).

Note that the size of the holding is calculated, for the purposes of the 10% limit, after aggregation with the holdings of connected and associated persons (SI2006/964 Regulation 54(1) and [CTM48730](#)).

Examples of tax treatment if a substantial holding is reduced within the time limit and retained are at [CTM48770](#) and [CTM48775](#) respectively.

CTM487570 - Authorised investment funds: qualified investor schemes: substantial QIS holding: 'inadvertent breach': example: rectified

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Inadvertent breach – holding reduced within time limit – example

The qualified investor scheme (QIS) has reporting dates of 30 June and 31 December. All units in the QIS have equal rights to the net asset value.

Ms C (who is, as required by Financial Services Authority rules, a sophisticated investor) holds 6% of the units in QIS fund. On 1 March 2007 a major holder of units sells units to the value of 40% of the entire fund which are immediately cancelled. This has the result that Ms C is left holding units representing exactly 10% of the remaining net asset value of the fund at the end of 1 March 2007.

In this example the next reporting date of the fund following 1 March 2007 is 30 June 2007. The second reporting date following 1 March 2007 is 31 December 2007.

Provided Ms C reduces her holding to below 10% of the net asset value of the fund before 31 December 2007 (the second reporting date) then she does not need to treat her holding as having been substantial at any time up to 31 December 2007.

If, on the other hand, Ms C chooses to retain her full holding then she must calculate her income for tax purposes using the 'substantial QIS holding' rules, with the holding becoming substantial on 1 March 2007. As an example the steps of her calculation are set out at [CTM48775](#).

How will Ms C know that she has a holding of over 10% of the fund?

She can check this periodically by dividing the value of her own holding (after aggregating this with those of any associates or connected persons) by the net asset value of the fund at the same date. As the fund managers need to calculate the net asset value of the fund as part of the process of calculating a unit price this should be available for any day on which a unit price is calculated.

She must in any event be automatically informed of these details following each reporting date, as the fund will have to make a half-yearly report in order to comply with Financial Services Authority regulations. As, in this example, there is a reporting date on 30 June 2007 this means that she will be informed following this date of the details needed for her to check her position.

She then has until the next reporting date, in this example 31 December 2007, to reduce her holding.

Some fund managers may choose to offer a service to participants in a QIS whereby they will undertake to check the position at regular intervals for them and inform them if a holding becomes substantial. However, it should be emphasised that the responsibility to check lies with the individual participant.

It should be noted that only the individual participant can know in full those who may be connected or associated with them and it is the responsibility of the participant to check the position of those persons (in a similar way to shareholders in a potentially close company).

CTM48775 - authorised investment funds: qualified investor schemes: substantial QIS holding: 'inadvertent breach': example: not rectified

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Inadvertent breach - holding retained - example

As in the previous example ([CTM48770](#)) the qualified investor scheme (QIS) has reporting dates of 30 June and 31 December. All units in the QIS have equal rights to the net asset value.

Ms C, (who is, as required by Financial Services Authority rules a sophisticated investor) holds 6% of the units in QIS fund. On 1 March 2007 a major holder of units sells units to the value of 40% of the entire fund which are immediately cancelled. This has the result that Ms C is left holding units representing 10% of the remaining net asset value of the fund. Ms C does not carry out any further transaction in units of the QIS before 6 April 2008. In particular, in contrast to the previous example at CTM48750, she does not reduce her holding before 31 December 2007. This means that her holding will be a 'substantial QIS holding' until she disposes of it in full.

In order to complete her Self Assessment for 2007/08 Ms C needs to take the following steps:

1. Calculate the value of her holding (as at the end of 1 March 2007) at the 'bid price' or single price ruling on 1 March 2007 - this is the last measuring date before the tax year.
2. Calculate the value of her holding (as at the start of 30 June 2007) at the 'bid price' or single price ruling on 30 June 2007 - this is the first measuring date in the tax year.
3. Subtract the value calculated at (1) above from the value calculated at (2) above.
4. Calculate the value of her holding (as at the end of 30 June 2007) at the 'bid price' or single price ruling on 30 June 2007. In this example this value will be the same as that reached at point (2) above but this will not always apply (see example 2 for 1 June 2007).
5. Calculate the value of her holding (as at the start of 31 December 2007) at the 'bid price' or single price ruling on 31 December 2007 - this is the last measuring date in the tax year.
6. Subtract the value calculated at (4) above from the value calculated at (5) above.
7. Add together the values calculated at points (3) and (6) above. This amount should be reported as 'other income' in her SA return. (If the result is negative it may be carried forward and set against a future positive result.)
8. As her holding became substantial on 1 March 2007 she will also need to calculate her accrued Capital Gain on the holding up to that date. This falls into charge only as she starts to dispose of her holding ([CTM48780](#)).
9. As in previous examples amounts received as distributions should be reported in the normal way as dividends or interest (as the case may be).

Notes

Ms C will need to check periodically not just the value of her own holding but also the net asset value of the fund so that she is aware that she is a substantial QIS holder. Once she becomes aware she can find out when her holding became substantial by dividing the value of her holding by the net asset value of the entire fund for each day during the period since her last check. The first day on which this exceeds 10% (in this case 1 March 2007) will be the day she acquired a substantial QIS holding.

As the increase in Miss C's percentage holding was the result of a disposal by a third party she has an 'inadvertent breach' of the 10% holding rule. However, in this example, she has retained a holding of over 10% of the fund past 31 December 2007. This means that her holding in the QIS must be treated as substantial from 1 March 2007, and must continue to be treated as substantial until she has disposed of all her units in that QIS.

CTM48780 - Authorised investment funds: qualified investor schemes: substantial QIS holdings: disposals

This page applies to the calculation of taxable returns arising from a substantial holding until 31.12.2008

Capital Gains/ Chargeable Gains on disposal or partial disposal of substantial QIS holdings

Holding substantial from inception

There is no profit or loss for Capital Gains purposes, nor any chargeable gain or loss for CT payers (SI2006/964 Regulation 68(4)). The reason for this is that any gain in value of the holding will have already been taken into account as 'other income' (IT payers) or Case VI income (CT payers) ([CTM48740](#)).

Holding becomes substantial

This covers cases where the participant with a 'substantial QIS holding' initially acquired units that did not amount to a substantial holding, but the holding later became substantial. This could be as a result of the acquisition of additional units by the participant (or by a connected or associated person). It could also be by an 'inadvertent breach' which is not rectified, that is where the participant's percentage holding is increased by a reduction in the net asset value of the fund, and the participant does not reduce their holding to below 10% of the net asset value of the fund within the time limit ([CTM48765](#)).

When the holding first becomes substantial the participant must calculate the chargeable gain or loss that would have arisen had they disposed of their entire holding at the first measuring date at its then market value (SI2006/964 Regulation 65). The first measuring date is the date on which the holding first became a substantial QIS holding, (SI2006/964 Regulations 64 and 60(1)). They must also calculate any taper relief due by reference to the period ending on the first measuring date, (TCGA92/SCHA1/PARA16 as modified by SI2006/964 regulation 110). The gain thus calculated is then charged to tax only when there is a disposal of units as explained below.

At the time of disposal (or part disposal) the gain or loss calculated in the above paragraph (or a corresponding part of it) is treated as accruing for the purposes of TCGA92, (SI2006/964 Regulations 67 and 68).

In case of partial disposal the provisions of TCGA92 apply to determine how the units disposed of are to be identified. Further guidance on this point is at CG50500 onwards.

Any remaining chargeable gain or loss is treated as accruing for the purposes of TCGA 1992 on the date of final disposal of the remaining units, (SI2006/964 Regulation 68(3)(a)).

The CG Manual gives further details of the calculation of Capital Gains Tax and chargeable gains for CT.

Note that any gain or loss which accrues following the first measuring date is not brought into account for the purposes of TCGA92 (SI2006/964 Regulations 67(4) and 68(4)). This is because any gains or losses following this date are treated as 'other income' (IT) or Case VI income (CT), as the case may be ([CTM48740](#)).

PART B OF DRAFT GUIDANCE FOR CONSULTATION: TRADING OR INVESTMENT

CTM48200 - Authorised investment funds: taxation of funds: contents

CTM48280	Trading or investment
CTM48282	Trading or investment: "investment transactions"
CTM48284	Investment transactions: relevant contracts
CTM48286	Investment transactions: loan relationships and related transactions
CTM48288	Investment transactions: units in a collective investment scheme
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CTM48280 - Authorised investment funds: taxation of funds: trading or investment

SI2006/964 Regulation 14E - "investment transactions" of diversely owned funds

Regulation 14E prevents defined financial transactions carried out by diversely owned authorised investment funds (AIFs) from being characterised as trading transactions for tax purposes. This rule gives diversely owned AIFs certainty that gains on the realisation of certain types of investments, which would not be chargeable gains (see CTM48215), cannot be re-characterised as profits arising from a trade which would then be taxable as income.

The rule applies where an AIF:

- carries out an "investment transaction" (see CTM48282) in an accounting period; and
- meets the genuine diversity of ownership condition (see CTM48155 to CTM48170) throughout that period.

An AIF meeting those two conditions is referred to as a "diversely owned AIF".

Where the rule applies, all capital profits, gains or losses arising from "investment transactions" are treated as non-trading and the corporation tax provisions under which trading profits and losses are computed and charged do not apply to those transactions.

Capital profits, gains and losses for this purpose are any profits, gains or losses treated as capital for accounting purposes under the Statement of Recommended Practice (SORP) which applies to AIFs.

The rule applies to transactions carried out on or after 1 September 2009.

Capital and revenue

Regulation 14E prevents capital gains being re-characterised as trading profits (and therefore revenue), but it does not prevent revenue profits from "investment transactions" being taxable as income. For example, interest receivable in respect of a loan relationship will be taxable income even where regulation 14E applies to prevent any capital profit on disposal of the loan relationship being characterised as trading income.

AIFs and trading

Where regulation 14E does not apply, it remains a question of fact whether or not activities carried out by an AIF amount to trading for tax purposes.

In such cases, the normal principles for determining whether or not there is a trade will apply and there is no automatic assumption that transactions which are not "investment transactions" for the purposes of regulation 14E will be trading transactions by default. Where an AIF carries out financial transactions and regulation 14E does not apply, the principles set out in the guidance at BIM20252 should be considered.

Whilst it is possible that some activities carried out by an AIF might, on the facts, amount to trading, there is a general and prevailing assumption that AIFs will not be conducting a trade. The statements published in the August 2002 and December 2005 articles in Tax Bulletins 60 and 80, in relation to AIFs and loan relationships and derivative contracts continue to apply.

CTM48282 - Authorised investment funds: taxation of funds: trading or investment: "investment transactions"

SI2006/964 Regulations 14F - 14L

Regulations 14F to 14L specify the types of transaction that are an "investment transaction" for the purposes of regulation 14E. The regulations provide that an "investment transaction" is any transaction:

- In stocks or shares;
- In a "relevant contract" (see CTM48284)
- Which results in the diversely owned AIF becoming party to a "loan relationship" or "related transaction" (see CTM48286);
- In units in a collective investment scheme (see CTM48288);
- In securities (see CTM48290);
- Consisting in the buying or selling of foreign currency; or
- In a carbon emission trading product (see CTM48292).

Any transaction that is not specified in regulations 14F to 14L will not be an "investment transaction" for the purposes of regulation 14E. This does not mean, however, that the transaction will be a trading transaction by default. Such a transaction may still be non-trading on first principles.

CTM48284 - Authorised investment funds: taxation of funds: trading or investment: "investment transactions": relevant contracts

SI2006/964 Regulation 14G - relevant contracts

Regulation 14G provides that any transaction in a relevant contract is an investment transaction for the purposes of regulation 14E. In regulation 14G a "relevant contract" is:

- An option;
- A future; or
- A contract for differences.

Regulation 14G is designed to encompass transactions in a very wide range of derivative contracts. The definitions are widely-drawn and, importantly, there is no requirement for the option, future or contract for differences to be accounted for as a derivative financial instrument in order to be a relevant contract. An option includes, but is not limited to, the type of instrument described in regulation 14G(3); commonly called "warrants".

Where a contract provides for cash settlement only and does not provide for the delivery of any property, it will not be an option or a future for the purposes of regulation 14G; but such cash-settled derivative contracts will generally be contracts for differences within the meaning of regulation 14G(9).

Regulation 14G(7)(c) provides that an option or future will not be a relevant contract where physical delivery of the underlying property takes place and that property is not of a type itself specified in the regulations 14F to 14L. This excludes transactions in contracts which result in physical delivery of property other than stocks and shares, relevant contracts, loan relationships, units in collective investment schemes, securities, currency or carbon emission trading products. This prevents, for example, an option under which a physical commodity, such as oil or precious metals, is delivered from being a relevant contract.

Contracts which provide for, but do not result in, physical delivery are not excluded (whatever the underlying subject matter) and neither are contracts which result in the delivery of property, transactions in which are themselves specified in regulations 14F to 14L. For example, a transaction in an option which has a physical commodity, such as wheat, as the underlying property is not prevented from being a relevant contract by regulation 14G(7)(c), provided the option is not settled by physical delivery of the commodity. A transaction in an option which is settled by the delivery of shares, for example, will be a relevant contract, because transactions in shares are themselves specified in regulation 14F.

Regulation 14G(11)(c) excludes a contract of insurance from being a contract for differences. For the purposes of regulation 14G, a contract of insurance does not include a credit default swap (CDS). Transactions in CDS will be within regulation 14G(1) as transactions in contracts for differences, which are relevant contracts by virtue of regulation 14G(2).

Regulation 14G(13) prevents an option, future or contract for differences from being a relevant contract where the contract relates to land. But this exclusion does not apply to contracts the underlying subject matter of which is an index, provided the index is publicly accessible, comprised of a significant number of properties and not maintained by the non-resident person, the investment manager, or a person or persons connected with either. Connection is determined in accordance with ITA07/S993 and S994 (for income tax) and ICTA88/S839 (for corporation tax).

The conditions in regulation 14G(13)(a)-(c) are designed to exclude arrangements that may be structured in such a way as to replicate or approximate the returns from specified or identifiable holdings of land. Such arrangements would be contrary to the general prohibition on transactions in land and contracts relating to land. In order to meet the "significant

number of properties" condition, an index must be sufficiently broadly based to ensure that a contract based upon it is not tailored around specific real estate holdings. Publicly accessible indices providing regional and sectoral data based upon valuations of a wide and changing range of institutional investment portfolios will, for example, meet this requirement.

CT&VAT, Collective Investment Schemes, can advise on the admissibility of property indices in particular cases of doubt or difficulty.

CTM48286 - Authorised investment funds: taxation of funds: trading or investment: "investment transactions": loan relationships and related transactions

SI2006/964 Regulation 14H - loan relationships and related transactions

Regulation 14H provides that any transactions which result in the diversely owned AIF becoming party to a loan relationship or a related transaction in respect of a loan relationship is an investment transaction for the purposes of regulation 14E.

A loan relationship includes all lending debts in relation to which the diversely owned AIF stands as creditor or debtor, but is not limited to such arrangements. Regulation 14H(2)(b) extends the definition to include non-lending (or "simple") debts on which interest is payable or in relation to which exchange gains or losses arise. And regulation 14H(3) further extends the definition to include all debts in relation to which the diversely owned AIF stands as creditor and which give rise to a discount, whether of an income or capital nature. Regulation 14H(6) admits all debts in relation to which an instrument is issued by any person representing security for or the rights of a creditor in respect of the debt. This provision includes debentures and other debts in note form.

A related transaction, in respect of a loan relationship, means any disposal or acquisition of rights or liabilities under that loan relationship. This means that the transactions coming within regulation 14H are not limited to those whereby the diversely owned AIF becomes party to a debt as the original creditor or debtor, but includes transactions involving the acquisition or disposal of existing debts to which the diversely owned AIF was not the original party.

Regulation 14H designed to encompass a very wide range of transactions in debt and debt instruments. As well as making loans, depositing money at interest and transactions in debentures and bonds, regulation 14H also admits transactions involving the acquisition and disposal of loans and other debts giving rise to interest, foreign exchange gains/losses or discount; including, for example, the acquisition of a stream of 'consumer debt' receivables (e.g. in relation to credit cards), a portfolio of distressed debt, or a non-performing loan. Transactions in convertible debt are also within regulation 14H.

Where fees are receivable by a diversely owned AIF as a direct incidence of that AIF becoming party to a loan relationship or related transaction, those fees derive from an "investment transaction" within regulation 14H. This includes commitment, placement and documentation fees where the diversely owned AIF becomes party to a loan relationship by making a loan or placing the diversely owned AIF's own money. Where consent or amendment fees are receivable by the diversely owned AIF in connection with the amendment of the terms of a loan relationship (e.g. a bond or loan) to which the diversely owned AIF is a party as creditor or debtor, such fees will also derive from an "investment transaction" within regulation 14H where the amendment of terms constitutes a related transaction within regulation 14H(10).

CTM48288 - Authorised investment funds: taxation of funds: trading or investment: "investment transactions": units in a collective investment scheme

SI2006/964 Regulation 141 - units in a collective investment scheme

Regulation 141 provides that any transaction in units in a collective investment scheme is an investment transaction for the purposes of regulation 14E.

The definition of 'collective investment scheme' in regulation 8 is widely drawn and encompasses any arrangements under which participants share in, or receive profits or income arising from the acquisition, holding, management or disposal of any property (whether the participants become the owners of the property or otherwise). The arrangements must also be such that:

- The participants do not have day-to-day control over the management of the property; and either
- The contributions of the participants and the profits or income out of which payments are made are pooled; or
- The property is managed as a whole by or on behalf of the scheme operator.

This definition can encompass arrangements such as unit trust schemes, contractual arrangements such as Common Contractual Funds (CCFs) and Fonds Commun de Placement (FCPs), and partnerships, whether incorporated or unincorporated.

The term 'units' is also given a wide definition and means the rights or interests of the participants in a collective investment scheme, however those rights or interests are described. Rights under a contractual arrangement such as an FCP, for example, are within the meaning of 'units' in regulation 8, as are membership interests in a partnership, as well as interests actually represented by the issue of units (as in the case of a unit trust).

For the purposes of regulation 8, no account is taken of the transparency or opacity of the vehicle by virtue of which the arrangements subsist. Provided the transaction is in rights or interests in a collective investment scheme meeting the requirements of paragraphs (2) to (5) of regulation 8, it is an 'investment transaction' for the purposes of regulation 14E.

CTM48290 - Authorised investment funds: taxation of funds: trading or investment: "investment transactions": securities

SI2006/964 Regulation 14J - securities of any description

Regulation 14J provides that any transaction in securities is an investment transaction for the purposes of regulation 14E.

A transaction in securities for the purposes of regulation 14J is any transaction in securities of any description not otherwise falling within any of regulations 14F (stocks and shares), 14G (relevant contracts), 14H (loan relationships) and 14I (units in a collective investment scheme). This formulation gives 'securities' a wide meaning and makes regulation 14J residual: equity and debt instruments, for example, although securities in the wider sense of the term, will not come within regulation 14J if they fall within regulation 14F or regulation 14H respectively.

CTM48292 - Authorised investment funds: taxation of funds: trading or investment: "investment transactions": carbon emission trading products

SI2006/964 Regulation 14L - carbon emission trading products

Regulation 14L provides that any transaction in a carbon emission trading product is and investment transaction for the purposes of regulation 14E.

Carbon emission trading products for the purposes of regulation 14L are either:

- Community tradable emissions allowances; or
- Transferable units issued pursuant to the Kyoto Protocol.

Community tradable emissions allowances are transferable allowances relating to the making of emissions of greenhouse gases, allocated under a system for implementing any European Community obligation of the UK in relation to such emissions.

Transferable units issued pursuant to the Kyoto Protocol include assigned amount units, certified emission reductions, emission reduction units and removal units.

To qualify for admission under regulation 14L, the transaction must not otherwise fall within any of regulations 14F to 14K.

CTM48295 - Authorised investment funds: taxation of funds: trading or investment: anti-avoidance

SI2006/964 Regulations 52B, 52C and 52D - diversely owned AIFs and financial traders

Because certain profits from “investment transactions” cannot be taxed as trading profits when carried out by a diversely owned AIF to which regulation 14E applies, special rules are needed to prevent financial traders sheltering profits from these types of transactions in such an AIF. Without such rules, what would otherwise be taxable profits of the financial trader could be rolled-up as exempt capital gains in the AIF and later realised as a chargeable gain when the trader disposes of the units.

The special rules are set out in SI2006/964 Regulations 52B to 52D. They ensure that financial traders holding units in a diversely owned AIF to which regulation 14E applies must include all distributions and realised and unrealised gains or losses in respect of those units in the computation of their trading profits.

These rules target participants in diversely owned AIFs who are financial traders. They do not affect in any way the tax treatment of the diversely owned AIF itself.

Further guidance on these rules can be found at:

- CTM48530 (for participants within the charge to corporation tax); and
- CTM48570 (for participants within the charge to income tax)

CTM48500 - Authorised investment funds: taxation of participants within the charge to CT: contents

- [CTM48530](#) Financial traders and diversely owned AIFs
- [CTM48535](#) Financial traders and diversely owned AIFs – special rules
- [CTM48540](#) Meaning of “financial trader”

CTM48530 - Authorised investment funds: taxation of participants within the charge to CT: financial traders and diversely owned AIFs

Because certain profits from “investment transactions” (see CTM48282+) cannot be taxed as trading profits when carried out by a diversely owned AIF (see CTM48280) to which SI2006/964 Regulation 14E applies, special rules are needed to prevent financial traders sheltering profits from these types of transactions in such an AIF. Without such rules, what would otherwise be taxable profits of the financial trader could be rolled-up as exempt capital gains in the AIF and later realised as a chargeable gain when the units are disposed of.

The special rules are set out in SI2006/964 Regulations 52B to 52E. They ensure that financial traders (including in some cases persons connected with a financial trader) holding units in a diversely owned AIF must include all distributions and realised and unrealised gains/losses in respect of those units in the computation of their trading profits (see CTM48535 and 48540).

CTM48535 - Authorised investment funds: taxation of participants within the charge to CT: financial traders and diversely owned AIFs: special rules

SI2006/964 Regulations 52B – 52D

Regulations 52B to 52D set out special rules applying to financial traders (see CTM48535) holding units in diversely owned AIFs (see CTM48280). The rules require the financial trader to include in its computation of trading profits for CT purposes:

- All distributions; and
- All realised and unrealised gains/losses

in respect of the units in the diversely owned AIF arising in each accounting period.

Realised and unrealised gains/losses in an accounting period are calculated by reference to the difference between the actual disposal value, or market value at the end of the accounting period where the units have not been disposed of, and the market value at the end of the previous accounting period, or the acquisition cost if the units were acquired during the accounting period.

Market value means the price published by the manager of the AIF on the appropriate day, or nearest preceding day. Where the manager publishes both buying and selling prices, the market value will be the buying price (which will be the lower of the two).

The rules are subject to CTA2009/S130, which means that financial traders which are insurance companies are not required to include distributions from diversely owned AIFs in the computation of trading profits where S130 would exempt them from that requirement.

The rules do not apply in the following cases:

- Where the units in the diversely owned AIF are included in the financial trader's trading stock and all profits/losses, including distributions (subject to CTA2009/S130), are included in the computation of trading profits on the basis of fair value accounting; or
- Where the diversely owned AIF is a bond fund (see CTM48270?) and CTA2009/S490 applies so that the financial trader must treat the units as a deemed creditor loan relationship which is accounted for on the basis of fair value accounting (see CTM48505?).

This is because in both such cases the financial trader will already be recognising the distributions and realised/unrealised gains/losses required by regulations 52B and 52C.

CTM48540 - Authorised investment funds: taxation of participants within the charge to CT: financial traders and diversely owned AIFs: meaning of "financial trader"

SI2006/964 Regulation 52E

Regulation 52E defines a financial trader as a person carrying on a business which is:

- A banking business;
- An insurance business; or
- A business consisting wholly or partly in dealing in "trading assets" such that any profit on such assets would form part of the trading profit of that business.

"Trading assets" for these purposes means:

- Stocks and shares;
- Relevant contracts;
- Loan relationships;
- Units in collective investment schemes;
- Securities;
- Foreign currency; and
- Carbon emission trading products.

This aligns with the definition of "investment transactions" for the purposes of SI2006/964 Regulation 14E (see CTM48282 to 48292).

An insurance business for the purposes of Regulation 52E does not include a life assurance business, or that part of a wider insurance business that is life assurance business, carried on by a company. This carve out ensures that the special tax rules applying to life assurance companies are not disturbed by the rules in regulations 52B and 52C.

The definition of "financial trader" is extended to include a person connected with a financial trader (as defined above) in certain circumstances. This applies only where a financial trader transfers trading assets (as defined above) to a diversely owned AIF, under or as part of an arrangement which has an unallowable purpose, and a person connected with the financial trader either holds units in that AIF at the time of the transfer or later acquires units in that AIF. The purpose of this extension is to prevent a financial trader from getting around regulations 52B and 52C by arranging for the units in the diversely owned AIF to be held by a connected person who would not be caught by those regulations.

An arrangement has an unallowable purpose if the main or one of the main purposes is to obtain a tax advantage within the meaning of ICTA88/S840ZA, or an income tax advantage within the meaning of ITA2007/S683, for any person.

CTM48550 - Authorised investment funds: taxation of participants within the charge to IT: contents

- [CTM48570](#) Financial traders and diversely owned AIFs
- [CTM48575](#) Financial traders and diversely owned AIFs – special rules
- [CTM48580](#) Meaning of “financial trader”

CTM48570 - Authorised investment funds: taxation of participants within the charge to IT: financial traders and diversely owned AIFs

Because certain profits from “investment transactions” (see CTM48282+) cannot be taxed as trading profits when carried out by a diversely owned AIF (see CTM48280) to which SI2006/964 Regulation 14E applies, special rules are needed to prevent financial traders sheltering profits from these types of transaction in such an AIF. Without such rules, what would otherwise be taxable profits of the financial trader could be rolled-up as exempt capital gains in the AIF and later realised as a chargeable gain when the units are disposed of.

The special rules are set out in SI2006/964 Regulations 52B to 52E. They ensure that financial traders (including in some cases persons connected with a financial trader) holding units in a diversely owned AIF must include all distributions and realised and unrealised gains/losses in respect of those units in the computation of their trading profits (see CTM48575 and 48580).

CTM48575 - Authorised investment funds: taxation of participants within the charge to IT: financial traders and diversely owned AIFs: special rules

SI2006/964 Regulations 52B - 52D

Regulations 52B to 52D set out special rules applying to financial traders (see CTM48535) holding units in diversely owned AIFs (see CTM48280). The rules require the financial trader to include in its computation of trading profits for IT purposes:

- All distributions; and
- All realised and unrealised gains/losses

in respect of the units in the diversely owned AIF arising in each period of account.

Realised and unrealised gains/losses in a period of account are calculated by reference to the difference between the actual disposal value, or market value at the end of the period of account where the units have not been disposed of, and the market value at the end of the previous period of account, or the acquisition cost if the units were acquired during the period of account.

Market value means the price published by the manager of the AIF on the appropriate day, or nearest preceding day. Where the manager publishes both buying and selling prices, the market value will be the buying price (which will be the lower of the two).

The special rules do not apply where the units in the diversely owned AIF are included in the financial trader's trading stock and all profits/losses, including distributions, are included in the computation of trading profits on the basis of fair value accounting. This is because in such cases the financial trader will already be recognising the distributions and realised/unrealised gains/losses required by regulations 52B and 52C.

CTM48580 - Authorised investment funds: taxation of participants within the charge to IT: financial traders and diversely owned AIFs: meaning of "financial trader"

SI2006/964 Regulation 52E

Regulation 52E defines a financial trader as a person carrying on a business which is:

- A banking business;
- An insurance business; or
- A business consisting wholly or partly in dealing in "trading assets" such that any profit on such assets would form part of the trading profit of that business.

"Trading assets" for these purposes means:

- Stocks and shares;
- Relevant contracts;
- Loan relationships;
- Units in collective investment schemes;
- Securities;
- Foreign currency; and
- Carbon emission trading products.

This aligns with the definition of "investment transactions" for the purposes of SI2006/964 Regulation 14E (see CTM48282 and 48292).

The definition of "financial trader" is extended to include a person connected with a financial trader (as defined above) in certain circumstances. This applies only where a financial trader transfers trading assets (as defined above) to a diversely owned AIF, under or as part of an arrangement which has an unallowable purpose, and a person connected with the financial trader either holds units in the AIF at the time of the transfer or later acquires units in that AIF. The purpose of this extension is to prevent a financial trader from getting around regulations 52B and 52C by arranging for the units in the diversely owned AIF to be held by a connected person who would not be caught by those regulations.

An arrangement has an unallowable purpose if the main or one of the main purposes is to obtain a tax advantage within the meaning of ICTA88/S840ZA, or an income tax advantage within the meaning of ITA2007/S683, for any person.

PART C OF THE DRAFT GUIDANCE FOR CONSULTATION: TAX ELECTED FUNDS

CTM48900 – AIFs: Tax Elected Funds (TEFs): contents

CTM48910	Introduction and conditions of membership for the regime
CTM48920	Application process and effects of entry to the TEF regime
CTM48930	Tax treatment and distributions made by TEFs
CTM48940	Tax treatment of distributions in the hands of participants
CTM48950	Provisions for providing tax information to participants
CTM48960	Breaches of conditions
CTM48970	Leaving the TEF regime

CTM48910 – AIFs: Tax elected funds (TEFs): introduction & conditions of membership for the TEF regime

- [CTM48911](#) Introduction
 - [CTM48912](#) Overview of conditions of membership
 - [CTM48913](#) The property condition
 - [CTM48914](#) The genuine diversity of ownership (GDO) condition
 - [CTM48915](#) The loan creditor condition
 - [CTM48916](#) The scheme documentation condition
-

CTM48911 - AIFs: Tax elected funds (TEFs): introduction and conditions of membership: introduction

Reference to these pages

These pages should be read as part of the guidance published in respect of 'The Authorised Investment Funds (Tax) Regulations 2006' (SI 2006/964), which can be found in this manual at CTM48000 onwards. That material applies to tax elected funds (TEFs) in the same way as to other authorised funds, except as set out in Part 4B of the regulations (inserted by [SI 2009/2036](#)) and explained in the following chapters. All authorised investment funds (AIFs) (including TEFs) are Collective Investment Schemes which are regulated by the Financial Services Authority (FSA) under the terms of the Financial Services and Markets Act 2000 (FSMA00). For further information on Collective Investment Schemes please refer to [CTM48105](#).

What is a TEF and what is the intention of the new regime?

The TEF is a tax regime that applies to authorised investment funds that have a mixed portfolio of assets but does not receive any income directly from a UK or overseas property business. (Funds that specialise in property investment may instead use the Property AIF regime which is set out in [CTM48800](#) to CTM48882.)

The intention of the TEF regime is to move the point of taxation from the TEF to the investor so that the investor is taxed as though they had invested in the underlying assets directly. This will allow the TEF to be an appropriate investment fund for a variety of investors, including those not subject to tax in the UK.

How does the TEF regime work?

A TEF is required to make two types of distribution, a dividend distribution and a non-dividend distribution. In general all dividend income received by the TEF will be distributed as a dividend distribution and all other income will be distributed as a non-dividend distribution.

Investors are then taxed as though they have received a dividend, including the non-payable dividend tax credit and a payment of yearly interest.

Under normal corporation tax (CT) rules income from UK dividends and most foreign dividends is exempt from CT in the hands of the TEF. Any other income (such as interest) will be required to be distributed as a non-dividend, for which the TEF will be entitled to receive a deduction up to the same amount to off-set the taxable income that would ordinarily be liable to CT.

Key features of the regime

The TEF regime is elective and in order to become a TEF an existing or new fund will need to meet certain conditions, which are explained in [CTM48912](#) to CTM48916.

An existing or new fund will need to apply to HMRC and receive approval before adopting the new regime. See [CTM48921](#) to CTM48926 for further guidance on the application process.

There are special provisions within the regime that allow a TEF to make tax information available to their participants electronically that would ordinarily have to be sent to participants. See [CTM48951](#) to CTM48956.

There are breaching rules and sanctions if any of the conditions of the regime are not met - the guidance on these rules can be found at [CTM48961](#) to CTM48965.

Further information

If, after reading this guidance, you have any further queries regarding the TEF regime please refer them to:

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CTM48912 - AIFs: Tax elected funds (TEFs): overview of conditions of membership

Entry into the Tax Elected Fund (TEF) regime is subject to HMRC approval. The manager of the fund, or proposed manager for a newly formed fund, must make an application in writing that it wants the TEF rules to apply from a given date to the fund and to investors who receive those distributions. The fund must be an open-ended investment company (OEIC) or an authorised unit trust (AUT) (see [CTM48110](#)) and meet the following conditions:

- the property condition ([CTM48913](#));
- the genuine diversity of ownership (GDO) condition ([CTM48914](#));
- the loan creditor condition ([CTM48915](#)); and,
- the scheme documentation condition ([CTM48916](#)).

An application for the TEF regime will apply from the beginning of an Accounting Period (AP) for an existing and newly formed fund. The term AP, for the purposes of this guidance, is as defined in section 12 ICTA 1988.

CTM48913 – AIFs: Tax elected funds (TEFs): the property condition

Under regulation 69Z46 SI 2006/964, a tax elected fund (TEF) must **not** have a UK property business or an overseas property business as defined in sections 205 and 206 of the Corporation Tax Act 2009 respectively. For further information on what we consider to be a UK and overseas property business is please refer to the Property Income Manual at [PIM1020](#).

However, the property condition will not prevent a TEF from holding shares in a UK-Real Estate Investment Trust (UK-REIT) (for further information on UK-REITs please refer to the Guidance on UK Real Estate Investment Trusts which can be found at [GREIT01000](#)) or a Property AIF (explained at [CTM48800](#) to CTM48882). Nor should the property condition prevent the TEF from holding debt instruments (bonds, loan or debenture stock) or simple debts (mortgage loans) that are secured on the borrower's real property assets as the income received from the debt instrument is interest and not income from a UK or overseas property business.

CTM48914 - AIFs: Tax elected funds (TEFs): the genuine diversity of ownership (GDO) condition

Under regulation 69Z47 SI 2006/964 the tax elected fund (TEF) must meet the genuine diversity of ownership (GDO) condition set out in regulation 9A SI 2006/964. This condition is to prevent the regime from being manipulated by a small group of people or a larger connected group who may intend to gain a tax advantage. The GDO sets out three sub-conditions (A to C) that must be met by a TEF which are explained in detail at [CTM48160](#).

Advance clearance

There is a clearance arrangement ([CTM48165](#)) to enable proposed TEFs to check in advance that their proposed arrangements will meet the GDO.

CTM48915 - AIFs: Tax elected funds (TEFs): the loan creditor condition

This condition restricts the way in which a tax elected fund (TEF) can borrow money. The purpose is to prevent income or capital growth being extracted from the TEF via a profit-related loan. The TEF will be in breach of this condition if it is the debtor in a loan which is not a normal commercial loan.

The wording in the legislation is similar to the definition of 'normal commercial loan' in paragraph 1(5) Schedule 18 ICTA. For guidance on interpretation of 'normal commercial loan' as defined in Schedule 18 ICTA, see [CTM81010](#) and [CTM81020](#).

Regulation 69Z47 SI 2006/964 determines that the TEF must fulfil the following conditions throughout the accounting period for any loan relationship to which the fund is party as a debtor:

Condition A

The creditor is not entitled to a payment by way of interest which is dependent upon the results of all or part of the TEF's business or the value of its assets. For the purposes of this condition a loan shall not be treated as dependent upon the results of the TEF's business by reason only that the terms of the loan provide for the interest to be reduced if results improve or increased if results deteriorate.

Condition B

The creditor is not entitled to a payment by way of interest which exceeds a reasonable commercial return.

Condition C

The creditor is entitled on repayment to an amount which does not exceed the consideration lent or is reasonably comparable with the amount generally repayable (in respect of an equal amount of consideration) under the terms of the issue of securities listed on a recognised stock exchange.

CTM48916 - AIFs: Tax elected funds (TEFs): the scheme documentation condition

Under regulation 69Z48 SI 2006/964 the scheme documentation condition requires that the instrument constituting the authorised investment fund (ie a trust deed for an authorised unit trust (AUT) or the instrument of incorporation for an open-ended investment company) and the fund's prospectus must include provisions (in each of the documents) which require the fund to meet the property condition and the loan creditor condition on entry and throughout the accounting period.

CTM48920 – AIFs: Tax elected funds (TEFs): application process and effects of entry to the TEF regime: contents

CTM48921	Introduction
CTM48922	Key points about the application process
CTM48923	Timing of the application process
CTM48924	Contents of the application
CTM48925	HMRC refusal notice
CTM48926	Effects of entry into the TEF regime

CTM48921 - AIFs: Tax elected funds (TEFs): application process and effects of entry to the TEF regime: introduction

This section covers the process for entry into the TEF regime.

Key points about the application process are set out in [CTM48922](#). The application needs to be made in writing to HMRC by the manager of an existing authorised investment fund (AIF) or proposed manager of a future fund, confirming to HMRC that all the conditions of entry apply. A TEF can voluntarily leave the TEF regime at anytime and re-join, subject to various conditions.

An application from an existing authorised investment fund should be received at least 28 days before the beginning of the specified accounting period or at least 42 days before the fund is expected to be authorised by the FSA. See [CTM48923](#). This page also explains the approval process and how minor errors and omissions will be dealt with by HMRC within the approval process.

The contents of an application are set out [CTM48924](#). There is no prescribed application form but HMRC has designed an application form that can be used to apply for the TEF regime.

HMRC will issue a refusal notice if the application is incorrect or incomplete or if HMRC is not satisfied that all the conditions of entry have been or will be met ([CTM48925](#)).

The effects of entry to the TEF regime are set out in ([CTM48926](#)).

CTM48922 - AIFs: Tax elected funds (TEFs): application process and effects of entry to the TEF regime: key points about the application process

The application process is covered in regulation 69Z49 SI 2006/964.

The application process

In order to become a tax elected fund (TEF), an application must be submitted to HM Revenue & Customs (HMRC) by the manager of an existing authorised investment fund (AIF) or the proposed manager for a future AIF, which must then be approved by HMRC.

Before an existing AIF makes an application, it must obtain any necessary unit holder or shareholder approval that is required under its own rules or by the Financial Services Authority to apply for the TEF regime. The AIF must also notify HMRC when any regulatory authorisation has been given.

Key points to note about the application process

Once a fund has been approved to be a TEF it can subsequently voluntarily leave the regime at anytime (see [CTM48971](#) for further details). If it decides to leave the regime and at a later date wants to re-apply to become a TEF again, the AIF can only do so at the beginning of an accounting period that begins six years after it left the regime, under regulation 69Z49(4)(b) SI 2006/964.

If a termination notice is issued by HMRC for the reasons set out in chapter 6 (see [CTM48960](#) onwards), then the AIF will not be able to re-apply to become a TEF at a later date under regulation 69Z49(4) (a) SI 2006/964 .

CTM48923 - AIFs: Tax elected funds (TEFs): application process and effects of entry to the TEF regime: timing of the application process

The rules regarding the form and timing of an application are detailed in regulation 69Z50 SI 2006/964.

When should a TEF application be received by HMRC?

An application to become a tax elected fund (TEF) must be made in writing to HM Revenue & Customs (HMRC).

- The application for an existing authorised investment fund (AIF) must be received by HMRC at least 28 days before the beginning of the specified accounting period (AP) (ie from the beginning of the AP in which the TEF regime is to apply).
- A proposed fund application must be received by HMRC at least 42 days before the date the fund is expected to be established and FSA authorisation is given.

Timing of applications with a pre-clearance for the genuine diversity of ownership condition

Under regulation 69Z50 (8) & (9) SI 2006/964 the time limits for the TEF application may be reduced to at least 14 days before the beginning of the specified accounting period for an existing fund, or the time when the proposed fund is established and authorised, if HMRC has given clearance that the genuine diversity of ownership condition (GDO) has been met under regulation 9B SI 2006/964 (see [CTM48165](#)). However, in this instance the application must certify that there have been no changes in substance between:

- the form in which the instrument constituting the fund and its prospectus which was considered by HMRC before giving the GDO clearance; and,
- the form in which it is proposed that those documents will take at the beginning of the specified accounting period (for an existing fund) or the time when the proposed fund is authorised (for a proposed fund).

The HMRC approval process

Regulation 69Z50(4) SI 2006/964 specifies that within 28 days of receipt of an application (or 14 days for applications that have been given a GDO pre-clearance under regulation 9B), HMRC must either:

- notify the manager (for an existing fund) or proposed manager (for a future fund) that the application is accepted; or,
- issue a refusal notice to reject the application (see [CTM48925](#) for further information).

Amended applications

An application may be amended at any time before it is accepted but it is then treated as a new application under regulation 69Z50 (6) SI 2006/964. However in order to give flexibility to correct minor errors or omissions without giving rise to delay, the amended application can take effect from the date stated on the first application, if HMRC are satisfied before that time that the amended application is valid (regulation 69Z50(7) SI 2006/964).

Minor errors or omissions with the application

Where HMRC identifies any minor errors or omissions in an application, then where practicable, HMRC will contact the applicant to give them an opportunity to amend the application appropriately before issuing a refusal notice.

Withdrawing an application

Under regulation 69Z50(5) SI 2006/964, an application may be withdrawn at anytime before it is accepted by the manager or proposed manager.



CTM48924 - AIFs: Tax elected funds (TEFs): application process and effects of entry to the TEF regime: contents of the application

There is no prescribed application form for the TEF regime but regulation 69Z51 SI 2006/964 sets out the information that must be contained in a TEF application, which must be made in writing.

The Collective Investment Schemes Centre, who process the applications, have designed an [application form](#) that can be used (also available on the collective web pages) to assist HMRC in processing the application more efficiently.

Application from an existing fund

An application from an existing fund must contain the following information:

- notification of the start of the first accounting period from which the fund seeks to apply the TEF regime (specified accounting period);
- a statement from the fund manager confirming that each of the conditions of entry (as explained in [CTM48913](#) to CTM48916) have been or will be met for the specified period;
- the instrument constituting the fund (trust deed or instrument of incorporation) and the fund's prospectus;
- a copy of the application to the Financial Services Authority (FSA) for approval for any changes in the instrument constituting the fund and its prospectus, including copies of any documents that accompanied the application to the FSA;
- whether the AIF has been within the TEF regime during a previous accounting period, the period it was in the TEF regime (that is dates of entry and cessation), the reasons for leaving the regime and whether a termination notice was issued by HMRC; and
- a statement from the manager confirming that either shareholder or unit holder consent for the application is not required or where it is, that shareholder or unit holder consent has been given and the date that consent was given.

Application from a future fund

An application from a future fund must contain the following information:

- notification of the earliest date by which it is expected the future fund will be established and authorised by the FSA, as the TEF regime will apply from that date;
- a statement by the proposed manager confirming that each of the conditions of entry (as explained in [CTM48913](#) to CTM48916) for the TEF regime are reasonably expected to be met by the proposed fund throughout its first accounting period;
- a copy of the application to the FSA for authorisation to be an AIF, including copies of any documents which accompanied the application to the FSA; and
- the proposed instrument constituting the fund (trust deed or instrument of incorporation) and the fund's proposed prospectus (including any supplements to the proposed prospectus).

Where applications should be sent to?

Applications and queries regarding the application process not covered by the guidance should be sent to:

Andrew Marshall

HM Revenue & Customs
Collective Investment Schemes Centre
Concept House
5 Young Street
Sheffield
S1 4LB

Tel: 0114 2969361

e-mail: andrew.marshall@hmrc.gsi.gov.uk



CTM48925 - AIFs: Tax elected funds (TEFs): application process and effects of entry to the TEF regime: HMRC refusal notice

When will a refusal notice be issued?

Where a TEF application fails to show that the fund or (proposed fund) will meet any of the conditions set out below then the application will be refused in accordance with regulation 69Z52 SI 2006/964 (unless a minor error or omission has occurred - see [CTM48923](#)). If a refusal notice is issued, HMRC will set out the reasons for doing so, in writing.

Condition A

The documents supplied with the application do not demonstrate that the TEF will meet the conditions of entry (set out in [CTM48913](#) to [CTM48916](#)) or the statements supplied by the manager or proposed manager do not demonstrate that the fund or proposed fund can have a reasonable expectation that it will meet the conditions of entry.

Condition B

The application is not accompanied by the necessary documents and statements set out in [CTM48924](#).

Condition C

Any necessary shareholder, unit holder or regulatory authorisation or approval by the FSA has not been given.

Re-applications following the issue of a refusal notice

If a refusal notice is issued, the manager or proposed manager can re-submit the application as soon as the required amendments have been made and this will be treated as a new application.

Appeal against a refusal notice

Where a refusal notice is issued, the fund manager or proposed fund manager has the right to appeal against the notice to the first tier tribunal, on behalf of the fund or proposed fund in accordance with regulation 69Z53 SI 2006/964. The notice of appeal must be submitted to HMRC within 28 days of the date when the refusal notice is given.

If an appeal is notified to the tribunal, the tribunal will determine whether the issue of the refusal notice was correct and reasonable. If the tribunal allows the appeal, it may direct the TEF regime to apply and specify the date from which it should commence. (The tribunal cannot specify a commencement date earlier than the beginning of the specified date that an existing fund applied for, or the date of FSA authorisation where a future fund application was submitted.)

CTM48926 - AIFs: Tax elected funds (TEFs): application process and effects of entry to the TEF regime: effects of entry into the TEF regime

Once an application to join the tax elected fund (TEF) regime (see [CTM48922](#)) has been approved by HMRC, then the effects of entry are that the provisions sets out in Part 4B of SI 2006/964 will apply and a new distribution period of the fund will commence, as per regulation 69Z54 SI 2006/964.

The provisions in part 4B of SI 2006/964 will continue to apply to the TEF unless it voluntarily leaves the regime, there is a merger with another fund or a termination notice is issued by HMRC (see [CTM48971](#)).

CTM48930 – AIFs: Tax elected funds (TEFs): tax treatment & distributions made by TEFs: contents

- [CTM48931](#) Introduction
 - [CTM48932](#) Components of income received by a TEF
 - [CTM48933](#) Attribution of income and the distributions made by a TEF
 - [CTM48934](#) Tax treatment of components of income received by a TEF
-

CTM48931 - AIFs: Tax elected funds (TEFs): tax treatment & distributions made by TEFs: introduction

As set out in [CTM48911](#), the aim of the tax elected fund (TEF) regime is to move the point of taxation from the authorised investment fund (AIF) to the investor, and this chapter explains how this is achieved in most cases.

Under the regime, the TEF is required to identify the different components of its income, (see [CTM48932](#)) and to attribute the income to make two types of distribution, a dividend distribution and a non-dividend distribution (taxed in the hands of the investor in the same way as a payment of yearly interest). The process of attributing the TEF's income is set out in [CTM48933](#).

UK investors are then taxed as though they have received a UK dividend, including the non-payable dividend tax credit and a payment of yearly interest, which is also explained in [CTM48933](#).

The tax treatment of the component parts of the income received by the TEF is then explained in more detail in [CTM48934](#).

CTM48932 - AIFs: Tax elected funds (TEFs): tax treatment & distributions made by TEFs: components of income received by a TEF

When a tax elected fund (TEF) receives income, it must identify the different elements of the income and classify it into the components specified below, as per regulation 69Z56 SI 2006/964. Normal rules for management expenses apply as set out in [CTM48225](#).

Dividend income

This is any income received from a company distribution that is taxable or exempt under Part 9A CTA 2009.

Within the TEF regime, the option to tax exempt foreign distributions under section 931R CTA 2009 will not apply.

Property investment income

This is any property income distributions received from the shares held by a TEF in UK real estate investment trust and/or property authorised investment funds, as explained in [CTM48913](#).

Property business income

While the property condition (see [CTM48913](#)) prevents a TEF from receiving income from a UK or overseas property business, if a TEF inadvertently receives such income for a limited period of time, for instance if it takes over another AIF which happens to have a small amount of UK property income, then while the TEF rectifies the inadvertent breach of the property condition, such income must be recognised in the TEF as property business income (and taxed, as explained in [CT48934](#)).

Other income

Any income not derived from company distributions, a UK or overseas property business or property income distributions, will fall into this category. The main form of income to fall into this category will be interest received from interest bearing assets.

The taxation of each component part of the income

The taxation of each component part of the income in the fund, once it has been attributed into the two types of distributions, is explained in [CTM48934](#).

CTM48933 - AIFs: Tax elected funds (TEFs): tax treatment & distributions made by TEFs: attribution of income and the distributions made by a TEF

Once the different components of the income of a tax elected fund (TEF) have been identified as per [CTM48932](#), **all** the income shown in the accounts as available for distribution or accumulation (see [CTM48415](#)) must be attributed between TEF distributions (dividends) and TEF distributions (non-dividends) in accordance with 69Z59 SI 2006/964.

The regulations do not prevent separate physical payments of each type of distribution being made.

TEF distributions (dividends)

The following component parts of the income of a TEF are attributed to TEF distributions (dividends):

- dividend income;
- property investment income (net income); and
- property business income.

Under regulation 69Z60 SI 2006/964 a TEF distributions (dividends) are amounts available for distribution as dividends and are treated as dividends on shares which are paid on the distribution date.

TEF distributions (non-dividend)

The income attributed to TEF distributions (non- dividend) is other income as defined in [CTM48932](#).

TEF distributions (non-dividend) are treated for the purposes of the Tax Acts as a payment of yearly interest made on the distribution date under regulation 69Z61 SI 2006/964.

In the hands of investors the distribution is treated in the same way as interest received by them. This is explained more fully in [CTM48945](#) and [CTM48946](#).

As this distribution is treated as a payment of yearly interest a sum must be deducted by the TEF in respect of income tax at the basic rate in force for the tax year in which the distribution is made (as defined in section 7 Income Tax Act 2007 (ITA)) in accordance with section 874, chapter three of part 15 of ITA 2007. The tax deducted at source should be accounted for to HMRC under section 951, chapter 15 of part 15 of ITA 2007.

Where a non-dividend distribution is made to a participant there are a range of circumstances in which payments must be made without deduction of income tax. The exceptions from the duty to deduct are given in chapter 3 and in chapter 11 of part 15 ITA 2007. These circumstances are covered in [CTM48600](#).

The TEF must account for the income tax on forms CT61 in the usual way.

CTM48934 - AIFs: Tax elected funds (TEFs): tax treatment & distributions made by TEFs: tax treatment of components of income received by a TEF

This page explains the tax treatment of the various component parts of the income received by a tax elected fund (TEF). While the aim of the TEF regime is to move the point of taxation from the authorised investment fund (AIF) to the investor, there are certain circumstances when this may not be achieved and a tax liability may be incurred by the AIF - this is also explained below.

Distribution income

Most company distributions received by the TEF are exempt from corporation tax under Part 9A CTA 2009 in the same way as for any other body within the charge to corporation tax (CT). However, there may be certain circumstances where the distributions received will be taxable, for instance if the distributions do not qualify for exemption under Part 9A. If this is the case, then the distributions will be subject to corporation tax (CT) in the same way as taxable income is treated in an AIF that has not elected for TEF status (see [CTM48210](#)).

Property investment income

Any property income distributions received from a UK real estate investment trusts (UK-REITs) and/or Property AIFs will be received net of basic rate of income tax under regulation 33 of the Real Estate Investment Trusts (Assessment and Recovery of Tax) Regulation 2006 as amended by SI 2009/2036. The TEF cannot claim back or offset the tax deducted by the UK-REIT and or Property AIF under regulation 69Z57 SI 2006/964 and the net PID received will be treated as though it is an exempt distribution under Part 9A CTA 2009.

Property Business Income

Any income from a UK or overseas property business is prohibited in the TEF. If the property condition (see [CTM48913](#)) is inadvertently breached (see [CTM48963](#)) then until the TEF corrects rectifies the inadvertent breach, any income received will be subject to CT, in the same way as taxable income is treated in an AIF that has not elected for TEF status (see [CTM48210](#)). (If there is a deliberate breach of the property condition then a termination notice will be issued by HMRC – see [CTM48962](#))

Other income

Any other income received (see [CTM48932](#)), which, in the main is likely to be interest, is taxable in the hands of the TEF. However, as all the income received in this category of income must be attributed and paid out as a TEF distributions (non-dividend), which under regulation 69Z61 SI 2006/964 treats this as a payment of yearly interest, then under regulation 13 of SI 2006/964 (as amended by regulation 7 SI 2009/2036) the distribution is treated as a loan relationship debit.

Therefore, TEF distributions (non-dividend) are allowed as a deduction against the TEF's category of other income for CT purposes thus eliminating any CT liability that would otherwise occur on this taxable income. See [CTM48230](#) to [CTM48235](#) for further information on authorised investment funds and the loan relationship rules.

Offshore income gains

Where a TEF incurs an offshore income gain (as defined in Chapter 5 of Part 17 ICTA 1988, currently being revised), normal rules will apply. That is, where a TEF makes a disposal of a holding in a non-distributing or non-reporting offshore fund, the gain received is treated as income for tax purposes but for accounting purposes is treated as a capital receipt and, because FSA rules prevent the distribution of capital receipts, the income received is liable to CT.

CTM48940 – AIFs: Tax elected funds (TEFs): tax treatment of distributions in the hands of participants: contents

- [CTM48941](#) Introduction
 - [CTM48942](#) Accumulation units
 - [CTM48943](#) TEF distributions (dividends) – general treatment and taxation of investors within the charge to income tax
 - [CTM48944](#) TEF distributions (dividends) – specific treatment for investors within the charge to corporation tax
 - [CTM48945](#) TEF distributions (non-dividend) - general treatment and taxation of investors within the charge to income tax
 - [CTM48946](#) TEF distributions (non-dividend) – specific treatment for investors within the charge to corporation tax distributions
-

CTM48941 - AIFs: Tax elected funds (TEFs): tax treatment of distributions in the hands of participants: introduction

Once a tax elected fund (TEF) has identified the different components of its income and attributed it into two types of distributions as per [CTM48933](#), it will make TEF distributions (dividends) and TEF distributions (non-dividends) in accordance with 69Z59 SI 2006/964.

Under regulation 69Z60 SI 2006/964 TEF distributions (dividends) are amounts available for distribution as dividends and are treated as dividends on shares which are paid on the distribution date.

Under regulation 69Z61 SI 2006/964 TEF distributions (non-dividend) are amounts treated for the purposes of the Tax Acts as payment of yearly interest made on the distribution date.

This chapter sets out the tax treatment of such distributions in the hands of the participant.

CTM48942 - AIFs: Tax elected funds (TEFs): tax treatment of distributions in the hands of participants: accumulation units

An authorised investment fund (AIF) may issue different classes of units, subject to approval by the Financial Services Authority (FSA), see [CTM48420](#).

Accumulation units in an AIF give rise to income (net of any tax deducted) that is credited periodically to the capital property of the fund and reinvested by the AIF, instead of paying out the income to the unit holder.

Amounts transferred to the capital property of the fund, for the benefit of the holders of accumulation units, are taxable in the hands of participants in the same way as if those amounts had been distributed. Therefore, [CTM48943](#) to CTM48946 apply equally to accumulation units as they do to income units.

CTM48943 - AIFs: Tax elected funds (TEFs): tax treatment of distributions in the hands of participants: TEF distributions (dividends) – general treatment and taxation of investors within the charge to income tax

Where a TEF makes TEF distributions (dividends) the participant is treated as receiving a dividend distribution under regulation 69Z60 SI 2006/964 (as explained in [CTM48933](#)). Amounts that are shown in the accounts of a TEF as available for distribution as dividends are treated as dividends on shares which are paid on the distribution date.

As with other dividend payments, these distributions carry a one ninth non-repayable tax credit that will satisfy any income tax liability at the basic rate. This means that IT payers with a liability at the basic rate will have no further tax liability on the dividend payments. Higher rate taxpayers will have a further liability.

For further information on the tax treatment of investors within the charge to corporation tax please refer to [CTM48944](#).

CTM48944 - AIFs: Tax elected funds (TEFs): tax treatment of distributions in the hands of participants: TEF distributions (dividends) - specific treatment for investors within the charge to corporation tax

Special treatment is provided for dividend distributions in the hands of participants in authorised investment funds (AIFs) when they are within the charge to CT. The treatment is designed to prevent companies liable for the full rate of CT from reducing their tax bill by channelling some types of investment (such as bonds) through AIFs. This could otherwise enable them to receive franked investment income that would have borne tax at only the lower rate of income tax. This treatment (known as the 'corporate streaming' rules) is set out in regulations 48 to 52A SI 2006/964 and equally applies to participants in a TEF that receive TEF distributions (dividend) as per regulation 69Z62 SI 2006/964. Please refer to [CTM48515](#) for further information on the application of the corporate streaming rules.

Treatment of property investment income within the corporate streaming rules (in regulations 48 to 52A SI 2006/964)

Under the corporate streaming rules, property investment income (explained in [CTM48932](#)) should be treated as franked investment income as per regulation 69Z57 (2) SI 2006/964.

CTM48945 - AIFs: Tax elected funds (TEFs): tax treatment of distributions in the hands of participants: TEF distributions (non-dividend) - general treatment and taxation of investors within the charge to income tax

Where a tax elected fund (TEF) makes TEF distributions (non-dividend) the participant is treated as receiving payments of yearly interest under regulation 69Z61 SI 2006/964, as explained in [CTM48933](#).

For participants within the charge to income tax (IT), IT will normally be deducted at source by the TEF at the basic rate ([CTM48260](#)) and in such cases the participant is treated as receiving yearly interest with IT deducted at the basic rate.

Higher rate taxpayers will have a further liability to tax to account for.

Participants with no liability to IT will be able to reclaim the tax deducted.

However, in some cases, individuals may have established entitlement to payment without deduction of tax and so will be treated as receiving a gross amount of yearly interest. Such cases will normally be non- resident individuals. Details of entitlement to payments without deduction of tax can be found at [CTM48600](#) onwards.

The TEF (the open-ended investment company or the trustees of the authorised unit trust) is responsible for deducting tax at the basic rate and for paying the tax deducted to HMRC.

The TEF is also responsible for making gross payments where the participant has met certain requirements and is obliged to notify HMRC (The Collective Investment Scheme Centre) of gross payments made and is subject to audit by HMRC ([CTM48600](#) onwards).

CTM48946 - AIFs: Tax elected funds (TEFs): tax treatment of distributions in the hands of participants: TEF distributions (non-dividend) – specific treatment for investors within the charge to corporation tax distributions

Except as explained below, companies and other specified participants (see [CTM48600](#) onwards) receive interest distributions without deduction of tax and are, consequently, treated as receiving a gross amount of yearly interest (in the same way as they would receive an interest distribution from a bond fund). This is treated as a loan relationship credit by the participant.

The rules requiring holdings in certain funds with significant interest bearing and economically similar investments to be treated as loan relationships, apply to tax elected funds (TEFs) in the same way as they do to authorised funds that have not elected for TEF status (see [CTM48505](#) for further information and regulation 69Z64 SI 2006/964.).

Exception to gross payments to a corporate body

The exception to the rule is where the person receiving the interest is not itself the participant but is acting as a nominee for the person beneficially entitled to the interest distribution. In such cases income tax (IT) will still be deducted at source by the AIF and the participant will be treated as receiving yearly interest with IT deducted at the basic rate. However, this is subject to the nominee being a reputable intermediary – see [CTM48615](#) for further information.

CTM48950 – AIFs: Tax elected funds (TEFs): provisions for providing tax information to participants

- [CTM48951](#) Introduction
 - [CTM48952](#) Basic rules for sending tax information to participants
 - [CTM48953](#) Alternative rules for providing tax information to participants
 - [CTM48954](#) Example of alternative rules for providing tax information to participants
 - [CTM48955](#) Alternative rules for providing tax information to participants – tax information that should be retained by participants
 - [CTM48956](#) Consolidated tax vouchers
-

CTM48951 - AIFs: Tax elected funds (TEFs): provisions for providing tax information to participants: introduction

This chapter sets out the tax information that should be provided by tax elected funds (TEFs) to participants. In particular, it covers:

- the basic rules that apply to distributions made by companies (see [CTM48952](#)),
 - optional alternative rules for authorised investment funds making more than one type of distribution which allows them to make the information that would ordinarily be sent in a tax voucher to be made available to participants by electronic or alternative means (see [CTM48953](#)),
 - an example of the way the alternative rules could work (see [CTM48954](#)),
 - what information participants should retain if a TEF adopts the alternative rules for providing their investors with tax information (see [CTM48955](#)) and
 - obtaining approval for consolidated tax vouchers (see [CTM48956](#)).
-

CTM48952 - AIFs: Tax elected funds (TEFs): provisions for providing tax information to participants: basic rules for sending tax information to participants

Tax information sent by companies to their shareholders

Under section 234A ICTA 1988 where dividends or interest are distributed by a company to its shareholders, a written statement must be sent (by post or electronically) to the shareholder. These rules apply to authorised investment funds as they are treated as companies (see [CTM48210](#)). The information that must be contained in the written statement is set out below.

A written statement made under section 234A (6) ICTA 1988

In the case of a payment of interest which is not a qualifying distribution or part of a qualifying distribution (as explained in [CTM15120](#)), a written statement must contain the following information:

- a. the gross amount which, after deduction of the income tax appropriate to the interest, corresponds to the net amount actually paid,
- b. the rate and the amount of income tax appropriate to such gross amount,
- c. the net amount actually paid, and
- d. the date of the payment.

A written statement made under section 234A (7) ICTA 1988

In the case of a payment of dividend or interest which is a qualifying distribution or part of a qualifying distribution (see [CTM15120](#)), a written statement must contain the following information:

- a. the amount of the dividend or interest paid
- b. the date of the payment, and
- c. the amount of the tax credit to which a person is entitled in respect of the dividend or interest, or to which a person would be so entitled if he had the right to a tax credit in respect of the dividend or interest.

Delivering information electronically

In 2003 further provisions to section 234A ICTA 88 were introduced under SI 2003/3143 to allow statutory dividend vouchers and tax deduction certificates to be sent by electronic means. The regulations do not prescribe the methods of electronic communication that must be used, but possibilities include sending PDF files by e-mail or making the voucher or certificate available on a secure website for the recipient to download.

Sending such information electronically is subject to three conditions, which are:

- the company has indicated to the recipient that it intends to use electronic communications for the purposes of delivering a statement under section 234A;
- the recipient consents to this form of communication; and
- the statement is delivered in an electronic format that can be stored, which permits paper copy of the information contained in the statement to be printed and is designed to prevent alteration of contents.

From the 1 September 2009, these regulations have been extended by virtue of SI 2009/2050 so that where a company pays distributions of dividends or interest directly into a recipient's bank or building society account, they will be able to send the appropriate statement (to either

the bank or building society concerned or the person holding the account) by electronic means, as described above.



CTM48953 - AIFs: Tax elected funds (TEFs): provisions for providing tax information to participants: alternative rules for providing tax information to participants

Introduction

Regulation 70 SI 2006/964 as amended by regulation 25 SI 2009/2036 prescribes an alternative way in which participants can be provided the tax information in a written statement (tax voucher).

The alternative provision (which is optional) allows a tax elected fund (TEF) to send to the participant (by post or electronically) less detailed information, that is **'generic information'** that would ordinarily be sent on a tax voucher (see [CTM48952](#)), if the participant is provided access to the all the information that would be contained in the tax voucher by **'electronic means'**, or in the case where participants may not be able to access this information electronically, is provided with an **'alternative method'** to access the information. This is explained below in more detail.

Generic information

Under regulation 70(4)(a) SI 2006/964 as amended by SI 2009/2036, the generic information that must be sent by post or electronically (if electronically then this subject to the conditions set out in [CTM48952](#)) to participants is as follows:

- a. the gross amount of the distribution made to the participant (this should include any amount accumulated to the investor),
- b. the number and class of units held by the participant in respect of which the distribution is made,
- c. the net amount of the distribution per unit (if a gross share class then the gross amount of the distribution per unit),
- d. Whether any tax has been deducted or not,
- e. The date the distribution was made, and
- f. The percentage of the gross distribution attributable to the TEF distribution (dividend) and the percentage attributable to the TEF distribution (non-dividend).

Access to an electronic means of information

Where generic information is sent by the TEF to its participants, under regulation 70(4)(b) SI 2006/964 as amended by SI 2009/2036, the TEF must provide access to an electronic means that should contain all the information required to complete a written statement set out in section 234A(6) or (7) ICTA 88 (see [CTM48952](#)).

The regulation is not prescriptive about the format this electronic means should take but an example of fulfilling this requirement would be where participants were directed to the TEF's website (or one provided on its behalf) and a web calculator, which on inputting the generic information, would calculate the more specific information as shown below:

- The amount of the dividend and or interest paid
- The rate and the amount of any income tax deducted from the interest paid
- The net amount of interest paid
- the amount of the tax credit to which a person is entitled in respect of the dividend or interest, or to which a person would be so entitled if he had the right to a tax credit in respect of the divided or interest

to ensure that the participant had electronic access to all the information contained in a written statement as set out in section 234A(6) or (7) ICTA 88 (see [CTM48952](#)).

It would be preferable for the electronic access to the information above to be as informative as possible and in particular to show clearly the entries to be made on an income tax return. For an example of the information that should be made accessible electronically and the type of information that could be shown to help an UK individual participant complete their tax return see [CTM48954](#).

Access to an alternative method of information

Under 70(4)(c) SI 2006/964, as amended by SI 2009/2036, the TEF must provide an alternative method of accessing information for participants who cannot access information electronically (perhaps because they have no internet access). Again, this is not prescribed for in the regulations but an example of satisfying this alternative method might be a customer information telephone line where this additional information was sent in writing on request.

CTM48954 – AIFs: Tax elected funds (TEFs): provisions for providing tax information to participants: example of alternative rules for providing tax information to participants

Example

If a participant has units in a tax elected fund (TEF) and holds 100 net income units or 100 gross income units (that is units that allow a participant to receive gross distributions - see [CTM48420](#)), with an equal split of dividends and non dividends, the following example shows the information that should be provided to the participant under the new provisions in regulation 70(4) SI 2006/964, as amended by regulation 25 SI 2009/2036.

Example of generic information that should be sent to the participant

	Net income units	OR	Gross income units
• Date of payment	1 October 2009		1 October 2009
• Gross amount of distribution	£100		£100
• Number & class of units	100 income units		100 gross units
• Net amount of distribution/unit	£0.90		£1.00
• Whether tax has been deducted	Yes		No
• Date of distribution	1/10/2009		1/10/2009
• % split of the gross amount	50% dividends		50% dividends
between divs/non divs	50% non dividends		50% non dividends

Electronic information made available to the participant

On receipt of the generic information, the participant should be given clear instructions on how to access the further information required to complete their return electronically or by an alternative method. Using the example above, the information below gives an indication of what information should be accessible electronically or by other means, with the necessary information required to complete a written statement emphasised in bold (as set out in [CTM48953](#)).

For 100 net income units

Date of payment **1 October 2009**

Gross amount of distribution = **£100** (£50 dividends and £50 non dividends)

Actual amount received = **£90** (90p x 100 units)

The actual amount received is made up of:

£50.00 dividends (This should be entered onto your tax return in the box relating to Dividends from UK companies)

£40.00 non dividend (interest) (This amount should be entered onto your tax return in the box relating to income from UK bank, building society, unit trust etc interest amount which has been taxed already, that is the net amount after tax)

The dividend amount has a 1/9 tax credit of **£5.56**

The non dividend (interest) is the amount after basic rate income tax has been deducted @20% of £10.

For 100 gross income units

These units should not be held by UK resident individual taxpayers (except within an ISA) therefore there is no need to specify the boxes the final distributions should be entered into onto the tax return.

Date of payment **1 October 2009**

Gross amount of distribution = **£100** (£50 dividends and £50 non dividends)

Actual amount received = **£100** (£1 x 100 units)

The actual amount received is made up of:

£50.00 dividends

£50.00 non dividend (interest) (In the event that that you are liable to UK income tax then the income received should be recorded on your tax return in the box relating to untaxed UK interest etc.)

The dividend amount has a 1/9 tax credit of £5.56

The non dividend (interest) is the gross amount received as **no tax has been deducted**

Accumulation units

The amounts accumulated should be dealt with in the same way as the amounts distributed. Therefore, if the example included 100 net accumulation units and 100 gross accumulation units then the example above would be identical except that instead of showing the net amount distributed it would show the net amount accumulated per unit.

CTM48955 - AIFs: Tax elected funds (TEFs): provisions for providing tax information to participants: alternative rules for providing tax information to participants - tax information that should be retained by participants

What tax information should participants retain?

Participants should keep the generic information **sent** to them (either by post or electronically) along with a print out of the information accessed electronically or information gained by alternative means. If the alternative method of accessing information is used to obtain all the required tax information, which may include telephoning a call centre, then a record of the conversation should be retained accordingly.

If a participant is not liable to tax then any tax that has been deducted can be reclaimed. The participant should retain the generic information sent by the fund **and** the information accessed electronically or by alternative means (as described above), in case of an enquiry.

CTM48956 - AIFs: Tax elected funds (TEFs): provisions for providing tax information to participants: consolidated tax vouchers

Nominee account holders that invest in a tax elected fund on behalf of their clients are able to use consolidated tax vouchers. HMRC has now developed a [generic voucher template](#) for use in these circumstances, which should be adapted accordingly. Where this template is used there will be no need for the nominee account holders to seek prior approval from HMRC that the voucher is acceptable.

If the generic voucher template cannot be adopted for any reason, then prior approval of the proposed format of the consolidated tax voucher may be sought from HMRC by e-mailing Kingsley Shaw at Kingsley.shaw@hmrc.gsi.gov.uk or writing to him at:

Kingsley Shaw
HM Revenue & Customs Residency
Technical Advice Group
Ferrers House
PO Box 38
Nottingham
NG2 1BB

Tel: 0115 974 2535

CTM48960 – AIFs: Tax elected funds (TEFs): breaches of conditions: Contents

CTM48961	Introduction
CTM48962	General provisions for breaching a condition
CTM48963	Breach of the property condition, the genuine diversity of ownership condition & the scheme documentation condition
CTM48964	Breach of the loan creditor Condition
CTM48965	Multiple breaches of separate conditions
CTM48965	Information requirements

CTM48961 - AIFs: Tax elected funds (TEFs): breaches of conditions: introduction

General

Chapter 2, SI 2006/964 sets out the conditions that must be met in order for an authorised investment fund (AIF) to adopt the TEF regime. The conditions themselves are explained earlier in this guidance ([CTM48912](#) to CTM48916). The pages at CTM48962 to CTM48964 explain how the breaches of those conditions are treated. [CTM48962](#) explains general breaching rules that apply if any of the conditions are breached and then [CTM48963](#) to CTM48964 set out more specific rules for each condition that is breached.

Multiple breaches of separate conditions

In addition to any consequences of single or multiple breaches of specific conditions, there are also consequences when the TEF breaches more than one separate condition - see [CTM48965](#).

Information notice

[CTM48966](#) sets out the information requirements that the manager of a fund will need to comply with where HMRC suspects that a fund has or may have breached a condition.

CTM48962 - AIFs: Tax elected funds (TEFs): breaches of conditions: general provisions for breaching a condition

General provisions for breaching a condition of entry

The general provisions in regulation 69Z65 SI 2006/964 set out the process that a manager of a fund must comply with if they realise that the fund has breached any conditions of entry and the potential consequences of such a breach. The following two pages, that is [CTM48963](#) to [CTM48964](#), explain specific breaching rules that apply for each condition of entry.

What should a TEF do if it becomes aware it has breached a condition of entry?

If the tax elected fund (TEF) discovers that it has breached any of the conditions of entry (see [CTM48912](#) to [CTM48916](#)), then under regulation 69Z65 SI 2006/964 it must write to HMRC (address shown below) within 28 days of becoming aware of the breach and provide the following information:

- the date on which the condition first ceased to be met;
- the date on which the fund became aware of the breach;
- details of the condition that was breached;
- the reason for the breach;
- the steps the fund proposes to take to rectify the breach;
- the date when the breach was or will be rectified. This must be the earliest date that complying with this condition can reasonably be achieved. (In order for HMRC to determine whether the time specified by the manager is reasonable or not, it is recommended that the manager should advise HMRC what needs to be done in order to rectify the breach, and why the proposed timescale should be considered to be reasonable.); and
- details of any previous breaches of conditions, specifically; which condition was breached, the date of the breach and the date by which it was rectified.

If desired, the steps to be taken to rectify any breach may be discussed with HMRC before sending a formal notice of the intended rectification.

Consequences of such a breach

If, on receipt of the information above, HMRC believes that:

- the steps that the fund proposes to take will not rectify the breach;
- the proposed date to rectify the breach is not the earliest date that remedying the relevant condition can be reasonably be achieved;
- the fund intentionally or negligently breached a condition; or
- there are three breaches of the same condition in a period of 10 years (beginning with the first day of the accounting period in which the fund first became aware of the first of the breaches) (multiple breach of the same condition)

then HMRC will issue a termination notice. For further information on termination notices please refer to [CTM48971](#).

Where information should be sent to?

The information required under regulation 69Z65 SI 2006/964 should be submitted to:

Andrew Marshall

HM Revenue & Customs
Collective Investment Schemes Centre
Concept House
5 Young Street
Sheffield
S1 4LB

Tel: 0114 2969361

e-mail: andrew.marshall@hmrc.gsi.gov.uk

CTM48963 - AIFs: Tax elected funds (TEFs): breaches of conditions: breach of the property condition, the genuine diversity of ownership condition & the scheme documentation condition

Breach of the genuine diversity of ownership condition or the scheme documentation condition

If a TEF breaches the property condition, the genuine diversity of ownership condition or the scheme documentation condition (explained at [CTM48913](#) to [CTM48916](#)) then the manager of the fund should follow the information requirements set out at the beginning of the 'general provisions' for breaching a condition, covered in [CTM48692](#).

Consequences of such a breach

If, on receipt of the information above, HMRC is content that the breach was inadvertent and that it has been rectified within a reasonable timeframe, then the TEF can continue to remain in the regime under regulation 69Z66 (2) SI 2006/964 (unless there is a multiple breach of the same condition - explained in [CTM48962](#) or a multiple breach of separate conditions - explained in [CTM48966](#)).

If HMRC is content that the breach was inadvertent but it was not rectified within a reasonable time (as explained in [CTM48962](#)) then a termination notice will be issued under regulation 69Z66(3) SI 2006/964. See [CTM48971](#) for further information on termination notices.

Taxable income that arises from a breach of the property condition

If a TEF breaches the property condition and receives income from a UK or overseas property business as defined in sections 205 and 206 of CTA 2009, then while the TEF takes action to remedy the breach (that is to dispose of the asset or cease the UK or overseas property business) then any income received will be defined as property business income and treated as taxable income subject to corporation tax as explained in [CTM48934](#).

CTM48964 - AIFs: Tax elected funds (TEFs): breaches of conditions: breach of the loan creditor condition

Breach of the genuine diversity of ownership condition or the scheme documentation condition

If a TEF breaches the loan creditor condition (explained at [CTM48915](#)) then the manager of the fund should follow the information requirements explained at the beginning of the general provisions for breaching a condition, covered in [CTM48692](#).

General consequences of such a breach

If, on receipt of the information above, HMRC is content that the breach was inadvertent and the fund rectifies the breach within 28 days of the fund becoming aware of the breach, then the TEF can continue to remain in the regime under regulation 69Z67 (2) SI 2006/964 (unless there is a multiple breach of the same condition - explained in [CTM48962](#) or a multiple breach of separate conditions - explained in [CTM48966](#)).

If HMRC are content that the breach is inadvertent but that the breach has not been rectified within 28 days or there has been three breaches of the same condition in regulation 69Z47 (see [CTM48915](#)) in a 10 year period beginning on the first day of the accounting period that the fund became aware of the first of the breaches, then under regulation 69Z67 (3) & (4) SI 2006/964 a termination notice will be issued by HMRC. See [CTM48971](#) for further information on termination notices.

CTM48965 - AIFs: Tax elected funds (TEFs): breaches of conditions: multiple breaches of separate conditions

Under regulation 69Z68 SI 2006/964, in addition to the consequences relating to breaches of particular conditions of entry into the TEF regime, there may also be consequences of multiple breaches of different conditions.

The rules relating to multiple breaches work as follows:

- where there has been a breach of at least two different conditions of entry, and
- where there has been four such breaches in a period of ten years (beginning with the first day of the accounting period in which the first breach occurs),

then HMRC will issue a termination notice to the manager of the TEF.

CTM49865 - AIFs: Tax elected funds (TEFs): breaches of conditions: information requirements

If HMRC has reason to believe that a TEF does not meet or may not meet any of the conditions of entry or has not rectified a breach then an officer of HMRC may request any of the information shown below in the form of an information notice. If an information notice is issued to the manager of fund, the manager must respond to the information notice within 28 days of the date the notice was served (the specified period). (See regulation 69Z69 SI 2006/964.)

What information may be requested under an information notice?

An information notice may seek to obtain any of the following information from the manager of a fund:

- the date on which the condition first ceased to be met;
- the date on which the company became aware of the breach;
- details of the condition that was breached;
- the reason for the breach;
- the steps the AIF proposes to take to rectify the breach;
- the date when the breach was rectified or by which the AIF proposes to rectify it;
- details of any previous breaches of conditions, stating which condition was breached, the date of the breach and when it was rectified.

Consequences of not complying with an information notice

If the manager of the fund does not provide HMRC with the information requested in the information notice within the specified period of 28 days then a termination notice will be issued by HMRC.

If there are good reasons why the specified period cannot be met, then the manager of the fund can make an application to HMRC for this to be extended by a reasonable amount of time, which will need approval from HMRC.

CTM48970 – AIFs: Tax elected funds (TEFs) : leaving the TEF regime : contents

[CTM48971](#) Issue of termination notices by HMRC or the TEF

[CTM48972](#) Effects of leaving the TEF regime

CTM48971 - AIFs: Tax elected funds (TEFs): leaving the TEF regime: issue of termination notices by the TEF or HMRC

Termination notice issued by the tax elected fund (TEF)

Where the manager of a TEF wishes the fund to leave the regime, then under regulation 69Z69 SI 2006/964, they must give a notice specifying the final day on which the regulations are to apply to it. The notice must be given in writing to HMRC, and the date specified must be after the date on which HMRC receive the notice. The notice must also specify the reasons for leaving the regime. See [CTM48972](#) for the effect of such a notice.

Termination notice issued by HMRC

As set out under the previous chapter relating to breaches of conditions ([CTM48960](#) onwards), HMRC will, in certain circumstances, issue a termination notice to the manager of the TEF under regulation 69Z71 SI 2006/964.

The effect of giving the notice will be that the TEF will be taken to have ceased to be within the regime at the end of the accounting period (AP) immediately preceding the AP in which the notice was given. Where a termination notice is served then any TEF distributions (non-dividend) made before the notice was given will still be deductible in the fund's corporation tax calculation.

Tax treatment of participants where a notice has been issued

The tax treatment of participants that receive distributions made before a termination notice is issued will not be affected by the issue of a termination notice.

Appeal against termination notice

Where the manager of a fund that receives a termination notice from HMRC then under regulation 69Z72 SI 2006/964 they may appeal against the notice. The notice of appeal must be sent to HMRC within 28 days, beginning with the day on which the termination notice was given and should be sent to:

Andrew Marshall
HM Revenue & Customs
Collective Investment Schemes Centre
Concept House
5 Young Street
Sheffield
S1 4LB

Tel: 0114 2969361

e-mail: andrew.marshall@hmrc.gsi.gov.uk

If an appeal is later notified to the tribunal, the tribunal will determine whether the issue of the termination notice was just and reasonable. If the tribunal decides that it was, it will confirm the notice; if not, it will set aside the notice.

Other reasons for exclusion from the regime

Under regulation 69Z73 SI 2006/964, where a TEF is party to a merger or takeover and as a result fails to meet one or more of the conditions of entry to the regime, then its accounting period will end on the date of the merger or takeover, and the fund will cease to be within the regime from that time. If a TEF is taken over by an authorised investment fund (AIF) that is not a TEF, then the AIF will be able to apply to become a TEF according to the rules explained in [CTM48923](#), unless a termination notice had been issued to the AIF six years prior to the merger – see [CTM48922](#).

See [CTM48972](#) for the effects of leaving the regime.

CTM48972 - AIFs: Tax elected funds (TEFs): leaving the TEF regime: effects of leaving the TEF regime

Effects of cessation from leaving or exclusion from the regime

The effects of a fund leaving or being excluded from the regime are as follows:

- if a termination notice is issued by HMRC then the TEF will not be allowed to re-enter the regime at a later date.
 - if a fund chooses to leave the TEF regime voluntarily by issuing a termination notice (see [CTM48971](#)), then it can only re-enter the regime from an AP that started 6 years after the regime ceased to apply. So, for example, if a TEF has an AP that ends on the 31 December, and on the 1 December 2009, it notified HMRC that it wanted to leave the TEF regime, then it would be able to do so on the 31 December 2009 and would become a normal AIF on the 1 January 2010. It would need to remain out of the regime for the period beginning 1 January 2010 to 31 December 2015 but then would be able to rejoin the TEF regime on the 1 January 2016.
 - the consequence of leaving the regime (where a termination notice has been issued by the TEF or HMRC) is that Part 4B of SI 2006/964 ceases to apply to the fund.
 - Where a termination notice is issued by HMRC then in circumstances where a TEF distribution (non-dividend) is made between the date that the TEF is deemed to leave the regime (ie the beginning of the AP in which the notice was issued) and the date the notice was issued then the AIF (former TEF) should treat the non-dividend distribution already made as a deduction in its CT calculation. However, this will not apply to any future distributions as it will be an AIF (outside the TEF regime).
 - Any corporate streaming rules (as defined in [CTM48943](#)) that were applied by participants within the charge to corporation tax will continue to apply where the TEF becomes a normal AIF.
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