CG73995P Non-resident capital gains from 6 April 20129: UK property rich collective investment vehicles

CG73996A Schedule 5AA TCGA92: UK property rich collective investment vehicles: Introduction

This guidance explains how the rules in Schedule 5AAA apply to disposals of UK land by non-UK resident collective investment vehicles (CIVs), and to disposals of interests in 'UK property rich'

CIVs by non-UK resident investors. This guidance is in draft and HMRC will work with stakeholders to make further changes where required. The final version is likely to be split into smaller sections, and is expected to be included in a new Investment Funds Manual to be published in early 2019.

For guidance on the core rules on disposals of interests in UK land refer to CG73920 onwards.

Purpose and scope of the rules in Schedule 5AAA

HMRC policy with regard to taxation of investors and CIVs generally is to tax investors in a way that provides a similar outcome to direct investment in the underlying assets. Prior to April 2019, the capital gains of non-resident CIVs were only within the scope of UK tax in limited circumstances (broadly, where CIVs were closely held). From April 2019, all non-UK resident CIVs are brought into charge, and areas of difficulty thereby potentially arise for those CIVs under the core rules –

• Exempt investors would indirectly suffer tax where a CIV or entities that CIV is invested in become liable to tax on gains; and

• Investors generally could indirectly suffer from multiple charges to tax on a CIV or entities that CIV is invested in (for example, where a gain arises for a special purpose vehicle in the fund structure disposing of a property, and again when the CIV disposes of an intermediate holding company above that SPV); UK and non-resident investors would also be liable to tax on any gains on a disposal of their interest in the CIV.

The rules in Schedule 5AAA address these points by providing for two forms of election that effectively move the tax point to the investor. The Schedule also provides the default framework for how the rules for taxing non-residents' gains on disposals of interests in UK land apply to CIVs.

CG73996C Overview of the rules for collective investment vehicles

Scope of the rules and definitions

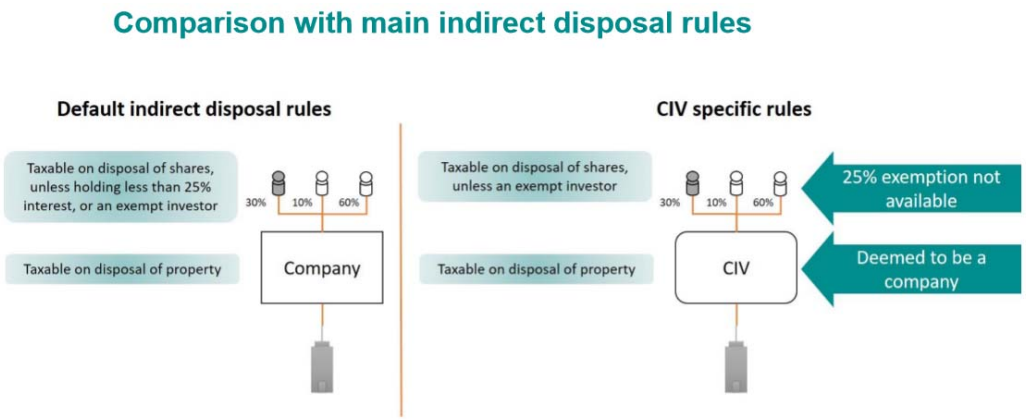
The scope and key definitions are contained in Part 1 of the new Schedule 5AAA to TCGA 1992. The term 'collective investment vehicle' is defined at TCAG92/SCH5AAA/para 1(1) – see CG73996E. This is a key term as it acts as a 'gateway' into the treatment of entities within the definition, and of their investors.

Default position for CIVs and their investors

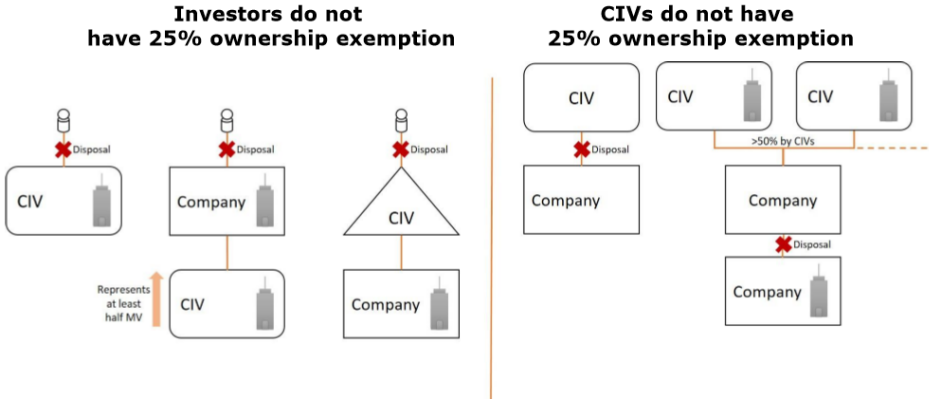
The default position for CIVs is –

- Irrespective of their legal form, non-corporate CIVs other than partnerships are deemed to be companies and are chargeable to corporation tax on all disposals of UK land (this includes non-UK entities that are transparent for income tax purposes, such as so-called 'Baker' unit trusts (for example, Jersey property unit trusts ('JPUTs')), Luxembourg Fonds Commun du Placement ('FCPs') and Irish common contractual funds ('CCFs'));
- Such 'companies' are treated as having shares to link in to the indirect disposal rules in Schedule 1A to TCGA 92 (see CG73930+), so that investors will hold an interest in a UK property rich asset where the CIV itself is UK property rich;
- Investors will be treated as having a substantial indirect interest (CG73936) where the CIV is UK property rich, so that investors with a less than 25% interest will still be within charge (subject to an exception for property funds that are not intended to be and are not marketed as UK real estate funds – see C73996E).

This default position for CIVs and investors can be illustrated as follows -



In the following diagram '**x**' indicates a taxable disposal



Elections for transparency or exemption

As can be seen, the default position would result in the problems described at CG73996A. Schedule 5AAA addresses those problems for UK property rich CIVs by providing (subject to certain conditions) for them to elect –

- In the case of offshore CIVs that are transparent for income, to be treated as a partnership for capital gains purposes (so a CIV that makes the election will also be transparent for capital gains purposes - see TCAG92/SCH5AAA/para 8 and CG73996L);
- For all offshore CIVs, to be treated as exempt from Corporation Tax on chargeable gains accruing on all direct and indirect disposals of land (see TCAG92/SCH5AAA/para 12 and CG73997A).

Para 12 also provides that limited partnerships (including UK based ones) that come within the definition of a collective investment scheme at section 235 Financial Services and Markets Act 2000, and UK co-ownership contractual schemes may make an election for companies in their ownership chain which are not CIVs to be similarly exempt.

The above represents the basic position only – refer to the guidance that follows for more detail.

CG73996E Definitions

Introduction

The key expressions are defined in Part 1 of Schedule 5AAA. Other terms used in the Schedule are defined in Parts 4 and 6. The Part 1 definitions are explained below; explanations of terms defined in Parts 4 and 6 are provided later in this guidance in the context of the rules they apply to.

Meaning of 'collective investment vehicle' (CIV)

The expression 'collective investment vehicle' is a key part of the rules as entities within that definition, and their investors, are subject to the specific rules set out in the Schedule. It therefore acts as a gateway test – entities that do not come within the definition are subject to the core rules, as are their investors (see CG73920 onwards). Note that being a CIV does not mean an entity is automatically entitled to make an election for transparent treatment (see CG73996L) or exemption (see CG73997A) as the relevant elections are subject to certain conditions being satisfied.

A CIV is any of the following (TCAG92/SCH5AAA/para 1(1)) –

- A collective investment scheme, as defined in section 235 of the Financial Services and Markets Act 2000;
- An Alternative Investment Fund (AIF) as defined in regulation 3 of the Alternative Investment Fund Managers Regulations 2013 (SI 2013/1773);

- A UK Real Estate Investment Trust (REIT) within Part 12 of Corporation Tax Act 2010; or
- A company that is resident outside the UK and meets the property income condition.

The property income condition (TCAG92/SCH5AAA/para 1(2)) is intended to include entities that are similar in nature to UK REITs and requires that –

- The company is not close, or is only close because of control by 'qualifying investors' (see CG73997C/TCAG92/SCH5AAA/para 46);
- At least half of its income is property income from long term investments (long-term investments means property intended for letting that is held as an investment asset on the balance sheet);
- Either as a result of a requirement of law, a commitment to its investors in its prospectus or similar documents made available to investors, or as a matter of established practice it annually distributes all, or substantially all, of its property income from long term direct or indirect investments in land, estates, interests or rights over land (substantially all in this context means around 90%; annually can include more frequently, such as quarterly distributions); and
- It is not liable to tax on that income under the law of any territory in which it is resident (that is, it does not pay tax on that income as the result of tax rules that provide for a single-level of taxation in the hands of the investors in the company or otherwise because it is exempt or subject to a nil rate of tax).

This is adapted from the OECD definition of a real estate investment trust, with appropriate modifications for the policy. The TCGA legislation does not refer to this as a REIT equivalence test, and it should not be taken to mean the same as or affect the meaning of a UK REIT equivalent at CTA10/S528(4A)(j) or elsewhere.

Meaning of 'offshore collective investment vehicle' and 'collective investment vehicle being UK property rich'

Parts of Schedule 5AAA have relevance even where a CIV is not an 'offshore CIV' – for example, as regards the treatment of non-resident investors in UK REITs or UK property authorised investment funds (PAIFs). The rules in the Schedule then have effect according to whether a CIV is an 'offshore collective investment vehicle' and whether it is 'UK property rich'. These key terms are defined in paragraphs 2 and 3 respectively.

Offshore collective investment vehicle

An offshore CIV is any CIV, as defined in TCAG92/SCH5AAA/para 1(1), where (TCAG92/SCH5AAA/para 2) –

- if it is a body corporate, it is resident outside of the UK;
- if it is a unit trust, all of the trustees are resident outside of the UK; and

- if it is a co-ownership arrangement, the arrangements take effect as a result of the law of a territory outside of the UK (the term co-ownership is not restricted to having any particular meaning in UK law; as examples it would include Luxembourg or French fonds commun du placement (FCPs) and Irish common contractual funds (CCFs)).

This is a key concept as (subject to applicable conditions) only an offshore CIV can make an election for transparency or exemption – see CG73996L and CG73997A (but note also that limited partnership collective investment schemes - including UK LPs - and UK co-ownership authorised contractual schemes (CoACS) can make an exemption election in respect of companies in their ownership chain, which are not CIVs themselves, to be exempt - see CG73997A).

UK property rich

Whether a CIV is UK property rich (TCAG92/SCH5AAA/para 3) at a given time is determined by applying the rules in Part 2 of Schedule 1A to TCGA 92 (see CG73930) and, other than partnerships, deeming non-corporate CIVs to be companies for this purpose (see CG73996G) and any disposal of an investor's interest as if it were be a disposal of a right or interest in that company. CIVs that are already bodies corporate will also apply the Schedule 1A rules.

If a disposal were made of such a right or interest at a particular time and such a disposal would be regarded as a disposal of a UK property rich asset (that is, one deriving 75% or more of its value from interests in UK land) then the CIV is UK property rich at that time.

This is also a key concept affecting whether an offshore CIV can make an election for transparency or exemption, and the tax treatment of its non-resident investors.

CG73996G Basic rules

Application of rules to offshore CIVs and UK co-ownership authorised investment schemes (CoACS)

Offshore CIVs deemed to be companies

Irrespective of their legal form, non-corporate offshore CIVs other than partnerships are deemed to be companies and as having shares, so that investors will hold an interest in a UK property rich asset where the CIV itself is UK property rich. This deeming does not go so far as treating them as having ordinary share capital, so they will not be able to rely on provisions that require a relationship to be established between a parent and subsidiary, or common subsidiaries of a parent, through ownership of ordinary share capital. Note that some rules in Schedule 5AAA apply in the context of actual companies and where that is the case this distinction is made clear – for example, where an election may be made under TCAG92/SCH5AAA/para 12(3) (see CG73997A).

UK CoACS

CoACS will continue to be treated as not being persons for UK tax purposes generally, and so nothing in Schedule 5AAA brings them within charge to UK tax for any purpose. Interests in a CoACS are deemed to be shares from the perspective of a non-UK resident investor (TCAG92/SCH5AAA/para 5(1)), purely for the purposes of considering whether those investors hold an interest in a UK property rich asset.

Default treatment for non-resident CIVs

The default treatment of non-UK resident non-corporate CIVs is that they are companies for the purposes of TCGA in respect of their disposals of interests in UK land (TCGA92/s1C; CG73922), so they will be persons and chargeable to Corporation Tax on their gains on such disposals, whether or not they are UK property rich.

This default treatment is subject to the elections detailed in CG73996L (election for transparency) and CG73997A (election for exemption).

CIVs which are partnerships on first principles will remain transparent for gains.

Interaction with rules in Chapter 3 of Part 3 TCGA92

Schedule 5AAA TCGA92 and Chapter 3 of Part 3 TCGA92 set out how unit trusts and contractual funds (for example, UK co-ownership authorised contractual schemes (CoACS), Luxembourg or French fonds commun du placement (FCPs) and Irish common contractual funds (CCFs)) and their investors are treated for relevant TCGA purposes.

This is necessary because whereas funds which take corporate form are treated in the same way as any other company for TCGA purposes, unit trusts and contractual funds may on first principles be transparent for capital gains purposes and that analysis would lead to considerable complexity for investors as regards their capital gains position.

Chapter 3 of Part 3 provides rules to simplify that position. The Schedule 5AAA rules provide a basis that treats unit trusts and contractual funds in a similar way to companies for relevant TCGA purposes, specifically as regards sections 1A(3)(b)&(c) and 2B(4) TCGA 92 (broadly, non-residents' interests in UK land, or assets that derive at least 75% of their value from UK land – see CG73920 onwards).

Some of the rules in Chapter 3 are impacted by Schedule 5AAA. The following table sets out what the two different sets of rules do and how they interact; text in *italics* refers to provisions in Chapter 3 that, for non-UK residents only, are superseded by Schedule 5AAA.

	Ch.3 of Pt.3 TCGA92	Sch.5AAA TCGA92
UK resident unit trusts	TCGA92/S99 treats the unit trust scheme as if it were a company, and the rights of	Not covered, therefore TCGA92/S99 applies

	the unit holders as shares in the company	
Non-resident unit trusts that are not within the meaning of a transparent fund in SI/2009/3001*	*TCGA92/S99 treats the unit trust scheme as if it were a company, and the rights of the unit holders as shares in the company*	TCGA92/SCH5AAA/para 4(1),(2)&(6) apply to treat the unit trust scheme as if it were a company, and the rights of the unit holders as shares in the company Note: S99 is therefore disapplied but Sch 5AAA has the same effect
Non-resident unit trusts within the meaning of a transparent fund in SI/2009/3001*	*TCGA92/S103D treats a unit as an asset for TCGA purposes and a participant's interest in the fund property (that is, the underlying assets) is disregarded for those purposes* Note: In practice, this has a similar effect to S99 Note: S103D(4) to (9) (calculation of gains on disposal of units etc.) still apply for all investors, whether UK resident or not	TCGA92/SCH5AAA/para 4(1)&(2) apply to treat the unit trust scheme as if it were a company, and the rights of the unit holders as shares in the company. Note: TCGA92/SCH5AAA/para 4(4) disapplies this treatment where an election for transparency under para 8 has been made (see CG73996L)
UK authorised co-ownership contractual scheme (CoACS)	TCGA92/S103D treats a unit as an asset for TCGA purposes and a participant's interest in the fund property (that is, the underlying assets) is disregarded for those purposes	Sch 5AAA does not disturb the S103D treatment generally, but note that TCGA92/SCH5AAA/para 4(5) provides that for Sch 1A purposes (the core rules) 'the asset' is treated as a share in a company. This means that a CoACS is, for Sch 1A purposes, treated as a company

		when considering the UK property rich test
Non-UK co-ownership contractual arrangements within the meaning of a transparent fund in SI/2009/3001*	*TCGA92/S103D treats a unit as an asset for TCGA purposes and a participant's interest in the fund property (that is, the underlying assets) is dis-regarded for those purposes*	TCGA92/SCH5AAA/para 4(1)&(2) apply to treat the scheme as if it were a company, and the rights of the unit holders as shares in the company Note: TCGA92/SCH5AAA/para 4(4) disapplies this treatment where an election for transparency under para 8 has been made (see CG73996L)

* see regulation 11 of the Offshore Funds (Tax) Regulations 2009

CG73996J Disposals by non-UK residents

Disposals by non-resident investors of interests in property funds with UK property interests: General

The term 'property funds' is used here in its widest sense, that is it refers to any sort of fund vehicle whether or not within the TCAG92/SCH5AAA/para 1(1) definition of a collective investment vehicle.

Property funds that are not within the TCGA92/SCH5AAA/para 1(1) definition

Examples may include non-resident listed property funds that are neither alternative investment funds (AIFs) as at TCAG92/SCH5AAA/para 1(1)(b) nor within scope of TCAG92/SCH5AAA/para 1(1)(d) as companies similar to a UK real estate investment trust. Such funds are not within Schedule 5AAA and so the core rules apply – in brief, non-UK resident investors will be within the charge to corporation tax or capital gains tax on any gains on disposal of their shares if the company is UK property rich. This is subject to any exceptions, including the availability of the 25% de minimis – see the guidance on the core rules at CG73920 onwards for further details.

Property funds that are within the TCAG92/SCH5AAA/para 1(1) definition of collective investment vehicle

In general, non-UK resident non-corporate CIVs will be treated in the same way as corporate CIVs, that is as companies, and interests in them as shares. A disposal by a non-resident investor

will be chargeable as a disposal of an interest in a UK property rich company in accordance with TCGA92/SCH1A (see CG73920 onwards); see more on the treatment of investors below.

Disposals by non-resident investors of interests in CIVs and assets with an 'appropriate connection' to CIVs

Non-resident investors will be chargeable on gains on disposal of an interest where that disposal has an 'appropriate connection' to a UK property rich CIV regardless of their level of investment in the CIV – they will not benefit from the 25% ownership exemption provided in Part 3 of Schedule 1A). This is because where a CIV has a 75% interest in UK land it can reasonably be expected to have been marketed on the basis that it is a UK property fund and investors will accordingly be aware of that. This is the case for investment in both non-UK CIVs and UK resident CIVs such as UK real estate investment trusts (REITs) and property authorised investment funds (PAIFs), but see below for details regarding TCGA92/SCH5AAA/para 7 where the 25% ownership exemption may still be available for certain non-UK focused property funds that happen to be UK property rich in particular circumstances.

TCGA92/SCH5AAA/Para 6(1) sets out a two-part test to identify a disposal by a non-UK resident person (person here meaning legal or natural person) of a UK property rich asset, where that disposal has an 'appropriate connection' to a collective investment vehicle.

Where there is such a disposal then TCGA92/SCH5AAA/para 6(2) removes the exemption from charge on indirect disposals for investors holding a less than 25% interest in a company (as provided for in Part 3 Schedule 1A). This is the case for investment in both non-UK CIVs, and UK resident CIVs such as UK real estate investment trusts (REITs) and property authorised investment funds (PAIFs), as well as where a disposal has an 'appropriate connection' to such a CIV (see below).

TCGA92/SCH5AAA/para 6(3) to (6) defines when a disposal has an appropriate connection, and this is explained using examples below. In each case the sub-para needs to be read together with para 6(1)(a), that is the requirement for the entity in question to be UK property rich. Note also that in each case within para 6(3), (5) or (6) there is an exception at TCGA92/SCH5AAA/para 7 so that the 25% de minimis can apply subject to particular conditions being met. This is explained further below.

TCGA92/SCH5AAA/para 6(3)

Para 6(3) applies where the disposal is of a right or interest in –

- a UK property rich CIV as defined at para 1(1) (see CG73996E regarding the meaning of UK property rich and CIV), wherever resident

- A company (wherever resident) that is not itself a CIV but that derives at least half of its market value from being a participant in one or more CIVs, meaning effectively that the company cannot be UK property rich without reference to those CIVs. A participant is, broadly, an investor – see TCGA92/SCH5AAA/para 1(5) for the definition of participant.

Example

A owns 10% of the shares in UK property rich Company B, which is not a CIV. B owns units worth £4.5m in a UK property rich CIV 'C', and bonds worth £500,000 unconnected to UK land. As at least half of A's value (90%) derives from UK property rich CIVs, a disposal of an interest in B will have an appropriate connection to a CIV, and A will not benefit from the 25% ownership exemption.

TCGA92/SCH5AAA/para 6(4)

Para 6(4) applies where the disposal is of a right or interest in a UK property rich company (whether or not it is a CIV) where the disposal is made in respect of a person's investment in a partnership which is itself a CIV.

Example

X is a partner in a collective investment scheme limited partnership. The partnership is invested in UK property rich Company Y, which is not a CIV. The partnership disposes of its interests in Company Y. For capital gains purposes, X has made a disposal of their interest in Y; as this disposal was in Y's capacity as a partner in a CIS limited partnership, it will have an appropriate connection to a CIV. The same analysis would apply if it were X disposing of their partnership interests. If X held an interest in Company Y directly (i.e. not through the partnership), then a disposal of that interest would not have a connection to a CIV.

Para 6(4) is not subject to paragraph 7, as explained below, so even if the CIV was marketed as something other than a UK property fund the partners would not benefit from the 25% exemption if at the point they made a disposal the company was UK property rich.

TCGA92/SCH5AAA/para 6(5)

Para 6(5) applies where a non-UK resident CIV disposes of an interest in a UK property rich company. This sub-paragraph applies where the CIV is a company (including where it is deemed to be so by para 4 of Schedule 5AAA, which will not include a case where the collective investment scheme is a partnership for which see above regarding para 6(4)).

TCGA92/SCH5AAA/para 6(6)

Para 6(6) applies where a company 'A' (which is not itself a collective investment vehicle) makes a disposal of a UK property rich company 'B', and two or more UK property rich CIVs have a 50% or more interest in company A. This rule is aimed at disposals by companies that are predominantly owned by one or more CIVs, including (but not limited to) CIVs that are partnerships.

Example

S is a collective investment vehicle, and is UK property rich. S owns 100% of the shares in company T, a company which is not a CIV; in turn, T owns 10% of the shares in Company U, which is not a CIV but is UK property rich. The balance of the shares in Company U are owned by R, which is another UK property rich collective investment vehicle.

If Company T disposes of its interests in Company U, this is one body corporate disposing of another, and neither are CIVs. However, the disposal has an appropriate connection to a CIV because 50% or more of the investment in Company U (100%) is held by UK property rich CIVs, S and R.

Establishing the percentage of investment

Establishing the percentage of investment for para 6 purposes is explained in para 6(7) and (8). This relies on the tracing provisions in Schedule 1A (see CG73934) and where two or more CIVs have an interest in a company they are treated as if they are a single person.

Disapplying the 'appropriate connection' rules

TCGA92/SCH5AAA/para 7 provides an exception to the treatment set out in para 6(3), (5) or (6) so that non-resident investors making a disposal which would otherwise have an 'appropriate connection' to a CIV may nonetheless benefit from the 25% ownership exemption provided by Part 3 of Schedule 1A and therefore will not automatically be considered to have a substantial indirect interest in UK land (note though that they may still do so where they have an interest of 25% or more – see CG73920 onwards).

Para 7 is subject to the following conditions –

- The non-UK real estate condition; and
- The CIV must meet either –
    - the Genuine Diversity of Ownership (GDO) condition as set out in regulation 75 of The Offshore Funds (Tax) Regulations 2009 (SI 2009/3001)) or,
    - if the vehicle is a company (including a deemed company as a result of paragraph 4 of Sch.5AAA), the non-close condition.

The non-UK real estate condition requires that the prospectus made available to investors in the collective investment vehicle (or vehicles for paragraph 6(3)(b)) would not lead them to believe the vehicle to be likely to hold more than 40% of its assets in UK land on an ongoing basis. This is to prevent the removal of the 25% ownership exemption where a collective investment vehicle meets the mechanical test for being UK property rich in paragraph 6(1)(a) at a given point in time, but has been marketed to investors as, for example, a pan European property fund that is not likely to be primarily UK property focused on a general basis.

See CG73997A for further guidance regarding the GDO and non-close conditions.

Paragraph 7 does not apply to disposals under paragraph 6(4), where the interest in question is held through a partnership collective investment vehicle. Where such a CIV disposes of assets that derive at least 75% of their value from UK land, for example a UK property rich company or CIV, the partners in a such a CIV will be treated as making a disposal of their fractional interest in that company or CIV (as a consequence of normal operation of the tax rules for partnerships). Regardless of the level of interest in that asset all partners will be considered as having a UK substantial indirect interest.

CG73996L The transparency and exemption elections

Overview

Introduction

Schedule 5AAA provides for offshore CIVs that meet particular conditions to make one of two elections (and in some circumstances, both) that are designed to address the problems described at CG73996A that could otherwise adversely affect their investors (broadly, taxation of exempt investors, and multiple charges at different tiers within CIVs generally).

Both elections are explained in detail in the following guidance. This section gives an overview of each and the differences between them.

The transparency election

An election under TCGA92/SCH5AAA/para 8 provides, subject to certain conditions being met, for offshore collective investment vehicles which are transparent for income tax purposes (for example, 'Baker' unit trusts, Luxembourg or French fonds commun du placement (FCPs), and Irish common contractual funds (CCFs)) to elect to be treated as partnerships for the purposes of TCGA 1992.

The effect of the transparency election is to treat the offshore CIV as a partnership for the purposes of capital gains (and related provisions), with the result that –

- the CIV itself is not within charge to tax on its gains;
- an interest in the CIV is not an asset for capital gains purposes, so the investors are taxed on disposals of the underlying assets of the partnership and not on a disposal of their interest in the CIV itself.

An investor who is exempt from capital gains would therefore be able to directly engage that exemption on disposal of assets by the CIV, as for capital gains purposes they will be disposing directly of those assets rather than the disposal being by the CIV.

This exemption was not designed for, and is unlikely to be suitable for, CIVs that are widely held and have regular changes of investors, as the effect of investors investing or disposing of interests is likely to trigger regular disposals of other investors' interests in the underlying assets (see section 4 of Statement of Practice D12). HMRC would anticipate the likely users of this election to be smaller, joint-venture arrangements where the investors are predominantly or wholly exempt investors and/or are unlikely to change regularly. It may also be appropriate where the CIV is essentially a captive vehicle in the structure of a larger fund.

The exemption election

An election under TCGA92/SCH5AAA/para 12 provides, subject to certain conditions being met, for managers of certain collective investment vehicles to treat the vehicle and / or entities it has

at least a 40% interest in as exempt on gains on disposals of interests in UK land (both direct and indirect disposals).

The investors are already, and remain, chargeable on their gains on disposals of interests in the CIV (see CG73996J regarding the 25% ownership exemptions not generally being available).

The transparency election in detail

TCGA92/SCH5AAA/para 8(1) enables non-resident UK property rich CIVs that are transparent for income tax purposes to elect to be treated as transparent for gains (except partnerships, for which an election is unnecessary).

TCGA92/SCH5AAA/para 8(7) explains when a CIV is considered to be transparent for income tax purposes. Paragraph 8(7) does not attempt to define what makes a CIV transparent for income, and that remains something to be determined by reference to case law principle. Instead, it assumes that analysis has already been applied and that as a conclusion of a CIV being transparent for income a hypothetical UK resident individual invested in the CIV would be chargeable to income tax on his or her share of the vehicle's income.

TCGA92/SCH5AAA/para 8(5) removes the need to consider whether or not an income transparent CIV would, on first principles, already be transparent for gains.

Making an election is subject to the CIV being UK property rich at the time of the election, or having published scheme documents at that time clearly stating the intention of the CIV to invest predominantly in UK land.

How and when the election must be made

The election must be made by the fund manager (TCGA92/SCH5AAA/para 8(2)), and must be accompanied by the consent of all of the investors in the fund at the time of making the election (TCGA92/SCH5AAA/para 9(1)(a)). The election must be made within 12 months of the CIV first acquiring a direct interest in UK land or an asset that is UK property rich (TCGA92/SCH5AAA/para 9(1)(c)). In the case of a fund with such interests that exists at 6 April 2019, the election must be made by 5 April 2020.

Investor consent may be assumed where it is evident that it has been made clear to investors in fund documentation or other relevant material that they are buying an interest in a fund that intends to make a transparency election. For funds that exist at 6 April 2019, evidence of investor consent can be retained in any form (for example, email, web form, note of telephone call or in writing).

Effect of election

Once the election is made the CIV will be treated as a partnership for the purposes of TCGA generally, so that the investors will be treated as if they directly held an interest in the underlying assets of the fund. The transparent treatment will apply for all investors in the fund, both UK and non-resident, and TCGA92/SCH5AAA/para 8(8) therefore disapplies TCGA92/S99 (application of TCGA to unit trusts) and S103D (tax transparent funds treated as an asset for TCGA purposes).

The CIV is also considered a partnership, and so transparent, for the purposes of establishing a group relationship for capital gains purposes. So for example, Company A owns 100% of the units in a CIV which is subject to the transparency election, and that CIV owns 100% of the shares in Company B. For the purposes of establishing a group relationship for TCGA92/s171, and looking at a chain of ownership as per CTA10/s1154, Company A will be treated as directly holding the shares in Company B. This would not apply for purposes other than capital gains (such as group relief).

The TCGA rules for partnerships and the principles of Statement of Practice D12 will apply to assist in calculating the gains of the investors.

The election will have retrospective effect to cover any disposals by the CIV from commencement of the non-resident gains rules on 6 April 2019, or if the CIV is formed after that date, from the date it is formed.

CGT at the upper rate on disposals of UK residential land will apply where, as a consequence of the transparency election, an investor is treated as making a direct disposal of an underlying asset of the CIV that is liable at that rate.

Once made, the election cannot be withdrawn (TCGA92/SCH5AAA/para 9(3)). If the investors in the CIV change, or it ceases to be 75% UK property rich, it will remain a partnership for gains. There will be no need to make a new election or provide the consent of the new investors, who should be aware of the CIV's status when they acquire an interest in it.

Interaction with rebasing rules in Schedule 4AA TCGA

The rebasing rules for non-UK residents disposing of interests in UK land that were held at 5 April 2015 and/or 5 April 2019 are covered in detail in CG73960P and CG73970P (for CGT and CT respectively).

A non-UK resident disposing of an interest in a UK property rich CIV would be making an indirect disposal, and so would fall within Part 2 of Schedule 4AA to TCGA 92; hence the default position would be for them to calculate their gain or loss using the 5 April 2019 market value as the base cost.

Where the CIV has made an election for transparency, the effect will be that an investor disposing of an interest in the CIV will be treated as disposing of the underlying assets directly. This

may mean in some cases that the investor is therefore making a disposal that would fall into Part 3 or Part 4 of Schedule 4AA (such as an individual disposing of an interest in a residential property), and may have an earlier rebasing date or a mixed-use calculation.

TCGA92/SCH5AAA/PARA 11 provides that the 5 April 2019 rebasing date be retained, so that if a person would (absent the transparency election) have fallen into Part 2 as making an indirect disposal, then they will still fall into that Part.

Where the CIV itself is making the disposal (rather than the investor making a disposal of their interests in the CIV), and that disposal would have fallen into Part 3 or 4 anyway – such as a direct disposal of UK residential land by a closely-held corporate CIV - then para 11 will not apply.

Effect of the election on UK tax resident investors

Under existing provisions in Chapter 3 of Part 3 of TCGA, UK resident investors will already have an interest in the CIV as an asset for the purposes of capital gains. The transition for investors between holding an interest in the CIV as an asset and holding an interest in the underlying assets, including UK resident investors under current rules, will be done by deeming the underlying assets to always have been so held for the purposes of calculating the gain.

Statement of Practice D12, and principles such as those in section 43 TCGA, will assist in calculating any gain or loss when the investor or the CIV makes a disposal. There is no deemed disposal on making the election, and no need to substitute market value for base cost as a consequence of the disposal.

UK insurance companies

To prevent complexity and ensure insurers maintain the current tax treatment under section 212 of TCGA 1992, TCGA92/SCH5AAA/para 10 treats an election under paragraph 8 as having no effect from the perspective of any investors in the offshore CIV which are UK insurance companies holding the units for the purposes of their long-term business. The affected insurance companies will continue to hold an interest in the vehicle itself as a capital gains asset rather than in the underlying property of the vehicle. This is the only exception to the transparency principle once an election has been made.

Interaction with 30 day reporting and payment on account rules

Where a CIV has yet to make an election, it will remain opaque and chargeable on gains arising from its own disposals. Non-resident investors chargeable to Capital Gains Tax will therefore, at that stage, not be within the rules for 30 day reporting and payment on account (set out in Schedule 2 to Finance Bill 2019) in respect of a disposal by the CIV. The election for transparency has retrospective effect, so that a disposal by the CIV will become chargeable on the investor.

In these circumstances, the investor's 30 day time limit for reporting and paying tax on any gain begins on the day the election for transparency is sent to HMRC, rather than the normal time limits. Once the election has been made, the normal time limit applies.

The normal rules for the 30 day reporting and payment on account provisions will apply for any disposal by the investors themselves, regardless of whether the CIV is transparent (a disposal of underlying property) or opaque (a disposal of an interest in the fund itself).

CG73997A The exemption election - Overview

Offshore CIVs

Eligible offshore CIVs that –

- are UK property rich companies (including deemed companies under paragraph 4, see CG73996G);
- meet certain qualifying conditions in TCGA92/SCH5AAA/PARA 13; and
- commit to report certain information on annual basis to HMRC

can make an election under TCGA92/SCH5AAA/PARA 12 to provide exemption for the CIV itself and for entities in which it has at least a 40% investment.

This addresses the problems described at CG73996A where the default position could otherwise adversely affect such CIVs and their investors (broadly, taxation of exempt investors, and multiple charges at different tiers within CIVs generally).

Commercial restructuring to facilitate an election for exemption

Constitutional or structural changes that are needed to meet the relevant conditions, or to enable an investor to benefit from its own tax exemptions, in particular where all of the ultimate investors are tax-exempt or otherwise qualifying investors, will generally not be caught by the anti-avoidance rules (paragraph 11 of Sch.1A to TCGA; see CG73952) or otherwise be considered to be unacceptable planning. The following examples will specifically be accepted:

- Changing terms in a prospectus or fund document to clarify the GDO position,
- Changing distribution provisions to ensure that the fund manager does not trigger a deemed disposal as a result of making a payment to investors that would come within paragraph 21 (payments not otherwise taxable, see CG73887J).
- Changing distribution rights so that the full benefit of tax exemptions may pass to the tax exempt investors who effectively enabled such tax exemptions, with underlying tax being allocated to taxable investors.

There may be other examples that would also be acceptable but each case must be considered on its own merits.

Limited partnership collective investment schemes and UK co-ownership authorised investment scheme (CoACS)

An election can also be made under paragraph 12 by –

- a CIV which is a partnership collective investment scheme (based in any jurisdiction, including the UK); or

- a UK co-ownership authorised investment scheme (CoACS).

in respect of one or more companies that it wholly owns or almost wholly owns (see CG73997L –broadly that it is at least 99% invested in), and which are UK property rich. Elections cannot be made in respect of companies that are CIVs, but CIVs in the ownership chain can make an election themselves if eligible to do so.

Other UK property funds

There are existing special tax regimes for other types of UK property funds, specifically UK real estate investment trusts (REITs; see the GREIT Manual) and property authorised investment funds (PAIFs; see CTM48800), and these funds are unable to make an election under paragraph 12(2), or to be the company covered by an election under paragraph 12(3) by a CIS limited partnership or a CoACS. As a result of the provisions brought in by Schedule 5AAA, certain changes were made to the rules for UK REITs. The most significant of these was to extend exemption to gains arising on disposals of UK property rich companies. HMRC guidance for REITs will be updated to reflect these changes, and a draft of that amended guidance is included at Annexe 2.

Paragraph 12 elections – further detail

Collective investment vehicles – election under TCGA92/SCH5AAA/PARA12(2)

Only offshore CIVs as defined at TCGA92/SCH5AAA/PARA 2 are eligible to make an election. Once an election is made, the CIV is referred to in the legislation as a "qualifying fund". A company that is within the TCGA92/SCH5AAA/PARA 1 definition of a CIV only by being an alternative investment fund may not make the election. In order to be eligible to make an election a CIV must therefore be –

- an offshore collective investment scheme as defined at FSMA2000/S235 (this will include transparent for income entities, such as Jersey property unit trusts for example, that have not made an election under paragraph 8 and therefore remain opaque for capital gains purposes) or
- a non-UK resident company that comes within TCGA92/SCH5AAA/PARA 1(1)(d), so that it will be similar to a UK real estate investment trust.

The entities in which the CIV has an interest and which are covered by the election as a result of TCGA92/SCH5AA/PARA16 may be UK or non-UK resident, bodies corporate or deemed companies under TCGA92/SCH5AAA/PARA4, and may themselves be CIVs. The exemption covers direct or indirect disposals of UK land.

The CIV must have an investment of at least 40% in an entity for that entity to benefit from exemption. Where the investment is less than 100% the gain or loss is exempted proportionately to the level of investment the electing CIV (referred to as the 'qualifying fund' in Schedule 5AAA)

has in the entity. The level of investment is established using the tracing rules in TCGA92/SCH1A/PARA 9 (see CG73938).

The CIV must continue to meet certain qualifying conditions for the election to have effect. If the circumstances of the CIV change so that it does not meet the conditions, this will trigger a deemed disposal and reacquisition of the interests of the investors. In some circumstances any gains triggered by the deemed disposal will be brought into charge immediately, and in some the gain will not come into charge until the investors receive funds from the CIV, the CIV winds up, or a period of three years elapses (whichever is earliest) - see CG73997J for further detail.

Companies invested in by limited partnership collective investment schemes and UK co-ownership authorised contractual schemes

Nothing within Schedule 5AAA treats a limited partnership CIS (LP CIS) or a UK co-ownership authorised contractual scheme (CoACS) as a company for TCGA purposes, and as they are not otherwise legal persons they are not within the charge to tax. LP CISs remain transparent for gains, and so interests in them are not assets for their investors; units in a CoACS are treated as shares in a company for the purposes of considering whether non-UK resident investors hold an interest in a UK property rich asset, and for UK investors the units are a CG asset (TCGA92/s103D).

Investors in LP CISs and CoACS used in property fund structures would however, as a result of the default position for companies in those structures, face the problems described at CG73996A in respect of tax being charged on those companies. TCGA92/SCH5AAA/PARA 12(3) therefore provides for a manager of such funds to make an election on behalf of companies that are wholly or almost wholly owned by LP CISs and CoACS (that is companies that the LP CIS or CoACS holds at least a 99% investment in; see CG73997L).

The company and the collective investment vehicle that holds it between them must meet the qualifying conditions in paragraphs 12 and 13 (see CG73997C). Companies invested in by the electing LP CIS or CoACS are referred to in Schedule 5AAA as 'qualifying companies'.

The 40% minimum interest required for an entity in the fund structure to be eligible for exemption is considered in respect of ownership by the company for which the election has effect.

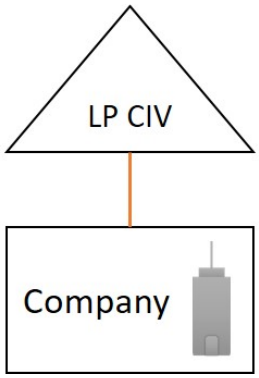
LP CISs

A LP CIS may make an election in respect of one or more companies that are not CIVs themselves and that it wholly or almost wholly owns (broadly, at least a 99% interest - see TCGA92/SCH5AAA/PARA40, and CG73997L), providing the qualifying conditions are met in respect to each company. This rule applies only in the case of a single LP CIS having such an interest; it would not apply where two or more LP CISs wholly or almost wholly owned a company between them (but where two or more partnerships wholly or almost wholly own a company through a common LP CIS, that LP CIS could meet the requirements).

Where a LP CIS has an interest in a company that is a CIV itself then that CIV can make its own election under TCGA92/SCH5AAA/PARA 12(2), provided the relevant conditions are met.

A LP CIS need not be UK property rich for an election to be made, but the investors' interests in the company directly underlying the LP must be an interest in a UK property rich asset (so the company must be UK property rich).

CIVs that have made the transparency election at TCGA92/SCH5AAA/PARA 8 (see CG73996L) and that are therefore deemed to be partnerships may also make an election under TCGA92/SCH5AAA/PARA 12(3) on behalf of one or more companies which they wholly or almost wholly own, where they consider it appropriate to do so.

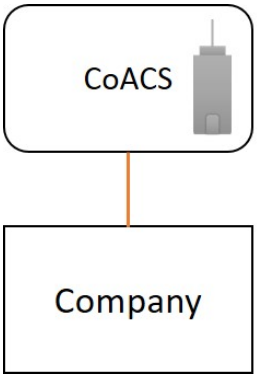


- Either:
  - The CIS LP must meet GDO, or
  - The company must be not-close and meet the UK tax condition
- The company must be UK property rich
- The company must not be a CIV

UK CoACS

A UK CoACS may also make an election in respect of one or more companies that are not CIVs themselves and that it wholly or almost wholly owns. Purely for the purposes of applying these rules and considering whether the fund and underlying companies qualify, TCGA92/SCH5AAA/PARA 12(7) treats the CoACS as transparent for gains (for example when looking at the not-close condition).

It is the CoACS that must be UK property rich to meet the eligibility requirements for the election as (unlike for the partnership) it is the CoACS' units not the shares in the underlying companies that are capital gains assets in the hands of the investors.



- Either:
  - The CoACS must meet GDO, or
  - The company must be not-close and meet the UK tax condition
- The CoACS must be UK property rich
- The company must not be a CIV

Intermediate holding vehicles

TCGA92/SCH5AAA/PARA 33 provides for a company (other than one that is also a collective investment vehicle) to have exemption on any gains on disposals of an interest in a qualifying fund or qualifying company under paragraph 12 of this Schedule, if that company is wholly owned by persons listed in paragraph 33(4). These persons are those, as in TCGA92/SCH7AC/Para 30A, who are themselves not chargeable on gains or subject to special regimes for gains. The persons must be direct participators in the company. This rule is necessary as such persons often invest through wholly owned holding companies. See CG73997G for further details. "Wholly owned" is covered in CG73997L.

The persons who are eligible to be owners of such companies are:

- Qualifying Institutional Investors (see CG53012)
- Qualifying funds and qualifying companies (within Schedule 5AAA to TCGA 92)
- Life assurance businesses where the right or interest in the para 33 company is an asset which, applying the rules in section 138 of the Finance Act 2012, is wholly matched to a liability of its life assurance business that is not BLAGAB, or
- Companies carrying on long-term business, none of which is BLAGAB where its right or interest in the para 33 company is an asset held for the purposes of its long-term business.

Inter-dependency between para 12 and para 33

A holding vehicle may be eligible to fall within para 33 because it is wholly owned by the persons above, but the CIV or company it is invested in may not be eligible for a para 12 election purely because the holding company is resident in a territory that would make the CIV or company fail the UK tax condition (see CG73997C). If making the holding vehicle exempt through para 33 would mean the CIV or company **would** be eligible for a para 12 election (because the interest held by that vehicle would no longer be out of charge to UK tax for reasons other than the application of the Double Tax Agreement), then the CIV or company may make the para 12 if the holding vehicle applies para 33.

Example

Holding Company A is a body corporate and not a CIV and is resident in a territory with which the UK has a Double Tax Agreement that does not allocate taxing rights to the UK for indirect disposals of UK land (see CG73948).

Holding Company A has a 50% investment in Fund B, a CIV which is tax resident outside the UK. Fund B meets the not close condition, but not GDO, so is required to meet the UK tax condition. All of the other investors in Fund B are UK tax resident.

Pension fund C holds a 50% investment in Holding Company A, and is a non-UK resident pension fund, which meets the conditions to be exempt from UK capital gains and is eligible to be a Qualifying Institutional Investor under TCGA92/SCH7AC/PARA3A. The other 50% is held by Fund D, which is a qualifying fund within the meaning of TCGA92/SCH5AAA, and is subject to a para 12 election under that Schedule.

Holding Company A meets the conditions to fall within para 33 in terms of being wholly owned by the right investors. Fund B, however, does not meet the UK tax condition due to the tax residence of Holding Company A. If Holding Company A were already subject to para 33, then Fund B would meet the UK tax condition.

Fund B is eligible to make an election under TCGA92/SCH5AAA/PARA12(2), at which point para 33 will apply to Holding Company A and will meet the UK tax condition.

CG73997C The exemption election - Qualifying conditions

Summary of conditions

The conditions that collective investment vehicles (CIVs), limited partnerships collective investment schemes (LP CISs) and UK Co-ownership authorised contractual schemes (CoACS) must meet in order for an election to be made under TCGA92/SCH5AAA/PARA 12(2) or (3) are shown in the following table.

CIVs (Election under para 12(2))	
Para 12(2)(a)	The vehicle must be offshore
Para 12(2)(b)	The vehicle is a company (including deemed companies under para 4)
Para 12(2)(c)	The vehicle is UK property rich (see para 3 / CG73996E)
Para 12(2)(d)	All of the qualifying conditions at para 13 are met
Para 12(2)(e)	If the vehicle is an alternative investment fund it must also be either a collective investment scheme or meet the property income condition at para 1(2)
Para 13	If the CIV is a collective investment scheme (under FSMA2000/S235) it meets either -

(1)(a) (1)(c) (1)(b) (1)(c)	• the genuine diversity of ownership test (see Annexe 1), or • it meets the UK tax condition (at para 13(7) – see below) and the non-close condition (at para 13(5) – see below) If the CIV is a company (excluding entities deemed to be companies by para 12(4), see CG73996G) it meets either – • the recognised stock exchange condition (at para 13(4) – see below) and the non-close condition (at para 13(5) – see below), or • it meets the UK tax condition (at para 13(7) – see below) and the non-close condition (at para 13(5) – see below)
LP CISs and CoACS (Election under Para 12(3)) – conditions to be satisfied by companies for which an election is to be made	
Para 12(3)(a)	The company is wholly or 'almost wholly' (which para 41(1) defines as at least 99%) owned by the LP CIS or CoACS (in the case of a CoACS, para 12(7) disapplies TCGA92/S103D so that for the purposes of applying this test the CoACS is treated as being transparent for capital gains purposes)
Para 12(3)(b)	In the case of a LP CIS, the company is UK property rich (see para 3 / CG73996E); In the case of a CoACS, the CoACS is UK property rich (see para 12(4)(b))
Para 12(3)(c)	All of the qualifying conditions at para 13 are met
Para 13 (2)(a) (2)(b)	Either – • the company meets the UK tax condition and the non-close condition, or • the CIS that owns it meets the genuine diversity of ownership test

All elections made under paragraph 12 are subject to initial and ongoing reporting obligations as set out in paragraphs 14 and 15; see CG73997N for details.

TCGA92/SCH5AAA/PARA 12 and 13 elections – further detail

The genuine diversity of ownership (GDO) condition

TCGA92/SCH5AAA/PARA 13(3) points to regulation 75 of The Offshore Funds (Tax) Regulations 2009 (SI 2009/3001) and applies the rules therein as if any CIV were within the definition of an 'offshore fund' at TIOPA2010/S355. A collective investment scheme meets the condition if it meets either –

- conditions A to C of regulation 75, or
- the condition in regulation 75(5)

Regulation 75(5) moves the requirement for meeting conditions A to C to a feeder fund investing in the CIV where that feeder fund is an offshore fund, an open-ended investment company or an authorised unit trust scheme.

There is existing HMRC guidance on the GDO as the condition has relevance for offshore funds and UK authorised investment funds in the Offshore Funds Manual and Company Taxation Manual respectively. A rewrite of that guidance, which does not make significant changes but provides additional commentary and examples, will be published in a new Investment Funds Manual in 2019 and a draft of that rewrite is included at Annexe 1.

The non-close condition

The meaning of 'close company' is provided at TCGA92/SCH5AAA/PARA 46(2) for the purposes of the non-close test at TCGA92/SCH5AAA/PARA13(5). The test is modelled on the test at CTA10/S528(4) and (5) which applies to UK real estate investment trusts (REITs; see GREIT02015).

A CIV or company is (broadly) close if it is controlled by five or fewer participators, but it may pass the non-close test if it is only close because control can only be established by the inclusion of qualifying investors (see below).

The close company rules in CTA10/PART10/CHAP2 are further modified as follows –

- CTA10/S442(a) (non-UK resident companies not to be regarded as close) is disapplied;
- CTA10/S444 (companies involved with non-close companies not to be regarded as close) is disapplied;
- CTA10/S447(1)(a) (shares in quoted companies beneficially held by non-close companies) is disapplied.

Qualifying investors

TCGA92/SCH5AAA/PARA46(3): For the purposes of paragraph 46 'qualifying investors' are as set out at CTA10/S528(4A), and also includes a qualifying fund or company (that is, one that is subject to an election for exemption under paragraph 12). There is an additional requirement in that certain entity types listed in section 528(4A) must themselves either not be close or meet the genuine diversity of ownership test ('GDO', see above for details):

- Authorised unit trust schemes or their overseas equivalents;
- Open ended investment companies or their overseas equivalents;
- Limited partnership collective investment schemes (LP CIS);
- UK REITs or their overseas equivalents.

In the case of a LP CIS, the test for 'qualifying investor' applies at the level of the LP CIS itself. Accordingly, the LP CIS will need to meet the GDO test. If the LP CIS fails to meet the GDO test then an election under paragraph 12(3) may nonetheless still be made provided the company that is the subject of the election is not close on a separate analysis. So, if the LP CIS fails to meet the GDO test, the LP CIS is subject to look through and the test for closeness of the company concerned will depend on the interests of the partners themselves. Where the general partner of the LP CIS controls the company in question by virtue of its powers as general partner to manage the affairs of the partnership, the company would remain close notwithstanding the disregard for attribution of partner rights at paragraph 46(2)(d). For the purposes of paragraph

46(5) HMRC will nevertheless regard the company in question as not being close provided it is not close for any other reason.

UK REIT equivalence takes its meaning from CTA10/S528(4A)(j) and does not entirely align with a company that meets the UK property income condition at TCGA92/SCH5AAA/PARA 1(1)(d) (but note that a para 1(1)(d) company is a qualifying investor if it is exempt as a result of an election under paragraph 12).

Unlike the test in section 528 the non-close test for the exemption election allows a look-through of immediate investors to establish whether control is ultimately established through institutional investors. The look-through must be through bodies corporate. For example a company which is a direct investor in the CIV could count toward the level of control held by qualifying investors if it were itself owned by sufficient qualifying investors.

Example

Holding Company A is a body corporate and has a 60% investment in Fund B, a CIV which is tax resident outside the UK. Fund B does not meet the GDO test, so is required to meet the UK tax condition and the not-close test. The remaining 40% investment in Fund B is held by three other investors, none of whom can exert control within the meaning of the CTA10/PART10/CHAP2 close company rules.

Holding Company A controls Fund B, and is not itself a Qualifying Investor within TCGA92/SCH5AAA/PARA46.

Pension fund C holds a 50% investment in Holding Company A, and is a non-UK resident pension fund, which meets the conditions to be exempt from UK capital gains and is eligible to be a qualifying investor under TCGA92/SCH5AAA/PARA46.

The other 50% is held by Fund D, which is the overseas equivalent of an authorised unit trust scheme. Fund D is eligible to be a qualifying investor only if it, itself, is either not close or meets the GDO. Fund D meets the not-close condition, so is eligible to be a qualifying investor.

Holding Company A is 100% invested in (wholly owned) by qualifying investors. The control exerted by Holding Company A therefore counts as control by qualifying investors, and as that is the only reason that Fund B is close, Fund B will meet the not close test.

The UK tax condition

The test at TCGA92/SCH5AAA/PARA 13(7) must be met in certain cases by the qualifying fund or qualifying company in order for the election under paragraph 12 to be made (see table above).

To meet this test the manager of the CIV must reasonably believe that, should all of the assets of the fund be liquidated and the proceeds returned to investors at that point, no more than 25% of the total value returned would not be subject to UK tax in the hands of the investors because of the allocation of taxing rights under Double Tax Agreements.

This percentage is to be calculated with regard to the holdings of all of the investors in the fund, including exempt investors and taxable UK resident investors. So where a manager can be sure that more than 75% of the investors are UK residents and, or, exempt investors, they can meet the condition. See above under heading 'Corporate feeder vehicles wholly owned by institutional investors' for details of how investors that are companies within TCGA92/SCH5AAA/PARA33 are treated for the purpose of this test. Wholly owned is covered in CG73997L.

In many cases the manager will have no reason to know the tax residence of its investors, particularly for funds already in existence at 6 April 2019. The manager is not required to obtain information in order to perform a test of this condition, but if they are aware of the tax residence of their investors for other reasons - such as for due diligence, the Common Reporting Standard, or Anti Money Laundering procedures, then they should use the information they hold in order to establish whether the condition is passed.

CG73997E The exemption election: Making & revoking an election, and effect of election

Timing and form of election

Making the election - TCGA92/SCH5AAA/PARA17

The election must be made by the CIV manager 'to an officer of HMRC'; in practice this will be to a mailbox – this guidance will be updated to include the relevant details. The election should include details of the name and address of the CIV making the election, the names and addresses of entities included in its structure which are also to be treated as exempt and the level of interest the CIV making the election has in them. HMRC will publish a form for this in due course.

Timing of election

There is no time limit for making an election but it is assumed that managers of CIVs will generally want to make an election as soon as possible to gain certainty about the treatment of gains arising to a fund or to an entity in the fund structure.

The election must specify the day from which it is to have effect. That day may be up to 12 months before the date of the election. HMRC will consider cases where the specified day is more than 12 months before the date of the election and may give consent in specific cases and, based on cases seen, may in future specify in guidance that where particular circumstances apply then consent may be assumed.

There is an interaction with the requirement in paragraph 14 for an election to be accompanied by a report about disposals made by investors of their interests in the CIV for the two years preceding the date of the election (but only in respect of disposals on or after 6 April 2019); see

CG73997N for further details of that requirement. Where an election is made prospectively for a newly formed fund the requirement under paragraph 14 will clearly not apply, although as for all CIVs or companies for which a valid election is made, there will be ongoing reporting requirements under paragraph 15 as explained at CG73997N.

Revocation of election

Revocation by manager of a CIV - - TCGA92/SCH5AAA/PARA18(3)

The manager of a CIV may revoke a paragraph 12 election by written notice to HMRC. A notice must state the day from which the election is to cease to have effect. The paragraph 12 election will cease to have effect for disposals made on or after that date. A notice may have retrospective effect with HMRC consent, and guidance may be published in future setting out the circumstances in which that consent will apply based on reviews of the circumstances in any such revocation requests.

Revocation by HMRC - TCGA92/SCH5AAA/PARA15(5) and PARA18

A designated officer of HMRC may revoke the election for exemption if –

- there is a breach of the reporting requirements (TCGA92/SCH5AAA/PARA15(5) - see CG73997N for further details); or
- a designated officer of HMRC considers it appropriate to do so in order to protect the public revenue.

This revocation must be given in writing to the manager of the CIV in question and specify the day from which the election is to cease to have effect, and state the grounds for revoking the election. There is an appeal process, as set out in TCGA92/SCH5AAA/PARA19 – an appeal notice must be sent to the designated officer within 30 days from the day on which the notice of revocation is given.

The designated officers of Revenue and Customs are:

> (a) a Director with policy responsibility for the taxation of collective investment vehicles, and
>
> (b) any Deputy Directors under the line management of that Director.

Protect the public revenue

In general, HMRC expect that the use of the power in regulation 18 to revoke an election to protect the public revenue will only be used in exceptional circumstances. The gateway tests into the exemption election should ensure that only genuine commercial investment arrangements are within the regime.

HMRC will not revoke an election except in response to a set of arrangements undertaken by the CIV or its investors where tax avoidance is the main object, or one of the main objects, of those arrangements. Arrangements will not be considered to have such an object where they can reasonably be regarded as consistent with the principles on which the provisions in Schedule 5AAA are based (see CG73996A).

Effect of revocation

Where an election is revoked, a deemed disposal and reacquisition of all the investors' interests in the CIV will occur immediately before the revocation. Tax on any gain so arising is immediately brought into charge; see CG73997J for further details.

Effect of making an election

Exemption for gains on direct and indirect disposals

A combination of TCGA92/SCH5AAA/PARAS 12 and 16 mean that a gain, or an appropriate proportion of a gain, on a direct or indirect disposal of UK land made by –

- 'Q' - a UK property rich qualifying fund or a qualifying company for which a paragraph 12 election has been made, and
- A company 'C' that Q has a 40% or more interest in immediately before the disposal

will not be a chargeable gain.

The "appropriate proportion" means the proportion of the gain as relates to the direct or indirect interest held in the asset disposed of by Q.

Rebasing assets owned by company disposed of

TCGA92/SCH5AA/PARA31 provides for a proportionate, market value rebasing of qualifying UK land assets of a company 'C' where it is disposed of by a qualifying fund or qualifying company 'Q', or another company owned by such a fund or company, and the assets being rebased have been covered by the paragraph 12 election (whether wholly or to an appropriate proportion in accordance with paragraph 16(4)) for a period of 12 months prior to disposal. This ensures that the value of the exemption is preserved within the relevant fund structure; without rebasing a purchaser of the company disposed of might discount the purchase price to reflect the unrealised gains on the underlying assets. The company being disposed of may also be a company because of the deeming provisions in paragraph 4 of Schedule 5AAA.

Rebasing is applied by deeming C to have disposed of and having reacquired every asset the disposal of which would have been a direct or indirect disposal of UK land at market value immediately before it was sold by Q. Hence the disposal is covered by the exemption election.

Where the company being disposed of owns other UK property rich companies, the deemed disposal of those companies under paragraph 31 triggers the same effect on them, so that there is a cascade effect to rebase that subsidiary company's UK land assets.

Rebasing is proportionate to the level of interest held in the relevant asset by Q.

Example

Fund A is subject to an election under paragraph 12(2). Fund A holds 100% of the units in Company B, which in turn owns 100% of the units in Company C, which in turn owns 50% of the units in Company D, which owns 50% of the units in Company E. All of the entities have been so held and subject to the exemption election for some years.

Fund A has a 40% or greater investment in Company D (50%), so Company D is 50% exempt on its gains on direct and indirect disposals of UK land. Fund A only has a (50% x 50% =) 25% investment in Company E, so Company E is not covered by the exemption election. A disposal of Company E by Company D would also not be covered by the exemption election (as, again, Fund A does not have a 40% or greater investment in Company E).

Fund A disposes of its interest in Company A. Paragraph 31 applies so that immediately before the disposal, Company A is deemed to have disposed of all of its UK land assets to the extent that:

- Company A (or another company in the fund) has held them for at least a year prior to the disposal, and
- The disposal of the asset would be covered by the exemption.

Company A's interests in Company B is such an asset, so Company A is deemed to have disposed of its interest in Company B. This, in turn, means that paragraph 31 will apply to Company B so that it is deemed to dispose of all of its UK land assets meeting the conditions above, and so on down the chain.

Fund A has a 50% investment in Company D, so Company D is only 50% exempt on its gains on direct and indirect disposals of UK land. Hence when Company D is affected by paragraph 31 only 50% of the asset is rebased. This means that Company D is, effectively, deemed to have disposed of and reacquired 50% of its UK land assets. The base cost for those assets will be based on 50% of the existing base cost and 50% of the market value of the assets at the date of the deemed disposal.

Company E is not covered by the exemption, and a disposal of Company E by Company D would not be exempted. Therefore Company D is not deemed to dispose of its interest in Company E by paragraph 31.

Establishing a 40% investment

For the purposes of this paragraph, Q has a 40% investment in a company if, applying the rule in paragraph 9 (but ignoring paragraph 10) of Schedule 1A, references to 25% were references to 40%, and Q would be regarded as having a 40% investment in the company immediately before the disposal (see CG73938).

Limiting the exemption

HMRC may make a just and reasonable adjustment to the appropriate proportion of a gain accruing to any person to prevent the application of paragraph 16 resulting in the total proportion

of an exempt gain exceeding the whole of the gain. This may occur where, for example, different measurements of 'investment' (per TCGA92/SCH1A/PARA9; CG39938) lead to a total investment of greater than 100% -particularly where a company is a joint venture and benefits under paragraph 16 from paragraph 12 elections by two separate funds.

Investors in CIVs

Regardless of whether a CIV is within the exemption regime or not, investors in the CIV remain taxable under first principles on any disposal of an interest in a CIV that is a UK property rich entity, subject to any exemption that an investor may itself have. Note that in certain circumstances a deemed disposal of investors' interests in a fund that has elected for exemption will arise, for example where a fund no longer meets the conditions for exemption; see CG73997G for further details.

Corporate feeder vehicles wholly owned by institutional investors

TCGA92/SCH5AAA/PARA33 provides that where a company is wholly owned (see TCGA92/SCH5AAA/PARA40, and CG73997L) by certain specified investors, any gain accruing on a disposal by that company will not be a chargeable gain. This rule allows entities with their own exemption, immunity, or similar non-taxable status to pass it down to wholly owned companies that are invested in a qualifying fund or company that is the subject of an exemption election under paragraph 12.

The specified investors are –

- qualifying institutional investors, as listed in TCGA92/SCH7AC/PARA30A (the substantial shareholder exemption rules, see CG53012),
- a company carrying on life assurance business where, immediately before the disposal, its right or interest in the participant is an asset which, applying the rules in section 138 of the Finance Act 2012, is wholly matched to a liability of its life assurance business that is not BLAGAB,
- a company carrying on long-term business none of which is BLAGAB where, immediately before the disposal, its right or interest in the participant is an asset held for the purposes of its long-term business, and
- another qualifying fund or qualifying company in respect of which an election under paragraph 12 has effect.

A company that is directly investing in an exempt qualifying fund or company will therefore be exempt on any gains arising from disposal of an interest in the CIV, providing that all of the participators in the company would themselves not be liable to tax on the gain by reason of exemption or immunity.

In addition, a deemed disposal under TCGA92/SCH7AC/PARA21 (payments not otherwise taxable, see CG73997J) will not result in a deemed disposal by any investor mentioned above. A deemed disposal will arise for the paragraph 33 company itself but as any gain arising will be exempt this should have no practical effect.

Note that for the purposes of TCGA92/5AAA/PARA13(7), the UK tax condition, a company that would be a paragraph 33 company assuming all of the other relevant conditions were met by an entity contemplating a paragraph 12 exemption election will be treated as a 'good' investor no matter where it is resident for tax purposes. So, for example, a Luxembourg corporate vehicle that is wholly owned (see CG73997L) by investors within paragraph 33(4) will not be considered to be an investor for whom a disposal of shares in the prospective paragraph 12 exempt entity would be left out of account for TCGA purposes.

Interaction of different exemptions

It is possible for a gain arising from a single disposal to be exempted as a result of the application of more than one of the exemptions available under TCGA92/SCH5AA/PARA16, TCGA92/SCH7AC/PARA3A (the substantial shareholding exemption) and CTA10/S535 or 535A (exemption for certain disposals by UK real estate investment trusts (REITs)). Paragraphs 34 to 37 therefore set out priority rules, as well as limiting the overall exemption available to the correct aggregate amount. The rules work in a similar way for losses – the guidance below refers only to gains.

Interaction of TCGA92/SCH5AA/PARA16(3) and TCGA92/SCH7AC/PARA3A

TCGA92/SCH5AAA/PARA34 provides that where -

- a gain arising on an indirect disposal of UK land made by an investing company owned by a qualifying fund or qualifying company (both referred to as 'Q') is exempted under TCGA92/SCH5AAA/PARA16(3), and
- one or more qualifying institutional investors ('QIIs', as defined in TCGA92/SCH7AC) has an interest in the disposing company as a result of their interest in Q , then

the QIIs' interest in the investing company is ignored so that any exemption under TCGA92/SCH7AC is disapplied. In other words, TCGA92/SCH5AAA/PARA16(3) takes priority.

Interaction of TCGA92/SCH5AA/PARA16(2) and (3) and the REIT rules in CTA10/PART12

TCGA92/SCH5AAA/PARA35 provides that where a company that is both –

- a UK REIT, or a member of a UK REIT, and
- a company in the ownership chain of a qualifying fund or qualifying company

makes a gain on a direct or indirect disposal of UK land and that gain might otherwise be exempted under both TCGA92/SCH5AAA/PARA16(2) or (3) and CTA10/S535 or 535A, the exemption under paragraph 16 is disapplied. In other words, the exemption provided by the REIT rules takes priority.

This does not apply in the case of a joint venture company – see below.

TCGA92/SCH5AAA/PARA36 applies where a company makes a gain on a disposal and is –

- a member of a UK REIT group as a result of a notice under CTA10/S586(1) or 587(1) (a joint venture company), and
- is also in the ownership chain of a qualifying fund or qualifying company (both 'Q'), and
- both that company and the principal member of the UK REIT are covered by an election made by Q under TCGA92/SCH5AAA/PARA12,

then any exemption provided by TCGA92/SCH5AAA/PARA16(2) or (3) is reduced by the exemption provided under the REIT rules because of sections 535 or the new 535A of CTA 2010. In other words, the exemption provided by the REIT rules takes priority.

Separate application and limiting of exemptions

In addition to the rules described above that apply for an order of priority as between exemption under Part 4 of Schedule 5AA, the substantial shareholding exemption, and the REIT rules, PARA37 of Schedule 5AAA provides for how the different exemptions are to be calculated generally.

That is –

- each exemption must be calculated separately without regard to any of the other exemption provisions, and
- (bearing in mind the priority rules) the total proportion of a gain which is exempted is the total of those sums, except that the total can never exceed the whole amount of the gain.

CG73997G The exemption election: Ceasing to have effect

Introduction

Where a CIV ceases to meet any of the applicable conditions, or an election is revoked by either the fund or HMRC, the election ceases to have effect. A deemed disposal and reacquisition of the interests of the investors (including those that are UK resident) will generally be triggered but see below for an exception and CG73997J regarding the timing and effect of a deemed disposal.

Revocation of election

See CG73997E for guidance regarding revocation of an election by the fund manager or HMRC.

Ceasing to meet the applicable exemption conditions

Where an election has been made in respect of a qualifying CIV or a qualifying company and there is a time when it ceases to meet the applicable conditions at TCGA92/SCH5AAA/PARA 12(2) and (3) respectively, the election ceases to have effect from that time

(TCGA92/SCH5AAA/PARAs 20(2)). The applicable conditions include those at paragraph 13; see CG73997C for further details.

Where this is the case, TCGA92/SCH5AAA/PARA 22 provides that there is a deemed disposal and reacquisition of all investors' (including UK residents) interests in the CIV or company in question; see CG73997J for further details regarding such deemed disposals.

This is subject to the following –

Temporary period when applicable exemption conditions not met for up to 30 days

Where a CIV or company fails to meet an applicable condition but intends to meet the relevant condition(s) within a 30 day period and does in fact do so, TCGA92/SCH5AAA/PARA 27 provides that –

- a paragraph 12 election for exemption remains valid, and
- there is no deemed disposal of investors' interests

There is one exception to this; in order to protect UK taxing rights the 30 day temporary period does not apply when a CIV or company ceases to be UK property rich as required by paragraph 12(2)(c) or (3)(b).

Additionally, there can be no more than four failures to meet any of the other applicable conditions in aggregate in a rolling 12 month period - a fifth or subsequent will not benefit from the temporary period.

Temporary period when applicable exemption conditions not met for up to 9 months

Where paragraph 27 does not apply, TCGA92/SCH5AAA/PARA 28 may apply instead.

Paragraph 28 provides for an election under paragraph 12 to remain valid for up to nine months if the CIV or company fails to meet an applicable condition but intends to meet the relevant condition(s) within that time and does in fact do so. If the CIV does not meet the conditions again within that time then the exemption election is considered to have ceased to have effect at the point the CIV no longer met the first applicable condition.

The rules for this 9 month period differ to those for the 30 day period in the following respects -

- whilst a qualifying CIV or company cannot benefit from the 30 day exemption / no deemed disposal rule if it ceases to be UK property rich, it can benefit from the 9 month exemption if it ceases to be UK property rich but there will be a deemed disposal for investors, and
- a deemed disposal under paragraph 22 will also arise at the point where any of the other conditions are not met, with any gain being subject to paragraph 23 (see CG73997J).

Manager winding up relevant fund

TCGA92/SCH5AAA/PARA 30 maintains exemption under a paragraph 12 election where an applicable condition is no longer met in respect of a qualifying fund or a qualifying company if the

fund manager is actively taking steps to dispose of the assets of the fund so that it can be wound up.

In the case of a qualifying company, the fund means the limited partnership collective investment scheme (including a deemed partnership as a result of an election for transparency under paragraph 8; see CG73996L) or co-ownership authorised contractual scheme that owns the company and the fund manager is the person that manages that fund (TCGA92/SCH5AAA/PARA 39).

Note however that whilst the exemption continues to have effect a deemed disposal and reacquisition of the investors' interests will arise at the time of the first failure to meet one of the applicable conditions.

Rebasing on leaving the paragraph 12 exemption regime

Where an election under paragraph 12 ceases to have effect, TCGA92/SCH5AAA/PARA32 provides for a proportionate, market value re-basing of qualifying UK land assets of the qualifying fund or qualifying company ('Q') where Q leaves the paragraph 12 exemption regime other than as a result of a revocation notice being issued by HMRC under TCGA92/SCH5AAA/PARA15(5)(a) or 18(1) (see CG73997E). This ensures that the value of the exemption from tax on gains on UK land is preserved within the relevant fund structure as without rebasing the value of the UK land assets held by the fund would be discounted to reflect the unrealised gains.

In order for rebasing to apply, the election under paragraph 12 must have had effect for a continuous period of at least five years, and the rebasing will only affect assets that have been held by the fund for at least a year prior to disposal and which are covered by the election.

Rebasing similarly applies where the fund manager is taking steps to wind up a fund so that an applicable condition is not met but exemption nonetheless continues as a result of TCGA92/SCH5AAA/PARA30 (see above).

Rebasing is applied by deeming Q to have disposed of and reacquired at market value every asset the disposal of which would have been a direct or indirect disposal of UK land and covered by the exemption election. The disposal is deemed to occur immediately before the election ceased to have effect or the fund manager started to take steps to wind the fund up.

Rebasing also applies at the level of a company in the ownership chain of Q where that company holds an asset that has been covered by the paragraph 12 election for at least 12 months (for example, a company holding a UK property asset, where that company is owned by another company that is in turn owned by Q).

Rebasing is proportionate to the level of interest held in the relevant asset by Q.

CG73997J The exemption election - Deemed disposals

Introduction

When a paragraph 12 election ceases to have effect as a result of TCGA92/SCH5AAA/PARA 20 because the applicable conditions are no longer met, or the election is revoked, there is a deemed disposal and reacquisition at market value of all of the investors' interests in the qualifying fund (CIV) or qualifying company. The deemed disposal and reacquisition arises immediately before the point the election ceases to have effect. This is subject to one exception in respect of a failure to meet certain conditions for temporary periods lasting no longer than 30 days, see CG73997G for details.

A deemed disposal will also arise under TCGA92/SCH5AAA/PARA 21 where a return of value is made to investors and the amount in question is of a revenue nature; see below for further details.

Any tax due as a result of a deemed disposal of an interest in a qualifying fund or a qualifying company is generally not due until funds are paid to the investor in respect of their interest in the fund or a period of three years elapses from the deemed disposal, other than in a case of revocation of the election; see below for further details.

Occasions that will result in a deemed disposal

Ceasing to be UK property rich

If a qualifying fund or qualifying company ceases to be UK property rich the deemed disposal of investors' interests occurs immediately before that point (but see CG73997G for details where the fund or company itself may nonetheless continue to be exempt in respect of its disposals of UK land where it is not UK property rich for temporary periods lasting no longer than 30 days).

The fund or company ceases to be UK property rich as a question of fact, rather than at the point when it becomes aware that it is no longer UK property rich. HMRC would expect entities that have made a paragraph 12 election for exemption to regularly value their assets so that they know within a reasonable timeframe if they are no longer UK property rich. HMRC will accept for this purpose that quarterly appraisals would be sufficient (that is, taking a view of the market and making reasonable adjustments to the previous formal valuation), supplemented with periodic formal valuations as provided for in the fund's documentation.

See the table below regarding the time when gains are treated as accruing.

Payments not otherwise taxable

An election under TCGA92/SCH5AAA/PARA12 has the effect of exempting gains on direct and indirect disposals of UK land within a fund structure, but whilst disposals are exempt at fund level the investors remain taxable on gains on disposal of their interests in the fund. Without specific provisions, value arising from realisation of UK land assets within an exempt fund could be returned to non-resident investors in a form that would not be subject to UK tax and that would reduce any gain on a subsequent disposal by investors.

For example, if a corporate fund made a distribution to its investors that represented value deriving from gains on UK land and that payment was of a revenue nature it would not give rise to a charge under TCGA92/SCH1A and the value of those gains would also no longer be represented in the value of the interest held by the investors in the fund when they subsequently made a disposal of the whole or part of that interest.

TCGA92/SCH5AA/PARA21 therefore provides that where a qualifying fund or a qualifying company makes a return of value, and that amount is of a revenue nature and is representative of gains on disposals of UK land, there is a deemed disposal and reacquisition of the investors' interest. Note that this is not a condition that the fund or company must meet; if it does make such a return of value its exemption is not affected but a deemed disposal and reacquisition will arise for its investors.

The disposal occurs immediately before the payment is made and reacquisition immediately after. The deemed disposal only arises for investors who would be subject to tax on that distribution.

See the table below regarding the time when gains are treated as accruing.

Election ceasing to have effect

TCGA92/SCH5AA/PARA22 provides for a deemed disposal and reacquisition if a paragraph 12 election ceases to have effect. An election may cease to have effect because –

- the applicable conditions are no longer met (subject to an exception in respect of a failure to meet certain conditions for temporary periods lasting no longer than 30 days, see CG73997G for details), or
- the election is revoked by either the fund manager or HMRC.

There is a deemed disposal and reacquisition at market value of all of the investors' interests in the qualifying fund (CIV) or qualifying company immediately before the point the election ceases to have effect.

See CG73997E and CG73997G for further details regarding revocation of election, and ceasing to meet the applicable conditions for exemption.

See the table below regarding the time when gains are treated as accruing.

Revocation of election by fund manager or HMRC

Where an election is revoked, a deemed disposal and reacquisition of all the investors' interests in the CIV will occur immediately before the revocation.

See the table below regarding the time when gains are treated as accruing.

Calculation of the gain or loss on a deemed disposal and reacquisition

The basis of the gains or losses arising on a deemed disposal will be the market value of the interest at the time of the deemed disposal.

For the purposes of calculating the gain or loss arising on a deemed disposal, no account is taken of any later changes to the value of an investor's interest in the relevant fund or company after the point it loses its exempt status. So, if there is a deemed disposal any gain or loss is calculated at that time and cannot be adjusted to reflect any future change in value of an investor's interest in the fund (this does not affect the possible availability of any relievable losses).

TCGA92/SCH5AA/PARA24 does however provide for relief for any costs that could reasonably be expected to have been incurred in the event of an actual rather than a deemed disposal. This will be relevant where, for example, a fund ceases to be UK property rich because the manager is disposing of assets as part of a process of winding up the fund; any gain or loss will include realised and unrealised gains on the underlying assets of the fund and in such circumstances relief is available under TCGA92/S38(1)(c) in respect of anticipated costs of disposing of the remaining assets. See CG15150 for general guidance on items of expenditure that can be deducted in calculating a gain or loss.

Time at which gains accrue

In some circumstances, a gain on a deemed disposal is brought into charge immediately. A gain realised on an actual disposal will always be treated as accruing at the time of the actual disposal. In other cases, TCGA92/SCH5AA/PARA23 provides for gains on deemed disposals to be deferred and brought into charge at some time later. The table below summarises the position.

Occasion of deemed disposal	Time gain treated as accruing
1) Paragraph 21: Payments of a revenue nature not otherwise taxable	• The appropriate portion* of the deemed gain is treated as accruing to the person at the time of an actual disposal or otherwise the time of the receipt

	• Any balance of gains remaining is brought into charge on the occasion of an actual disposal or when the fund winds up
2) Paragraph 22: Para 12 exemption election ceases to have effect – revocation of election under para 15 or 18	Immediately prior to the para 12 election ceasing to have effect
3) Paragraph 22: Para 12 exemption election ceases to have effect – ceasing to meet applicable exemption conditions	When the fund winds up or, if sooner – • on an actual disposal, or • three years after the deemed disposal

* The proportion which the consideration for the amount of the receipt bears to the amount of the deemed gain.

In the case of (3) above, where a qualifying fund or company ceases to meet the applicable conditions for a temporary period of up to 9 months so that –

- paragraph 28 applies (see CG73997G) but
- a deemed disposal nonetheless arises

and the fund or company then meets the applicable conditions within the 9 month period, the three year period is switched off and any deemed gain will only be chargeable when an investor receives funds from the CIV, makes an actual disposal or at the point the fund is wound up. If the CIV again ceases to meet the condition, there is another deemed disposal and reacquisition, and the rules above apply again.

As there may be a number of deemed and actual disposals depending on the circumstances, paragraph 23 contains rules to ensure gains charged cannot exceed the overall total gains. If some of the deemed gain has accrued on one or more previous occasions, the appropriate portion is restricted so that, when added to the appropriate portion or portions on the previous occasion or occasions, it does not exceed 100%.

Notification to investors on the event of a deemed disposal

TCGA92/SCH5AA/PARA25 provides that in certain cases the manager of a relevant fund must notify the investors that a deemed disposal and reacquisition has occurred. This is because investors may not be aware of the event giving rise to the deemed disposal. A notification must be made within 30 days of the event leading to the deemed disposal.

Paragraph 25 specifies that notifications must be sent in the following cases (see guidance above for further details regarding these deemed disposal events) -

- There is a deemed disposal under TCGA92/SCH5AA/PARA21 (gains on UK land are distributed as revenue payments). In such cases, the fund manager is very unlikely to know

how each investor is impacted by the rules in paragraph 21 because that will be dependent on each investor's own tax status. The fund manager, however, must notify all investors to ensure that they are aware there may be a capital gains liability and can accordingly assess their own positions.

- There is a deemed disposal under TCGA92/SCH5AA/PARA22 where either the fund manager or HMRC has revoked a paragraph 12 exemption election.
- Where the balance of a deferred gain has come into charge at the end of a three year period or because the fund has wound up

Given that the deemed disposal will in some cases mean that the investors are immediately liable to pay tax on the gain, and in some cases the gain will accrue at a later date, whilst there is no legal requirement to do so the fund manager may wish to supplement the notification to provide further helpful information for its investors. It will though remain the responsibility of the investors to determine their own tax positions in any case.

In the case of a deemed disposal and reacquisition, investors in the CIV who are required to make a return and payment on account to HMRC within 30 days of making a disposal of UK land will instead have 30 days from receiving notice of the deemed disposal to make a report and payment.

TCGA92/SCH5AA/PARA26 provides for the fund manager being liable to a penalty not exceeding £3,000 where there is a failure to make a notification and HMRC assess the penalty and notify the manager within a period of 12 months from the date HMRC become aware of that failure. Paragraph 26 provides for an appeal process.

CG73997L Meaning of wholly owned and almost wholly owned

Paragraph 40 of Schedule 5AAA to TCGA 92

A company (including a deemed company under para 4 of Schedule 5AAA) is "wholly owned" if a person or persons have a 100% investment in the company. Investment is measured using the rules in paragraph 9 of Schedule 1A TCGA 92 (see CG73938), but assuming that the level is 100% rather than 25%. Where necessary, a CIV is considered a person in terms of whether paragraph 9 applies to test whether they have a 100% investment (such as for a limited partnership under paragraph 12(3) of Schedule 5AAA; see CG73997A).

Similarly, a company is "wholly owned or almost wholly owned" if a person or persons have a 99% or greater investment in that company.

CG73997N Reporting requirements

Introduction

The effect of an election for exemption under paragraph 12 of Schedule 5AAA is to move the point of taxation on gains on UK land from the relevant fund to its investors. It is therefore necessary for HMRC to have access to information regarding a fund's non-resident investors and Schedule 5AAA provides for information to be reported in two regards –

- TCGA92/SCH5AAA/PARA14 requires that in order for an election for exemption to have effect, information regarding disposals of investors' interests in the fund in the two years prior to the date of the election (or, if shorter, since the fund was constituted) must be provided to HMRC; and
- TCGA92/SCH5AAA/PARA15 of Schedule 5AAA provides that information or documents must be provided to HMRC in respect of every period of account ending at a time when the election has effect.

Paragraph 15 provides that HMRC may specify what information is to be reported in respect of participants in the fund and that –

- The information must be provided in relation to the fund's period of account,
- within 12 months of the end of the period of account.

This is subject to paragraph 16(8), which provides that for reporting a period of account may not be longer than 12 months.

This means that reporting requirements are not specified in Schedule 5AAA and are instead set out in this guidance. HMRC stated in the Technical Note published on 7 November 2018 that they will consult relevant stakeholders prior to making material changes to the information to be reported.

Reporting is done at fund level. This means that, where an election is made by a limited partnership or UK co-ownership authorised contractual scheme under paragraph 12(3), reporting is to be done at the level of the LP CIS or CoACS.

Where the requirements of paragraph 15 are not met as regards the provision of information and documents (a breach) without a reasonable excuse, a designated officer of HMRC may revoke the election. Notwithstanding the absence of a reasonable excuse, if a breach is considered insignificant it may be ignored. In considering whether a breach is insignificant HMRC will take account of the number and seriousness of previous breaches. See below for further detail.

This guidance will be updated to provide details of how to make the required reports and contact details for queries regarding reporting requirements.

Reporting for the exemption election

Contents of the report for CIV established on or after 1 June 2019

For CIVs set up on or after 1 June 2019, the report should contain the information listed below. This may require the insertion of suitable wording in the fund's terms and conditions to ensure investor consent to the sharing of their information.

The report should be accompanied by a statement that the CIV meets the qualifying conditions for the period the report covers, or in the case of a report where the exemption is not being claimed for the period, the conditions that are met.

There is no legislative significance to 1 June 2019. This date is to allow for a period of time after the rules come into force. Information in respect of the CIV making the election and entities in its structure.

Information in respect of the CIV making the election and entities in its structure

1. Name and address of the CIV making the report (the 'top-level' entity)
2. Total value of disposals by the top-level entity in the period (or £Nil)
3. Overall gain or loss on disposals (if appropriate)
4. Name and address of entities in the structure under the top-level entity which are covered by the exemption, and for each of the entities:
    - The percentage interest the top-level entity holds in them
    - The total value of their disposals
    - Overall capital gain or loss on their disposals

Information in respect of the investors in the CIV making the election

First name and surname or company name of all investors, and for each of those investors so reported:

1. Their address
2. Their UK Capital Gains Tax Unique Taxpayer Reference (if held)
3. Their UK Corporation Tax Unique Taxpayer Reference (if held)
4. The total value of their disposals
5. Their overall capital gain or loss (if this is calculable)
6. Whether the investor is not liable to UK tax on the disposals by reason of exemption, immunity, or other similar status (if held)

For the total value of disposals, the CIV must report on the basis of information it can reasonably be expected to obtain given the terms of its agreement with the investor and the information it has available.

This would at the least be any redemptions made by the investor in respect of their interest in the top-level entity, but in some cases may be secondary market transactions where the CIV's agreement with the investor would mean this information is available.

Contents of the report for CIV established before 1 June 2019

Established CIVs may be restricted in disclosing personal information about their investors under their local information law, and not have terms in their agreement with the investors that allows them to override those restrictions.

To the extent that they are prevented from providing information to HMRC for legal or regulatory reasons, or because of the contractual impediments of their agreement with the investors, there are easements to what is required to be reported in respect of the investors.

In general, provision of information is subject to reasonable excuse. If an existing CIV - set up without being able to take account of these requirements - legally cannot obtain information pertaining to an investor because of existing agreements or local law or regulations, it is reasonable that they not be able to supply that information to HMRC.

All information in respect of the CIV making the election itself and entities in its structure must still be reported.

Subject to the above, the same information regarding the investors set out above must be supplied in the report.

Breaches of requirement to make a report

Incorrect reporting

In general, HMRC will expect the CIV to take reasonable care to ensure that information reported to HMRC is complete and correct.

A designated officer of HMRC may revoke the election for exemption if there is a serious breach of the reporting requirements. Where the election is so revoked, there will be a deemed disposal and reacquisition of all of the investors' interests in the fund which occurs immediately before the revocation.

Where there is a reasonable excuse, the election will not be revoked. Otherwise, HMRC will consider the number and seriousness of breaches made in reporting.

HMRC will consider there to have been a serious breach where the CIV reports incorrect information with respect to the disposals by any investor who is taxable and:

- holds a 25% or greater interest in the CIV, or
- the value of whose investment in the CIV is £1,000,000 or greater

In other circumstances, a designated officer of HMRC may revoke the election if the information provided is consistently incorrect to a significant degree, and in particular with regard to information on the disposals by investors.

Late reports and failure to report

HMRC may allow an extension to the time limit where there is a reasonable excuse. If an extension is agreed then the election remains valid and there is no deemed disposal and reacquisition.

A simple failure to report at all will be treated as a serious breach and HMRC will revoke the election.

Annexe 1

IFM17050 Common Themes: Genuine Diversity of Ownership (GDO)

Foreword

This guidance has been drafted for the purposes of the tax rules for authorised investments funds, offshore funds (see below) and their investors. It brings together guidance from the HMRC Company Taxation Manual and Offshore Funds Manual and will be included in a new Investment Funds Manual in due course.

From 6 April 2019, the GDO test will also have relevance for the purposes of the non-resident capital gains rules in Schedule 5AAA of TCGA 1992. The GDO condition, where it applies for Schedule 5AAA purposes, is as set out in regulation 75 of The Offshore Funds (Tax) Regulations 2009 (SI 2009/3001) but the GDO condition for authorised investment funds operates in a similar way.

The guidance below is not yet final but is produced here as, aside from the parts that are clearly relevant only to authorised investment funds or offshore funds, it will have relevance for Schedule 5AAA purposes as well. The guidance should be read in that context.

Note that one of the key differences between the GDO rules for Schedule 5AAA purposes is that there is no clearance procedure as to whether the GDO condition is met for the latter. The original clearance procedures were introduced when the GDO condition first appeared in legislation; customers and advisers are now more familiar with how the condition operates, particularly as the guidance has developed, and this is evidenced by a steep decline in clearance requests. HMRC will continue to work with stakeholders to refine the guidance where necessary.

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IFM17100 Common Taxation Themes: Genuine Diversity of Ownership (GDO): Introduction

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

Some tax rules for collective investment schemes and investors only apply if a fund meets the GDO condition – for authorised investment funds see regulation 9A of SI 2006/964 and for offshore funds see regulation 75 of SI 2009/3001. See IFM17200.

To meet the condition a fund must be set up and managed to enable a diverse range of investors to benefit from the expertise of the investment manager and from the economy of scale that comes from pooling funds.

This protects against tax manipulation using funds controlled by a small number of investors (such as members of a family or companies in common ownership).

There are three conditions (Conditions A, B and C) which a fund must meet throughout an accounting period to qualify as having genuine diversity of ownership. Conditions A, B and C are explained at IFM17300.

A fund may also meet the GDO if an investor in the fund is an authorised investment fund or offshore fund (a "feeder fund") and conditions A to C are met in relation to the fund when taking into account the fund documents and investors of the feeder fund. Both funds must be under the same manager for this to apply.

IFM17200 When does the Genuine Diversity of Ownership condition (GDO) apply?

Authorised Investment Funds – regulation 9A of SI 2006/964

The GDO applies in determining the tax treatment of investment transactions carried out by diversely owned AIFs under Part 2B SI 2006/964 (see IFM02260).

It also applies to authorised investment funds (AIFs) that are (or will be applying to be):

- Property AIFs (see IFM04050).
- Tax Elected Funds (see IFM06050).
- Qualified investor schemes (QISs) (see IFM02300).

Offshore Funds – regulation 75 of SI 2009/3001

The GDO applies in determining the tax treatment of investment transactions carried out by offshore funds that are reporting funds (see regulation 80 SI 2009/3001).

Where an offshore reporting fund can demonstrate compliance with the GDO it will benefit from certainty of treatment with regard to investment transactions and in calculating the

amount of reportable income arising to investors (see IFM12500 for further details on the calculation of reportable income).

To qualify for this treatment, an offshore reporting fund must be of a kind that meets the equivalence condition in regulation 74.

Optional advance clearance application form

An AIF or an offshore fund can apply to HMRC for an advance clearance for the GDO. (See IFM17400).

IFM17300 Common Taxation Themes: Genuine Diversity of Ownership (GDO) Conditions

IFM17310	Condition A
IFM17320	Condition B
IFM17330	Condition C

IFM17310 Common Taxation Themes: Genuine Diversity of Ownership (GDO): Conditions: Condition A

Condition A: The fund documents (authorised investment funds: Regulation 9A(3) SI2006/964 or offshore funds: Regulation 75(2) SI 2009/3001))

The purpose of Condition A is to ensure that access to the fund is made widely available to the intended categories of investors. To achieve this the fund must have committed to targeting the categories of investors it has specified and to market the fund and make it available to those target categories. This commitment should be binding and public.

Specifying in the fund documentation that the fund will be marketed and made available to a target market, which includes a large number of unconnected persons will always meet the requirements of this condition. For example, fund documents could state:

> "The fund is suitable for investors looking to make a medium to long term investment and who are looking for capital growth returns. Units in the fund will be marketed to these types of investors and will be made available to them by a network of distributors appointed by the fund."

Unconnected persons in this context means any persons who are not connected under s1122 CTA 2010 for companies and ITA07/S993 and S994 for individuals.

For offshore funds, evidence of meeting the GDO does not have to be in a prescribed form; Condition A only requires that the fund produces 'documents' that contain the relevant statements and undertakings and that are made available to investors (including potential investors) and HMRC.

A fund may have one or more categories of investor and reference to categories is meant to be widely drawn. Some typical examples may include one or more of:

- General retail investors - individual investors, who may be tax exempt ISA investors, with no requirements as to wealth levels.
- High net worth investors - individual investors, where there is a significant minimum investment level.
- Institutional investors - investors such as pension funds, sovereign wealth funds and insurance companies.

In determining whether condition A has been met, HMRC will look at the fund documents to ensure that they contain a statement that the units in the fund will be marketed and made widely available. The documents should also clearly specify the intended categories of investor. HMRC will consider whether these are sufficiently wide to ensure that the fund is not limited to a few specific persons named or implied by the given categories.

IFM17320 Common Taxation Themes: Genuine Diversity of Ownership (GDO): Conditions: Condition B

Condition B: Terms and conditions of the fund (authorised investment funds: Regulation 9A(4) & (5) SI2006/964 or offshore funds: Regulation 75(3) SI 2009/3001)

The purpose of Condition B is to exclude funds which (notwithstanding anything contained within the fund's documents designed to meet condition A) are 'private' or only available to specific individual or corporate investors. Such a limitation may be achieved by a specific rule in the fund documentation or by imposing terms and conditions that would deter investors outside the limited group.

The terms and conditions of the fund should not be set in such a way as to limit investment to a select group within the stated categories of investors and they should not deter a reasonable investor within the target market from investing in the fund.

For example, Condition B may not be met where charges differ for particular investors and the charges are such that a potential investor within a target category could not reasonably be expected to invest. The condition is not intended to prohibit normal commercial variations in charges. It is aimed at situations where the target market is stated to include a particular category of investor but either the charges or the minimum investment are applied in a discriminatory way so as to effectively exclude all but a select few, such as quoting a reasonable market rate annual management charge for favoured persons but a much higher charge for another person within the same category of investor.

Fund documentation may cover possible future extension of the target market, but that will not be taken into account in determining whether Condition B is met: the test is by reference to the current position.

IFM17330 Common Taxation Themes: Genuine Diversity of Ownership (GDO): Conditions: Condition C

Condition C: Marketing requirements, providing information and selling units (AIF Regulation 9A(6) SI2006/964 or OFs Regulation 75(4) SI 2009/3001)

The purpose of Condition C is to exclude any fund that, despite meeting Conditions A and B, does not act in a way that supports the statements it has made as to the intended categories of investor – even where that is contrary to the statements in its own documentation.

Detailed guidance on Condition C can be found in the sections below.

IFM17335	Marketing Requirements
IFM17340	Feeder Funds
IFM17345	Temporary Circumstances where Condition C is met
IFM17350	Continuing Requirements
IFM17375	Checking Condition C

IFM17335 Common Taxation Themes: Genuine Diversity of Ownership (GDO): Criteria to meet the GDO: Condition C: Marketing requirements

'Marketing' for this purpose includes any activity that is designed to bring the fund to the attention of investors within the target market.

Where there are a substantial body of unconnected investors in a fund then HMRC accept that this condition has been met.

Generic marketing may include (but is not limited to):

- Advertisements mentioning the fund in relevant publications, online or on posters.
- Direct mail packs sent to the target market and/or their advisers which specifically promote the fund.

- Events for intended categories of investors and/or their advisers featuring content relating to the fund.
- Active representation to IFA firms and/or other distributors to add one or more individual funds/sub-funds to their fund offering for investors.

Specialist marketing: Marketing to institutional and sophisticated investors may be more narrowly targeted. For example, a qualified investor scheme (QIS) may be aimed at a particular type of institutional investor, such as life insurance companies. Any activity designed to attract the specified category of investor will constitute marketing for this purpose. This could include:

- Direct contact such as presentations to or meetings with institutional or high net worth investors or their consultants.
- Advertisements in specialist or financial publications to attract sophisticated investors or their advisers.

HMRC would expect that the fund manager would retain records to show that such activity had taken place.

Marketing activity that may not be continuous: HMRC also recognises that marketing is not necessarily a continuous activity. For example:

- it may not begin immediately on launch of a fund because, for example, there is a need to establish a short term performance record; or
- the fund's marketing strategy may be more active when initially launched and then decline as the fund reaches maturity or decline stage; or
- while marketing activities have been undertaken, for instance in the form of meetings with high net worth individuals, there may be a period of no meetings because of a fall in the markets.

However, where there is no continuous marketing activity then there must be a clear and continuing intention to make the fund available to its target market or to wind it up. A marketing plan that is documented or recorded may help to satisfy condition C in these instances.

HMRC would not seek to exclude a case where a fund starts out with a low number of investors (for example, cornerstone investors), as long as there is subsequently a clear and continuing intention to market and make available the fund to all categories of investors specified.

Marketing activities not required: Some specialist funds may not need active marketing to gain the investors identified in the target market, for instance because of the reputation of the fund manager. In this situation, HMRC will accept that condition C is met where the information about the fund is made available to all investors within the target market and is made accessible to them on request. In these circumstances, as long as there is no evidence of a 'privately owned fund' and there are a number of unconnected investors in the fund, then condition C will be considered to be met.

IFM17340 Common Taxation Themes: Genuine Diversity of Ownership (GDO): Criteria to meet the GDO: Condition C: Feeder Funds

Feeder funds (authorised investment funds: Regulation 9A(8) SI2006/964; offshore funds: Regulation 75(5) SI 2009/3001)

This provision allows HMRC to take into account the intended categories of investors in an associated investor fund of an AIF (a 'feeder fund') in establishing whether the GDO is met. The feeder fund and the fund must have the same manager.

For example, HMRC would not seek to exclude an AIF or Offshore Fund where the only beneficial investor was a unit trust scheme (feeder fund), providing that the funds together satisfy the GDO and the two entities have the same manager.

If a fund meets the GDO without needing to rely on a feeder fund then there is no need for it also to demonstrate that any feeder fund(s) meet the condition.

IFM17345 Common Taxation Themes: Genuine Diversity of Ownership (GDO): Criteria to meet the GDO: Condition C: Temporary Circumstances where Condition C is met

Temporary circumstances where Condition C will still be met (AIF Regulation 9A(7) SI2006/964) or OF Regulation 76(2) SI2009/3001)

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 this 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) SI2006/964.)

There are two exceptions to this:

Where the capacity of the fund to accept investments is fixed by the fund documents;

Where 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.

In either case, condition C will not be met.

The exceptions are not intended to prevent pre-launch marketing of a fund, but a fund should retain evidence that a range of investors in the target market have had the opportunity to invest in case access to the fund becomes temporarily limited.

HMRC also recognises that the manager of the fund may not be able to accept investment for regulatory or legal reasons. For example, it may not have been possible to complete customer

due diligence under the money laundering regulations or in the case of a QIS the intending investor does not meet the 'Eligible Investor' test. Exclusion of a particular investor in such circumstances will not in itself cause condition C to be failed.

IFM17350 Common Taxation Themes: Genuine Diversity of Ownership (GDO): Criteria to meet the GDO: Condition C: Continuing Requirements

Where a fund is already established, HMRC would not expect the fund documents (or draft fund documents) supplied to be in conflict with the fund's normal practice of marketing and making available the units or shares in the fund. 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.

Where the fund documents meet Conditions A (IFM17310) and B (IFM17320) and clearance has been given to a newly established fund on the basis of meeting these two conditions, then HMRC expects that Condition C will normally be met because the fund's own documentation will require this in accordance with Condition A.

IFM17375 Common Taxation Themes: Genuine Diversity of Ownership (GDO): Criteria to meet the GDO: Condition C: Checking Condition C

HMRC accept that this condition has been met where there is clear evidence that a substantial part of the fund investors are unconnected, as the marketing would have had to be sufficiently wide to achieve this outcome.

If an HMRC officer believes that a fund may not have satisfied Condition C in accordance with the relevant statements in the fund documents then they should seek advice from the Collective Investment Schemes Centre or Business, Assets and International Directorate.

IFM17400 Common Taxation Themes: Genuine Diversity of Ownership (GDO): advance clearance procedure

IFM17410	Introduction
IFM17420	Application
IFM17430	Reliance on a clearance

IFM17410 Common Taxation Themes: Genuine Diversity of Ownership (GDO): advance clearance procedure: Introduction

Authorised investment funds: regulation 9B of SI 2006/964; offshore funds: regulations 77-79 of SI 2009/3001

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) (IFM17100). The manager or proposed manager is advised to use the GDO advance clearance application form to make this clearance request. The form provides a 'checklist' which it is hoped will, when followed, reduce the chance of an application being refused.

The pro forma application form (CISC5) is available on the gov.uk website.

If a fund plainly meets the GDO, for example where:

- a fund has or is intended to have a wide range of unconnected investors
- a professional adviser can confirm compliance with the condition

then it will not need clearance.

Where a fund is planning to become a Property AIF (see IFM04050) or a Tax Elected Fund (see IFM06050) then advance clearance will simplify the notification or application process.

IFM17420 Common Taxation Themes: Genuine Diversity of Ownership (GDO): advance clearance procedure: Application

Applications for clearances must be made in writing in respect of an accounting period for which clearance is sought to HMRC's Collective Investment Schemes Centre whose address can be found on the gov.uk website.

The application should be accompanied by:

- the instrument constituting the fund (the instrument of incorporation for an open-ended investment company or the trust deed for an authorised unit trust) or other document which outlines the form the fund will take; and
- the current prospectus or proposed prospectus (including any supplements to the prospectus).

A fund may find it helpful to explain in the application the reasons for particular terms and conditions, such as variations in management charges or minimum investment levels for different categories of investors.

Where the fund relies on an associated feeder fund structure to meet the GDO, in addition to the fund documents stated above, the manager must also submit the fund documents of the feeder fund.

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

- request further information (the 28 day period to respond will re-start once all the relevant information has been received by HMRC);
- give clearance (which may be subject to stated conditions);
- refuse to give clearance. HMRC will explain the reasons for refusal. Refusal does not prevent a further application, but HMRC would expect that the reasons for the refusal would be addressed before a further application is made.

IFM17430 Common Taxation Themes: Genuine Diversity of Ownership (GDO): advance clearance procedure: Relying on clearance

A fund may only rely on a clearance in any period of account if the relevant statements in fund documents are in accordance with such statements made in the documents provided to HMRC with the fund's clearance application. The fund must not act in any way that contravenes such statements, and must continue to meet the GDO condition.

If the fund materially amends any of the documents sent with its original application then it must make a new application if it wishes to rely on the clearance.

The fund will be able to rely on the clearance from the date on which the fund documents became effective in the form supplied to HMRC for clearance (even if that is earlier than the date clearance was given).

If GDO clearance is given for one purpose then it is also applies for others. For example, if a qualified investor scheme (see IFM02300 onwards) has obtained GDO clearance it will also be treated as a diversely owned AIF if it carries out investment transactions (see IFM02260).

Annexe 2

GREIT05005 Capital gains: general: CTA2010/S535 and S535A

Exemption from tax of gains

As well as exempting property rental income from tax, gains made on assets that are used in the property rental business (GREIT05006) and, for accounting periods beginning on or after 6 April 2019, on disposals of UK property rich companies (GREIT05007) are not chargeable gains (CTA2010/S535 and S535A). If such a disposal results in a loss, that loss will not be an allowable loss (TCGA1992/S8(2)).

The amount of gain or loss on any disposal is calculated following the normal rules in TCGA, including indexation. Other terms and expressions used in connection with the calculation also take their meaning and interpretation from TCGA given CTA2010/S535 and S535A are to be read as if contained in TCGA 1992 (CTA2010/S535(9) and S535A(9)).

GREIT05007: Capital gains: Indirect disposal of property rental business assets: CTA2010/S535A

For accounting periods beginning on or after 6 April 2019 an appropriate proportion of gains arising on disposals of interests in UK property rich companies by a UK REIT, or a member of a UK REIT, are not chargeable gains (CTA2010/S535A).

Section 535A also applies to entities within TCGA92/SCH5AAA/Para 8 (see CG73996L), referred to in the legislation as a 'relevant fund'. These are offshore collective investment vehicles which are transparent for income tax purposes, excluding partnerships, and that have not made an election for transparency for TCGA purposes under paragraph 8.

Whether a company or relevant fund is UK property rich is determined by reference to the rules in Schedule 1A of TCGA 1992 (see CGM73920 onwards).

The appropriate proportion is the proportion that (in respect of the company in which the interest is disposed of) assets deriving value, directly or indirectly, from assets used for the purposes of the UK PRB, bear to the total assets. For this purpose the values are taken at the beginning of the accounting period, or the date of acquisition if later, valued in accordance with international accounting standards, using fair value where there is a choice and ignoring any liabilities secured against or otherwise relating to the assets.

Example

A gain of £1000 arises in the accounting period ending 31/12/21 on a disposal by UK-REIT company A of its interest in subsidiary company B. Company B's assets at 1/1/21 consist of residual business assets value 20 and PRB assets 80. Using the value of PRB assets/value of total assets x gain (80/100x1000) results in £800 not being a chargeable gain. The chargeable gain is therefore £200.

Where the disposal is of a relevant fund then the appropriate proportion is the proportion the value of the fund's assets, derived directly or indirectly from assets used in the PRB, bears to the value of its total assets.

Example

A gain of £1000 arises in the accounting period ending 31/12/21 on a disposal by UK-REIT company A of its units in Jersey property unit trust (JPUT). JPUT's assets at 1/1/21 consist of property rental business assets £400 and 80% of the shares in company B, value £500 from PRB assets and £100 from residual business assets. The value of JPUTs assets, derived directly or indirectly from assets used in the PRB, is (400 + 80% of 500) £800 and total assets (400+80% of 600) £880. Using the value of PRB assets/value of total assets x gain (800/880x1000) results in £909 not being a chargeable gain. The chargeable gain is therefore £91.

Pre-April 2019 residual business losses or deficits

A company may use any unused residual business losses or non-trade deficits at 6 April 2019 in computing the amount of the gain not chargeable under CTA2010/S535A (CTA2010/S535B).

It may appear strange to use losses against a gain which is not chargeable. However by doing so the UK REIT may reduce the level of property income distribution which is paid under deduction of withholding tax. A distribution from gains, covered by losses brought forward at 6 April 2019, would be a normal dividend.

Where the gain is not covered by losses then the amount not chargeable under CTA2010/S535A will contribute to reserves under category (d) of CTA2010/S550 (Attribution of distributions). This means that any distribution from the proceeds of the disposal may need to be attributed to pot(d) (see GREIT08035) and is then a property income distribution to which the withholding tax provisions of SI2006/2867 Real Estate Investment Trusts (Assessment and Recovery of Tax) Regulations 2006 apply (see GREIT08060).

Where the company's accounting period straddles 6 April 2019 then, for the purpose of determining losses at 6 April 2019, the accounting period is treated as 2 separate accounting periods. Any losses are time apportioned between the period ending 5 April and the period beginning 6 April. If such an apportionment produces an unjust or unreasonable result then the apportionment may be carried out on a just and reasonable basis.

GREIT04050 Property rental business income: investment/trading borderline: 3 year development rule: CTA2010/S556

If a UK-REIT develops a property with the intention of disposing of it, before or following completion of the development, any gain, loss or profit arises to the residual business. Likewise a disposal of property by disposing of the shares in a holding company before 6 April 2019 also falls to the residual business.

If a UK-REIT disposes of property used wholly and exclusively in the property rental business, any gain or loss arising on its disposal may be exempt (CTA2010/S535 &S535A). However if a UK-REIT develops a property with the intention of retaining it as part of the portfolio, but sells it within three years of completion, the disposal may be taken out of the property rental business and any gain, loss or profit arises to the residual business. (CTA2010/S556(3) & 556(3A)).

Conditions

The rule in CTA2010/S556(3) applies to a direct disposal of property if:

- the property has been developed since acquisition
- the cost of the development exceeds 30% of the fair value of the property at the later of the date the company acquired the property and the date the company joined the regime, and
- the company disposes of it within three years of completion of the development.

CTA 2010/S556 does not apply to developments completed before entry into the REIT regime. 'Fair value' is to be determined in accordance with international accounting standards (see GREIT02040). None of the other terms have any specific definition for the purposes of this rule. Broad descriptions of how HMRC will interpret them in applying this rule are set out in GREIT04060.

The rule in CTA2010/S556(3A) applies to the indirect disposal of property, on or after 6 April 2019, by a company C if:

- one or more properties acquired (directly or indirectly) by a relevant UK property rich company B have been developed since acquisition
- the cost of the development exceeds 30% of the fair value of the property (determined in accordance with international accounting standards) at entry or at acquisition, whichever is later,
- C disposes of any of its rights or interests in B, not intra-group, within three years of completion of the development

The rules apply in respect of developments completed after entering the UK-REIT regime, irrespective of when they commenced. Simply transferring the property from one member of a Group REIT to another would not trigger this rule. The rule does *not* say that the disposal is automatically to be taxable as a trading transaction. The transaction moves to the residual business where the normal rules apply to decide if the disposal is by way of trade or capital in nature.

If the property was owned when the company joined the regime, the deemed sale and reacquisition at entry are ignored. The cost of acquisition will therefore be the original cost of the property to the company, as enhanced by any subsequent capital expenditure. As well as the property reverting to its original cost, the company can claim repayment of any Entry Charge paid in respect of the property (see GREIT04055).

Examples

Case 1

Company C acquired property P on 1 July 2015 for 800, which it rents out for 50 per year net of expenses. C enters the UK-REIT regime on 1 January 2016, the market value (and fair value) of P is 1,000, and the market value of the rest of the property rental business properties is 9,000.

In May 2017, the company completes an extension to the building, which cost 350. A too-good to miss offer is made and C sells the property for 2,500 in November 2017.

The developed property is sold within three years of completion of the development, and the cost of development exceeds 30% of the fair value of the property at entry to the regime. The disposal therefore moves to C's residual business. In the circumstances, this would probably be regarded as capital and not a trading transaction.

The gain before indexation of is 1,350 = 2,500 – (800 + 350) (deemed sale and reacquisition at 1 January 2017 is ignored). The gain accrues to and is taxable as part of C's residual business.

Note that although the deemed sale and reacquisition on entry to the REIT regime is ignored, no adjustment is made to the profits of the property rental business for the period 1 January 2017 to November 2017 to reflect the 50 annual rent.

Case 2

Company B, a UK property rich member of UK-REIT group, acquired property P on 1 July 2019 for 800, intending to rent it out. B also has rental property Q. B has no residual business assets. In May 2021 B completes an extension to property P at cost 400.

In November 2020 Parent Company C sells B to an unconnected party and makes a gain of £2000. The gain attributed to P on disposal is 1500 and to Q 500.

The disposal of B is within 3 years of completion of development of P and the cost of that development at £400 is more than 30% of the value of P on acquisition £800. The gain relating to B £1500 is taxed in the residual business. The gain relating to Q £500 is not charged to tax (CTA2010/S535A).