

## CTM48850 - Property Authorised Investment Funds (Property AIFs): tax treatment of distributions in the hands of participants: contents

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## **CTM48851: Property Authorised Investment Funds (Property AIFs): tax treatment of distributions in the hands of participants: introduction**

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In accordance with the principles set out at CTM48811 distributions made by a Property AIF must be split into three pools.

The Financial Services Authority rules that apply to all types of Authorised Investment Funds require a Property AIF must distribute all of its net income. CTM48852 sets out the rules which must be followed in allocating the income of the Property AIF to each type of distribution.

General principles for the taxation of property income distributions are set out at CTM48852.

The tax treatment of each type of distribution in the hands of different participants is set out in the following pages as follows:

- participants within the charge to corporation tax (CT) (generally companies) CTM48853
  - participants within the charge to income tax (IT) (generally individuals) CTM48854 to CTM48857
  - non-resident participants CTM48858
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## **CTM48852 - Property Authorised Investment Funds (Property AIFs): tax treatment of distributions in the hands of participants: property income distributions: general principles**

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### **Property income distributions (PIDs) (regulation 69Z18 SI 2006/964)**

In general, distributions from the tax-exempt profits of a Property AIF are taxable as the profits of a UK property business, in the case of a participant chargeable to income tax, or as the profits from a Schedule A business for a participant chargeable to corporation tax.

#### **PIDs do not carry a tax credit**

Generally, where a person receives a distribution from a company resident in the UK, a one-ninth tax credit is attached to the distribution. However, as the Property AIF is exempt from tax on property income, no tax has been paid to provide a tax credit, any more than there is when a distribution by a UK Real Estate Investment Trusts (UK-REIT) is paid out of its tax-exempt profits.

However, the Property AIF is generally required to deduct income tax at basic rate when paying a PID unless the participant is subject to UK corporation tax.

#### **PIDs are separate from other property income**

A PID is treated as profit of a separate business from any other Schedule A or UK or overseas property business that the participant may have. Receipts of property income distributions from different Property AIFs as well as from UK-REITs, whether one or more are treated as receipts of the same business. This means that losses on other rental business of a shareholder cannot be set off against distributions from Property AIFs or from UK-REITs.

This treatment of Property AIF distributions as deriving from a separate business is extended to the share of the distribution received by a partner in a partnership which is a participant in a Property AIF.

This tax treatment continues to apply after the open-ended investment company has left the Property AIF regime in respect of distributions made in respect of the period before the fund ceased to be within the regime.

Dividend statements provided to participants by a Property AIF (and by a former Property AIF) will make clear the amount of the distribution that is treated as a PID and the amount of tax that has been deducted from it on payment. See CTM48863.

#### **Certain PIDs are treated as trade receipts**

The PID is not treated as property income in various cases where a participant would normally be taxable on distributions as trading receipts. This affects financial traders and members of Lloyd's. In such cases it remains taxable as a trade receipt.

#### **Specific categories of participant**

- corporation tax (CT) payers – see CTM48853
- income tax (IT) payers – see CTM48854 to CTM48857

- non-residents (companies and individuals) – see CTM48858



## **CTM48853: Property Authorised Investment Funds (Property AIFs): tax treatment of distributions in the hands of participants: participants within the charge to corporation tax**

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### **Property income distributions (PIDs)**

For corporate tax payers, under regulation 69Z18 SI 2006/964, PIDs are generally charged to corporation tax as profits of a Schedule A business. This is unlike normal company distributions, which are exempt from tax in the hands of most UK companies. A PID will in general be paid without deduction of tax to persons within the charge to UK corporation tax (regulation 69Z24 SI 2006/964).

The exception to Schedule A treatment is where the recipient is a member of Lloyd's or a financial trader, when the PID is treated as a receipt of their Schedule D Case I trade.

### **Property AIF distributions (interest)**

Property AIF distributions (interest) are treated as if they were payments of yearly interest.

As with a PID, a Property AIF distribution (interest) is generally paid without deduction of tax to companies or Authorised Investment Funds (AIFs) within the charge to UK corporation tax and the participant is, consequently, treated as receiving a gross amount of yearly interest (Regulation 69Z19 SI 2006/964). This is treated as a Case III receipt.

### **Exceptions to gross payments of PIDs and Property AIF distributions (interest) to a company**

1. The exception to the rule is where the person receiving the PID and interest distribution is not itself the participant, but is acting as a nominee for the person beneficially entitled to the interest distribution. In such cases basic rate income tax will still be deducted at source by the AIF and the participant will be treated as having received yearly interest with income tax deducted at the savings rate.

The reason why tax is deducted from payments made to nominee companies is that the nominee is not beneficially entitled to the payment and so is not within the conditions listed at section 349B ICTA 88 to be excepted from the requirement to deduct tax in section 348 ICTA88.

As with PIDs, no tax credit is available under section 231 ICTA 88 for Property AIF distributions (interest).

2. Companies not within the charge to corporation tax (which will include all non-residents except those where the income is attributable to a permanent establishment in the UK) are within the charge to income tax on UK source income and will receive the distribution after deduction of savings rate of income tax.

### **Property AIF distributions (dividends)**

Under regulation 69Z20 SI 2006/964, Property AIF distributions (dividends) received by participants are treated in the same manner as any other UK company dividend. Hence, they are exempt in the hands of participants within the charge to corporation tax.

Unlike a normal AIFs dividend distribution, corporate streaming rules do not apply to Property AIF distributions (dividends) (regulation 69Z20(2)).

## Disposals

Normal rules for corporation tax on chargeable gains apply when a company disposes of shares in a Property AIF.

The only exception to this is where the shares have been held as part of the long-term fund of a life assurance company. In these circumstances, the shares are treated in the same way as shares in other AIFs, with changes in the fair value of the holding being taxable each year.

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## **CTM48854 - Property Authorised Investment Funds (Property AIFs): tax treatment of distributions in the hands of participants: participants within the charge to income tax – property income distributions**

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### **Tax treatment for income tax payers – general (regulation 69Z18 SI 2006/964)**

The property income distribution (PID) is generally taxable as profits of a UK property business (within the meaning of section 264 of ITTOIA 2005).

Persons within the charge to income tax will receive PIDs net of basic rate tax. The amount that is chargeable to tax is the full amount of the PID – that is, the amount of cash received plus the amount shown as deducted from the PID on the voucher that accompanies the distribution. If the participant holds 100 units and the Property AIF pays a PID of £1.00 per unit then the Property AIF will pay £80 to the shareholder and pay over the £20 deducted to HM Revenue & Customs (HMRC) assuming the basic rate of income tax is 20 per cent. The amount chargeable on the shareholder would be £100, made up of £80 cash paid and £20 tax deducted.

The exception to the property income treatment above is for members of Lloyd's and financial traders, for whom the PID is a receipt of their trade.

### **Basic rate taxpayers**

Basic rate taxpayers have no further tax to pay on the PID, as their tax liability on the PID is met in full by the tax deducted on payment. Receiving a PID does not result in basic rate taxpayers having to complete a Self Assessment return if they would not need to do so otherwise.

### **Individuals not liable to income tax**

Investors who are not liable to tax on income can claim repayment of all the tax shown as deducted on the statement attached to the PID, by completing a claim form R40 in the normal way – further information is available on the HMRC website at: <http://www.hmrc.gov.uk/taxback/claiming-back.htm>.

### **Higher rate taxpayers**

Higher rate taxpayers will have a further liability to tax on their PID. If they receive a net PID of £80 after deduction of £20 tax, the amount of income brought into charge is £100, and the tax due in respect of the PID is £40 (£100 at 40 per cent). The £20 tax shown as deducted is credited against the £40 due, leaving a further £20 to pay.

Higher rate taxpayers who do not normally complete a tax return will need to inform their tax office when they receive a PID so that their tax codes can be adjusted to collect the additional tax. Unless the amount of additional income from the Property AIF is large, a higher rate taxpayer would not be sent a tax return just because they were receiving PIDs.

### **Completion of tax returns**

Although chargeable to tax as property income, the PID should not be shown on the property pages. Investors in a Property AIF do not therefore need to obtain and complete property pages, if they have no income from property apart from the PID. Instead the gross amount of any PIDs should be recorded together with the total amount of tax deducted in the 'other

income' section in the main tax return. Losses on other property business, for example income from buy-to-let properties, must **not be off-set against the PID**.

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**CTM48855 - Property Authorised Investment Funds (Property AIFs): tax treatment of distributions in the hands of participants: participants within the charge to income tax – Property AIF distributions (interest)**

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Under regulation 69Z19 SI 2006/964, income tax (IT) will normally be deducted at source by the fund at the savings rate and the participant is treated as receiving yearly interest with IT deducted at the savings rate.

For basic rate taxpayers, there will be no further liability to tax, but higher rate taxpayers will have a further liability.

Participants with no liability to IT will be able to reclaim the tax deducted, as described under property income distributions (PIDs) at CTM48854.

The Property AIF is responsible for deducting tax at the savings rate and for paying the tax deducted to HM Revenue & Customs.

As with PIDs, no tax credit is allowable under section 397 of ITTOIA 2005 for Property AIF (distributions) interest.

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**CTM48856 - Property Authorised Investment Funds (Property AIFs): tax treatment of distributions in the hands of participants: participants within the charge to income tax – Property AIF distributions (dividends)**

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Under regulation 69Z20 SI 2006/964, Property AIF distributions (dividends) received by participants are treated in the same manner as any other UK company dividend.

In the hands of participants within the charge to income tax, Property AIF distributions (dividends) carry a one ninth non-repayable tax credit that will satisfy any income tax liability at the basic rate whilst higher rate taxpayers will have a further liability.

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**CTM48857 - Property Authorised Investment Funds (Property AIFs): tax treatment of distributions in the hands of participants: participants within the charge to income tax –disposals**

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Disposals of shares in a Property AIF are treated in exactly the same way as disposals of units in any other type of Authorised Investment Fund for capital gains tax purposes (see CTM 48215).

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## **CTM48858 - Property Authorised Investment Funds (Property AIFs): tax treatment of distributions in the hands of participants: non-resident participants**

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### **Property income distributions (PIDs) made to non-resident participants**

PIDs receivable by non-resident participators are in general chargeable to income tax (regulation 69Z8(2) SI 2006/964), in the same way as they are for UK-resident income tax payers. In the same way as for UK resident income taxpayers, PIDs are payable under deduction of income tax at the basic rate.

Except where non residents are carrying on a trade in the UK, as set out below, PIDs will always be paid to non-residents under deduction of basic rate income tax. Dispensation to operate nil or reduced rates of deduction will not be given.

Although the PIDs are treated as income from UK property, the Non-Resident Landlord Scheme does not apply to the income (as the PID is paid under deduction of basic rate income tax).

### **Property AIF distributions (interest) made to non-resident participants**

For the purposes of liability to UK income tax, a Property AIF distribution (interest) is treated as a payment of interest originating in the UK.

Except where non residents are carrying on a trade in the UK, as set out below, Property AIF distributions (interest) will always be paid to non-residents under deduction of savings rate income tax. Dispensation to operate nil or reduced rates of deduction will not be given.

### **Property AIF distributions (dividends) made to non-resident participants**

These are treated in the same way as dividends paid by UK companies, and no tax is deducted.

### **Treaty claims for repayment of tax deducted**

If the recipient is resident in a state with which the UK has a double tax treaty, they may be able to make a treaty claim for payment of some or all of the UK tax withheld, depending on the provisions of the relevant treaty and the circumstances of the recipient. Claims are processed by Centre for Non-Residents in the usual way.

The overall withholding rate which actually applies to the whole (three part) distribution will vary depending on the mix of types of income in the distribution and so the percentage that can be reclaimed may vary from one distribution to another.

Hence, a treaty claim will be required in respect of each distribution.

### **Exception to the tax treatments described above**

The only exception to the above is non-residents carrying on a trade in the UK through a permanent establishment who are required to bring the relevant distribution into account in computing their chargeable profits for corporation tax in the same way as UK companies (see CTM48853).

