

Authorised Investment Funds - Interest Distributions and Property Income

Following representations to HM Revenue & Customs (HMRC) the Government has considered the effect of regulation 17(2) of The Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964).

Regulation 17(2) states that “Amounts chargeable to corporation tax in accordance with Part 4 of CTA 2009 must not be included in any amount of income allocated for distribution as yearly interest”. This part of the Corporation Tax Acts deals with income derived from land and buildings.

As an authorised fund is required distribute all its income, this rule has the effect that if even a small amount of income from land and buildings (property income) is received by a fund then it is unable to pay an interest distribution for that period; therefore any distribution must be a dividend distribution.

Normally a bond fund paying an interest distribution would not derive income directly from property. Therefore in most instances this rule would not appear to present a problem. However following the introduction of UK Real Estate Investment Trusts (UK-REITS) and Property Authorised Funds (PAIFs), some companies and authorised funds which invest in property are now paying Property Income Distributions (PIDs). It has been brought to HMRC’s notice that certain funds which previously received dividends may now receive PIDs, which are treated as income from a UK property rental business for tax purposes rather than as dividends.

There has been some doubt expressed over the effect of the regulation mentioned above by some stakeholders.

In the view of HMRC the Regulations as currently drafted do not permit a fund that receives property income to make an interest distribution. However, the Regulations will be amended to make provision for the case of an authorised fund which receives some property income and intends to make an interest distribution.

The Regulations will be amended to provide that where-

1. an authorised fund is (apart from the current regulation 17(2)) qualified to make an interest distribution in respect of a distribution period, and
2. the fund’s total income for the distribution period includes some income which is chargeable to tax under Part 4 of CTA 2009,

then the fund will still be able to make an interest distribution but will be subject to corporation tax on any of its property income with no amounts being deductible against that income.

Regulation 17(2) will then be deleted.

The changes will not be retrospective but see the next paragraph for cases where a past distribution has incorrectly been characterised as an interest distribution.

Past practice

HMRC does not agree with the interpretation of regulation 17(2) that has been proposed by certain fund managers under which an element of PID income could be disregarded, where exceeded by management expenses.

However this has been considered carefully and HMRC has arrived at the conclusion that this is a view that a person might reasonably take from an accounting perspective, although this does not give full consideration to the intention of the regulations.

We have also arrived at the view that, for the cases we are aware of, the overall tax effect of the incorrect treatment applied by some funds and tax effect of the incorrect information given to their investors is negligible. HMRC also note the significant practical and commercial difficulties involved in unwinding a distribution.

Therefore, in the interests of good administration and management of the tax system, and also in view of the announced intention to change the legislation, HMRC will not expect funds who have made incorrect distributions to unwind them and to give new and corrected information to investors provided that the error was made in the context of an incorrect reading of regulation 17(2) and there is no significant tax effect.

Regulations

It is not intended that there will be a full or formal consultation due to the minor and technical nature of the proposed amendment. Draft Regulations will be made available shortly to known interested parties and to industry representative bodies for informal consultation.

Contact Information

If you would like to be included in this consultation please contact Hayley Moran at HM Revenue & Customs (hayley.moran@hmrc.gsi.gov.uk /03000 514795) as soon as possible.

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