



# Income Tax Act 2007

## 2007 CHAPTER 3

### PART 13

#### TAX AVOIDANCE

#### [<sup>F1</sup>CHAPTER 5F

#### INCOME-BASED CARRIED INTEREST

##### Textual Amendments

- F1** Pt. 13 Ch. 5F inserted (with effect in accordance with s. 37(4) of the amending Act) by [Finance Act 2016 \(c. 24\), s. 37\(2\)](#)

#### *Income-based carried interest*

##### **809FZA Overview**

- (1) This Chapter determines when carried interest arising to an individual from an investment scheme is “income-based carried interest” for the purposes of Chapter 5E (and, in particular, section 809EZB(1)(c)).
- (2) Section 809FZB contains the general rule, under which the extent to which carried interest is income-based carried interest depends on the average holding period of the investment scheme.
- (3) Sections 809FZC to 809FZP contain further provision relating to average holding periods.
- (4) Sections 809FZQ and 809FZR contain a particular rule for direct lending funds.
- (5) Sections 809FZS and 809FZT contain an exception to the general rule for carried interest which is conditionally exempt from income tax.

*Status: Point in time view as at 15/09/2016.*

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- (6) Sections 809FZU to 809FZZ contain supplementary and interpretative provision.
- (7) Nothing in this Chapter affects the liability to any tax of—
- (a) the investment scheme, or
  - (b) external investors in the investment scheme.

### **809FZB Income-based carried interest: general rule**

- (1) “Income-based carried interest” is the relevant proportion of a sum of carried interest arising to an individual from an investment scheme.
- (2) The relevant proportion is determined by reference to the investment scheme's average holding period as follows.

<i>Average holding period</i>	<i>Relevant proportion</i>
Less than 36 months	100%
At least 36 months but less than 37 months	80%
At least 37 months but less than 38 months	60%
At least 38 months but less than 39 months	40%
At least 39 months but less than 40 months	20%
40 months or more	0%

- (3) This section is subject to the following provisions of this Chapter.

#### *Average holding period*

### **809FZC Average holding period**

- (1) The average holding period of an investment scheme, in relation to a sum of carried interest, is the average length of time for which relevant investments have been held for the purposes of the scheme.
- (2) In this section, “relevant investments” means investments—
  - (a) which are made for the purposes of the scheme, and
  - (b) by reference to which the carried interest is calculated.
- (3) The average holding period is calculated by reference to the time the carried interest arises.
- (4) It is calculated as follows.
 

*Step 1* For each relevant investment, multiply the value invested at the time the investment was made by the length of time for which the investment has been held.

*Step 2* Add together the amounts produced under *step 1* in respect of all relevant investments.

*Step 3* Divide the amount produced under *step 2* by the total value invested in all relevant investments.

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- (5) Disregard intermediate holdings or intermediate holding structures (including intermediate investment schemes) by or through which investments are made or held—
- (a) when identifying, for the purpose of determining the average holding period of an investment scheme, what relevant investments are held for the purposes of an investment scheme, and
  - (b) for any other purpose relating to the determination of the average holding period.

This is subject to the following provisions of this Chapter.

- (6) In this section, references to the length of time for which a relevant investment has been held are—
- (a) in the case of an investment which has been disposed of before the carried interest arises, references to the time for which it was held before being disposed of, and
  - (b) in any other case, references to the time for which it has been held up to the time the carried interest arises.
- (7) For the purposes of this Chapter, carried interest which is deferred carried interest in relation to a person within the meaning of section 103KG of TCGA 1992 is to be treated as arising to that person at the time it would have arisen had it not been deferred as specified in section 103KG(3)(a) or (b) of that Act.
- (8) Sections 809FZD to 809FZP apply for the purposes of determining the average holding period of an investment scheme.

*Average holding period: disposals*

### **809FZD Disposals**

- (1) An investment or part of an investment is disposed of where—
- (a) there is a disposal of the investment or the part of the investment for the purposes of the investment scheme,
  - (b) there is a disposal for the purposes of the investment scheme of an intermediate holding or intermediate holding structure (including an intermediate investment scheme) by or through which the investment is held, or
  - (c) in any other case, there is a deemed disposal under subsection (2).
- (2) There is a deemed disposal of an investment or part of an investment under this subsection where—
- (a) under any arrangements—
    - (i) the scheme in substance closes its position on the investment or the part of the investment, or
    - (ii) the scheme ceases to be exposed to risks and rewards in the respect of the investment or the part of the investment, and
  - (b) it is reasonable to suppose that the arrangements were designed to secure that result.
- (3) In the case of a disposal of part of a holding of securities in a company which are of the same class, suppose for the purposes of determining which investments have

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been disposed of that the disposal affects the securities in the order in which they were acquired (that is, on a first in first out basis).

- (4) The references in subsection (1)(a) and (b) to a disposal are to something which is a disposal for the purposes of TCGA 1992; but for the purposes of subsection (1)(a) disregard section 116 of TCGA 1992 (which disapplies sections 127 to 130 of that Act in relation to qualifying corporate bonds).

### **809FZE Part disposals**

- (1) Where there is a disposal of part of an investment, the part disposed of and the part not disposed of are to be treated as two separate investments which were made at the same time.
- (2) The value of each of those two separate investments is the appropriate proportion of the value first invested in the whole investment.
- (3) The appropriate proportion is the proportion of the value of the part in question to the value of the whole investment at the time of the disposal.
- (4) The disposal of part of an asset includes the disposal of an interest in or right over the asset (and “part disposed of” is to be construed accordingly).

### **809FZF Unwanted short-term investments**

- (1) The making and disposal of an investment for the purposes of an investment scheme are to be disregarded if—
  - (a) the investment is an unwanted short-term investment, and
  - (b) the unwanted short-term investment is excludable.
- (2) An investment is an unwanted short-term investment where—
  - (a) the investment is made as part of a transaction under which one or more other investments are made for the purposes of the scheme,
  - (b) the value of the investment does not exceed that of the other investments taken together,
  - (c) it is reasonable to suppose that the investment had to be made in order for the other investments to be made,
  - (d) at the time the investment is made, managers of the scheme have a firm, settled and evidenced intention to dispose of the investment for the purposes of the scheme within the relevant period,
  - (e) the investment is disposed of for the purposes of the scheme within the relevant period, and
  - (f) any profit resulting from the disposal has no bearing on whether a sum of carried interest arises or on the amount of any sum of carried interest which does arise.
- (3) An unwanted short-term investment is excludable if it constitutes—
  - (a) an investment in land,
  - (b) an investment in securities in an unlisted company,
  - (c) the making of a direct loan where the other investments specified in subsection (2)(b) are shares or other securities in an unlisted company, or

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- (d) the making of a direct loan which is a qualifying loan within the meaning given by section 809FZR(2).
- (4) In subsection (2)(e) “relevant period” means—
- (a) for an investment within subsection (3)(a), 12 months;
  - (b) for an investment within subsection (3)(b) or (c), 6 months;
  - (c) for an investment within subsection (3)(d), 120 days.
- (5) But if at any time it becomes reasonable to suppose that, when the scheme ceases to invest, 25% or more of the capital of the investment scheme will have been invested in unwanted short-term investments which are excludable, subsection (1) does not apply to any investment made subsequently for the purposes of the scheme.

*Average holding period: derivatives and hedging*

### **809FZG Derivatives**

- (1) A derivative contract entered into for the purposes of an investment scheme is an investment, subject to the following provisions of this section.
- (2) The value invested in the derivative contract is—
- (a) where the contract is an option, the cost of acquiring the option (whether from the grantor or another person),
  - (b) where the contract is a future, the price specified in the contract for the underlying subject matter, or
  - (c) where the contract is a contract for differences, the notional principal of the contract.
- (3) But where entering into a derivative contract constitutes a deemed disposal of an investment or part of an investment by virtue of section 809FZD(2)(a)(ii)—
- (a) the derivative contract is not an investment, and
  - (b) the subsequent disposal of the derivative contract without a corresponding disposal of the investment or part investment is to be regarded as the making of a new investment to the extent that the scheme becomes materially exposed to risks and rewards in respect of the investment or part investment.
- (4) For the purposes of this Chapter, references to disposal, in the case of a derivative contract, include any of the following events (to the extent that the event is not otherwise a disposal under section 809FZD(1) or (2))—
- (a) the expiry of the contract,
  - (b) the termination of the contract (whether or not in accordance with its terms),
  - (c) the disposal, substantial variation, loss or cancellation of the investment scheme's rights under the contract, and
  - (d) in the case of a derivative contract which is an option, the exercise of the option,
- but do not include the renewal of the contract with the same counterparty on substantially the same terms.
- (5) The substantial variation of an investment scheme's rights under a derivative contract constitutes (in addition to the disposal of the contract as originally entered into (see subsection (4)(c)) a new investment consisting of the contract as varied.

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### **809FZH Hedging: exchange gains and losses**

- (1) This section applies where—
  - (a) an investment scheme has a hedging relationship between a relevant instrument and a relevant investment, and
  - (b) the hedging relationship relates to exchange gains or losses.
- (2) In this section—
 

“relevant instrument” means a derivative contract or a liability representing a loan relationship, and

“relevant investment” means—

  - (a) where the relevant instrument is a derivative contract, an investment made for the purposes of the scheme or a liability representing a loan relationship;
  - (b) where the relevant instrument is a liability representing a loan relationship, an investment made for the purposes of the scheme.
- (3) An investment scheme has a hedging relationship between a relevant instrument and a relevant investment if or to the extent that—
  - (a) the instrument and the investment are designated by the scheme as a hedge, or
  - (b) in any other case, the instrument is intended to act as a hedge of exposure to—
    - (i) changes in fair value of the investment or an identified portion of the investment, or
    - (ii) variability in cash flows,
 where the exposure is attributable to exchange gains or losses and could affect profit or loss of the investment scheme.
- (4) Entering into the hedging relationship is not a deemed disposal of the relevant investment under section 809FZD(2).
- (5) The relevant instrument is not an investment for the purposes of the investment scheme to the extent that the conditions in subsection (3)(a) and (b) are met.
- (6) But the termination of the hedging relationship is the making of an investment constituting the relevant instrument if or to the extent that that instrument continues to subsist.

### **809FZI Hedging: interest rates**

- (1) This section applies where an investment scheme has a hedging relationship between—
  - (a) an interest rate contract, and
  - (b) a qualifying investment held for the purposes of the fund.
- (2) An investment scheme has a hedging relationship between an interest rate contract and a qualifying investment if or to the extent that—
  - (a) the interest rate contract and the investment are designated by the scheme as a hedge, or
  - (b) in any other case, the interest rate contract is intended to act as a hedge of exposure to—
    - (i) changes in fair value of the investment or an identified portion of the investment, or

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- (ii) variability in cash flows,  
where the exposure is attributable to interest rates and could affect profit or loss of the investment scheme.
- (3) Entering into the hedging relationship is not a deemed disposal of the relevant investment under section 809FZD(2).
- (4) The interest rate contract is not an investment for the purposes of the investment scheme to the extent that the conditions in subsection (2)(a) and (b) are met.
- (5) But the termination of the hedging relationship is the making of an investment constituting the interest rate contract if or to the extent that the interest rate contract continues to subsist.
- (6) In this section “qualifying investment” means—
- money placed at interest,
  - securities (excluding shares issued by companies),
  - alternative finance arrangements, and
  - a liability representing a loan relationship.

*Average holding period: aggregation of acquisitions and disposals*

### **809FZJ Significant interests**

- (1) Where an investment scheme has a controlling interest in a trading company or the holding company of a trading group—
- any investment made for the purposes of the scheme in that company after the time when the controlling interest was acquired is to be regarded as having been made at that time, and
  - any disposal for the purposes of the scheme of an investment in the company after the time the controlling interest was acquired is to be regarded as not being made until a relevant disposal is made.
- (2) In subsection (1)(b) “relevant disposal”, in relation to a company, means a disposal which (apart from subsection (1)) has the effect that the investment scheme ceases to have a 40% interest in the company.
- (3) For the purposes of this section, in determining whether an investment scheme has a controlling interest or a 40% interest in a company, any share capital of the company which is held for the purposes of an associated investment scheme is to be regarded as held for the purposes of the investment scheme.

### **809FZK Venture capital funds**

- (1) Where a venture capital fund has a relevant interest in a trading company or the holding company of a trading group—
- any venture capital investment made for the purposes of the scheme in the company after the time the relevant interest was acquired (and before a relevant disposal) is to be regarded as having been made at the time the relevant interest was acquired, and
  - any disposal for the purposes of the scheme of a venture capital investment in the company after that time is to be regarded as not being made until—

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- (i) a relevant disposal is made, or
  - (ii) the scheme director condition ceases to be met.
- (2) For the purposes of subsection (1) a venture capital fund has a relevant interest in a company if—
- (a) by virtue of its venture capital investments the fund has at least a 5% interest in the company, or
  - (b) venture capital investments held for the purposes of the scheme in the company have a value of more than £1 million.
- (3) For the purposes of subsection (1) “relevant disposal” means a disposal which (apart from subsection (1)) has the effect that the venture capital fund has disposed of more than 80% of the greatest amount invested at any one time in the company for the purposes of the fund.
- (4) In this Chapter, “venture capital fund” means an investment scheme in relation to which the condition in subsection (5) is met.
- (5) The condition is that when the scheme starts to invest it is reasonable to suppose that over the investing life of the scheme—
- (a) at least two-thirds of the total value invested for the purposes of the scheme will be invested in venture capital investments, and
  - (b) at least two-thirds of the total value invested for the purposes of the scheme will be invested in investments which are held for 40 months or more.
- (6) In determining whether subsection (5)(b) is met in relation to an investment scheme, apply the rule in subsection (1) to the scheme.
- (7) In this section, “venture capital investment”, in relation to an investment scheme, means an investment in a trading company or the holding company of a trading group where—
- (a) at the time the investment is made the company is unlisted and is likely to remain so,
  - (b) at least 75% of the total value of the investment is invested in—
    - (i) newly issued shares or
    - (ii) newly issued securities convertible into shares,
  - (c) the investment is used in a trade carried on by the trading company or the trading group—
    - (i) to support its growth, or
    - (ii) for the development of new products or services,
 and is not used directly or indirectly to acquire shares in the company which are not newly issued,
  - (d) if the investment is the first investment made in the company for the purposes of the scheme, the trading company or group has not carried on that trade for more than 7 years, and
  - (e) the scheme director condition is met.
- (8) In this Chapter, the scheme director condition, in relation to an investment scheme and a company, is that—
- (a) the scheme (or the scheme and one or more investment schemes acting together) are entitled to appoint a director (“the scheme director”) of—
    - (i) the company, or



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- (ii) a company which controls the company, and
  - (b) the scheme director is entitled to exercise rights within subsection (9).
- (9) Those rights are rights which—
- (a) are rights conferred under contractual arrangements—
    - (i) to which some or all of the investors in the company are parties, and
    - (ii) which it would be reasonable to suppose would not otherwise be capable of being exercised by the scheme director,
  - (b) relate to the conduct of the business and affairs of the company, and
  - (c) are at least equivalent to the rights which it is reasonable to suppose a prudent investor would have obtained on making an investment in the company at arm's length of the same size and nature as that held in the company for the purposes of the investment scheme.
- (10) In determining whether the condition in subsection (2)(a) or (b) is met in relation to a venture capital fund, any share capital of a company which is held for the purposes of an associated investment scheme is to be regarded as held for the purposes of the venture capital fund.

### **809FZL Significant equity stake funds**

- (1) Where a significant equity stake fund has a significant equity stake investment in a trading company or the holding company of a trading group—
- (a) any investment made for the purposes of the fund in that company made after the time the significant equity stake investment was acquired is to be regarded as having been made at that time, and
  - (b) any disposal for the purposes of the fund of an investment in the company after that time is to be regarded as not being made until—
    - (i) a relevant disposal is made, or
    - (ii) the scheme director condition ceases to be met.
- (2) In subsection (1)(b) “relevant disposal” means a disposal which (apart from subsection (1)) has the effect that the significant equity stake fund ceases to have a 15% interest in the company.
- (3) In this Chapter, “significant equity stake fund” means an investment scheme—
- (a) which is not a venture capital fund, and
  - (b) in relation to which the condition in subsection (4) is met.
- (4) The condition is that when the scheme starts to invest it is reasonable to suppose that over the investing life of the scheme—
- (a) more than 50% of the total value invested for the purposes of the scheme will be invested in investments which are significant equity stake investments, and
  - (b) more than 50% of that value will be invested in investments which are held for 40 months or more.
- (5) In determining whether subsection (4)(b) is met in relation to an investment scheme, apply the rule in subsection (1) to the scheme.
- (6) In this section, “significant equity stake investment”, in relation to an investment scheme, means an investment in a trading company or the holding company of a trading group where—

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- (a) at the time the investment is made, the company is unlisted and likely to remain so,
  - (b) by virtue of the investment (on its own or with other investments) the scheme has a 20% interest in the company, and
  - (c) the scheme director condition is met.
- (7) For the purposes of this section, in determining whether a significant equity stake fund has an interest of a particular percentage in a company, any share capital of the company which is held for the purposes of an associated investment scheme is to be regarded as held for the purposes of the significant equity stake fund.

### **809FZM Controlling equity stake funds**

- (1) Where a controlling equity stake fund has a 25% interest in a trading company or the holding company of a trading group—
- (a) any investment made for the purposes of the controlling equity stake fund in the company after the time the 25% interest was acquired is to be regarded as having been made at that time, and
  - (b) any disposal for the purposes of the controlling equity stake fund of an investment in the company after that time is to be regarded as not being made until a relevant disposal is made.
- (2) In subsection (1)(b), “relevant disposal”, in relation to a company, means a disposal which (apart from subsection (1)) has the effect that the controlling equity stake fund ceases to have a 25% interest in the company.
- (3) In this Chapter, “controlling equity stake fund” means an investment scheme—
- (a) which is not a venture capital fund or significant equity stake fund, and
  - (b) in relation to which the condition in subsection (4) is met.
- (4) The condition is that when the scheme starts to invest it is reasonable to suppose that, over the investing life of the scheme—
- (a) more than 50% of the total value invested for the purposes of the scheme will be invested in investments which are controlling interests in trading companies or holding companies of trading groups, and
  - (b) more than 50% of the total value invested for the purposes of the scheme will be invested in investments which are held for 40 months or more.
- (5) In determining whether subsection (4)(b) is met in relation to an investment scheme, apply the rule in subsection (1) to the scheme.
- (6) For the purposes of this section, in determining whether a controlling equity stake fund has a controlling interest or an interest of a particular percentage in a company, any share capital of the company which is held for the purposes of an associated investment scheme is to be regarded as held for the purposes of the controlling equity stake fund.

### **809FZN Real estate funds**

- (1) Where a real estate fund has a major interest in any land—
- (a) any investment made for the purposes of the fund in that land after the time the major interest was acquired is to be regarded as having been made at that time, and

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- (b) any disposal for the purposes of the fund of an investment in the land after that time is to be regarded as not being made until a relevant disposal is made.
- (2) In subsection (1)(b) “relevant disposal” means a disposal which (apart from subsection (1)) has the effect that the real estate fund has disposed of more than 50% of the greatest amount invested at any one time in the land for the purposes of the real estate fund.
- (3) Where a real estate fund has a major interest in any land (“the original land”) and subsequently acquires a major interest in any adjacent land—
  - (a) the acquisition is an investment in the original land for the purposes of subsection (1)(a), and
  - (b) after the acquisition, the adjacent land is to be regarded as part of the original land for the purposes of subsections (1) and (2).
- (4) In this Chapter, “real estate fund” means an investment scheme—
  - (a) which is not a venture capital fund, significant equity stake fund or controlling equity stake fund, and
  - (b) in relation to which the condition in subsection (5) is met.
- (5) The condition is that when the scheme starts to invest it is reasonable to suppose that over the investing life of the scheme—
  - (a) more than 50% of the total value invested for the purposes of the scheme will be invested in land, and
  - (b) more than 50% of the total value invested for the purposes of the scheme will be invested in investments which are held for 40 months or more.
- (6) In determining whether subsection (5)(b) is met in relation to an investment scheme, apply the rule in subsection (1) to the scheme.

### **809FZO Funds of funds**

- (1) Section 809FZC(5) (disregard of intermediate holdings and holding structures) does not apply to an investment made for the purposes of a fund of funds in a collective investment scheme (and, accordingly, such an investment is regarded as an investment in the collective investment scheme itself).
- (2) Subsection (1) does not apply in relation to a fund of funds in relation to a collective investment scheme if it is reasonable to suppose that the main purpose or one of the main purposes of the making of any investment in any collective investment scheme for the purposes of the fund of funds is to reduce the proportion of carried interest arising to any person which is income-based carried interest.
- (3) Where by virtue of subsection (1) a fund of funds has a significant investment in a collective investment scheme (“the underlying scheme”)—
  - (a) any qualifying investment made for the purposes of the fund in the underlying scheme after the time the significant investment was acquired is to be regarded as having been made at that time, and
  - (b) any disposal for the purposes of the fund of a qualifying investment in the underlying scheme after that time is to be regarded as not being made until a relevant disposal is made.
- (4) In subsection (3)(b) “relevant disposal”, in relation to an underlying scheme, means a disposal which (apart from subsection (3)) has the effect that—

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- (a) the fund of funds has (by virtue of disposals of its interest in the underlying scheme) disposed of at least 50% of the greatest amount invested for its purposes at any one time in the underlying scheme, or
  - (b) the fund of fund's investment in the underlying scheme is worth less than whichever is the greater of—
    - (i) £1 million, or
    - (ii) 5% of the total value of the investments made before the disposal for the purposes of the fund of funds in the underlying scheme.
- (5) In this Chapter, “fund of funds” means an investment scheme in relation to which the condition in subsection (6) is met.
- (6) The condition is that when the scheme starts to invest it is reasonable to suppose that over the investing life of the scheme—
- (a) substantially all of the total value invested for the purposes of the scheme will be invested in collective investment schemes of which the scheme holds less than 50% by value,
  - (b) more than 50% of the total value invested for the purposes of the scheme will be invested in investments which are held for 40 months or more, and
  - (c) more than 75% of the total value invested in the scheme will be invested by external investors.
- (7) In determining whether subsection (6)(b) is met in relation to an investment scheme, apply the rule in subsection (3) to the scheme.
- (8) In this section, “significant investment”, in relation to a collective investment scheme, means—
- (a) an investment of a least £1 million in the scheme, or
  - (b) an investment of at least 5% of the total amounts raised or to be raised from external investors in the scheme.
- (9) In this section, “qualifying investment” means an investment made for the purposes of an investment scheme in a collective investment scheme (“the underlying scheme”) where—
- (a) the investment is held on the same terms as other investments made by external investors in the underlying scheme,
  - (b) the fund of funds, together with any connected funds, does not hold more than 30% by value of the underlying scheme,
  - (c) the underlying scheme has not made an investment in the fund of funds,
  - (d) no person providing investment management services to the underlying scheme provides investment management services to the fund of funds, and
  - (e) it is reasonable to suppose that the investment in the underlying scheme is not part of arrangements the main purpose or one of the main purposes of which is to reward any person involved in providing investment management services to the underlying scheme or a scheme connected with that underlying scheme.

### **809FZP Secondary funds**

- (1) Section 809FZC(5) (disregard of intermediate holdings and holding structures) does not apply to investments acquired for the purposes of a secondary fund in a collective investment scheme (and, accordingly, such an investment is regarded as an investment in the collective investment scheme itself).

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- (2) Subsection (1) does not apply in relation to a secondary fund in relation to a collective investment scheme if it is reasonable to suppose that the main purpose or one of the main purposes of the making of any investment in any collective investment scheme for the purposes of the secondary fund is to reduce the proportion of carried interest arising to any person which is income-based carried interest.
- (3) Where by virtue of subsection (1) a secondary fund has a significant investment in a collective investment scheme (“the underlying scheme”)—
- (a) any qualifying investment acquired for the purposes of the fund in the underlying scheme after the time when the significant investment is acquired is to be regarded as having been made at that time, and
  - (b) any disposal for the purposes of the fund of a qualifying investment in the underlying scheme after that time is to be regarded as not being made until a relevant disposal is made.
- (4) In subsection (3)(b) “relevant disposal” means a disposal which (apart from subsection (3)) has the effect that—
- (a) the secondary fund has (by virtue of disposals of its interest in the underlying scheme) disposed of at least 50% of the greatest amount invested for its purposes at any one time in the underlying scheme, or
  - (b) the secondary fund's investment in the underlying scheme is worth less than whichever is the greater of—
    - (i) £1 million, or
    - (ii) 5% of the total value of the investments held immediately before the disposal for the purposes of the secondary fund in the underlying scheme.
- (5) In this Chapter, “secondary fund” means an investment scheme in relation to which the condition in subsection (6) is met.
- (6) The condition is that when the scheme starts to invest it is reasonable to suppose that over the investing life of the scheme—
- (a) substantially all of the total value invested for the purposes of the scheme will be in the acquisition of investments in, or the acquisition of portfolios of investments from, unconnected collective investment schemes,
  - (b) more than 50% of the total value invested for the purposes of the scheme will be invested in investments which are held for 40 months or more, and
  - (c) more than 75% of the total amount invested in the scheme will be invested by external investors.
- (7) In determining whether subsection (6)(b) is met in relation to an investment scheme, apply the rule in subsection (3) to the scheme.
- (8) In this section, “significant interest”, in relation to a collective investment scheme, means—
- (a) an investment of at least £1 million in the scheme, or
  - (b) an investment of at least 5% of the total amounts raised or to be raised from external investors in the scheme.
- (9) In this section, “qualifying investment” means an investment in a collective investment scheme (“the underlying scheme”) acquired for the purposes of a secondary fund where—

*Status: Point in time view as at 15/09/2016.*

*Changes to legislation: There are currently no known outstanding effects for the Income Tax Act 2007, CHAPTER 5F. (See end of Document for details)*

- (a) the investment acquired was originally made on the same terms as investments in the underlying scheme made by external investors,
- (b) the terms on which the investment was acquired or investments made in the underlying scheme were made by external investors have not significantly changed since the investment was acquired,
- (c) the secondary fund, together with any connected funds, does not hold more than 30% by value of the underlying scheme,
- (d) no person providing investment management services to the underlying scheme provides investment management services to the secondary fund, and
- (e) it is reasonable to suppose that the investment in the underlying scheme is not part of arrangements the main purpose or one of the main purposes of which is to reward any person involved in providing investment management services to the underlying scheme or a scheme connected with that underlying scheme.

#### *Direct lending funds*

#### **809FZQ Direct lending funds**

- (1) Carried interest arising from an investment scheme which is a direct lending fund is income-based carried interest in its entirety.

Subsections (2) to (4) apply for the purposes of this Chapter.

- (2) A direct lending fund is an investment scheme—
- (a) which is not a venture capital fund, significant equity stake fund, controlling equity stake fund or real estate fund, and
  - (b) in relation to which it is reasonable to suppose that, when the scheme ceases to invest, a majority of the investments made for the purposes of the scheme (calculated by reference to value invested) will have been direct loans made by the scheme.
- (3) An investment scheme makes a direct loan if for the purposes of the scheme money is advanced at interest or for any other return determined by reference to the time value of money.
- (4) The acquisition of a direct loan is to be regarded as the making of a direct loan if the loan is acquired within the period of 120 days beginning with the day on which the money is first advanced.

#### **809FZR Direct lending funds: exception**

- (1) Section 809FZQ does not apply to carried interest arising from a direct lending fund if—
- (a) the fund is a limited partnership,
  - (b) the carried interest is a sum falling within section 809EZD(2) or (3), and
  - (c) it is reasonable to suppose that, when investments cease to be made for the purposes of the fund, at least 75% of the direct loans made by the fund (calculated by reference to value advanced) will have been qualifying loans.
- (2) In this section “qualifying loan” means a direct loan made by an investment scheme where—
- (a) the borrower is not connected with the investment scheme,

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*Status: Point in time view as at 15/09/2016.*

*Changes to legislation: There are currently no known outstanding effects for the Income Tax Act 2007, CHAPTER 5F. (See end of Document for details)*

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- (b) the money is advanced under a genuine commercial loan agreement negotiated at arm's length,
  - (c) repayments are fixed and determinable,
  - (d) maturity is fixed,
  - (e) the scheme has the positive intention and ability to hold the loan to maturity, and
  - (f) the relevant term of the loan is at least four years.
- (3) In this section “relevant term”, in relation to a loan, means the period which—
- (a) begins with the time when the money is advanced, and
  - (b) ends with the time by which, under the terms of the loan, at least 75% of the principal due under the loan must be repaid.
- (4) For the purposes of determining the average holding period of a scheme, where—
- (a) a qualifying loan made by an investment scheme is repaid by the borrower to any extent before the end of 40 months from the time the loan is made, and
  - (b) it is reasonable to suppose that the borrower's decision to repay was not affected by considerations relating to the application of this Chapter,
- the loan is, to the extent it is repaid by the borrower before the end of 40 months from the time it is made, to be treated as held for 40 months.
- (5) In determining for the purposes of subsection (1)(b) whether a sum falls within section 809EZD(2) or (3), read section 809EZD(4)(b) as if the reference to 6% were to 4%.
- (6) Section 809FZB applies to carried interest to which, by virtue of subsection (1), section 809FZQ does not apply.

#### *Conditionally exempt carried interest*

### **809FZS Conditionally exempt carried interest**

- (1) Carried interest which—
- (a) arises to an individual from an investment scheme, and
  - (b) is conditionally exempt from income tax,
- is to be treated as if it were not income-based carried interest to any extent.
- (2) Carried interest is conditionally exempt from income tax if Conditions A to D are met.
- (3) Condition A is that the carried interest arises to the individual in the period of—
- (a) four years beginning with the day on which the scheme starts to invest, or
  - (b) ten years beginning with that day if the carried interest is calculated on the realisation model.
- (4) Condition B is that the carried interest would, apart from this section, be income-based carried interest to any extent.
- (5) Condition C is that it is reasonable to suppose that, were the carried interest to arise to the individual at the relevant time (but by reference to the same relevant investments), it would not be income-based carried interest to any extent.
- (6) The “relevant time” is whichever is the earliest of—

*Status: Point in time view as at 15/09/2016.*

*Changes to legislation: There are currently no known outstanding effects for the Income Tax Act 2007, CHAPTER 5F. (See end of Document for details)*

- (a) the time when it is reasonable to suppose that the investment scheme will be wound up;
  - (b) the end of the period of four years beginning with the time when it is reasonable to suppose that the scheme will cease to invest;
  - (c) the end of the period of—
    - (i) four years beginning with the day on which the sum of carried interest arises to the individual, or
    - (ii) ten years beginning with that day if the carried interest was calculated on the realisation model;
  - (d) the end of the period of four years beginning with the end of the period by reference to which the amount of the carried interest was determined.
- (7) Subsection (5) does not affect what would otherwise be the time at which an investment is disposed of for the purposes of this Chapter.
- (8) Condition D is that the individual makes a claim under this section for the carried interest to be conditionally exempt from income tax.

#### **809FZT Carried interest which ceases to be conditionally exempt**

- (1) Carried interest which is conditionally exempt from income tax ceases to be conditionally exempt from income tax at whichever is the earliest of—
- (a) the time when the investment scheme is wound up;
  - (b) the end of the period of four years beginning with the time the scheme ceases to invest;
  - (c) the end of the period of—
    - (i) four years beginning with the day on which the sum of carried interest arises to the individual, or
    - (ii) ten years beginning with that day if the carried interest was calculated on the realisation model;
  - (d) the end of the period of four years beginning with the end of the period by reference to which the amount of the carried interest is determined;
  - (e) the time at which Condition C in section 809FZS(5) ceases to be met.
- (2) Carried interest which ceases to be conditionally exempt from income tax is to be treated as having been income-based carried interest at the time it arose to the individual if or to the extent that, had it arisen to the individual at the time it ceased to be conditionally exempt (but in relation to the same relevant investments) it would have been income-based carried interest.
- (3) All such assessments and adjustments of assessments are to be made as are necessary to give effect to subsection (2).
- (4) Any amount paid by way of capital gains tax in respect of carried interest which is conditionally exempt from income tax is to be treated as if it had been paid in respect of any income tax liability arising under subsection (2).



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*Status: Point in time view as at 15/09/2016.*

*Changes to legislation: There are currently no known outstanding effects for the Income Tax Act 2007, CHAPTER 5F. (See end of Document for details)*

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## Supplementary

### 809FZU Employment-related securities

This Chapter does not apply in relation to carried interest arising to an individual in respect of employment-related securities as defined by section 421B(8) of ITEPA 2003.

### 809FZV “Loan to own” investments

- (1) This section applies where—
  - (a) an investment scheme acquires a debt,
  - (b) the debt is to any extent uncollectable or otherwise impaired,
  - (c) the debt is acquired at a discount with a view to securing direct or indirect ownership of any assets which are—
    - (i) owned by a company which is the debtor in respect of the debt, or
    - (ii) subject to a security interest in respect of the debt, and
  - (d) the fund acquires ownership of the assets within three months of the acquisition of the debt.
- (2) For the purposes of this Chapter—
  - (a) the debt and the assets are to be treated as a single investment, and
  - (b) the value invested in that single investment is the amount paid for the debt.
- (3) In this section “security interest” means an interest or right (other than a rentcharge) held for the purpose of securing the payment of money or the performance of any obligation.

### 809FZW Anti-avoidance

- (1) For the purposes mentioned in subsection (2), no regard is to be had to any arrangements the main purpose of which, or one of the main purposes of which, is to reduce the proportion of carried interest which is income-based carried interest.
- (2) The purposes referred to in subsection (1) are—
  - (a) determining the average holding period, or
  - (b) determining whether an investment scheme is a venture capital fund, significant equity stake fund, controlling equity stake fund, real estate fund, fund of funds or secondary fund.
- (3) In determining to what extent carried interest is income-based carried interest, no regard is to be had to any arrangements the main purpose, or one of the main purposes, of which is to secure that section 809EZA(1) (charge to income tax) does not apply in relation to some or all of the carried interest.

### 809FZX Treasury regulations

- (1) The Treasury may by regulations make—
  - (a) provision relating to the calculation of the average holding period in some or all cases;

*Status: Point in time view as at 15/09/2016.*

*Changes to legislation: There are currently no known outstanding effects for the Income Tax Act 2007, CHAPTER 5F. (See end of Document for details)*

- (b) provision repealing, or restricting the application of, section 809FZU (employment-related securities).
- (2) The provision referred to in subsection (1)(a) includes in particular—
  - (a) provision for a method of calculating that period which is different from that in section 809FZC;
  - (b) provision as to what is and is not to be regarded as an investment;
  - (c) provision as to when an investment is to be regarded as made or disposed of;
  - (d) anti-avoidance provision.
- (3) Regulations under this section may—
  - (a) amend this Chapter;
  - (b) make different provision for different purposes;
  - (c) contain incidental, supplemental, consequential and transitional provision and savings.

### **809FZY “Reasonable to suppose”**

- (1) For the purposes of this Chapter, in determining what it is reasonable to suppose in relation to an investment scheme, regard is to be had to all the circumstances.
- (2) Those circumstances include in particular any prospectus or other document which—
  - (a) is made available to external investors in the investment scheme, and
  - (b) on which external investors may reasonably be supposed to have relied or been able to rely.

### *Interpretation*

### **809FZZ Interpretation of Chapter 5F**

- (1) In this Chapter—
  - “5% interest”, “15% interest”, “20% interest”, “25% interest” and “40% interest” are to be construed in accordance with subsection (4);
  - “act together”: two or more investment schemes act together in relation to a company if—
    - (a) they enter into contractual arrangements (with or without other persons) in relation to the conduct of the company's affairs,
    - (b) the arrangements are negotiated on arm's length terms, and
    - (c) the investment schemes act together to secure greater control or influence over the company's affairs than they would be able to secure individually;
  - “alternative finance arrangements” has the same meaning as in Part 6 of CTA 2009 (see section 501(2) of that Act);
  - “arrangements” has the same meaning as in Chapter 5E (see section 809EZE);
  - “associated”: two (or more) investment schemes are “associated if—
    - (a) the same or substantially the same individuals provide investment management services to both schemes;
    - (b) the investment schemes have the same or substantially the same investments, and

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*Status: Point in time view as at 15/09/2016.*

*Changes to legislation: There are currently no known outstanding effects for the Income Tax Act 2007, CHAPTER 5F. (See end of Document for details)*

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- (c) the schemes act together in relation to all or substantially all of the investments they acquire;
- “carried interest” has the same meaning as in section 809EZB (see sections 809EYC and 809EYD);
- “collective investment scheme” has the same meaning as in Chapter 5E (see section 809EZE);
- “connected” and “unconnected” are to be construed in accordance with subsections (6) and (7);
- “contract for differences” has the same meaning as in Part 7 of CTA 2009 (see section 582 of that Act);
- “controlling equity stake fund” has the meaning given in section 809FZM;
- “controlling interest” has the meaning given in subsection (3);
- “derivative contract” has the same meaning as in Part 7 of CTA 2009 (but see below);
- “designated” has the same meaning as for accounting purposes;
- “direct lending fund” and “direct loan” have the meanings given in section 809FZQ;
- “exchange gain or loss” is to be construed in accordance with section 475 of CTA 2009;
- “external investor” has the same meaning as in Chapter 5E (see section 809EZE);
- “fund of funds” has the meaning given in section 809FZO;
- “future” has the same meaning as in Part 7 of CTA 2009 (see section 581 of that Act);
- “interest rate contract” means—
- (a) a derivative contract whose underlying subject-matter is, or includes, interest rates, or
  - (b) a swap contract in which payments fall to be made by reference to a rate of interest;
- “investing life” is to be construed in accordance with subsection (2);
- “investment” does not include—
- (a) cash awaiting investment, or
  - (b) cash representing the proceeds of the disposal of an investment, where the cash is to be distributed as soon as reasonably practicable to investors in the scheme;
- “investment scheme” has the same meaning as in Chapter 5E (see section 809EZA(6));
- “limited partnership” means—
- (a) a limited partnership registered under the Limited Partnerships Act 1907,
  - (b) a limited liability partnership formed under the Limited Liability Partnerships Act 2000 or the Limited Liability Partnerships Act (Northern Ireland) 2002 (c.12 (N.I.)), or
  - (c) a firm or entity of a similar character to any of those mentioned in paragraph (a) or (b) formed under the law of a country or territory outside the United Kingdom;
- “loan relationship” has the meaning given by section 302 of CTA 2009 (but see below);

*Status: Point in time view as at 15/09/2016.*

*Changes to legislation: There are currently no known outstanding effects for the Income Tax Act 2007, CHAPTER 5F. (See end of Document for details)*

“major interest”, in relation to land, has the meaning given by section 96 of the Value Added Tax Act 1994;

“option” has the same meaning as in Part 7 of CTA 2009, disregarding section 580(2) of that Act;

“real estate fund” has the meaning given by section 809FZN;

“realisation model”: a sum of carried interest is calculated on the “realisation model” if it falls within section 809EZD(2) or (3) (disregarding section 809EZD(2)(b) and (3)(b));

“scheme director condition” has the meaning given by section 809FZK(8) and (9);

“secondary fund” has the meaning given by section 809FZP;

“significant equity stake fund” has the meaning given by section 809FZL;

“sum” has the same meaning as in Chapter 5E (see section 809EZB(3));

“trading company” and “trading group” have the meanings given by paragraphs 20 and 21 of Schedule 7AC to TCGA 1992;

“underlying subject matter” has the same meaning as in Part 7 of CTA 2009;

“unlisted”: a company is unlisted if—

- (a) no shares of any class issued by the company are listed on any stock exchange, and
- (b) there are no other trading arrangements in place in respect of shares of any class issued by the company;

“venture capital fund” has the meaning given by section 809FZK.

(2) In this Chapter—

- (a) references to when a scheme starts or ceases to invest are to the time when investments start or cease to be made for the purposes of the scheme, and
- (b) references to the investing life of the scheme are to the time between when a scheme starts and ceases to invest.

(3) For the purposes of this Chapter, an investment scheme has a controlling interest in a company if share capital of the company is held for the purposes of the scheme which—

- (a) amounts to more than 50% of the ordinary share capital of the company, and
- (b) carries an entitlement to more than 50% of—
  - (i) voting rights in the company,
  - (ii) profits available for distribution to shareholders, and
  - (iii) assets of the company available for distribution to shareholders in a winding-up.

(4) For the purposes of this Chapter, an investment scheme has an interest of a particular percentage in a company (for example, a 40% interest) if share capital of the company is held for the purposes of the scheme which—

- (a) amounts to at least that percentage of the ordinary share capital of the company, and
- (b) carries an entitlement to at least that percentage of—
  - (i) voting rights in the company,
  - (ii) profits available for distribution to shareholders, and
  - (iii) assets of the company available for distribution to shareholders in a winding-up.

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*Status: Point in time view as at 15/09/2016.*

*Changes to legislation: There are currently no known outstanding effects for the Income Tax Act 2007, CHAPTER 5F. (See end of Document for details)*

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- (5) For the purposes of subsections (3) and (4) any share capital held by a company controlled by an investment scheme is to be regarded as held for the purposes of the investment scheme.
- (6) For the purposes of this Chapter, an investment scheme (A) is connected with another investment scheme or person (B) if—
- (a) A directly or indirectly has control of B, or
  - (b) the same person, directly or indirectly, has control of A and B.
- (7) For the purposes of subsection (6) “control”—
- (a) in the case of control of a company, is to be read in accordance with sections 450 and 451 of CTA 2010;
  - (b) in the case of control of a partnership, has the meaning given in section 995(3);
  - (c) in the case of control of an investment scheme which is not a company or partnership, or of any other person which is not a company or partnership, means the ability to secure that the affairs of that scheme or other person are conducted in accordance with one's wishes.
- (8) For the purposes of the definition of “derivative contract”, read Part 7 of CTA 2009 as if—
- (a) references to a company were references to an investment scheme, and
  - (b) references to a contract of a company were references to a contract for the purposes of an investment scheme.
- (9) For the purposes of the definition of “loan relationship”, read Part 5 of CTA 2009 as if—
- (a) references to a company were references to an investment scheme, and
  - (b) references to a loan relationship of a company were references to a loan relationship for the purposes of an investment scheme.]

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Point in time view as at 15/09/2016.

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