Canaccord Genuity
Wealth Management

Excess reportable income and income equalisation explained

What is excess reportable income (ERI)?

Investment funds based in the UK are generally required to distribute income that they earn, however funds based outside the UK are not subject to this requirement. Instead funds based outside of the UK, including offshore based exchange-traded funds, may adopt 'reporting fund' status whereby they are required to disclose to HMRC the income that they have accrued during each financial year. Such status gives UK tax resident investors, capital gains tax treatment on disposal of such fund investments.

Income earned by a reporting fund in a reporting period which is not distributed is known as 'excess reportable income'. While the fund manager may endeavour to distribute all of the income earned this may not be possible for various reasons, but typically this is due to the nature of the fund's underlying investments.

Who does excess reportable income affect?

Excess reportable income is primarily relevant to UK tax residents who invest in reporting funds outside an ISA or pension. These investors are liable to tax on the total reported income of the fund i.e. both the income distributed and any excess reportable income.

Additionally, excess reportable income will be relevant to tax residents of other jurisdictions in which CGWM operates, in particular Guernsey where similar to the tax treatment of investing in accumulation funds, the income earned by reporting funds, whether distributed or not, is treated for certain investors as taxable income. **Guernsey tax resident investors should seek their own professional tax advice in relation to ERI.**

What is the relevant taxable date for excess reportable income?

Relevant investors are subject to tax on the excess reportable income of a reporting fund if they hold the investment on the last day of the fund's reporting period.

Excess reportable income is 'deemed' to be distributed to relevant investors six months after the end of the fund's reporting period. That is the date that the income is treated as being earned for UK tax purposes.

For example, a UK resident investor that holds an investment in XYZ reporting fund on the last day of its reporting period being 31 December 2020, will be deemed to have received an excess reportable income distribution on 30 June 2021. The deemed distribution should be included as taxable income by the investor in their 2021/22 tax return.

How does excess reportable income affect capital gains?

For UK tax resident investors, any gain arising from the disposal of an investment in a reporting fund is subject to capital gains tax. The excess reportable income amounts that have been subject to income tax should generally be added to the base cost of the investment, thereby reducing the gain subject to capital gains tax.

Where can I find information on the excess reportable income for my investments?

Details of the excess reportable income in relation to your investments in reportable funds can be found in your annual tax report (or consolidated tax voucher) issued by CGWM.

Please note that the excess reportable income reported in your tax report is based on data feeds from external providers. The timing of when excess reportable income is reported by fund managers can vary from fund to fund. We may therefore provide you with further update(s) in relation to excess reportable income that is reported to us or amended subsequent to the issue of the annual tax report.

What is income equalisation?

Equalisation is relevant to investors that purchase shares part way through the fund's reporting period.

Certain funds operate income equalisation arrangements with a view to ensuring that the level of income accrued within a fund and attributable to each share (or unit) is not affected by the issue, conversion, or redemption of shares during a distribution or accumulation period. A reporting fund may elect to operate full equalisation.

These arrangements may have an impact on the tax position of investors.

Where an investor buys shares during a distribution or accumulation period, the price at which those shares are bought may include an amount of income earned since the last distribution or accumulation by the fund - 'income equalisation'. On the occasion of the first distribution or accumulation of income following that purchase, that income equalisation will normally be regarded as a non-taxable capital return.

Therefore, investors who are deemed to be in receipt of reportable income or in receipt of distributions are allowed to adjust their taxable income for their share of any income equalisation. Investors should note, however, that where this adjustment is made, there may be a corresponding adjustment to the base cost of their shares.

For example, a UK resident investor purchases 1 share for £100 on 31 March 2020, in a reporting fund which has a reporting period ending on 31 December 2020. The report to investors shows excess reportable income of £10 per share and an income equalisation factor of £3 per share.

As the investor held the investment at the end of the fund reporting period, they will be subject to income tax on the £10 of excess reportable income. However, as they purchased the share part way through the year, they will need to consider the income equalisation factor of £3 which will effectively be treated as a return of capital as outlined in the calculation below.

Income tax	
Excess reportable income	£10
Income equalisation	(£3)
Taxable distribution	**£7**

Capital gains tax	
Purchase price	£100
Income equalisation	(£3)
Excess reportable income	£10
Adjusted base cost	**£107**

Where can I find income equalisation information?

The income equalisation policy of the fund and equalisation rates are usually published by the fund manager on their website along with the distribution data.

Important information

The information provided in this document is based on our understanding of the laws and regulations as at the date of publication, however, it is not exhaustive and does not constitute legal or tax advice. You should consult your tax advisor to ensure the information is relevant to your facts and circumstances. Please note that the tax treatment in relation to reporting funds may change at any time.

Glossary of terms

Distribution period

The period from one distribution record date to the next. Typically, a distribution period is annual, but the period may be shorter i.e. it may be a quarter or a month in duration.

Accumulation period

A fund that does not distribute its profits will accumulate those profits on periodic basis – the process whereby the income property of the fund is added to the capital property of the fund. Typically, an accumulation period is the annual accounting period of the fund for UK reporting purposes.

Reporting period

The period for which the fund provides a report of taxable income to investors. Generally, this will correspond to the period for which financial statements for the fund are drawn up.

Distribution rate

The amount of the total distribution paid per share in respect of a distribution period. This will be the cash per share received by each investor.

Equalisation rate

The amount of income per share earned at any particular point during the distribution or accumulation period.

UK reporting fund status (UKRF)

UK taxable investors disposing of interests in a fund that has obtained UKRF for their entire period of ownership should be subject to capital gains tax on the disposal proceeds.

UK taxable investors disposing of interests in a fund that has not obtained UKRF during the entire period of ownership should be subject to income tax on the disposal proceeds.

Excess reportable income rate

Funds that have entered the UKRF regime may have to report taxable income to investors that is greater than the total distributions paid; the excess of the amount of reportable income per share in the fund, for the reporting period, over the amount actually distributed to participants per share in the fund in respect of the reporting period.

Excess reportable income

Excess reportable income is calculated by multiplying the excess reportable income rate by the number of shares held by the investor on the last day of the reporting period. For UK taxable investors, the excess reportable income is treated in the same way as a distribution and should be included as such on a UK tax return. The excess reportable income should be treated as a distribution that is received six months after the end of the accounting period.