EXPLANATORY MEMORANDUM TO

THE INVESTMENT TRUST (APPROVED COMPANY) (TAX) (AMENDMENT) REGULATIONS 2013

2013 No 1406

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations amend the Investment Trust (Approved Company) (Tax) Regulations 2011 (S.I. 2011/ 2999 ('the Regulations')).

2.2 The amendments remove an unintended consequence of changes to the tax rules for investment trusts introduced in Finance Act 2011.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 A company that is approved by HMRC as an investment trust benefits from an exemption from corporation tax on its chargeable gains (section 100(1) of the Taxation of Chargeable Gains Act 1992). This is to reflect the fact that investors in investment trusts are chargeable to capital gains tax or corporation tax on any gains arising on disposal of their holdings and the rules therefore prevent a double layer of taxation.

4.2 In order to be approved for an accounting period, a company must meet certain conditions set out in section 1158 of Corporation Tax Act 2010 and satisfy 'ongoing requirements' in the Regulations throughout that period.

4.3 One of the ongoing requirements, set out in regulations 19 and 21, is that a company approved as an investment trust must not retain more than 15% of its income for the accounting period. There are exceptions to the requirement, set out in regulation 22, that apply when the sum available for distribution is within a de minimis amount or cannot be distributed because of a restriction imposed by law. Similar provisions applied under the previous rules.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 One of the changes introduced by Finance Act 2011 was the abolition of a restriction preventing investment trusts from distributing realised capital profits. This was a de-regulatory change, and a similar restriction in section 832 Companies Act 2006 was removed with effect from 6 April 2012.

7.2 Prior to the changes, section 832 would have prevented an investment trust that had accumulated income deficits brought forward in excess of its income for an accounting period from distributing its income for that period. Consequently, the exception to the requirement to distribute income for the period where such a distribution would be contrary to a restriction imposed by law would have applied.

7.3 An unintended consequence of the abolition of the restriction on distributions from capital profits was that an investment trust would in the circumstances described, and from the date of the changes to Companies Act, be required to make a distribution of its income for the period.

7.4 Whilst the intention of the changes was to *permit* distributions from capital profits, it was not intended to force a distribution from capital profits. The changes being made therefore restore the previous position for accounting periods beginning on or after the date that this instrument comes into force.

- Consolidation

7.5 There are no plans to consolidate the revised Regulations in the immediate future.

8. Consultation outcome

8.1 A draft of these regulations was published for consultation on 1 May 2013 for a period of 4 weeks in accordance with the Government's Tax Consultation Framework. There was no prior consultation as the changes made by the regulations are relieving and remove an unintended consequence of previous changes.

8.2 HMRC received 5 responses to the draft regulations, from the industry representative body the Association of Investment Companies and the advisory firms Deloittes, Ernst & Young, KPMG and PwC. All welcomed the change. Each of the advisory firms requested that it be made clearer that references in the consultation draft to 'revenue expenses brought forward from previous accounting periods' should be changed to make it clear that the reference was to an accounts figure rather than a tax figure. These final regulations include that change.

9. Guidance

9.1 HMRC will amend the relevant guidance to reflect changes made by these regulations.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note covering this instrument was published on 20 March 2013 alongside Budget 2013 and can be found on the HMRC website at http://www.hmrc.gov.uk/budget2013/tiins.htm#2 . It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 The impact of the requirements on firms employing up to 20 people is expected to be minimal as the changes are wholly relieving.

12. Monitoring & review

12.1 HMRC and HM Treasury will continue to liaise with stakeholders from time to time to discuss the implementation of the proposed new rules as part of continuing engagement with industry.

13. Contact

Wayne Strangwood at HMRC Tel: 020 7147 2545 or email: wayne.a.strangwood@hmrc.gsi.gov.uk can answer any queries regarding the instrument.