EXPLANATORY MEMORANDUM TO

THE INVESTMENT TRUSTS AND VENTURE CAPITAL TRUSTS (DEFINITION OF CAPITAL PROFITS, GAINS OR LOSSES) ORDER 2006

2006 No. 1182

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before Parliament by Command of Her Majesty. This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 This order defines capital profits, gains or loses arising from derivative contracts and loan relationships for investment trust companies and venture capital trusts in cases where they prepare accounts under International Accounting Standards.

2.2 It provides that for tax purposes, providing an Investment Trust Company (ITC) or Venture Capital Trust (VCT) applies correctly their Statement of Recommended Practice (SORP), those items of a capital nature can be taken to the capital column of the accounts, and therefore will not be subject to corporation tax.

2.3 The effect will be that ITCs and VCTs using International Accounting Standards will remain in the same position as those using UK Generally Accepted Accounting Practice (UK-GAAP).

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

3.1 None.

4. Legislative Background

4.1 The powers for the Treasury to make this order are set out in paragraphs 1A(2)(b), 1B(2)(b) and 9(1) of Schedule 10 to the Finance Act 1996, and paragraphs 38(2)(b) and 38A(2)(b) of Schedule 26 to the Finance Act 2002.

5. Extent

5.1 This order applies throughout the United Kingdom.

6. European Convention on Human Rights

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

7. Policy Background

7.1 ITCs and VCTs are both within the ambit of the corporation tax provisions that apply to loan relationships and derivative contracts. Under those provisions, all profits, gains and losses – including those of a capital nature – are chargeable to corporation tax as income.

7.2 However, as ITCs and VCTs are not subject to corporation tax on chargeable gains, special rules are required to exclude capital profits, gains or losses from loan relationships and derivative contracts from forming part of income.

7.3 For those ITCs and VCTs that prepare accounts under UK GAAP these special rules are set out in Schedule 10 Finance Act 1996 (for loan relationships) and Schedule 26 Finance Act 2002 (for derivative contracts).

7.4 This order defines capital profits, gains and losses in the cases of ITCs and VCTs preparing accounts in accordance with International Accounting Standards.

8. Impact

8.1 It is not expected that these changes will give rise to any costs.

9. Contact

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