EXPLANATORY MEMORANDUM TO

THE UNAUTHORISED UNIT TRUSTS (TAX) (AMENDMENT NO.2) REGULATIONS 2015

2015 No. 2053

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument seeks to ensure that the deduction for finance costs on let residential property on Exempt Unauthorised Unit Trusts ("EUUTs") and Mixed Unauthorised Unit Trusts ("MUUTs") is not withdrawn.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 The taxation of EUUTs is provided for in the Unauthorised Unit Trust (Tax) Regulations 2013 (the "Regulations") (as amended by S.I. 2014/585 and S.I. 2015/463) in the exercise of the powers conferred by section 217 of the Finance Act 2013.

4.2 Regulation 32 of the Regulations provides that the repeal of the provisions set out in Part 5 of Income Tax Act 2007 ("ITA 2007"), that had previously applied to tax unauthorised unit trusts, does not apply if the unit trust had a mix of exempt and non-exempt investors during the period 24 May 2012 and 5 April 2014. Therefore the repeal of section 504 ITA 2007 does not apply for MUUTs.

4.3 Section 24 of Finance (No.2) Act 2015 ("F(2)A 2015") restricts relief for finance costs (such as mortgage interest) on let residential properties to the basic rate of income tax, by introducing sections 272A, 272B, 274A and 274B to Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005").

5. Extent and Territorial Application

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury, David Gauke, has made the following statement regarding Human Rights:

In my view the provisions of the Unauthorised Unit Trusts (Tax) (Amendment No.2) Regulations 2015 are compatible with the Convention rights.

7. Policy background

What is being done and why

7.1 The intention of section 24 of F(2)A 2015 is to restrict finance cost relief for finance costs (such as mortgage interest) on let residential properties to the basic rate of income tax.

7.2 Section 272A ITTOIA 2005 withdraws the deduction for finance costs when calculating the profits of a residential property business.

7.3 Basic rate relief for those finance costs is given by sections 274A and 274B ITTOIA 2005. However these sections only provide basic rate relief for individuals and certain trustees. EUUTs and MUUTs would not receive any relief for the finance costs incurred on let residential properties from 2020-21.

7.4 As trustees of EUUTs and MUUTs are subject to income tax at the basic rate only, they can only receive basic rate relief for finance costs under the current rules. Therefore, the intention of section 24 F(2)A 2015, to restrict relief to the basic rate of tax, is already achieved in these cases without the application of that section.

7.5 The Regulations therefore disapply the operative sub-sections of section 272A ITTOIA 2005, so that EUUTs and MUUTs continue to obtain a full deduction for finance costs when calculating the profits of a residential property business.

Consolidation

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

8. Consultation outcome

8.1 In line with the Tax Consultation Framework a consultation has not taken place because this instrument is to ensure that a policy that has already been announced operates effectively for a particular group of taxpayers.

9. Guidance

9.1 HMRC is reviewing its guidance for investment funds generally, and guidance on the effect of this measure will be included in redrafted material in due course.

10. Impact

10.1 There is no impact on business, charities or voluntary bodies, as these regulations will ensure that they are not affected by the restriction of finance cost relief for landlords if they invest in EUUTs or MUUTs.

10.2 There is no impact on the public sector.

10.3 A Tax Information and Impact Note has not been prepared for this Instrument as it contains no substantive changes to tax policy. A Tax Information and Impact Note for the measure introduced by F(2)A 2015 can be found on the gov.uk website at

https://www.gov.uk/government/publications/restricting-finance-cost-relief-for-individual-landlords

11. Regulating small business

11.1 The legislation does not apply to activities that are undertaken by small businesses.

12. Monitoring & review

12.1 This will be kept under review through communication with affected taxpayer groups.

13. Contact

13.1 Megan Shaw at HMRC Telephone: 03000 585628 or email: megan.shaw@hmrc.gsi.gov.uk can answer any queries regarding the instrument.