EXPLANATORY MEMORANDUM TO

THE VENTURE CAPITAL TRUST (AMENDMENT) REGULATIONS 2008

2008 No. 1893

1. This explanatory memorandum has been prepared by HM Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

2. Description

2.1 The Venture Capital Trust scheme encourages investment in small unquoted companies. Individuals invest in such companies by holding shares in a venture capital trust company ("VCT"). A VCT is a company, broadly similar to an investment trust, which has been approved by HMRC and which subscribes for shares in, or lends money to, small unquoted companies. Investors, by investing in a VCT, are able to spread their risk across a range of small unquoted companies. A range of tax reliefs are available to investors in VCTs.

2.2 An investor receives these tax reliefs on an investment in a VCT provided the VCT is approved by HMRC. To be approved, the VCT must meet a number of conditions (see section of 274 Income Tax Act 2007 ("ITA")). The approval process is governed by the Venture Capital Trust Regulations 1995 (S.I. 1995/1979, amended by S.I. 1999/819). These Regulations amend those regulations to introduce greater flexibility to deal with cases where a VCT has breached, or is likely to breach, the conditions for its approval to continue.

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

The explanatory note to this Instrument explains that:

"A full and final Impact Assessment has not been produced for this instrument as a negligible impact on the private or voluntary sectors is foreseen."

This is because the accepted Government practice is that no IA will be published for HMRC and HMT tax measures for which:

- the total effect of the changes across all UK business is less than £100,000 of administrative burden costs/savings and/or £3m of compliance cost in total; and
- the Department's Better Regulation and Policy team has confirmed that
  - there are no disproportionate impacts on any business or sector; and
  - there are no other issues which might make publication of an IA advisable.

This is such a measure.

HMRC are working with BERR to ensure that the next edition of the Statutory Instrument Practice reflects these changes.

4. Legislative Background

4.1 The VCT scheme was originally enacted by Finance Act 1995 which inserted section 842AA and Schedule 28B into the Income and Corporation Taxes Act 1998. This

legislation, including that relating to the approval of VCTs, has been rewritten as part of the Tax Law Rewrite project and is now sections 258 - 332 of ITA.

4.2 These Regulations amend SI 1995/1979 to update references to take account of the creation of HMRC and the rewriting of the relevant legislation by ITA. These Regulations also make amendments to provide greater administrative flexibility where, through circumstances outside its control, a VCT breaches, or is likely to breach, the conditions for its approval as a VCT to continue. The amendments allow HMRC not to withdraw approval from the VCT, provided that the VCT takes all reasonable steps to correct the circumstances that led to the approval conditions being breached, or in cases where there is no action that it could take, provided that the breach will nevertheless be corrected in the course of events.

The power to make provision dealing with breaches of the conditions for VCT approval was inserted into section 284 ITA by paragraph 21 of Schedule 16 to the Finance Act 2007.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

Ms Angela Eagle has made the following statement regarding Human Rights:

"In my view the provisions of the Venture Capital Trust (Amendment) Regulations 2008 are compatible with the Convention rights."

7. Policy background

7.1 To be approved by HMRC, VCTs must meet a number of conditions, which they must then continue to meet for a specified period of time. Some of these conditions need to be met throughout an accounting period, others are assessed at the end of an accounting period. Currently, if the VCT fails to satisfy the conditions, then approval is withdrawn. If this happens, then further investments do not attract tax relief, and tax reliefs for existing investors are curtailed and may be withdrawn.

7.2 The conditions are that:

- the VCT's income must be derived wholly or mainly from shares or securities (nature of income condition);
- at least 70% by value of the VCT's investments must be in qualifying holdings of shares or securities throughout each accounting period (70% qualifying holdings condition);
- at least 30% by value of the VCT's qualifying holdings must be in holdings of eligible shares throughout the accounting period (30% eligible shares condition);

- no holding in any company may represent more than 15% by value of the VCT's investments at any time during the accounting period (15% holding limit condition);

- the VCT's ordinary share capital must be included in the official UK list throughout the accounting period (listing condition); and

- the VCT must not retain more than 15% of its income derived in the accounting period from shares and securities (income retention condition).

7.3 Approval may be full or provisional. When giving provisional approval, HMRC may attach additional conditions.

7.4 If any of the conditions above are broken, or seem likely to be broken (which may not be through any action or omission of the VCT) the VCT must inform HMRC as soon as possible. HMRC must then withdraw approval. In turn, future tax relief to investors will be denied and relief already given may be withdrawn. This is the case even if the breach has subsequently been corrected.

7.5 This non-discretionary loss of approval makes the operation of the existing rules inflexible and potentially inequitable.

7.6 These Regulations address this problem by amending SI 1995/1979 so that, notwithstanding the breach or likely breach, the VCT may apply for its approval as a VCT to continue, provided that either it takes action to rectify the situation, or that it can show that while there is no such action it could reasonably take, the situation will rectify itself within a reasonable length of time.

8. Impact

A full and final Impact Assessment has not been prepared for this instrument as a neglible impact on the private or voluntary sectors is foreseen.

9. Contact

David Harris at HM Revenue & Customs (tel: 020 7147 2562 or e-mail: david.harris@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.

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