EXPLANATORY MEMORANDUM TO

THE VENTURE CAPITAL TRUST (WINDING UP AND MERGERS) (TAX) (AMENDMENT) REGULATIONS 2015

2015 No. 361

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

2. Purpose of the instrument

2.1 Where a venture capital trust ("VCT") issues shares on or after 6 April 2014 and makes a repayment of share capital ("return of capital") before the end of the period specified, but for this instrument there would be grounds for its VCT approval to be withdrawn.

2.2 This instrument provides that there would not be such grounds where there has been a merger of VCTs, and the return of capital is in respect of new shares issued on or after 6 April 2014 which correspond to old shares in the merging companies that had been issued before 6 April 2014.

2.3 This instrument also ensures that for the purposes of this rule where there has been a merger of VCTs and the return of capital is in respect of new shares issued on or after 6 April 2014, which correspond to old shares in the merging companies that had been issued after 6 April 2014, the specified period in respect of those new shares runs from the date when the old shares were issued.

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

None.

4. Legislative Context

4.1 The instrument is being made to counteract the potentially adverse effect on merging VCTs of the return of capital rules, which were introduced by the Finance Act (FA) 2014.

4.2 In general, where a VCT issues shares on or after 6 April 2014, and makes a return of capital before the end of a specified period, referred to as the "restricted period", there will be grounds for its VCT approval to be withdrawn under section 281(1)(f) of the Income Tax Act 2007 (ITA 2007). The restricted period is three years from the end of the accounting period in which the shares were issued.

4.3 During the passage of the Finance Bill 2014 through Parliament, it was noted that the new rules would apply to new shares exchanged for old shares in a VCT that was merging with one or more other VCTs. The result would be to stop share capital being repaid on replacements for old shares that would not have been subject to the new rules, if the merger had not taken place.

4.4 Such an impact of the new rules in section 281(1)(f) of ITA 2007 on merged VCTs was not intended. A new power was introduced under section 322(5A) ITA 2007 by paragraph (4) of Schedule 10 of the FA 2014 to enable provision to be made for section 281(1)(f) not to apply (or to apply subject to modifications) in circumstances where there is a merger of two or more VCTs.

4.5 The instrument has retrospective effect and applies to shares issued on or after 6 April 2014 under the provisions of section 324(1)(e) of ITA 2007.

5. Territorial Extent and Application

5.1 This instrument applies to all of 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 The policy objective is to "look through" new shares issued on or after 6 April 2014, as a result of a merger of two or more VCTs, to the original shares issued by the original VCT, for the purposes of the return of capital rules.

7.2 Therefore, section 281(1)(f) does not apply to new shares issued on or after 6 April 2014 which correspond to old shares in the merging companies that had been issued before 6 April 2014.

7. 3 New shares issued by the new VCT which correspond to old shares in a VCT which merged to form the new VCT will take on the restricted period of the original shares. Where there has been a merger of VCTs and the old shares were issued on or after 6 April 2014 then without anything further the three year period required by section 281(1)(f) would apply from the end of the accounting period of the successor company in which the new shares were issued. For the purposes of section 281(1)(f) this instrument treats the new shares in the successor company as issued at the same time and for the same consideration as the old shares.

7.4 VCTs are listed companies and, without the instrument, several mergers may not have gone ahead, owing to the potential impact on long term investors in predecessor VCTs. Without the instrument, it would not be possible for merged VCTs to provide

capital repayments to long term investors for at least three years after the merger, irrespective of how long the investor had held the shares.

8. Consultation outcome

8.1 HMRC consulted informally with a number of VCT industry specialists on initial draft regulations and made some changes to the draft regulations in response to the specialists' comments. A public consultation was held for four weeks from 8 December 2014 to 5 January 2015 on the amended draft regulations. As a result of the consultation responses, the regulations were further amended to ensure shares issued on a merger on or after 6 April 2014 would take on the restricted period of the original shares.

9. Guidance

9.1 HMRC is drafting guidance on the application of the new rules and is working with VCT industry specialists on the final draft which will be published on the Government website in due course.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible. Merging VCTs will achieve economies of scale but there will be no effect on a VCT's underlying investments. Merging VCTs will be required to provide information about the number and value of shares, and the associated restricted periods, immediately before, and immediately after, the merger to enable HMRC to track the merged VCT's continuing compliance with the rules.

10.2 The impact on the public sector is negligible.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The impact of the new provisions will be considered as part of the monitoring of the return of capital provisions.

13. Contact

Cathy Wilson at HM Revenue & Customs Tel 03000 536678 or email: cathy.wilson@hmrc.gsi.gov.uk can answer any queries regarding the instrument.