These notes refer to the Income Tax Act 2007 (c.3)
which received Royal Assent on 20 March 2007

INCOME TAX ACT 2007

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 6: Venture capital trusts

Overview

Chapter 4: Qualifying holdings

Overview

856. One of the conditions relating to VCT approval is that the investing company holds at least 70% of its investments in qualifying holdings (the 70% qualifying holdings condition in section 274). This Chapter sets out the requirements that need to be met for an investment to be a qualifying holding.

Section 286: Qualifying holdings: introduction

857. This section describes the ground-rules for what is a qualifying holding. It is based on paragraph 1 of Schedule 28B to ICTA.

858. *Subsection (1)* introduces certain labels. The company invested in is described as “the relevant company”, the shares or securities are “the relevant holding” and in this Chapter the company that makes the investments is described as “the investing company”.

859. Where there are shared provisions, the order matches that in Part 5 Chapter 4 (EIS: the issuing company) as far as possible.

860. *Subsections (4)* and *(5)* provide that in this Chapter, if only part of the money raised by a relevant holding meets the requirements of section 287, section 293 and section 294, the holding is treated as two separate holdings.

Section 287: The maximum qualifying investment requirement

861. This section requires that the relevant holding does not represent an investment that exceeds “the maximum qualifying investment”. It is based on paragraph 7 of Schedule 28B to ICTA.

862. The maximum qualifying investment is £1m, see *subsection (2)*.

863. *Subsection (3)(a)* makes it explicit that if the maximum qualifying investment is exceeded, the £1m can be included as a qualifying holding and the shares or securities which represent the excess over the maximum qualifying investment are not regarded as part of the relevant holding.

864. *Subsection (3)(b)* ensures that there can be no double counting of an amount that represented such an excess. See *Change 60* in Annex 1.

865. *Subsections (4)* and *(5)* provide a rule for attributing shares or securities subsequently disposed of to the part of an investment that is in excess of the maximum qualifying investment.

866. *Subsections (6)* and *(7)* set out the consequences if the trade which meets the requirements of section 291(1) is carried on by the relevant company in a partnership or joint venture. The £1m is divided by the number of the members of the partnership or the parties to the joint venture. In subsection (6)(b*)* the words "as such" after "the joint venture" in paragraph 7(4)(b) of Schedule 28B to ICTA have not been reproduced, as they do not add anything.

867. In *subsection (8)*, which sets out what the relevant period is, it is made clear that the period ends with the issue of the relevant holding.

Section 288: The no guaranteed loan requirement

868. This section requires that the relevant holding does not include any securities that are backed up by a "guaranteed loan" and explains what is meant by this term. It is based on paragraph 10A of Schedule 28B to ICTA.

Section 289: The proportion of eligible shares requirement

869. This section requires a certain proportion of an investment in a relevant company to be in eligible shares. It is based on paragraph 10B of Schedule 28B to ICTA.

870. *Subsections (2)* and *(3)* set out rules about the value of shares in or securities of a company. The underlying approach is to value shares and securities at their value when acquired so that the requirement will not cease to be satisfied purely because of later fluctuations in the value of those investments.

871. *Subsection (4)* ensures that the value of the investment cannot be less than its initial cost price.

Section 290: The trading requirement

872. This section requires that the relevant company exists essentially for the purpose of carrying on qualifying trades or is a parent company of a group that carries on qualifying activities. It is based on paragraph 3(2) and (6) to (11) of Schedule 28B to ICTA.

873. A parent company, a group and a group company are defined in section 332.

874. Paragraph 3(6)(c) of Schedule 28B to ICTA is rewritten in s*ubsection (1)(b)* and*subsection (3)*. The requirements in paragraph 3(6)(b) and (c) are covered respectively by the definition of "parent company" in section 332 and by section 298.

875. *Subsections (2)* and *(6)* provide that certain requirements can be met in relation to a company that is not part of the group at the time the shares are issued. See *Change 61* in Annex 1. The provision for property used for R&D in *subsection (5)(d)* has been extended. See *Change 41* in Annex 1.

876. The words "capable of" have been omitted in *subsection (7)*, rewriting the definitions of "incidental purposes" and of "mainly trading subsidiary" in paragraph 3(2)(a) and (11) of Schedule 28B to ICTA. The intention is to make the definitions simpler to interpret: in practice the test will not change.

877. The label "non-qualifying activities" in subsection (1)(b) is defined in subsection (7). Paragraph (a) in subsection (7*)* refers to excluded activities. These are listed in section 303. Section 305 provides a let-out for certain leasing of ships from being treated as a non-qualifying activity.

878. The way that subsection (7) interprets non-qualifying activities means that no distinction is made between the let-out in section 305(4), derived from paragraph 4(7)

(a) to (d) of Schedule 28B to ICTA, and the let-out in section 305(7), derived from the final words of paragraph 4(7). This contrasts with paragraph 3(8)(b) of Schedule 28B to ICTA. See *Change 43* in Annex 1.

879. There is no reference to R&D in the definition of non-qualifying activities in subsection (7)(b), in contrast to the definition in section 181(8)(b) in Part 5 (Enterprise investment scheme). This is because in VCT the carrying on of R&D is treated as the carrying on of a trade in section 300(2).

Section 291: The carrying on of a qualifying activity requirement

880. This section requires that the relevant company carries on, or certain of its subsidiaries carry on, a qualifying activity at all times from the issue of the relevant holding to the time in question. It is based on paragraph 3(3) to (5B) of Schedule 28B to ICTA.

881. *Subsection (1)* introduces the term "qualifying activity" to cover the activities in paragraph 3(3)(a) and (b) of Schedule 28B to ICTA and these activities are set out in *subsections (2)* and *(3)*. This should make it easier for persons, who are not relying on subsection (3) to meet any of the requirements in this Chapter, to disregard the material in subsections (3) to (6).

882. *Subsection (8)* is new. The change enables the requirement in subsection (3) to be met in relation to a company that is not a qualifying 90% subsidiary at the time the shares are issued. See *Change 61* in Annex 1.

Section 292: Ceasing to meet requirements because of administration or receivership

883. This section provides a disregard from sections 290(1) and 291(1) where a company is in administration or receivership and there is no tax avoidance purpose. It is based on paragraph 11A(1) and (3) of Schedule 28B to ICTA.

884. The meanings of "in administration" and "in receivership" are provided by section 331.

Section 293: The use of the money raised requirement

885. This section sets out the times when, and extent and purpose for which, the money raised by the issue of the relevant holding must be intended to be employed or actually employed. It is based on paragraph 6(1) to (2AA) and (3) of Schedule 28B to ICTA.

Section 294: The relevant company to carry on the relevant qualifying activity requirement

886. This section contains requirements as to the persons who may carry on the relevant qualifying activity by reference to which the conditions in the preceding section have been met. It is based on paragraph 6(2AB) to (2AG) of Schedule 28B to ICTA.

887. *Subsection (1)* links the relevant qualifying activity that it refers to with the use of the money raised from the issue of shares in question. See *Change 62* in Annex 1.

Section 295: The unquoted status requirement

888. This section requires the relevant company to be unquoted and defines an unquoted company. It is based on paragraph 2 of Schedule 28B to ICTA.

889. The words in brackets in paragraph 2(1), "whether or not it is resident in the United Kingdom" are not rewritten. The words do not add anything to the tests in section 291.

890. Paragraph 2(5) of Schedule 28B to ICTA which concerns orders made by the Board is not rewritten in this section. It is instead covered by section 1014 which is based on section 828 of ICTA.

Section 296: The control and independence requirement

891. This section requires that:

- any company that the relevant company controls (on its own or together with connected persons) is a qualifying subsidiary of the relevant company;
- the relevant company is not controlled by another company (on its own or together with connected persons); and
- there are no arrangements which could lead the relevant company to fail either of these tests.

It is based on paragraph 9 of Schedule 28B to ICTA.

Section 297: The gross assets requirement

892. This section sets out the limits that apply to the value of a relevant company's gross assets before and after a share issue. It is based on paragraph 8 of Schedule 28B to ICTA.

893. The requirement differentiates between a "single company" and a "parent company". Both these terms are defined in section 332.

894. *Subsection (3)* sets out more clearly what is meant in relation to a group of companies by the "aggregate value at that time of the gross assets" in paragraph 8(2)(b) of Schedule 28B to ICTA. A similar wording is used in paragraph 12(3) of Schedule 5 to ITEPA (enterprise management incentives).

Section 298: The qualifying subsidiaries requirement

895. This section requires that any subsidiary of the relevant company must be a qualifying subsidiary. It is based on paragraphs 3(6) and 10(1) of Schedule 28B to ICTA.

Section 299: The property managing subsidiaries requirement

896. This section requires that any property managing subsidiary of the relevant company must also be its qualifying 90% subsidiary. It is based on paragraph 10ZA of Schedule 28B to ICTA.

897. In paragraph 10ZA(3) "land" and "property deriving its value from land" take the meaning in section 776 of ICTA. *Subsection (3)*, applying for the purposes of *subsection (2)* of the rewritten section, provides the definition of "property deriving its value from land". "Land" itself is not defined in this Act and instead relies on the definition in Schedule 1 to the Interpretation Act 1978. See the commentary on section 772.

Section 300: Meaning of "qualifying trade"

898. This section explains the term "qualifying trade". It is based on paragraph 4(1), (2) and (9) and on paragraph 5(4) of Schedule 28B to ICTA.

899. In *subsection (1)(b)* there is a reference to excluded activities. Excluded activities are set out in section 303.

900. *Subsection (2)* provides that the carrying on of any R&D activities is treated as the carrying on of a qualifying trade in certain circumstances. Paragraph (b) of subsection (2) now extends the cases in paragraph (a) in which this treatment occurs. See *Change 41* in Annex 1.

901. *Subsection (3)* provides that preparing to carry out R&D does not count as preparing to carry on a qualifying trade. See *Change 63* in Annex 1.

Section 301: Meaning of "qualifying 90% subsidiary"

902. This section gives the meaning of "qualifying 90% subsidiary". It is based on paragraph 5A of Schedule 28B to ICTA.

903. The label "qualifying 90% subsidiary" copies EIS section 190 and replaces "the relevant qualifying subsidiary".

Section 302: Meaning of "qualifying subsidiary"

904. This section says what "qualifying subsidiary" means. It is based on paragraph 10 of Schedule 28B to ICTA.

905. The term "51% subsidiary" in this paragraph and elsewhere takes its meaning from the definition in section 989. This provides a signpost to section 838 of ICTA.

Section 303: Meaning of "excluded activities"

906. This section gives the meaning of "excluded activities". It is based on paragraph 4(2) of Schedule 28B to ICTA.

907. The meaning of excluded activities is needed to determine whether a trade is a qualifying trade and the extent to which the business of a group includes non-qualifying activities.

908. *Subsection (2)* indicates where further detail can be found on certain of the activities listed in *subsection (1)*.

Section 304: Excluded activities: wholesale and retail distribution

909. This section supplements section 303(1)(b). It is based on paragraph 4(3) and (4) of Schedule 28B to ICTA.

910. *Subsection (2)* makes it clear that there are two sets of determinants, one set establishing what is a trade of wholesale and retail distribution and the other what is an ordinary trade of wholesale and retail distribution.

911. The words "or exposed" before "for sale" have been added in *subsection (4)*. This is intended to reflect the normal description of a trade of retail distribution in United Kingdom statute law.

912. *Subsection (5)(b)* refers to "the trader" rather than "the company" which is referred to in paragraph 4(3)(c)(ii) of Schedule 28B to ICTA. See *Change 45* in Annex 1.

Section 305: Excluded activities: leasing of ships

913. This section supplements section 303(1)(d). It is based on paragraph 4(7) and (8) and paragraph 5(1) of Schedule 28B to ICTA.

914. *Subsection (2)* uses as its model paragraph 18(2) of Schedule 5 to ITEPA (enterprise management incentives). This additional material, which is not in the source legislation, makes it clear that the requirements of *subsection (4)* do not have to be met in relation to offshore installations and pleasure craft.

915. *Change 43* in Annex 1 applies for the purposes of *subsection (7)*. See the commentary on section 290(7).

Section 306: Excluded activities: receipt of royalties and licence fees

916. This section supplements section 303(1)(e). It is based on paragraph 4(5) to (6D) of Schedule 28B to ICTA.

Section 307: Excluded activities: property development

917. This section supplements section 303(1)(g). It is based on paragraph 5(1), (5) and (7) of Schedule 28B to ICTA.

Section 308: Excluded activities: hotels and comparable establishments

918. This section supplements section 303(1)(j). It is based on paragraph 4(3A) and paragraph 5(6) of Schedule 28B to ICTA.

Section 309: Excluded activities: nursing homes and residential care homes

919. This section supplements section 303(1)(k). It is based on paragraph 4(3A) and paragraph 5(1) of Schedule 28B to ICTA.

Section 310: Excluded activities: provision of services or facilities for another business

920. This section treats the provision of services or facilities as excluded activities if:

- the services or facilities are provided to businesses which themselves consist largely of excluded activities; and
- the specified control requirements exist.

It is based on paragraph 4(2) and paragraph 5(2) to (4) of Schedule 28B to ICTA.

921. The section is written in terms of a business. The way the definition of a trade in paragraph 5(4), governing paragraph 4 and 5 of Schedule 28B, is applied within those paragraphs has been simplified. See *Change 64* in Annex 1.

Section 311: Power to amend Chapter

922. This section allows the Treasury to make orders amending the provisions mentioned in the section. It is based on paragraph 12 of Schedule 28B to ICTA.

Section 312: Winding up of the relevant company

923. This section provides that if the requirements of this Chapter would be met but for the winding up of the relevant company, they are treated as met. The winding up must be commercial and not entered into for tax avoidance purposes. It is based on paragraph 11 of Schedule 28B to ICTA.

924. This supplements the provisions on winding up in section 294(4) and (5) in relation to the relevant company or any other company (in this case this extends to a dissolution too) and in section 302(3) in relation to a qualifying subsidiary or any other company.

Section 313: Interpretation of Chapter

925. This section provides an interpretation for certain terms used in this Chapter. It is based on paragraphs 1(1), 5(4) and 13 of Schedule 28B to ICTA.

926. *Subsection (3)* excepts references to a trade in certain sections in this Chapter from the extended meaning of “trade” in section 989, based on the definition in section 832(1) of ICTA. See the commentary on section 310 and *Change 64* in Annex 1.