

**EXPLANATORY MEMORANDUM TO**  
**THE VENTURE CAPITAL TRUST (EXCHANGE OF SHARES AND SECURITIES)**  
**(AMENDMENT) REGULATIONS 2018**

**2018 No. 109**

**1. Introduction**

- 1.1 This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC), on behalf of HM Treasury, and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

**2. Purpose of the instrument**

- 2.1 The instrument specifies conditions in which a venture capital trust (VCT) can exchange shares or securities for new shares or securities without any immediate effect to its status as an approved VCT.

**3. Matters of special interest to Parliament**

*Matters of special interest to the Select Committee on Statutory Instruments*

- 3.1 The Regulations are the first to be made under the powers cited in them.

*Other matters of interest to the House of Commons*

- 3.2 As this instrument is subject to negative resolution 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 instrument is being made to facilitate company reconstructions that require a VCT to exchange its holding of shares and securities for new shares or securities. It enables commercial reconstructions to take place in circumstances where the exchange would result in the VCT being in breach of the rules in Chapter 4 to Part 6 of the Income Tax Act 2007, that prescribe the investments a VCT is permitted to hold. The instrument complements the existing rules in The Venture Capital Trust (Exchange of Shares and Securities) Regulations 2002.

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

## **7. Policy background**

### *What is being done and why*

- 7.1 The regulations will specify circumstances in which VCTs are permitted to swap investments for shares or securities that would otherwise put their approved status at risk. This will enable VCTs to participate in exchange transactions as part of the process of liquidating investments.
- 7.2 VCTs are listed companies approved by HMRC. VCTs and their individual investors receive a range of generous tax reliefs, provided the VCT meets a number of conditions. These include investing at least 70% of its funds in ‘qualifying’ shares or securities.
- 7.3 VCTs have been allowed to have up to 30% of funds in non-qualifying investments. Rules introduced by Finance Act 2016 imposed significant restrictions to the types of non-qualifying investments a VCT is now permitted to hold. These rules however do not directly affect pre-existing investments. VCTs can retain old non-qualifying investments without losing their HMRC approval provided that those investments are not disturbed in any way.
- 7.4 An exchange of shares or securities is treated as a disposal of the old investment and the acquisition of a new one. Where a VCT participates in an exchange and disposes of old non-qualifying investments, the new restrictive rules relating to permitted non-qualifying investments will apply to any shares or securities received.
- 7.5 Share exchanges are a feature of commercial reconstructions and buy-outs, but structured with little reference to minority shareholders. A VCT may be in a situation where it can dispose of an investment only partly for cash and is obliged to accept new shares or securities in part exchange. A result of such a transaction could be that the VCT is left with new shares or securities that do not meet the conditions of Chapter 3.
- 7.6 This puts VCTs at risk of having their approved status withdrawn if they participate in an exchange of shares and securities in the course of realising their investments. The Venture Capital (Exchange of Shares and Securities) Regulations 2002 provided VCTs with some leeway to dispose of investments in this manner. These regulations however only deal with disposals of qualifying investments.
- 7.7 The instrument now sets out circumstances, similar to those in the 2002 Regulations, in which a VCT can exchange non-qualifying shares or securities. It allows new non-qualifying shares or securities acquired through an exchange to be held for limited periods. This gives a VCT additional time to complete the liquidation of an original non-qualifying investment before it is in breach of the approval conditions of Chapter 4.

### *Consolidation*

- 7.8 The Venture Capital Trust Regulations 2002 are not being consolidated or updated by this instrument.

## **8. Consultation outcome**

- 8.1 The draft regulations were published for consultation on 1 December 2017. The consultation ended on 2 January 2018 and five responses were received. The time limits for holding new non-qualifying shares or securities in this instrument have been

doubled from those specified in the draft regulations following comments made on the problems in disposing of such shares and securities.

**9. Guidance**

- 9.1 HMRC will expand the current guidance on share exchanges to include guidance relating to this measure.

**10. Impact**

- 10.1 The impact on business, charities or voluntary bodies is confined to VCTs only. There may be some slight administrative burden as VCTs familiarise themselves with the details of the instrument and guidance.
- 10.2 The impact on the public sector will be a reduction in the requirement for HMRC to provide rulings in relation to exchanges of shares and securities. This will save HMRC resource.
- 10.3 A Tax Information and Impact Note has not been prepared for this instrument as it contains no substantive changes to tax policy.

**11. Regulating small business**

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

**12. Monitoring & review**

- 12.1 The information requirements will be reviewed as part of the work to support the independent evaluation in 2018-19.

**13. Contact**

- 13.1 Martin Trott at HM Revenue and Customs Telephone: 03000 585619 or email: [venturecapitalschemes.policy@hmrc.gsi.gov.uk](mailto:venturecapitalschemes.policy@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.