EXPLANATORY MEMORANDUM

THE VENTURE CAPITAL TRUST (WINDINGS UP AND MERGERS) (TAX) REGULATIONS 2004 No. 2199

1. These Regulations have been made by the Treasury, in exercise of powers conferred upon them by paragraphs 2 to 5, 7 to 9, 11 and 16 of Schedule 33 to the Finance Act 2002 and are laid before Parliament by Command of Her Majesty.

Description

2. The Regulations are concerned with Venture Capital Trusts (VCTs) which are companies whose ordinary shares are listed in the Official List of on the London Stock Exchange and approved by the Inland Revenue. VCTs are required to invest most of their portfolio in small higher-risk trading companies. A number of tax reliefs are available to individuals who invest in qualifying VCT shares. The most generous (income tax relief in respect of amounts invested) is available to individuals who subscribe for shares, while exemption from both capital gains tax on gains and income tax on dividends is available to individuals who acquire VCT shares whether by subscription or otherwise.
3. These Regulations are comprised of three parts, the first of which, from regulations 3 to 8, provides a grace period during which VCTs can wind up without the individuals who have invested in them losing entitlement to their tax reliefs on account of the winding-up, and without the companies themselves ceasing to be treated for tax purposes as VCTs.
4. Regulations 9 to 13 deal with mergers of VCTs and provide a “look-through” provision, so that the assets of one company (the acquired VCT) are treated as assets of another company (the successor company) for the purposes of determining whether certain requirements for the successor company to be a VCT are satisfied. This will allow one VCT to merge with or take over other VCTs.
5. Regulation 14 prevents tax-subsidised money being used to finance exits from VCTs either as part of these mergers or more generally.
6. Collectively, these Regulations have the effect of removing barriers to VCTs winding up or merging without putting their investors’ entitlements to tax relief at risk.

Matters of special interest to the Joint Committee on Statutory Instruments

7. The Regulations have taken rather longer than is the norm to draft. This has largely been due to the difficulty of designing a framework that achieves the tax policy objectives within the context of Company Act and Insolvency Act provisions on winding up and on mergers of companies in a way which will

not breach Stock Exchange and regulatory procedures. The Regulations have been drawn up in consultation with representatives of the VCT industry, and a number of tricky legal and administrative issues were identified and resolved during that process.

Legislative Background

8. These Regulations are being made under powers conferred by Schedule 33 to the Finance Act 2002. The Regulations come into force in accordance with the negative resolution procedure.

EU legislation

9. The Regulations do not implement EU legislation.

Extent

10. The instrument applies to all of the United Kingdom.

Policy Background

11. The venture capital trust scheme is one of a number of tax incentives that have the aim of encouraging third parties to invest money in small companies to enable these small companies to prosper and grow. The scheme was introduced in 1995 to provide a collective, regulated vehicle generally for higher net worth individuals who might wish to include some venture capital investment in their investment portfolio but not wish to make a direct investment in the small companies concerned.

12. A VCT is a company whose ordinary shares are listed on the Official List of the London Stock Exchange. It is required to invest most of its portfolio in small higher-risk trading companies. It must be approved by the Inland Revenue and must comply with a number of statutory rules to obtain this approval. Anyone may invest in a VCT, but only individuals over 18 may obtain the tax reliefs on offer.

13. One reason VCTs are required to have their ordinary shares listed is to provide investors with a possible "exit" after meeting the minimum holding period of three years which is a requirement for the income tax relief not to be withdrawn.

14. As it stands, VCTs cannot merge/consolidate or wind up in an orderly fashion without breaching the legislation which governs their approval. So the commercially-driven development of the VCT sector is constrained by its tax rules which added to the small scale of the market in VCT shares means that very few brokers/market-makers are prepared to deal in VCT shares.

15. The issues these Regulations address were first flagged up by way of an Opposition amendment to Finance Bill 2000 which attempted to allow VCTs to merge without losing their approved status in consequence. The

amendment was withdrawn but led to the formation of an industry/Inland Revenue Working Group which developed proposals leading to powers to make enabling Regulations being introduced as part of Finance Act 2002. Thereafter, Inland Revenue and the industry met and discussed successive drafts of the Regulations.

Impact

16. An initial regulatory impact assessment (RIA) was started, but early soundings and lack of response from the industry indicated no significant impacts or any additional compliance costs. In terms of record keeping/reporting there is no more than VCTs do now. Any costs are likely to be in becoming familiar with the changes, so no final RIA was prepared as it the measures were below the de minimis limit of compliance cost of under £3m.

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