EXPLANATORY MEMORANDUM TO

THE INVESTMENT TRUST (APPROVED COMPANY) (TAX) REGULATIONS 2011

2011 No. 2999

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 These Regulations contain provisions as to the approval of companies as investment trusts by HMRC for the purposes of section 1158 of the Corporation Tax Act 2010 (see section 1159 of that Act). Companies so approved are exempt from Corporation Tax on chargeable gains. These Regulations also contain provisions as to the treatment of specified transactions entered into by investment trusts (section 622A of that Act), so that such transactions will always be treated for the purposes of the Corporation Tax Acts as being entered into for the purposes of investment rather than in the course of a trade, and make consequential amendments to the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/3001).

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

3.1 These Regulations are laid in draft before the House of Commons for approval by resolution of that House.

4. Legislative Context

4.1 These Regulations, together with amendments made to the Corporation Tax Act 2010 by Finance Bill 2011 (subject to an Appointed Day Order), give effect to changes announced by the Government following a formal consultation on the modernisation of the tax rules for investment trusts.

4.2 Sections 1158, 1159 and 622A of the Corporation Tax Act 2010 were inserted by the Finance Act 2011, and will replace and augment existing legislation relating to investment trusts. Section 1158 makes new provision as to the conditions to be met by a company in order to come within the meaning of 'investment trust'. Section 1159 provides a power to enable HM Treasury to make Regulations as to the approval of such companies by HMRC, and as to additional conditions to be met by such companies. Section 622A provides a power to enable HM Treasury to make Regulations as to the treatment of certain transactions entered into by such companies.

4.3 These Regulations are the first instance in which the powers provided by Sections 1159 and 622A have been exercised and are subject to the affirmative resolution procedure.

4.4 The consultation was a joint exercise between HMRC and the Department for Business, Innovation and Skills (‘DBIS’). As a consequence of the proposals to modernise the tax rules for investment trusts, DBIS consulted on corresponding revisions to the meaning of an investment company. This was because most companies approved as investment trusts are also registered as ‘investment companies’ and the conditions for making distributions under Companies Act 2006 rules for investment companies are based on the tax rules for approval as an investment trust. Therefore, in order for companies that are both investment trusts and investment companies to take advantage of the revised, less restrictive, tax rules provided by these Regulations corresponding changes will be required to be made to Companies Act 2006.

4.5 DBIS are currently finalising their draft Regulations which will make the necessary amendments to Companies Act. Those Regulations will be made under powers provided by the European Communities Act 1972 and will be subject to the affirmative process. DBIS expect to lay their Regulations in time for them to apply, if the Regulations are approved by Parliament, to distributions made by investment companies on or after 6 April 2012**.**

4.6 The Regulations laid today apply to accounting periods commencing on or after 1 January 2012 and Regulations 43 and 45 apply to disposals of assets made on or after that date. These Regulations are being laid in advance of the corresponding DBIS regulations as most investment trusts have accounting periods commencing 1 January. As these Regulations may not have retrospective effect, a delay in laying them (so that they applied to accounting periods commencing on or after some date later than 1 January 2012) would lead to a delay of a further 12 months in them taking effect for most investment trusts.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury, Mark Hoban, has made the following statement regarding Human Rights:

In my view, the provisions of the Investment Trust (Approved Company) (Tax) Regulations 2011 are compatible with the Convention rights.

7. Policy background

- ***What is being done and why***

7.1 The tax rules relating to the approval of companies as ‘investment trusts’ were introduced in 1965 and have remained largely unchanged. Consequently they do not reflect the many changes in the investment industry since then, leading to unnecessary restrictions on the commercial activities of investment trusts, and do not provide the same certainty of tax treatment that is available to other parts of the investment management industry. The changes being introduced follow consultation with industry, and are consistent with other changes already made to modernise the tax rules for authorised investment funds and UK investors with holdings in offshore funds.

- ***Consolidation***

7.2 These Regulations do not consolidate any other instruments.

8. Consultation outcome

8.1 A consultation document was published on 27 July 2010 setting out the Government’s proposals for the changes which it intended to make to modernise the tax rules for investment trusts.

8.2 Respondents were generally supportive of the proposals. Further consultation and evaluation of evidence provided by industry led to some changes to the proposals and these were reflected in the Summary of Responses document published on 9 December 2010. Draft legislation to give effect to the changes and to provide powers to make Regulations containing the operational rules and conditions for approval was published on the same day.

8.3 A draft of these Regulations was published at Budget 2011. Further drafts of the Regulations have been shared on an informal basis with stakeholders as they have been developed.

9. Guidance

9.1 HMRC is developing guidance. The guidance will be finalised following discussions with stakeholders and is expected to be published before these Regulations take effect.

10. Impact

10.1 The impact on business is set out in the Tax Information and Impact Note.

10.2 The impact on the public sector is set out in the Tax Information and Impact Note.

10.3 A Tax Information and Impact Note covering this instrument was published on 9 December 2010 alongside draft legislation on the modernisation of the tax rules for investment trust companies and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm . It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on small firms employing up to 20 people, the approach taken is that the measure is beneficial and excluding companies with fewer than 20 employees would not achieve the policy objective.

11.3 No indication was given by small firms responding to the consultation that they would have any difficulty understanding and operating the legislation. HMRC will however provide assistance to small firms through the usual contact channels for customers requiring assistance, and by publishing guidance.

12. Monitoring & review

12.1 The impact will be assessed through monitoring information collected on tax returns and approval applications to ensure that the proposed legislation is working in the way intended. A particular measureable outcome will be whether new investment trusts choose to launch in the UK as a result of the changes, rather than offshore as has been the trend in recent years. HMRC and HM Treasury will also continue to liaise with stakeholders from time to time to discuss the implementation of the proposed new rules as part of continuing engagement with industry.

13. Contact

Wayne Strangwood at HMRC Tel: 020 7147 2545 or email: wayne.a.strangwood@hmrc.gsi.gov.uk can answer any queries regarding the instrument.