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 3: VCT approvals

Overview

823. This Chapter:

- lists the conditions relevant to VCT approval;
- sets out alternative bases on which VCT approval may be given and the time from which VCT approval has effect;
- deals with the withdrawal of VCT approval and the time from which withdrawal has effect; and
- deals with related matters (including powers to make regulations for certain matters).

Section 274: Requirements for the giving of approval

824. This section sets out the conditions which must be met before the Commissioners for Her Majesty's Revenue and Customs are able to approve a company as a VCT. It is based on section 842AA(2) and (3) of ICTA.

825. *Subsection (1)* specifies the accounting periods in relation to which the conditions have to be met.

826. *Subsection (2)* gives labels to each of the conditions in section 842AA(2) of ICTA, changes the order in which they appear and uses a tabular layout as an aid to navigation.

827. References in the conditions to qualifying holdings and eligible shares are explained in section 285(1) and (2).

828. *Subsection (3)* provides a signpost to the provisions that contain material supplementing some of the conditions listed in the table.

Section 275: Alternative requirements for the giving of approval

829. This section allows the Commissioners to approve a company as a VCT if they are satisfied that conditions, which are not met in relation to the company's most recent accounting period, will be met in certain other accounting periods. It is based on section 842AA(4) of ICTA.

830. Most approvals are in practice given under this provision.

Section 276: Conditions relating to income

831. This section supplements the nature of income condition and the income retention condition. It is based on section 842(1AB) and (2A) to (2C), section 842AA(11) of ICTA and paragraph 40 of Schedule 26 to FA 2002.

832. Section 842AA(11)(za) and (b) of ICTA relies on the user adapting material that applies to similar conditions in section 842 (investment trusts). This section eliminates the need to refer to section 842 of ICTA. In addition *subsections (1)*and *(2)* rewrite paragraph 40 of Schedule 26 to FA 2002 which deals with derivative contracts in relation to VCTs.

Section 277: The 15% holding limit condition

833. This section effectively restricts the times at which the 15% holding limit condition is applied in relation to investments in a company and provides supplementary material relating to that condition. It is based on section 842(1A), (2), (3) and (4) and section 842AA(11) of ICTA.

834. Section 842AA(11)(a) and (c) of ICTA applies certain provisions in section 842 (investment trusts) to section 842AA(2)(d). This section eliminates the need to refer to section 842 of ICTA.

835. *Subsection (1)* is based on section 842(3)(b) of ICTA, which provides that if an addition is made to a holding, the holding is treated as acquired at that time. Subsection (1) is also based on section 842(2)(b). The effect is that the 15% holding condition only applies on the occasion or occasions when the holding is acquired or when it is added to.

836. The underlying approach is that the 15% holding limit condition is applied in relation to a company only at times when shares or securities are acquired in that company. This prevents the condition being breached solely as a result of fluctuations in the value of investments.

Section 278: Conditions relating to value of investments: general

837. This section provides rules about the values of holdings of investments of particular descriptions. Those rules are used in applying the 15% holding limit condition, the 70% qualifying holdings condition and the 30% eligible shares condition. It is based on section 842(3) and (4) and section 842AA(5) and (11) of ICTA.

838. The underlying approach is that there is a valuation (or revaluation) of investments of any particular description only when investments of that description are acquired. In that way the three conditions will not cease to be satisfied solely because of later fluctuations in the value of investments.

839. The section makes it clear that the rules about the valuation of a holding in this section apply equally to the 15% holding limit condition, the 70% qualifying holdings condition and the 30% eligible shares condition. See *Change 59* in Annex 1.

Section 279: Conditions relating to value of investments: qualifying holdings

840. This section provides what is to be taken as the value of shares or securities acquired on certain exchanges or conversions if those shares or securities are treated as meeting some of the conditions in Chapter 4 (qualifying holdings). It also provides power to make regulations about the value of shares or securities in certain cases. It is based on section 842AA(5AA) to (5AE) of ICTA.

841. An exchange has to meet the requirements of section 326 (restructuring arrangements) and a conversion has to meet the requirements of section 329 (conversion of convertible shares and securities).

842. The power to treat conditions in Chapter 4 as met under section 330 (power to facilitate company reorganisations etc involving exchange of shares) is extended to encompass the valuation of shares and securities involved in reorganisations.

Section 280: Conditions relating to qualifying holdings and eligible shares

843. This section provides a period of grace during which the proceeds from most further issues of ordinary shares by a VCT are disregarded in determining whether the VCT meets the 70% qualifying holdings condition and the 30% eligible shares condition. It is based on section 842AA(5A) and (5B) of ICTA and paragraph 11(1), (2) and (4) of Schedule 33 to FA 2002.

844. The underlying rationale is to give the VCT a reasonable amount of time to invest the proceeds of the further share issue in qualifying holdings before taking those proceeds into account for the 70% qualifying holdings condition and the 30% eligible shares condition. Without any period of grace those conditions might deter VCTs from issuing further share capital to raise funds for investment in qualifying holdings.

845. The section also contains powers to make regulations varying the treatment that would otherwise apply under this section. These powers have been used in making the Venture Capital Trust (Winding up and Mergers) (Tax) Regulations 2004 (SI 2004/2199).

Section 281: Withdrawal of VCT approval of a company

846. This section sets out cases in which a company's approval as a VCT may be withdrawn and the time from which the withdrawal has effect, and contains supplementary material concerning the time limits for assessing tax consequent on the withdrawal. It is based on section 842AA(6) to (10) of ICTA.

Section 282: Withdrawal of VCT approval in cases for which provision made under section 280(3)

847. This section gives the Treasury power to make regulations that provide, in certain cases, for withdrawal of VCT approval to have effect before notice of withdrawal is given. It is based on paragraph 12 of Schedule 33 to FA 2002.

848. The cases are limited to those where, but for regulations under section 280(3), section 280(2) (disregard of money raised by further share issue) would have prevented withdrawal of approval.

Section 283: Time as from which VCT approval has effect

849. This section explains when a VCT approval takes effect. It is based on section 842AA(1) of ICTA.

850. Paragraph (a) of section 842AA(1) of ICTA, which refers to an approval given in 1995-96, has not been rewritten.

851. Section 842AA(1) and (4)(b) of ICTA, and regulation 4(2)(b) of SI 1995/1979, make it clear that the date from which approval has effect is not necessarily the date on which approval is given. *Subsection (3)* notes that an approval can be forward-dated as well as back-dated.

Section 284: Power to make regulations as to procedure

852. This section gives the Treasury powers to make regulations regarding VCT approvals, the obligations of VCTs in relation to certain matters and the persons liable to account for tax consequent on withdrawal of VCT approval. It is based on section 73(2) of FA 1995.

853. This power has been used in relation to the Venture Capital Trust Regulations 1995 (SI 1995/1979).

Section 285: Interpretation of Chapter

854. This section provides various definitions for this Chapter. It is based on section 842AA(11A) to (14) of ICTA.

855. *Subsections (4)* to *(6)*, based on section 842AA(11A) to (11C) of ICTA, provide an interpretation of references to a company's investments. Paragraph 8 of Schedule 14 to FA 2006 does not extend this interpretation explicitly to the definitions in section 842(3) of ICTA. Subsection (4) of this section applies the interpretation to Chapter 3 as a whole. See *Change 59* in Annex 1.