

Chapter 6: Investment trusts

Overview

This Chapter sets out the meaning of “investment trust” for the purposes of the Corporation Tax Acts.

Clause 1: Meaning of “investment trust”

1. This clause explains that an investment trust is a company that is not a close company and is approved by the Commissioners for HMRC as an investment trust. It is based on section 842(1) of ICTA.
2. *Paragraph (b)* makes it explicit that the requirement that the company is not a close company relates to the whole of the accounting period for which approval is sought.

Clause 2: Conditions for approval

3. This clause sets out conditions A to F which a company must meet for an accounting period in order for it to be approved by the Commissioners for HMRC. It is based on section 842(1) of ICTA.
4. Conditions A, B and E make it clear that the conditions concerned relate to the whole of the accounting period for which approval is sought. We take this to be implicit in section 842(1) of ICTA. Similarly, the reference in condition C to the income of the accounting period aims to state more clearly what is implied by the reference to “the company’s income” in section 842(1)(c).

Clause 3: Calculation of income

5. This clause provides additional information on conditions C and D. It is based on section 842(1AB), (1AC), (2D), (2E) and (3A) of ICTA.
6. *Subsection (1)* states that *subsections (2) to (4)* apply in determining what is to be included as the amount of the company’s income or the amount of income which a company derives from shares or securities for the purposes of conditions C and D “and accordingly of section 4{j2756}(2)(a)”.

7. While some references to income in section 842 of ICTA (those in subsection (1)(a) and (e) and the second reference in subsection (2A)(b)) are in a context that implies that the amount of the income is (prima facie) to be calculated in accordance with normal corporation tax principles, other references to income in the section (in subsections (2A) and (2B)) do not appear to invoke the tax-based meaning of income.
8. This distinction is reflected in section 842(1AB) of ICTA which makes special provision about the meaning of “income” only for the purposes of subsections (1)(a) and (e) and (2A)(b) of that section. The special provision made by section 842(1AB) takes the tax-based meaning of “income” as a starting point, and therefore is not relevant for the purposes of the other references to income in section 842.
9. Section 842(2D) and (3A) of ICTA (inserted by CTA 2009), are expressed to apply to section 842 as a whole. But it appears that those subsections presuppose a tax-based measure of income and that their application is accordingly limited to the purposes for which section

842(1AB) applies. In the rewrite we have explicitly limited the application of subsections (3) and (4) accordingly.

Q1. We welcome comments on the rewrite of section 842(2D) and (3A) of ICTA.

10. *Subsection (5)* is concerned specifically with what is to be included as income of the company for the purpose of condition C.

Clause 4: The income retention condition: exceptions

11. This clause qualifies the application of condition D. It is based on section 842(2A), (2B) and (2C) of ICTA.

Clause 5: The 15% holding limit: exceptions

12. This clause qualifies the application of condition E. It is based on section 842(1), (2) and (3) of ICTA.

13. A well-known HMRC practice with regard to the disposal of shares or securities from a holding is legislated for in *subsection (4)*. See *Change 684* in Annex 1.

Q2. We welcome comments on the provision that deals with the disposal of shares or securities from a holding in relation to condition E.

Clause 6: Basic Meaning of “holding in a company”

14. This clause explains references to “holding in a company” for the purposes of condition E. It is based on section 842(3) of ICTA.

15. *Subsection (2)* explains the reference to a holding being “enlarged” in clause 5{j2752}.

Clause 7: More about the meaning of “holding in a company”

16. This clause gives more information about how to interpret a holding in a company for the purposes of condition E. It is based on section 842(1A), (3) and (4) of ICTA.

17. *Subsections (1) and (2)* deal with certain cases involving a scheme of reconstruction. The newly issued shares or securities in the first company are treated under subsection (2) as forming part of the existing holding of shares or securities in the second company. Since the shares or securities are issued for no consideration there is no enlargement of the holding as defined in clause 6{j2759}(2).

Clause 8: Other interpretation

18. This clause sets out the meaning of company, shares and scheme of reconstruction in this Chapter. It is based on section 842(4) of ICTA.

19. Under *subsection (1)* references to company in this Chapter are read in accordance with section 99 of TCGA, which treats a unit trust scheme as a company. In section 842(4) of ICTA the definition of company in section 288 of TCGA is applied in addition to section 99 of TCGA. In this clause we have not included section 288 of TCGA so that the definition of company in clause 1071{j4996} of draft Bill 6, based on section 832(1) of ICTA, will apply.

The only difference is that clause 1071{j4996} omits a local authority and a local authority association from the definition of company and this can have no relevance to an investment trust.

ANNEX 1.

Change 684: Investment trusts: disposal of shares or securities from a holding: clause 5

This change puts into legislation a well-known and established concession relating to the 15% holding limit condition.

Under section 842(1) of ICTA, the Commissioners of HMRC may approve a company as an investment trust only if it is shown to their satisfaction that the company meets certain conditions. One of these conditions is that no holding in a company (other than an investment trust or a company that would qualify as an investment trust if its shares were included in the official UK list) represents more than 15% of the company's investments ("the 15% holding limit condition").

Section 842(2), read with subsection (3)(b) of that section, provides for some exceptions. One of these is that if a holding in a company meets the 15% holding limit condition when it was acquired or when it was last added to, it is treated as continuing to meet the condition until further shares or securities are acquired in that company.

In addition HMRC treats a holding as continuing to meet the test until further shares or securities are acquired where there is a disposal of shares or securities from a holding and immediately after the disposal the holding represented 15% or less of the company's investments.

This is set out in the Company Tax Manual as follows:

If a company has a holding which, at 6 April 1965 or at the date of acquisition, exceeded the percentage limits, it may dispose of part of the holding to bring the reduced holding within the 15 per cent limit. So long as no addition is made to the holding, approval should not be withdrawn for any subsequent accounting period solely because the reduced holding has appreciated relative to the other investments so that it exceeds 15 per cent of the company's investments.

In clause 5{j2752}(4) this concession is worded:

If a company disposes of shares or securities from a holding in a company and immediately after the disposal the holding represents 15% or less by value of the company's investments, the holding is treated for the purposes of condition E as continuing to represent 15% or less by value of the company's investments until the holding is next enlarged.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with current practice.