Amendment 1 to Clause 17 and Schedule 5: VCTs: further amendments

Summary

1. This amendment to Schedule 5 places restrictions on the amount of interest and other charges that Venture Capital Trusts (VCTs) can impose in relation to qualifying loan investments. It also prevents these loans being secured against the assets of the company being invested in. This amendment will take effect in relation to loans made on or after Royal Assent subject to regulations made by HM Treasury.

Details of the amendment

2. Amendment 1 inserts paragraph 6A into Schedule 5: Venture Capital Trusts: Further amendments. The paragraph makes changes to Part 6 of the Income Tax Act (ITA) 2007.

3. Paragraph 6A amends section 285 of ITA 2007 (interpretation of Chapter 3 etc of Part 6) to exclude certain loans from being a 'security' for the purposes of Part 6 and therefore will not meet the requirements to be a 'qualifying holding' of a VCT.

4. Subparagraph 2 removes the reference in section 285(2) to loans being secured and adds to the section a reference to new subsection (2A). Loans meeting the conditions of new subsection (2A) are prevented from being a 'security' and will not be part of a VCTs 'qualifying holding'.

5. Subparagraph 3 inserts new subsections (2A) to (2E) into section 285.

6. New subsection (2A) applies to loans where the terms of the loan provide:

   - Returns that are more than what would be a commercial return on the loan principal in the circumstances in which the loan is made, or

   - Security in the form of either rights over the assets of the company being invested in or control, as defined in sections 450 and 451 of the Corporation Tax Act 2010, over that company.

   For the purposes of this subsection the terms of the loan include all associated agreements and arrangements (whether legally enforceable or not).

7. New subsection (2B) provides for loans to be excluded from subsection (2A) where the returns meet the specified conditions. Those conditions are that:

   - In the first five years of the loan, when the principal of a 'security' is not to be repaid, the total amount returned is no more than 50% of the loan principal, and

- The total return over the full term of the loan averages out at no more than a return of 10% per annum, making allowance for any repayment of the principal after the end of the initial five years.

8. New subsection (2C) makes provision for HM Treasury to make regulations to change the various rates set out in subsection (2B).

9. New subsection (2D) defines 'return' for the purposes of subsections (2A) and (2B). It ensures that all amounts payable in relation to the loan are included.

10. New subsection (2E) makes provision for when the return on the loan is indexed or conditional such that the amount of the return over the term of the loan cannot be determined in advance. Subsections (2A) and (2B) are considered to apply, making the best estimate of the amounts payable where these are not known with certainty. If, once the amounts payable are determined with certainty, it is found that the loan has been treated incorrectly then any necessary adjustment to the amount of VCT relief given will be made. These adjustments can be made irrespective of the normal time limits for making or amending assessments.

Background note

11. VCTs can make loan investments as well as investing in equity but, to be a qualifying investment, the loan must have a minimum term of five years and cannot be repaid in that time. The loan should also rank alongside equity in having no preferential rights to repayment or claim to the investee company's assets.

12. Some VCTs have used loan terms, such as high interest rates and large redemption premiums, to have the effect of returning the loan and equity capital invested before the end of that five year period. The loan terms minimise the risk of loss of the VCT's capital while offering short terms loans to the investee company.

13. Schedule 5 to Finance (No.2) Bill contains a number of provisions relating to VCTs and their investments intended to direct VCT funding towards higher risk investments in companies with a potential to grow and develop.

14. Autumn Budget 2017 included the announcement that provisions would be included in the Finance Bill to ensure qualifying loans are unsecured and charged at a commercial rate.

15. Amendment 1 ensures that a VCT cannot recover the capital (equity or loan finance) invested in a company by means of high interest payments or other charges in relation to a qualifying loan investment. It also excludes loans from being qualifying investments where the terms of the loan secure rights over the company or its assets.

16. The changes made by this amendment will take effect for loans made on or after Royal Assent subject to commencement regulations made by HM Treasury.