

**EXPLANATORY MEMORANDUM TO  
THE INVESTMENT TRUSTS (DIVIDENDS) (OPTIONAL TREATMENT AS  
INTEREST DISTRIBUTIONS) REGULATIONS 2009**

**2009 No. 2034**

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 introduce an optional tax framework for investment trusts which enables such companies to invest in interest bearing assets without incurring a corporation tax liability that they would otherwise incur.

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

- 3.1 None.

4. **Legislative Context**

- 4.1 These Regulations have been made using the powers contained in section 45 of the Finance Act 2009. This is the first use of those powers.

- 4.2 An investment trust is a corporate entity which invests pooled funds obtained from investors with a view to making a return for those investors. For tax purposes, a company can be approved by the Commissioners for HM Revenue & Customs as an investment trust. Approval means that while the investment trust is subject to corporation tax on its income in the same way as any other company it is not subject to tax on any gains. It also enjoys exemption from tax on certain capital profits arising from loan relationships and derivative contracts which would otherwise be taxable as income.

- 4.3 Investment returns are distributed (paid out) by an investment trust to its investors in the form of company dividends and, like any other company dividend, tax at the dividend rate is payable in respect of the dividend. This can have the effect of making investments in assets that produce interest like returns (e.g. corporate bonds which pay interest) less attractive for the investors as the investment trust will be liable to corporation tax on the income received from such assets and additionally the investors suffers tax on the income received, which means that investors usually pay a higher effective rate of tax than if they had invested in the underlying assets directly.

- 4.4 Section 45 of the Finance Act 2009 enables regulations to be made so that investment trusts that invest in interest bearing assets can treat the distribution of income derived from such assets as payments of interest rather than as dividends, with

the consequence that the investor is taxed on the basis of receiving a payment interest, rather than a dividend, from the investment trust. The effect is that the investors are effectively taxed as though they had invested in the underlying assets directly (addressing the problem described in paragraph 4.3 above).

## **5. Territorial Extent and Application**

5.1 This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

## **7. Policy background**

- *What is being done and why*

7.1 The issue of the taxation of investment trusts was the subject of a report published in October 2007 by the Association of Investment Companies entitled “Delivering lower costs and innovation in pooled investments”. The report argued that tax rules acted as a barrier to investment trusts being established in the UK. The report identified the main problem with the tax rules as the absence of a tax-efficient method for UK based investment trusts to invest in bonds. Following that report, industry lobbying and extensive consultations, these Regulations introduce new rules to facilitate investment in interest-bearing assets.

- *Consolidation*

7.2 This instrument does not amend any other instrument.

## **8. Consultation outcome**

8.1 Drafts of these Regulations have been the subject of formal public consultation and a number of detailed changes have been made as a result.

## **9. Guidance**

9.1 Guidance on the instrument will be published in HMRC’s Corporate Tax Manual.

## **10. Impact**

10.1 An Impact Assessment is attached to this memorandum to cover the introduction of a new tax rules for investment trusts.

## **11. Regulating small business**

11.1 The legislation does not apply to small business.

## **12. Monitoring & review**

12.1 The Government intends to monitor the effects as the industry takes up the options available.

## **13. Contact**

Angela Nagarajah at HM Revenue & Customs Tel: 020 7147 2787 or email: [angela.nagarajah@hmrc.gsi.gov.uk](mailto:angela.nagarajah@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.