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18th October 2010

Dear Sir

Re: Modernisation of the tax rules for investment trust companies and Modernisation of company law rules on distributions by investment companies

We are grateful for the opportunity to comment on the above consultation document dated 27th July 2010.

By way of background, the City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.
The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Revenue Law Committee.

Our comments on the consultation document are as follows.

General Comments

- We welcome the proposals to modernise the investment trust rules for the first time since their introduction. As stated in the consultation document the marketplace has changed significantly since 1965.

- We believe it is vital that the UK is able to offer a tax efficient closed-ended investment vehicle as otherwise funds will continue to be established offshore.

- We generally welcome the proposal to set out the conditions and administrative rules in secondary legislation so that changes can be made more quickly to adapt the rules to reflect market changes etc. We hope that this will be accompanied by detailed HMRC guidance on the rules and regulations which we would want to be finalised before the new regime is introduced (as opposed to the position under the offshore funds reform where the final HMRC guidance was only published some six months after the new regime came into effect).

- We have seen a draft of the proposed submission by the Association of Investment Companies ("the AIC") which we support subject to our comments below.

Comments on specific points raised in the consultation document

Point 1 for discussion: The Government welcomes comments on the proposed approach to defining a closed-ended investment fund for CT purposes and invites comments on the types of entities that should be included or excluded. In particular, comments are also welcome on the scope of exclusions to ensure that the holding company of a trading group is not treated as a closed-ended fund while retaining holding companies of private equity type ITCs.

- We welcome adopting a characteristics based approach and seeking to model any definition on the test in Chapter 15 of the listing rules.

- One possibility is to define a "closed-ended investment fund" as any investment company (i.e. which meets the investment and spread of risks test) other than an open-ended investment company incorporated under the UK OEIC regulations or offshore equivalent.

- The definition should not exclude fixed life companies or companies that may wish, from time to time, to buy-back or redeem shares or otherwise periodically return capital.

- We are concerned that the word "sole" in the proposed definition is too restrictive for the reasons already highlighted to HMRC. We support the use of "primary" instead.

- The definition should not preclude an investment trust from investing borrowed funds.

- The definition should not exclude an investment trust from being a suitable vehicle for private equity funds (including where the fund may have full or majority ownership of underlying portfolio investments). If such a fund can qualify for listing as a fund under the listing rules, it should be able to be structured as an investment trust.

Point 2 for discussion: The Government welcomes comments from industry on the proposed tax framework for the new regime, in particular:

a) proposals to move to an up-front application process; and

b) provisions that should be made to enable a smooth transition to the new regime.

- We welcome the move to a one-off application process and endorse the comments made that HMRC should incorporate a procedure for new investment trusts to be approved pre-launch so that the Prospectus can state that approval has already been given.

- We support the proposal to implement the new regime as soon as possible (provided there has been adequate consultation on the proposed statutory provisions, the regulations and HMRC guidance).

- We suggest that the new regime should apply to existing investment trusts by reference to accounting periods commencing after the proposed start date of the new regime thereby avoiding issues with straddling periods.

- For existing investment trusts, it is will be necessary for there to be a suitable period to enable them to seek approval under the new regime before the new regime comes into effect or could existing investment trusts simply be deemed to be approved under the new rules?

- Where existing investment trusts have issues meeting the conditions of the new regime, consideration should be given to grandfathering existing trusts. In practice, this may only be an issue if the proposed amendment of the close company test is adopted (see further below).

Point 3 for discussion: Would the restriction to the close company test disturb existing structures or cause commercial restrictions in any way? Please ensure that examples of structures are sent in with responses.

- HMRC has already been made aware of the fact there are a number of existing investment trusts that may fail the close company condition if the quoted company exemption (at Section 446 CTA 2010) is removed. This will be unfair and obviously will cause commercial issues. Such investment trusts should be grandfathered (i.e. the quoted company exemption should continue to be available going forward) if this proposal is adopted.

- Generally we have difficulty in understanding why having a small number of large holders should prevent investment trust status where the large holders are independent of each other. The existing close company tests (ignoring the quoted company exemption) are too restrictive.

- If HMRC insist that there is a need to change the test to prevent "abuse", we would favour a test that focuses on where the large holders are truly connected. We also suggest giving consideration to adapting the exception at Section 444 CTA 2010 so that all large holders that are themselves non-close would be excluded and introducing provisions which enable nominee holdings to be ignored even where a nominee may be able exercise the voting rights for the underlying holders where the nominee is acting in a representative or fiduciary capacity.

- Alternatively, HMRC may want to consider modifying the quoted company exemption to move away from a test focussing on voting rights to one that focuses on economic rights or instead adopt a genuine diversity of ownership type test.

Point 4 for discussion: Does this purposive approach introduce greater flexibility to investment strategies while maintaining the original intention behind the 15% holding test? Can industry identify any practical difficulties with the proposed change and if so what solutions are suggested?

- We support the move to a "spread of risk" test and believe this will lead to greater flexibility for investment strategies.

- We support the proposed adoption of the listing rules test suggested by the AIC in their submission.

Point 5 for discussion: Can industry foresee any adverse effects of such a change?

- We support the change and do not see any adverse effects of such a change.
- An alternative would be to require listing on a "recognised stock exchange" which would offer greater flexibility and possibly cheaper listing costs and would align the test with ISA eligibility.

Point 6 for discussion: Would this modernisation result in a change of meaning that may lead to a different consequence?

- We would welcome HMRC considering removing this condition entirely as it is difficult to see its relevance to modern times (assuming there were good underlying policy reasons back in 1965).
- If retained, the restriction should not inhibit buy-back or share redemptions or other methods of returning capital in non-dividend form.

Point 7 for discussion: The Government welcomes views on the proposals set out above and whether they could result in any adverse commercial impacts and why. The Government would also welcome views on alternative options that could be proposed (bearing in mind the Government's objective of introducing new tax rules at no overall increase in cost to the Exchequer).

- We understand that this proposal is the one that has caused most concern amongst existing investment trusts generally (ignoring those with close company concerns). This is explained in great detail in the AIC submission.
- We support the AIC's recommendation to adopt Proposal 1 with the requirement being set at 15% rather than at 10%. This would seem the simplest way to address the commercial issues raised.

Point 8 for discussion: The Government welcomes comments on the most appropriate method for measuring 'revenue income' (i.e. non-capital). In particular, comments are welcomed on the role for the AIC SORP in determining income allocation (to revenue or capital).

- We support measuring income by reference to the accounts and for the AIC SORP to continue to be applied to determine the split between income and capital.

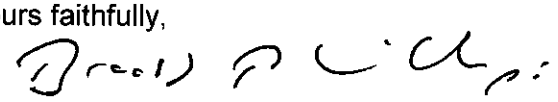
Point 9 for discussion: BIS welcomes comments on the deregulatory changes proposed to the rules on distributions by investment companies. Will the extra flexibility help the industry? Is there a risk that they will remove any important protection for creditors or others?

- We support the proposed changes. It would be preferable to also align the retention test with the test applying for tax purposes.

Other Comments

- We have concerns over the proposals regarding breaches of conditions/leaving the regime. Further detailed HMRC guidance (either in the regulations or manual guidance) will be needed on the meaning of inadvertent and deliberate breaches and also on determining whether a continuing breach is one breach or a repeated breach. If the breach is related to the close-company condition, this is particularly difficult, as the investment trust would not be in a position to remedy the breach easily.
- If an investment trust has to leave the regime, we do not consider it fair for the regime to cease to apply to periods before leaving the regime. We also consider it unfair that an ITC could not re-enter the regime at a later date.
- We have concerns over the comments in the consultation document (at paragraph 5.13) regarding investment trusts investing in reporting offshore funds. There are obvious difficulties with the position where an investment trust may need to distribute income it has not received.
- We welcome retaining the recently introduced interest streaming regime.
- We welcome the introduction of the "white list" for investment trusts. It would provide even greater flexibility if the white list could be extended to other assets such as contracts of insurance and commodities.

Yours faithfully,



Bradley Phillips
Chair
City of London Law Society Revenue Law Committee

THE CITY OF LONDON LAW SOCIETY
REVENUE LAW COMMITTEE

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