HM Treasury

HM Revenue & Customs

Tax-advantaged venture capital schemes:

ensuring continued support for small and growing businesses

July 2014

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Foreword

The government is committed to making the UK one of the best places to start, finance and grow a business in Europe. The tax-advantaged venture capital schemes are an integral part of this strategy as they incentivise private investment into smaller businesses. We recognise that this is a highly important source of finance for SMEs and we want to ensure that the schemes continue to support small and growing businesses.

Since their introduction nearly 20 years ago, around £16 billion of equity investment has been raised through the Enterprise Investment Scheme (EIS) and the Venture Capital Trust Scheme (VCTs), supporting over 20,000 companies. In recognition of the particular difficulties which start-up companies can face in obtaining seed finance, we introduced the new Seed Enterprise Investment Scheme (SEIS), commencing from April 2012. Since that scheme launched, over 2,000 companies have now benefited from SEIS investment of over £175 million.

We significantly expanded the EIS and VCT schemes at Budget 2012. Limits were increased so that larger companies with up to 250 employees and £15 million of gross assets could benefit from up to £5 million of investment per year. We also made changes to ensure that the tax breaks remain well-targeted at companies which would otherwise struggle to raise vital finance. This document seeks to better understand the impact of the recent expansions to the schemes and sets out proposals to ensure that they remain effective in incentivising investment. The government is committed to ensuring these flagship schemes continue to incentivise investment into smaller higher-risk companies that are essential for growth in the UK.

I am pleased to publish the consultation paper and hope that businesses, investors, representative bodies and others interested in promoting growth in the UK will play a full part in the consultation process.

David Gauke,
Exchequer Secretary to the Treasury

July 2014

1 Introduction

1.1 The tax-advantaged venture capital schemes are an important part of the government's growth strategy, facilitating access to finance and providing support for smaller businesses which otherwise have difficulty finding the necessary finance to develop and grow. The tax reliefs are intended to mitigate the risks that individuals face when investing in smaller and less-established businesses, to address this so-called "equity gap".

1.2 The UK has a long-standing history of offering tax incentives to encourage individuals to support SMEs in this way, and believes that income and capital gains tax reliefs can provide a very effective mechanism to encourage investment behaviour and stimulate the supply of finance. The UK also provides other forms of support to help SMEs that operate differently to the tax reliefs. For example, the British Business Bank is drawing together a range of existing access to finance initiatives and deploying £1.25 billion of capital on new programmes. The government also provides business support, for instance through GrowthAccelerator, a £200 million programme of business coaching for high growth potential businesses. The government recognises that different types of businesses may require different forms of support as they develop and grow. The tax-advantaged venture capital schemes are focussed on encouraging high-risk investments in the form of share capital.

1.3 Since 2010, the government has made a number of important changes to the tax-advantaged venture capital schemes. Following consultation in 2011, the government expanded the scope of the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs), in recognition that the previous scheme limits did not fully address the equity gap faced by companies as they sought to develop and grow. The key changes made were:

- increasing the limits for qualifying companies to allow companies with up to 250 employees, and up to £15 million gross assets before investment to qualify;
- increasing the rate of income tax relief for EIS to 30%, in line with the tax relief for VCTs;
- increasing the level of investment on which an EIS investor can benefit from tax reliefs to £1 million a year; and
- increasing the level of tax-advantaged investment that a qualifying company can receive to £5 million per year.

1.4 In recognition of the particular difficulties that start-up companies can face in accessing seed finance, the government also introduced the Seed Enterprise Investment Scheme (SEIS) in April 2012. SEIS was made permanent at Budget 2014. SEIS is similar to EIS, although its focus is on very early-stage companies which are carrying on or preparing to carry on a new business.

1.5 In addition to expanding the tax-advantaged venture capital schemes, the government has also made a number of changes to ensure that the schemes are well-targeted and address the finance gap. Changes include the introduction of the disqualifying arrangements rules, which are intended to prevent contrived usage of the tax relief; restrictions in relation to companies benefiting from forms of government support that were serving to significantly reduce the risk of investment; and specific changes to the issue and return of capital in VCTs. All of these changes serve to make the tax-advantaged venture capital reliefs more sustainable.

1.6 The government believes that the current framework for the tax-advantaged venture capital schemes provides an effective way to address the equity gap and the market failures that exist, without distorting the market in a way that is damaging. It is on this basis that the UK secured State aid approval for the reforms in 2012. Since then, the EU State aid rules that apply to risk finance measures such as VCT and EIS have been updated although the overall aim of the provisions remain – to allow Member States to provide support for risk finance where it is most needed and where there is a market failure.

1.7 The government is keen to understand the impact of the recent reforms to the tax-advantaged venture capital schemes, to ensure that they continue to work effectively and to confirm that the schemes continue to be well-targeted in supporting small and growing companies access finance where they need it most. The government also wants to better understand cases where the scheme rules may not be working as intended; to assess whether improvements can be made to continue to maintain the effectiveness of the tax reliefs. Budget 2014 referred to two particular areas where the government was interested in considering the potential for changes to the scheme rules, to consider a more principled approach to reduce investment into lower-risk companies already benefiting from government support, and to explore options for EIS and SEIS to accommodate the use of convertible loans.

1.8 The evidence gathered from this consultation will also be used to support discussions with the European Commission, as the government seeks to ensure that the tax-advantaged venture capital schemes continue to remain in line with the updated State aid guidelines.

Structure of the document

1.9 The remainder of the document is set out as follows:

- Chapter 2 sets out the key parameters of the tax-advantaged venture capital schemes and the State aid rules
- Chapter 3 considers how best to support SMEs access to finance in the current market, exploring the impact of the recent expansions and changes to the tax-advantaged venture capital schemes, options on convertible loans, and other issues raised by stakeholders
- Chapter 4 considers how best to ensure that the tax reliefs remain focussed, exploring the effectiveness of the recent changes to limit qualifying companies, and discussing options for a more principled approach going forwards
- Chapter 5 sets out a call for evidence
- Chapter 6 summarises the consultation questions

Stage of the consultation

1.10 The proposals in this document are at stage 1 (setting out objectives and identifying options) of the government’s tax consultation framework.

Implementation

1.11 The government intends to introduce any changes to the tax-advantaged venture capital schemes in a future Finance Bill. Any changes will depend on discussions with the European Commission.

How to respond

1.12 Please send comments by 00:00, 19 September 2014 to:

Tax-advantaged Venture Capital Schemes Consultation,
Enterprise and Property Tax Team,
HM Treasury,
1 Horse Guards Road
London
SW1A 2HQ

Email: venturecapitalconsultation@hmtreasury.gsi.gov.uk

2 The key parameters of the tax-advantaged venture capital schemes

2.1 The government provides three tax-advantaged venture capital schemes that provide tax reliefs for investment into small and growing companies. The government has also recently introduced a new form of tax relief to support investments into social enterprises, which have social as well as commercial goals.[1] A consultation is running alongside this exercise to consider options to expand the social investment tax relief (SITR),[2] and to make similar reliefs available to those who wish to invest in intermediary investment vehicles which in turn invest in social enterprises.

2.2 When referring to the tax-advantaged venture capital schemes in this consultation document, the government is describing the wholly "commercial" venture capital schemes – the Seed Enterprise Investment Scheme (SEIS), the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) – unless otherwise stated.

2.3 This chapter sets out the main features of the tax-advantaged venture capital schemes, the overarching principles behind the schemes, and provides more information about the State aid rules that apply. The chapter outlines the changes that have been made to the State aid rules and explains that the government expects that the effect of the current EIS and VCT rules is in keeping with the State aid rules. It also asks for views on this.

The main features of the tax-advantaged venture capital schemes

2.4 The tax-advantaged venture capital schemes set out rules for investors, funds, and qualifying companies. These are summarised below.

Investors

2.5 The tax-advantaged venture capital schemes provide a range of tax reliefs to investors who make qualifying investment. For EIS and VCT, investors are eligible for

- 30% income tax relief on the amount invested;
- CGT relief on disposal of shares held (for a minimum of 3 years for EIS);
- CGT deferral relief and Share Loss Relief on investments made in EIS; and
- the maximum annual investment an individual can receive tax relief on is £1 million under EIS, and £200,000 for VCTs.

2.6 The SEIS regime mirrors EIS in many ways. The key features of SEIS are:

- income tax relief of 50% for individuals who invest into qualifying seed companies with an annual investment limit of £100,000; and

[1] The social investment tax relief (SITR) is currently available for investment in charities, community interest companies and community benefit companies with fewer than 500 employees and up to £15 million gross assets. The maximum each organisation can receive is €344,827 (about £290,000) over 3 years.
[2] https://www.gov.uk/government/consultations/social-investment-tax-relief-enlarging-the-scheme

- investors are eligible for CGT reinvestment relief at 50% for gains realised and investments made in 2013/14 and onwards (this was originally a 100% relief, to kick-start the scheme). CGT and share loss relief is also available.

Funds

2.7 For VCTs, the individual can qualify for tax relief on subscription for the shares in the VCT (which must be a company whose shares are admitted to trading on a recognised stock exchange) rather than on the investments being made into the qualifying companies. In order for a VCT to maintain approval, at least 70% of its investments must be in qualifying holdings. The VCT must invest in the companies within 3 years of raising new money. These rules provide some flexibility to fund managers to allow them to manage the portfolio.

2.8 The managers of so-called EIS and SEIS Funds use nominee arrangements to make investments on behalf of individual investors. The EIS legislation (but not the SEIS legislation) has special rules for investors in EIS Approved Funds. These allow tax relief to be available for the tax year in which the fund closes, rather than the tax year in which the investments are made in the investee companies. In return, managers of EIS Approved Funds are subject to certain restrictions as to how they make investments.[3]

Qualifying companies

2.9 In addition to rules relating to the investor claiming the tax relief, investee companies must also meet certain rules in order to qualify for tax-advantaged investment. Principally, these are a Gross Assets limit of £15 million pre-investment and £16 million post-investment, an employee limit of fewer than 250 full-time employees, and a maximum annual investment of £5 million for qualifying EIS and VCT investee companies.

2.10 For SEIS, qualifying companies must have fewer than 25 employees, gross assets not exceeding £200,000 and cannot have received EIS/VCT funding. They must not receive more than £150,000 of SEIS funding.

2.11 In addition, for SEIS, EIS and VCTs, a list of excluded activities exists to determine what types of companies can qualify for investment. The list is the same for all of the schemes and is intended to ensure that the tax reliefs are well targeted. The excluded activities list limits companies from qualifying for the tax reliefs because the activities are either:

- relatively low-risk (e.g. asset backed activities that may be able to access finance more easily);
- provide routes for financing (e.g. leasing, financial services that can divert the tax reliefs elsewhere); or
- because of wider EU rules (e.g. shipping, farming).

[3] http://www.hmrc.gov.uk/manuals/vcmmanual/VCM16050.htm

Box 2.A: The overarching principles behind the tax-advantaged venture capital schemes

The principles behind the tax-advantaged venture capital schemes are that they remain:

- **Effective and targeted:** the government wishes to ensure that the nature of the problems is correctly understood and that the schemes achieve the policy aims and deliver positive economic impact. The intention is that the tax relief effectively shifts investor behaviour to provide finance for higher-risk and relatively unproven companies that might otherwise struggle to access finance.
- **Affordable:** the tax-advantaged venture capital schemes result in costs to the Exchequer by way of tax forgone. It is important that the tax reliefs continue to represent value for money for the taxpayer.
- **Simple and straightforward to administer:** the government is committed to simplifying the tax system and improving the ease with which taxpayers and businesses understand and interact with it, as far as possible. It is also important that HMRC can continue operating the schemes effectively.
- **Sustainable and not subject to abuse:** the schemes exist to incentivise investment in smaller high risk companies which would otherwise experience difficulties in raising finance. They are not intended to provide a tax-efficient investment solution for investors seeking to minimise their tax liability.
- **Compliant with State aid rules:** the Commission recognises that there is in general an insufficient level of risk capital available for start-up and innovative young businesses, and therefore provides guidelines to government who wish to provide support through grants or tax relief where there are market failures in the risk capital market. Nevertheless, it is the government's responsibility to ensure continued compliance with the guidelines.

State aid rules

2.12 The need to comply with State aid rules is important in considering future changes to the schemes and the impact of the recent expansions.

2.13 A State aid occurs where a measure transfers state resources (for example a tax credit or reduced rate) to an undertaking, type of undertaking, sector or region in such a way as to give an advantage that distorts or has the potential to distort competition and intra-EU trade. The European Commission has developed rules which ensure that where State aid exists it is properly targeted on genuine market failure and common European goals.

2.14 EIS and VCTs are State aids under this definition, because they provide government support to a limited group of companies, thereby potentially creating distortions in the market or creating differences in treatment across companies. Therefore, the tax-advantaged venture capital scheme rules are subject to approval from the EU Commission under the risk finance framework.

2.15 The Commission's new rules on risk finance aid[4] aim to help bridge the risk finance gap for SMEs and Mid-Caps with an increased emphasis on growth and innovation. The guidelines also acknowledge that there are market failures that exist in facilitating the growth and development of SMEs, particularly in the form of asymmetric information and growth externalities. However,

[4] http://ec.europa.eu/competition/state_aid/modernisation/risk_finance_guidelines_en.pdf

it is necessary to meet certain criteria to justify government intervention to address the potential gaps in the market. The criteria include: evidence of a need for intervention, and a justification for the incentive effect, appropriateness and proportionality of the intervention. With the recent changes made to these guidelines, **the government has to ensure that EIS and VCTs continue to meet the requirements for State aid.** SEIS falls under the "de minimis" criteria for State aid, and is not directly affected by the changes to the guidelines.

2.16 Risk finance investment as defined in the State aid guidelines includes both equity and quasi-equity investment for risk finance investment. Equity investment is defined as the provision of capital to an undertaking, invested directly or indirectly in return for the ownership of a corresponding share of that undertaking. Quasi-equity investment is defined as a type of financing that ranks between equity and debt, having a higher risk than senior debt and a lower risk than common equity and whose return for the holder is predominantly based on the profits or losses of the underlying target undertaking and which is unsecured in the event of default.

2.17 The new guidelines support the provision of investment incentives for the expansion stage of the companies. The rules include various parameters around the intervention, to ensure that risk finance interventions work effectively. The rules include two main criteria that differ from the rules in EIS and VCT:

1. **A total investment limit:** The new rules propose that overall government support to a company is no greater than €15 million in total. EIS and VCT allow companies to benefit from up to £5 million of tax-incentivised investment a year (a maximum on all State aided risk capital measures), with no limit on cumulative investment but with a test on gross assets that limits the types of companies that might qualify for investment

2. **An age limit to target less-established companies:** The new rules also propose that companies should be less than 7 years old as measured by their first commercial sale, when first benefiting from a State aid intervention[5]. The rules allow for follow-on funding. In addition, a caveat exists for the age limit of a company. EIS and VCTs have limits relating to qualifying companies in order to target the support on riskier and less established companies, but support can then be provided to any company that the market deems to have growth potential within those limits.

2.18 In order for the UK to remain in line with the updated State aid guidelines it is important that the overall effect of the existing legislation results in the type of targeted support that the EU Commission is looking to encourage. If it is not possible to demonstrate this, it may be necessary for the UK to make some amendments to the existing legislation for the tax-advantaged venture capital schemes.

2.19 A key aim of this consultation exercise is therefore to gather relevant evidence to ensure that the tax-advantaged venture capital schemes can be maintained with minimum changes to scheme rules, recognising that the substantive reforms to the schemes have only been operating for a few years. The government believes that the schemes adhere to the principles underlying the new guidelines. **The government expects that by showing that the current venture capital schemes rules achieve the same outcomes as the new Risk Finance guidelines, changes should not be required. To this end, the government is asking for evidence from stakeholders to demonstrate that EIS and VCTs achieve the intention of the guidelines.** Questions throughout

[5] Where a firm has been operating for many years but is entering a new market, the age limit may be overlooked providing that the amount of finance provided through the first investment round is at least 50% of annual turnover http://ec.europa.eu/competition/state_aid/legislation/forms_docs/gber_regulation_en.pdf, Section 3, Article 21

this consultation document seek to gather more evidence about the impact and effectiveness of the current rules.

2.20 However, the government would also welcome views on the potential impacts of the approach proposed by the European Commission.

Box 2.B: Questions on overarching principles and updated State aid guidelines

Question 1: Are the tax-advantaged venture capital schemes currently meeting the overarching principles, as detailed in Box 2A? Have the recent reforms to the schemes resulted in more effective and well-targeted support?

Question 2: Does the current limit for tax-advantaged investment into qualifying companies, of £5 million per year, achieve the same effect as a total limit of €15 million? Please provide details where you have experience with companies receiving more than €15 million under any of the schemes, and explain the need for that level of investment.

Question 3: Would a total investment limit of €15 million actually offer more flexibility and simplicity than an annual investment limit?

Question 4: Do the qualifying companies rules and limits on company size effectively target the investment towards less established companies? How would a limit on the time that a company had been trading in the market impact on any investments made? Please provide details where you have experience with older companies, or companies with more established trades, receiving investment under the schemes, and explain the need for that investment.

3 Supporting SME access to finance in the current market

3.1 This chapter is focussed on the impact of the 2012 reforms, how the market has changed since they were introduced, and shifts in investor behaviour.

3.2 It seeks views on how the current rules work and whether they are effectively addressing the needs of the market. In particular, the chapter sets out options for EIS and SEIS to accommodate the use of convertible loans, and explains the current rules in regard to other specific issues that are frequently raised by stakeholders.

The impact of the 2012 reforms – expanding EIS and VCT, introducing SEIS

3.3 The reforms introduced in 2012 sought to ensure that the venture capital tax reliefs continued to serve the needs of the market. In particular, the reforms recognised the need to encourage opportunities for financing through the early stages of growth – accommodating companies that might have reached the stage of being able to employ more than 49 people, or be of a certain size (as indicated through the gross assets test), and still requiring further capital than available under previous £2 million annual limits for investment. The previous limits did not fully address the equity gap in the UK venture capital market, but only provided support for part of the "funding ladder".

3.4 The intention of increasing the limits to investment (to £5 million annual investment for companies) and company size (to £15 million gross assets before investment, and fewer than 250 employees) was to allow the market to operate more sufficiently, stimulating more investment, in turn supporting job creation, innovation and growth. The changes also recognised that many venture investments require several years of development, with a number of funding rounds required to support enterprises for longer. **The intention was that the expansions of the scheme limits would unlock funding at an earlier stage and allow it to continue to support businesses as they grow. In addition, the introduction of SEIS provides another route to support businesses at the very initial stages of development.**

3.5 Although it is only a few years since these changes have been introduced, and it will take some time to assess the full impact, the government is keen to understand the extent to which the effects outlined in the previous paragraph have been felt. In particular, the expansion has raised the possibility of companies benefiting from multiple rounds of follow-on funding at different stages of their lifecycle. The latest State aid guidelines accept the need for companies to be able to continue to access follow-on funding, even where this funding occurs some time after the first commercial sale.[1]

3.6 The government is also interested in understanding the impact of the introduction of SEIS on the wider venture capital market.

[1] http://ec.europa.eu/competition/state_aid/legislation/forms_docs/gber_regulation_en.pdf, Section 3, Article 21

3.7 SEIS was designed to be targeted specifically at early stage companies, particularly those that struggle to raise EIS or other investment. The more generous tax reliefs that exist for SEIS are intended to reflect the higher levels of risk that investors typically take on with smaller, less established companies. While SEIS is intended to link closely with EIS, so that companies can move on from smaller SEIS funding to EIS funding as the company develops, it is not the policy intent that companies capable of generating investment that qualifies for EIS simply benefit from the higher tax incentives. Therefore the policy has been designed so that one large funding round cannot directly qualify for both SEIS and EIS investment. If shareholders are willing to take on the risk and uncertainty associated with a larger investment qualifying for EIS at a later stage in the company development, they are able to do so by delaying the share purchase for EIS. The government is aware that this approach (or variants on it) is used quite frequently by companies and investors seeking to raise more than £150,000.

Box 3.A: Questions on the impact of the 2012 reforms

Question 5: What do you think the impact of the increase to £5 million as annual limit for investment into qualifying companies has been? Has it unlocked investment throughout early and growth stages of company? Has it allowed for further rounds of funding over time?

Question 6: What do you think the impact of the increased employee limit for qualifying companies has been? Has it unlocked investment throughout early and growth stages of company? Has it allowed for further rounds of funding over time?

Question 7: Do you believe that these increased limits are now supporting more established companies that are less in need of support? Please provide evidence to support your answer.

Question 8: What do you believe the impact of SEIS has been on the market more generally?

Investors using the tax-advantaged venture capital schemes

3.8 The tax-advantaged venture capital schemes provide generous tax reliefs to individuals who wish to invest in relatively high risk and innovative SMEs.

Investor appetite

3.9 The tax reliefs are available for all individuals with taxable UK income. In practice though, the venture capital schemes have traditionally tended to be used by relatively wealthy and sophisticated individuals who often invest via wealth managers, and/or have sought advice from IFAs. The government expects that the tax reliefs will continue to be of interest to this group of individuals and believes that this is important, given that individuals with higher levels of disposable wealth may be in a better position to take on the risks of investment in the types of companies supported through the tax-advantaged venture capital schemes.

3.10 However, a wider group of individuals may now be considering investing in SMEs through the tax-advantaged venture capital schemes. Although the maximum investment limits are £1m (for SEIS and EIS), and £200,000 (for VCTs), investors using the tax-advantaged venture capital schemes typically invest a much lower level than this.[2] Anecdotal evidence also suggests that SEIS in particular is being used by new investors. There is no legal minimum investment limit for

[2] In 2011-12, around 80% of EIS investors made a claim for tax relief in respect of an investment of less than £50,000 and just over 50% of VCT investors for an investment of less than £10,000.

individuals making investments into SEIS, EIS qualifying companies, or into VCTs.[3] Some VCTs and EIS fund managers, as well as some platforms, do require a minimum investment from their clients, although these are typically no higher than £5,000.

3.11 **The government recognises that other factors, in relation to both government policy and external market developments, may be affecting investor appetite.** Over recent years the government has restricted the availability of pensions tax relief, which may have encouraged individuals who have already reached or who are approaching the annual and lifetime allowances, to seek other savings and investment opportunities. The government has also increased the limits for individual savings accounts (ISAs) and broadened the types of products that can qualify for stocks and shares ISAs,[4] which may be prompting individuals to think about a broader range of other tax-advantaged investments. Finally, the government has recently announced radical reforms to pensions to allow freedom and choice in the market, and to remove the requirement to annuitise. These changes may be affecting the way that different types of individuals, at different life stages, consider savings and investment opportunities.

The role of platforms

3.12 As well as policy developments, the market has also developed. Recently there has been real growth in the availability of crowdfunding platforms. Although they still represent a relatively small proportion of the market, these platforms can provide more access to investment opportunities for a wider group of individuals. Where the companies meet the qualifying criteria for the venture capital schemes, these platforms can facilitate use of the tax reliefs by operating nominee structures to hold investments on behalf of their clients.

3.13 The government recognises the importance of intermediaries – including platforms – to facilitate investments being made. The use of these types of intermediary vehicles can help to bridge some of the information gaps that exist, and can open up opportunities to invest to a broader range of individuals. At Budget 2014, the government announced that changes would be introduced so that VCT shares can also be subscribed for by nominees, in a similar way to SEIS and EIS investments.

3.14 The VCT regime was introduced particularly to encourage investment by retail investors who are interested in investing in smaller, higher-risk trading companies but who prefer to have their investments made and managed by a professional fund manager. In this context the government believes that the recent changes to allow VCT shares to be subscribed for by nominees are important in maintaining the original intent of the regime. This change could also facilitate investment by different types of individuals.

3.15 **The government is keen to develop appropriate opportunities for more individuals to participate in investing in SMEs in this way,** and for the tax reliefs to be available and used not only by the very high net worth population. The government also believes that it is right that individuals taking on the risk of investing in smaller and unproven SMEs are well-informed about the decisions that they are making. In particular, a VCT which makes an offer of transferable securities to the public or applies for such securities to be admitted to trading on a regulated market will generally be required to prepare a prospectus, which must contain all the information necessary to enable investors to make an informed assessment[5].

[3] There has previously been a minimum investment limit associated with EIS to ensure that only relatively well-off individuals were making what are high-risk investments. However, this limit had not been updated for many years and was removed in 2012 in recognition that it no longer achieved that original policy aim.

[4] Individuals can now to invest up to £15,000 a year in total into cash or stocks and shares ISAs or any combination of the two

[5] of a) the assets and liabilities, financial position, profits and losses, and prospects of the issuer and b) the rights attached to the securities

3.16 Alongside this consultation exercise, the government is also exploring options to expand the social investment tax relief, and is considering how best to facilitate investments via intermediary vehicles. One option to achieve this could be to make changes to the current VCT rules to allow future VCTs to be used for social investment. Another approach could be to introduce a new structure, building on many aspects of the VCT regime, which would only be used to make investments under the social investment tax relief scheme. The government is supportive of the VCT regime and wants to ensure that it can continue to work effectively, alongside the introduction of a regime to facilitate indirect investment into social enterprises.

The processes associated with investment

3.17 The government is also interested in understanding how the current processes for claiming tax relief may impact on the appetite for investment and the ease with which platforms and intermediaries can operate. The current systems have been designed to ensure that the investments made meet with the qualifying conditions and that tax relief is given accurately.

3.18 For EIS and SEIS, investors are able to claim tax relief once they have received a compliance certificate stating that the company that they have invested in meets the qualifying conditions for those schemes. Investors in a VCT are eligible to claim tax relief as soon as they have made their investment. Because tax relief is deducted from total income tax liability for the year of investment, most individuals use self-assessment to make their claim so that tax relief is netted off liabilities at the end of the tax year. It is also possible to have the tax relief given in-year, via a change to PAYE codes. The HMRC experts within Small Companies Enterprise Centre provide advance assurance for companies to help with the processes.

3.19 Some stakeholders have suggested that the mechanisms currently operated could be streamlined in some way. This point is raised most frequently in relation to EIS funds, where each investor needs a compliance certificate for each company invested in, so that the tax relief can be set against their tax liabilities appropriately. Others have suggested that instead of claiming tax relief at the end of the year, an approach similar to that utilised for Gift Aid[6] might work more easily for investors and companies.

[6] http://www.hmrc.gov.uk/individuals/giving/gift-aid.htm

Box 3.B: Questions on investors using the tax-advantaged venture capital schemes

Question 9: Do you believe that the type of investors using the venture capital tax reliefs is changing? What are the risks and benefits of this?

Question 10: Is the lack of a minimum investment limit for SEIS, EIS, and VCTs a help or a hindrance for investors, companies and intermediaries including fund managers?

Question 11: Do you believe that the recent change to allow VCT shares to be subscribed for by nominees will have a significant impact on the market going forwards?

Question 12: Is there more that the government should be doing to facilitate the use of tax reliefs by retail investors?

Question 13: Do the current mechanisms for claiming tax relief create difficulties for investors or investee companies? How?

Question 14: Do you believe an alternative process, such as that used for Gift Aid, would work more easily? Why? How would HMRC be able to verify the tax liabilities with this type of mechanism?

Qualifying investments

3.20 As set out in chapter 1, the venture capital tax reliefs are designed to help to fill the so-called "equity gap"; to support businesses in accessing finance in the area where they find it most difficult to do so. The schemes are primarily focussed on share capital. The government has focussed on incentivising equity investments because equity capital is typically less easily accessed by companies, and typically carries higher risk for investors, than debt. Equity also offers potential for upside returns, which means that it is often a suitable instrument for investors into small and growing businesses.

3.21 The rules relating to qualifying investment instruments have prompted some stakeholder comment. At Budget 2014, the government announced that it wanted to consider options for the tax reliefs to apply where investments are made in the form of convertible loans. This section discusses convertible loans in more detail, and also explains the current rules in relation to other issues that are frequently raised by stakeholders.

Convertible loan notes

3.22 The government believes that it is right that for investments into traditional high risk commercial ventures, it remains the case that equity is the primary instrument on which tax reliefs should be offered to encourage investment activities. In previous consultation exercises, it has become clear that extending tax reliefs to a wider group of debt or quasi-equity investments could quickly become very complex and could also potentially open up the schemes to misuse.

3.23 In many cases the use of loans offers the investor protection against the risk that they are taking on, with repayment and potentially performance conditions attached to the investment. For this reason, loan investments do not qualify for tax relief under the venture capital scheme, as they are typically lower risk investments. In addition, the EIS and SEIS legislation does not allow tax relief to be granted on a share issue where the shares have been issued in satisfaction of a loan, and requires that a share issue must be to raise money for a qualifying trade.

3.24 However, the government does recognise that it can be difficult and time consuming to value and purchase shares in companies at certain points in their development. In these cases, companies may require further investment very quickly, but because it may take time to negotiate a price for a share investment, investors may seek instead to invest via a convertible loan, on the understanding that the loan will be replaced by a share issue once an appropriate price has been agreed. Stakeholders have suggested that because the scheme rules do not directly accommodate convertible loans, some important investments cannot be made and companies may be unable to access finance at crucial points. This issue is said to be particularly relevant for SEIS and EIS investments.

3.25 In this context, **the government is keen to explore options for the tax reliefs to apply where investments are made in the form of convertible loans**. The intention of any change in this area would not be to allow low risk investments to be made that can qualify for the tax relief, but to ensure that the current rules do not create an unnecessary barrier to small and growing companies receiving finance. Where proposals are likely to significantly reduce the risk of the investment or leave the rules open to abuse, they will not be sustainable. The government will also need to ensure that any potential changes made in this area remain compatible with State aid guidelines on equity and quasi-equity finance.

3.26 The government believes that there are two main approaches that could be used to facilitate this:

- **formalise the use of advance purchase arrangements**. Some investors and EIS fund managers have successfully addressed issues with convertible loans by arranging advance purchase agreements, where a sum is subscribed for shares in advance of their issue, the price being determined in the period between subscription and issue. It may be that this type of arrangement could be used more widely, without requiring legislative change.

- **amend the legislation so that shares can qualify if issued in satisfaction of a loan, providing that certain criteria were met.** The government believes that it would be necessary to place restrictions around this type of legislative change, in order to limit opportunities for convertible loans to be used to mitigate the risk of the investment significantly. The government believes that at a minimum there would need to be restrictions on the length of time that a loan could be held, for example stating that shares only qualified where a loan was issued within 3 months of the conversion, and that the government may need to specify some of the conditions attached to the loan, for example preventing interest roll-up.

Box 3.C: Questions on convertible loans

Question 15: Do you agree with the summary of the issues relating to convertible loans set out at paragraphs 3.22 and 3.24?

Question 16: Have you used an advance purchase agreement to facilitate investment? If not, would you consider doing so if the process were formalised? Why?

Question 17: Do you believe that a change in legislation to enable shares received on the conversion of a loan note to qualify is necessary? If so, what conditions do you believe are reasonable to ensure that the use of loans in this circumstance does not create significant opportunities to mitigate risk?

Question 18: Are there other approaches that you believe would be preferable? Why?

Other issues raised by stakeholders

3.27 This section explains the current rules relating to particular issues raised by stakeholders, which again relate to qualifying investments. In some cases the current rules offer more flexibility than interested stakeholders may realise.

Qualifying shares

3.28 In general the tax reliefs are available for investment in full risk ordinary shares, to ensure that the investor cannot take significant protection against the risk of the investment (thereby suggesting that the tax relief intended to mitigate the risk was not required), and to align the investor with the interests and shareholding rights that company founders might typically hold.

3.29 In 2012, the government amended the EIS rules, mirroring changes the previous year for VCTs, to extend the types of qualifying shares that can benefit from tax reliefs. Shares cannot be redeemable or carry preferential rights to the company assets in the event of a winding up. However, there is some flexibility within the legislation. **Shares with certain preferential rights can be accommodated,** including shares with preferential rights on sale, or to certain dividend payouts providing that they are not cumulative or attached to voting rights.

3.30 In 2012, the government also received representations suggesting that the anti-dilution clauses should be accommodated within the EIS (and SEIS) rules. Some stakeholders suggest that without anti-dilution clauses, following funding rounds can be affected detrimentally. However, anti-dilution clauses typically protect investors against risk, without necessarily benefiting the founders of companies.

3.31 The government recognises that follow-on funding is important and believes that the recent expansions to EIS and VCT should facilitate further funding rounds. Based on anecdotal evidence, the government understands that many companies do indeed benefit from multiple rounds of EIS relief. Typically, issues that relate to preference shares and anti-dilution come into play when a company becomes very successful, grows quickly, and seeks additional funding more quickly than anticipated. This can create some tension with the existing regime, given that the tax reliefs exist to address a gap in the market where funding is not so easily available.

3.32 The government does not intend that the current rules limit opportunities for growth and development, but believes that the rules must be targeted on the points where companies most require support. **The government believes that the current rules on qualifying shares strike a sensible balance, but would welcome views.**

Intangible assets (IP and royalties)

3.33 Another issue that is often raised by stakeholders relates to the way that the venture capital tax reliefs may apply in relation to trades which involve the exploitation of intangible assets. This has come up in discussions with the creative industries in particular.

3.34 A trade which consists substantially in receiving royalties is excluded, because a company which receive royalties holds valuable assets which means it is less likely to need tax-advantaged investment. However, there is an exception where the company has itself created the whole or greater part of the value of the intangible asset which generates the royalties. This recognises that the company does not merely rely on an established idea but continues to develop it to produce something innovative.

3.35 This means that, **providing that a company develops acquired intangible assets, the trading activity may still qualify for the tax reliefs.** The government is concerned that there may be some misunderstanding among investors and companies who may not realise the intention of the current rules or the flexibilities within them.

Box 3.D: Questions on qualifying investments

Question 19: Has the recent change in shares allowed to qualify under EIS been beneficial? Have investors continued to make investments in line with the overarching principles of the schemes (see Box 2A)?

Question 20: Are there cases where the current rules on qualifying shares have created barriers to investments being made? What changes to the rules could prevent these cases without creating opportunities for investors to benefit from tax relief on investments where they are protected against risk?

Question 21: Have the current rules relating to the creation of intangible assets facilitated investments?

Question 22: Are there cases where the current rules on qualifying shares have created barriers to investments being made? What changes to the rules could prevent these cases without creating opportunities for investors to benefit from tax relief on investments where they are protected against risk?

Other

3.36 The government always welcomes views on areas where the current rules within the tax-advantaged venture capital schemes are not working as intended, or where the rules are creating particular difficulties.

Question 23: Are there other areas where current rules have created barriers to investments being made? What changes to the rules could prevent these cases while continuing to ensure that the overall principles, as outlined in Box 2A, are maintained?

4 Ensuring the tax reliefs remain focussed

4.1 The overarching objectives of the tax-advantaged venture capital schemes have been consistent for some time. The tax reliefs exist to incentivise the provision of finance from private individuals to companies that cannot otherwise access finance. The venture capital schemes have been very successful in encouraging individuals to support small and growing companies, and are used by many business angels as well as a significant number of retail investors. Up to[1] £16 billion investment has now been provided to SMEs across the schemes. The government believes that investment into small and growing companies is a crucial part of the wider economic environment, and therefore wants to ensure that the venture capital schemes can continue to support these companies in the most effective way possible.

4.2 As described in chapter 2, the schemes seek to address the market failure in access to finance for small and growing businesses. This exists where companies are relatively high risk in nature, usually because they are relatively unproven; or because investors do not have access to information about the growth potential of the companies. The intention of the venture capital schemes is not to support companies that are very low risk, as these companies do not suffer a comparable market failure in terms of access to finance. Equally, the intention is not to support companies that are set up purely for the purpose of maximising tax reliefs rather than carrying on a qualifying activity, as this can undermine the value of the tax reliefs.

4.3 In previous consultation exercises, the government has explored the concept of how best to target the tax reliefs by looking in more detail at how best to prevent other 'low risk' activities qualifying for tax relief. These exercises have shown that it is difficult to achieve a perfect targeting of the schemes that is sustainable and durable over time. As a result, the government has made various changes to the scheme rules over the past few years, including specific changes relating to VCT share buy-backs and returns of capital, and a series of modifications to the excluded activities list.

4.4 The government recognises that continuing to make changes to the scheme rules can be difficult for investors, fund managers, and companies seeking investment. The government does not want to continue to have to make these types of changes to the scheme rules going forwards, if it is possible to avoid this. Therefore, this chapter seeks views on how the current rules and recent changes are working, and explores options for a more principled approach to determine qualifying companies that could create more certainty, and could continue to ensure that the schemes support risky, innovative and high-growth potential companies.

Current rules for qualifying companies and excluded activities

4.5 As noted above, the government has made a number of changes in recent years in order to improve the focus of the schemes, including the introduction of the disqualifying arrangements rules to address contrived arrangements, and recent changes to the excluded activities list to prevent lower-risk companies qualifying for investment where they already receive support through particular renewable energy tariffs and incentives.

[1] Some funds raised may not yet have been invested

4.6 Under the existing venture capital scheme rules, and in line with State aid rules, the extent to which two forms of support can be provided for the same costs is limited – with exceptions for particular government interventions.[2] However, the government recognises that different types of funding are required at different stages of a company's lifecycle. Earliest-stage, most risky companies may be more likely to be reliant on other forms of government support in order to establish themselves. In some cases, it may be entirely appropriate that a company can benefit from several forms of government support. The government is **not concerned about companies that benefit from other forms of government support within the State aid approval limits, or those that directly encourage innovation, where the risk of investment still remains**. The current rules to determine qualifying companies reflect this point.

Overarching rules

4.7 The rules that determine whether companies can qualify for investment under the tax-advantaged v**enture capital schemes** include considerations about how the monies raised by an investment are used. The monies must be used for:

- activities preparatory to carrying on a qualifying trade;
- qualifying research and development intended to lead to a qualifying trade; or
- a qualifying trade.

4.8 In each case, the qualifying trade must be carried on either by the parent company of a group, or by a qualifying 90% subsidiary company. To be qualifying, a trade must not consist to a substantial extent in activities which are "excluded". HMRC's guidance on interpretation of the word "substantial" reads as follows:

"Whether excluded activities amount in aggregate to 'a substantial part' of a trade is a matter of fact, to be decided in the light of all the relevant circumstances. No definition of the phrase is provided by the legislation. But where, judged by any measure which is reasonable in the circumstances of the case (for instance, by reference to turnover or capital employed), such activities account for no more than 20 percent of the activities of the trade as a whole, HMRC will normally accept that they are not 'substantial'"

4.9 To ensure that the relief remains properly targeted the government introduced the "disqualifying activities test" in 2012. It will continue to monitor the schemes to ensure that the tax reliefs are not abused.

Recent modifications to the excluded activities list

4.10 The use of the tax reliefs to invest in companies which are lower-risk owing to their ability to access other forms of government support in the form of renewable energy tariffs and incentives has represented a significant proportion of funds raised under the tax-advantaged venture capital schemes over the last few years. As a result, the government has amended the excluded activities list as follows:

- Following consultation in 2011, companies benefiting from Feed-in Tariffs (FiTs) were excluded from the venture capital schemes in 2012. The combined use of FiTs and the tax incentives was resulting in investment opportunities were the risk had been significantly reduced and returns were effectively guaranteed. Exceptions were made for companies generating energy through anaerobic digestion and hydropower

[2] http://ec.europa.eu/competition/state_aid/modernisation/risk_finance_guidelines_en.pdf, Section 3.9

technologies, as riskier investments; and for community energy projects, where the government recognised that the sector was facing particular challenges.

- More recently, Budget 2014 announced changes to exclude companies benefiting from Renewables Obligation Certificates (ROCs) and/or the Renewable Heat Incentive (RHI) scheme, introducing similar exceptions to anaerobic digestion, hydropower and community energy, to mirror the Feed-in Tariffs exclusion in 2012.

Options going forwards

4.11 In considering options going forwards that can ensure that the venture capital schemes remain well targeted to encourage investment into riskier companies, the government is keen to reflect first on how the current approach is working and whether it should be maintained.

Reflections on the current approach

4.12 The government believes that the general rules for qualifying companies provide a clear framework, with some reasonable flexibility built in, so that trading companies (or those with an intention to trade) are prevented from qualifying only where a substantial part of their trade is in activities that are excluded. However, as discussed in previous consultation exercises, the government recognises that it can be difficult to keep the excluded activities list – and exceptions to that list – fit for purpose as the market develops.

4.13 The government believes that maintaining the focus on a "substantial" part of the qualifying trade is sensible and pragmatic. However, the government **welcomes views on whether the flexibility offered through the guidance on the interpretation of the word "substantial" is helpful, or whether more clarity in this area, set out in legislation, would be preferable.**

4.14 The government could continue to add to the excluded activities list that determines qualifying activity, if and when new examples of low risk investments emerge. The government is aware that, for example, the Renewable Obligations Certificates are shortly to be replaced by Contracts for Difference and that it may be necessary to look again at the qualifying companies rules in this context. However, the government **recognises that continuing amendments to the excluded activities list can be somewhat blunt, and might also feel piecemeal to stakeholders.**

4.15 For example, the recent changes to exclude companies benefiting from particular renewable energy tariffs and incentives, and the decision to maintain the exemptions described in paragraph 4.10 have prompted some debate. Some exempted activities within the exclusions for renewable energy companies, in both the commercial and community sector, are now arguably lower risk than they were in 2012, or may now receive other income guarantees that significantly reduce the investment risk. On the other hand, new untested and risky sectors within the energy sector have developed since the legislation was introduced. For example, some stakeholders have suggested that investment into less-established areas such as the provision of geothermal energy is particularly risky. **The government appreciates that there may be other areas currently within the excluded activities list where new developments in technology, or changes in the market, do face a market failure in access to finance and therefore represent high risk investments.**

4.16 The government also recognises that changes to the excluded activities list to address lower-risk investments in the renewable energy sector will not have addressed all the cases where tax-advantaged investment is targeted at companies or arrangements that guarantee low-risk, capital preservation opportunities. **The government is concerned that these types of opportunity may divert investment from higher-risk companies that may struggle to raise capital.**

4.17 Therefore, the government is keen to understand how the rules for qualifying companies and excluded activities are working in practice and whether companies and investors feel that they set sensible parameters. Alongside this consultation, the government is also consulting on the expansion of the social investment tax relief. The government will ensure that the approach taken for dealing with existing exclusions aligns in a sensible and consistent way across the tax-advantaged venture capital schemes, and the social investment tax relief. In relation to community energy schemes in particular, the government believes that there may be a case for reviewing the current approach.

4.18 The following questions seek views on various aspects of the current rules. Please provide evidence and examples to support your answers wherever possible.

Box 4.A: Questions on current rules to target the tax reliefs

Question 24: Do the current rules for determining qualifying companies work effectively overall?

Question 25: Do you find the flexibility offered by the interpretation of "substantial" useful in determining whether a trade can qualify? Or, would it be helpful to set this out in legislation, with rules explaining both the proportion of activities that can qualify and determining the criteria to which that applies (turnover, capital etc).

Question 26: Considering the existing exceptions to the excluded activities list for community energy projects, AD, and hydro, do you believe there is still a strong justification for these exclusions? To what extent are these projects reliant on venture capital tax reliefs?

Question 27: What impact, if any, would the removal of tax relief under EIS and VCT for investment in companies receiving energy subsidies, together with the absence of SITR, have on community energy schemes?[3]

Question 28: Are there any areas where the excluded activities list precludes investment into genuinely high risk investments?

Potential alternative approaches

4.19 As described in the introduction to this chapter, the government would like to consider potential options for a more principled approach to determine qualifying companies that could create more certainty for users of the venture capital schemes going forwards. The government would like to explore approaches that might better limit investment into lower-risk opportunities, and could continue to ensure that the schemes support risky, innovative and high-growth potential companies.

4.20 One option that has been put forward by stakeholders previously would be to attempt to identify common characteristics of activities that are innovative and higher-risk, to ensure that they can continue to benefit from investment under the schemes. The government is open to views on this approach, but has previously shied away from attempting to "pick winners" or limit investment into areas that may in the future become riskier investment opportunities with growth potential. The government would not want to restrict the scope of the venture capital schemes or prevent the market operating effectively in identifying these companies.

[3] This question appears in chapter 3 of the consultation on "Social investment tax relief: enlarging the scheme". Answers to this specific question will be collated so it is not necessary for organisations to respond twice.

4.21 As a variant on this approach, some stakeholders have suggested that it may be possible to identify company activities that are less-established and therefore represent higher risk investment opportunities. Again, the government is open to views on this approach, including on the common features of such activities that could be legislated within the tax code to ensure fairness and consistency, rather than relying overly on the judgement of particular individuals considering cases.

4.22 Finally, it may be possible to come up with other tests to identify those companies that are reliant on guarantees of other income or support that effectively remove the risk of investment, for example by setting a threshold in relation to company income or activity that must be generated directly by the company itself. As described in chapter 3, this type of approach is already used in relation to intangible assets and royalty income.

Box 4.B: Questions on alternative approaches to target the tax reliefs

Question 29: Are there particular areas where low-risk investment activity is taking place and that may be diverting investment away from higher-risk, innovative companies?

Question 30: Are there particular areas where high-risk investment activity into innovative companies with growth potential is not taking place? Are there any common features that could be used to identify these sectors, or investment opportunities?

Question 31: Do you believe that a new "principled" approach is necessary?

Question 32: Do any of the options outlined in paragraphs 4.19 to 4.22 appeal to you? Why?

Question 33: Are there any other approaches that you believe would be preferable? Why?

5 Call for evidence

5.1 The government needs to ensure that the schemes continue to effectively meet their aims. To this end, the government regularly monitors the schemes. However, there can be gaps and lags in the data that the government receives. In addition, it can be difficult to follow companies that have received investment over time. Therefore it is very important for the government to have access to other up-to-date information about the use of the tax reliefs.

5.2 The government has commissioned external research that will survey the companies that received funding through the venture capital schemes over the last few years. The research will improve the government's evidence base on; the dynamics of the market; the size and nature of equity gaps in the market; the impact of the schemes and the effects of recent scheme expansion.

5.3 As described throughout this consultation, the government needs to ensure that the schemes continue to fit with the State aid guidelines. In this context, it is important to have the best information possible to demonstrate the continued existence of an equity gap. Case studies can be very useful in demonstrating this.

5.4 It is also important to ensure that the rules for EIS and VCT align with the updated guidelines. The government believes that it can demonstrate that the outcomes of the current schemes broadly meet the intended outcomes of the new guidelines. However, where outliers do exist, it is important that the government is able to produce evidence that these outliers are still operating within the intention of the schemes and the guidelines. Again, case studies can be very useful in considering these points.

5.5 The government would welcome submissions of evidence and case studies from stakeholders demonstrating to what extent companies can currently comply with the amended State aid guidelines (described in more detail in chapter 2) and the impact of the recent expansion on investment. Questions which have already appeared in the consultation have been included again (overleaf) to gather the required evidence.

Box 5.A: Questions for supporting evidence and case studies

Where do you believe the funding gap in access to finance is most severe? Why?

Does the annual investment limit of £5 million achieve the same effect as a total limit of £15 million? Please provide details where you have experience with companies receiving more than £15 million under the scheme, and explain the need for that level of investment.

Do the qualifying companies rules and limits on company size effectively target the investment towards less established companies? How would a limit on the time that a company had been trading in the market impact on any investments made? Please provide details where you have experience with older companies receiving investment under the schemes, and explain the need for that investment.

What do you think the impact of the increased employee limit for qualifying companies has been? Has it unlocked investment throughout early and growth stages of company? Has it allowed for further rounds of funding over time?

Do you believe that these increased limits are now supporting more established companies that are less in need of support? Please provide evidence to support your answer.

Please provide case studies of companies that have received investment over time. It is particularly helpful if you are able to give some context around these case studies, considering:

- what you believe would have happened without that investment;
- whether the company tried to access finance via other means; and
- what the investment has enabled the recipient companies to do.

A Summary of consultation questions

Overarching principles and updated State aid guidelines

Question 1: Are the tax-advantaged venture capital schemes currently meeting the overarching principles, as detailed in Box 2A? Have the recent reforms to the schemes resulted in more effective and well-targeted support?

Question 2: Does the current limit for tax-advantaged investment into qualifying companies, of £5 million per year, achieve the same effect as a total limit of €15 million? Please provide details where you have experience with companies receiving more than €15 million under any of the schemes, and explain the need for that level of investment.

Question 3: Would a total investment limit of €15 million actually offer more flexibility and simplicity than an annual investment limit?

Question 4: Do the qualifying companies rules and limits on company size effectively target the investment towards less established companies? How would a limit on the time that a company had been trading in the market impact on any investments made? Please provide details where you have experience with older companies, or companies with more established trades, receiving investment under the schemes, and explain the need for that investment.

The impact of the 2012 reforms to the tax-advantaged venture capital schemes

Question 5: What do you think the impact of the increase to £5 million as annual limit for investment into qualifying companies has been? Has it unlocked investment throughout early and growth stages of company? Has it allowed for further rounds of funding over time?

Question 6: What do you think the impact of the increased employee limit for qualifying companies has been? Has it unlocked investment throughout early and growth stages of company? Has it allowed for further rounds of funding over time?

Question 7: Do you believe that these increased limits are now supporting more established companies that are less in need of support? Please provide evidence to support your answer.

Question 8: What do you believe the impact of SEIS has been on the market more generally?

Investors using the schemes

Question 9: Do you believe that the type of investors using the venture capital tax reliefs is changing? What are the risks and benefits of this?

Question 10: Is the lack of a minimum investment limit for SEIS, EIS, and VCTs a help or a hindrance for investors, companies and intermediaries including fund managers?

Question 11: Do you believe that the recent change to allow VCT shares to be subscribed for by nominees will have a significant impact on the market going forwards?

Question 12: Is there more that the government should be doing to facilitate the use of tax reliefs by retail investors?

Question 13: Do the current mechanisms for claiming tax relief create difficulties for investors or investee companies? How?

Question 14: Do you believe an alternative process, such as that used for Gift Aid, would work more easily? Why? How would HMRC be able to verify the tax liabilities with this type of mechanism?

Convertible loans

Question 15: Do you agree with the summary of the issues relating to convertible loans set out at paragraphs 3.22 and 3.24?

Question 16: Have you used an advance purchase agreement to facilitate investment? If not, would you consider doing so if the process were formalised? Why?

Question 17: Do you believe that a change in legislation to enable shares received on the conversion of a loan note to qualify is necessary? If so, what conditions do you believe are reasonable to ensure that the use of loans in this circumstance does not create significant opportunities to mitigate risk?

Question 18: Are there other approaches that you believe would be preferable? Why?

Qualifying investments

Question 19: Has the recent change in shares allowed to qualify under EIS been beneficial? Have investors continued to make investments in line with the overarching principles of the schemes (see Box 2A)?

Question 20: Are there cases where the current rules on qualifying shares have created barriers to investments being made? What changes to the rules could prevent these cases without creating opportunities for investors to benefit from tax relief on investments where they are protected against risk?

Question 21: Have the current rules relating to the creation of intangible assets facilitated investments?

Question 22: Are there cases where the current rules on qualifying shares have created barriers to investments being made? What changes to the rules could prevent these cases without creating opportunities for investors to benefit from tax relief on investments where they are protected against risk?

Other

Question 23: Are there other areas where current rules have created barriers to investments being made? What changes to the rules could prevent these cases while continuing to ensure that the overall principles, as outlined in Box 2A, are maintained?

Current rules to target the tax reliefs

Question 24: Do the current rules for determining qualifying companies work effectively overall?

Question 25: Do you find the flexibility offered by the interpretation of “substantial” useful in determining whether a trade can qualify? Or, would it be helpful to set this out in legislation, with rules explaining both the proportion of activities that can qualify and determining the criteria to which that applies (turnover, capital etc).

Question 26: Considering the existing exceptions to the excluded activities list for community energy projects, AD, and hydro, do you believe there is still a strong justification for these exclusions? To what extent are these projects reliant on venture capital tax reliefs?

Question 27: What impact, if any, would the removal of tax relief under EIS and VCT for investment in companies receiving energy subsidies, together with the absence of SITR, have on community energy schemes?[1]

Question 28: Are there any areas where the excluded activities list precludes investment into genuinely high risk investments?

Alternative approaches to target the tax reliefs

Question 29: Are there particular areas where low-risk investment activity is taking place and that may be diverting investment away from higher-risk, innovative companies?

Question 30: Are there particular areas where high-risk investment activity into innovative companies with growth potential is not taking place? Are there any common features that could be used to identify these sectors, or investment opportunities?

Question 31: Do you believe that a new "principled" approach is necessary?

Question 32: Do any of the options outlined in paragraphs 4.19 to 4.22 appeal to you? Why?

Question 33: Are there any other approaches that you believe would be preferable? Why?

[1] This question appears in chapter 3 of the consultation on "Social investment tax relief: enlarging the scheme". Answers to this specific question will be collated so it is not necessary for organisations to respond twice.

Box A.1: Call for evidence

Where do you believe the funding gap in access to finance is most severe? Why?

Does the annual investment limit of £5 million achieve the same effect as a total limit of £15 million? Please provide details where you have experience with companies receiving more than £15 million under the scheme, and explain the need for that level of investment.

Do the qualifying companies rules and limits on company size effectively target the investment towards less established companies? How would a limit on the time that a company had been trading in the market impact on any investments made? Please provide details where you have experience with older companies receiving investment under the schemes, and explain the need for that investment.

What do you think the impact of the increased employee limit for qualifying companies has been? Has it unlocked investment throughout early and growth stages of company? Has it allowed for further rounds of funding over time?

Do you believe that these increased limits are now supporting more established companies that are less in need of support? Please provide evidence to support your answer.

Please provide case studies of companies that have received investment over time. It is particularly helpful if you are able to give some context around these case studies, considering:

- what you believe would have happened without that investment;
- whether the company tried to access finance via other means; and
- what the investment has enabled the recipient companies to do.

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