HM Revenue
& Customs

Income tax and capital gains tax: changes to Venture Capital Schemes for companies and community organisations benefiting from energy subsidies

Who is likely to be affected?

Companies and community organisations seeking Seed Enterprise Investment Scheme (SEIS), Enterprise Investment Scheme (EIS) or Venture Capital Trust scheme (VCT) investment (tax-advantaged venture capital schemes) and community organisations seeking Social Investment Tax Relief (SITR) investment, where a substantial activity of the company or community organisation is, or will be, eligible for a government subsidy for the generation of energy from renewable sources. Individuals and some fund managers who invest in the companies or community organisations may also be affected.

General description of the measure

This measure amends the list of excluded activities within the tax-advantaged venture capital schemes and SITR. Companies (excluding community organisations) whose trade consists wholly or substantially of the subsidised generation of energy from renewable sources where anaerobic digestion or hydroelectric power is involved, or where a company enters into a Contract for Difference, will cease to be eligible for investment under the SEIS, EIS and VCT schemes.

When the enlargement of SITR receives State aid clearance, community energy companies whose trade consists wholly or substantially of the subsidised generation of energy from renewable sources will cease to be eligible for investment under the SEIS, EIS and VCT schemes. At the same time, the qualifying activities under SITR will be amended to allow activities for which a Feed in Tariff (FIT) subsidy is receivable.

The measure will apply in respect of UK subsidies and overseas equivalents.

Policy objective

The measure will help target tax reliefs provided by the venture capital schemes and SITR on investment for riskier, early stage and developing companies and community organisations, which may face barriers in raising external finance. It will help the venture capital schemes and SITR to provide better value for money. The change ensures the venture capital schemes continue to support smaller and growing businesses in a targeted and effective way and that SITR in particular supports activities which produce a social benefit.

Background to the measure

In general, where trading activity consists to a substantial extent of the generation of energy from renewable sources for which a government subsidy is available any investment will not be eligible for the tax-advantaged venture capital schemes or SITR. However there are exceptions where the activity is carried out by a community organisation or involves anaerobic digestion or hydroelectric power and, for SITR only, where the activity is subsidised by way of Renewables Obligation Certificates (ROCs) or Renewable Heat Incentives (RHI). Some of these subsidies will be replaced by new Contract for Difference subsidies from 2015.

The Government consulted over the summer to assess the impact of the tax-advantaged venture capital schemes and on changes to the SITR. The consultation sought views on whether the reliefs for some types of renewable energy generation that qualify for extra government support were still justified.

The Government continues to be concerned about the proportion of investments into renewable energy activities that are relatively low-risk and benefit from government support. There has been a recent increase in the marketing around these investment opportunities for companies currently unaffected by the restrictions on renewable energy. Much of this investment activity is explicitly marketed as lower risk or capital preservation, emphasising the tax reliefs, the predictable income stream from the energy generation and certain proven technologies, and the government support in the form of subsidies for the generation of renewable energy to attract investors.

Detailed proposal

Operative date

This measure will have effect for activities involving anaerobic digestion and hydroelectric power, and activities subsidised under a Contract for Difference, for:

- the EIS and SEIS, in relation to shares issued on or after 6 April 2015
- VCTs, in relation to relevant holdings issued on or after 6 April 2015.

The other provisions will take effect from a future date once State aid clearance is received for the enlargement of the SITR, but no earlier than 6 April 2015.

Current law

Sections 198A, 198B, 257MS, 309A and 309B of the Income Tax Act (ITA) 2007 provide exceptions to the general exclusion of subsidised energy production from the SEIS, EIS, VCT and SITR schemes in relation to community energy schemes and anaerobic digestion and hydroelectric electricity. There are no separate rules for the SEIS, which follows the EIS rules on excluded activities.

Proposed revisions

Legislation will be introduced in Finance Bill 2015 to amend ITA 2007 to modify the existing rules that currently allow companies and community organisations to be eligible for the SEIS, EIS and VCT schemes, where their activities consist wholly or substantially of the subsidised generation or export of electricity, or the subsidised generation of heat or production of gas or fuel, and:

- the activities are carried out by community groups or
- where anaerobic digestion or hydroelectric power is involved or
- the company has entered into a Contract for Difference under the Energy Act 2013.

For SITR, activities that are subsidised by way of FITs will cease to be excluded activities following State aid clearance of the scheme.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td><td>2019-20</td></tr>
<tr><td>-</td><td>-15</td><td>+30</td><td>+10</td><td>+10</td><td>+10</td></tr>
<tr><td colspan="6">These figures are set out in Table 2.1 of Autumn Statement 2014 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Autumn Statement 2014.</td></tr>
<tr><td>Economic impact</td><td colspan="6">This measure is not expected to have significant economic impacts.</td></tr>
<tr><td>Impact on individuals, households and families</td><td colspan="6">Individuals investing under the schemes benefit from a range of tax reliefs including income tax relief on the amount subscribed for shares in eligible companies (or qualifying loans under the SITR) and favourable capital gains tax treatment on eligible investments.

This measure is not expected to have an impact on family formation, stability or breakdown.</td></tr>
<tr><td>Equalities impacts</td><td colspan="6">From the data available it is reasonable to conclude that these changes will not have any further impact on those groups affected by equality legislation.</td></tr>
<tr><td>Impact on business including civil society organisations</td><td colspan="6">The changes proposed will limit the availability of tax reliefs for investment in some smaller companies and change the availability of tax reliefs for civil society organisations benefiting from, or planning to benefit from, existing government support, whose trades involve the production of electricity or heat from renewable sources. These changes will have some minimal administrative costs on those companies and organisations, although this is necessary to ensure that the reliefs remain properly targeted and the impact of the changes will be fairly small, within the existing framework of the reliefs.

VCTs will incur some one-off administrative costs since they will need to ensure that their investments meet the new conditions. These costs are expected to be negligible.</td></tr>
<tr><td>Operational impact (£m) (HMRC or other)</td><td colspan="6">The additional costs for HM Revenue and Customs in implementing this change are anticipated to be negligible. There will be some small costs in updating forms and guidance.</td></tr>
<tr><td>Other impacts</td><td colspan="6"><u>Small and micro business assessment:</u> tax-advantaged venture capital schemes are reliefs intended to help small and micro businesses and changes to them may therefore have an impact on such business.

<u>Competition assessment:</u> The changes should not have any impact on competition as they do not affect or limit suppliers' ability to compete.

<u>Environmental impact</u>: The removal of the exceptions for anaerobic digestion and hydroelectric power will remove the incentive for companies to be set up to take advantage of these "double-subsidies". Any impact on renewable energy will be offset in part by the extension of SITR to community energy organisations.

Other impacts have been considered and none have been identified.</td></tr>
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Monitoring and evaluation

Uptake of the Venture Capital Schemes in terms of numbers of investors and investees, amounts of investment and the distribution of levels of investment will continue to be monitored and published.

Further advice

If you have any questions about this change, please contact Cathy Wilson on 03000 536678 (email: cathy.wilson@hmrc.gsi.gov.uk).