HM Revenue & Customs

Income tax: amendment to tax-advantaged venture capital schemes

Who is likely to be affected?

This measure will affect companies and individuals using the Seed Enterprise Investment Scheme (SEIS), Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs), SEIS and EIS fund managers and VCTs.

General description of the measure

This measure makes amendments to EIS and VCT rules to specify the age of a company that is eligible for investment under EIS and VCT; to cap the total amount of tax-advantaged investment a company may receive over its lifetime; and to provide that investors are independent from the company in which they invest. It introduces higher limits on investments and employees to provide support for knowledge-intensive companies that are particularly likely to struggle to access finance and smooths the interaction between SEIS and EIS.

Policy objective

The measure ensures that the UK continues to offer generous tax incentives to encourage private investment into those small and growing companies most in need of support in accessing finance, while maintaining compliance with EU State aid rules.

Background to the measure

The measure was announced at Budget 2015.

A consultation document entitled "Tax-advantaged venture capital schemes: ensuring continued support for small and growing businesses" was published in July 2014. The document explained that new State aid rules were coming into force and sought evidence on the potential impact of any changes. The consultation sought views more generally on the recent expansions of EIS and VCT, the introduction of SEIS, and how the rules within the schemes were working. The consultation closed on 19 September 2014. A response document will be published once State aid clearance is received for the EIS and VCT schemes.

Detailed proposal

Operative date

The measure will have effect from:

- 6 April 2014 for the change to the rule on redemption of shares of SEIS investors
- 6 April 2015 for the provision removing the requirement for 70% of SEIS funds to be used before a company may raise funds under EIS and to make regulations under certain provisions and

- a date specified by order, subject to State aid clearance, for shares issued under the EIS and for investments made by VCTs and for determining whether investments held by the VCT are to be regarded as qualifying holdings.

Current law

The current EIS legislation is at Part 5 of the Income Tax Act (ITA) 2007.

The current VCT legislation is at Part 6 ITA 2007.

Proposed revisions

If an individual subscribes for shares in a company and the individual already holds shares in the company, the new shares will not be eligible for EIS unless the individual has made a risk finance investment in the company or the individual's shares in the company (excluding founders' shares) were a risk finance investment. A risk finance investment is an investment under EIS, SEIS or Social Investment Tax Relief.

A new requirement will be introduced in Part 5 and 6 of ITA 2007 for the money to be used for the growth and development of the company (or subsidiary company).

Companies must raise their first investment under EIS, VCT or other risk finance investment within 12 years of making their first commercial sale. However, no age limit will apply to companies raising an investment where the amount of the investment is at least 50% of the company's annual turnover, averaged over the previous 5 years.

In addition to the existing cap on annual investments of £5 million, a new cap will be introduced on the total amount of investments a company may raise under EIS, VCT or other risk finance investment, of £15 million, except for knowledge-intensive companies.

A knowledge-intensive company is a company:

- whose costs of research and development or innovation are at least 15% of the company's operating costs in at least one of the previous 3 years, or at least 10% of the company's operating costs in each of the previous 3 years and either
- the company has created, is creating or is intending to create, intellectual property or
- the company's employees with a relevant Masters or higher degree who are engaged in research and development or innovation comprise at least 20% of the company's total workforce.

For knowledge-intensive companies, the cap on the total amount of investments will be £20 million, and the limit on employees will be raised from 250 to 500 employees.

Section 173B and section 292B ITA 2007 will be repealed so that companies will not need to use at least 70% of SEIS funds before raising funds under EIS or VCT respectively.

Section 224 ITA 2007 will be amended so that the EIS relief of investors in companies that redeem the shares of SEIS investors will no longer be reduced, so long as the SEIS relief on the redeemed shares is repaid.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td><td>2019-20</td></tr>
<tr><td>nil</td><td>-5</td><td>-5</td><td>-15</td><td>-10</td></tr>
<tr><td colspan="5">These figures are set out in Table 2.1 of Budget 2015 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Budget 2015.</td></tr>
<tr><td>Economic impact</td><td colspan="5">This measure is not expected to have any significant economic impacts.</td></tr>
<tr><td>Impact on individuals, households and families</td><td colspan="5">There may be some impact on individual SEIS, EIS and VCT investors who have been expecting to make particular investments into companies. These investors reflect the demographic of investors in these schemes. These individuals will not be eligible for tax relief on investments made on or after the new limits take effect, where the investments no longer qualify under the tax-advantaged venture capital schemes.

The measure is not expected to impact on households, family formation, stability or breakdown.</td></tr>
<tr><td>Equalities impacts</td><td colspan="5">The government has considered whether this measure impacts on people sharing protected characteristics differently to others and has not identified any equalities impacts.</td></tr>
<tr><td>Impact on business including civil society organisations</td><td colspan="5">This measure is expected to have a negligible impact on business.

Some companies may find that they are no longer eligible for support under the scheme. It is estimated that more than 95% of companies qualifying under current rules will continue to remain eligible for tax-advantaged investments.

As this measure is an amendment to the existing schemes, it is unlikely that many eligible companies will face one-off and ongoing administrative costs in order to qualify for the relief, as they will already have some knowledge of the existing relief.

For the newly qualifying knowledge intensive companies with no knowledge of any of the schemes, there may be negligible one-off costs associated with familiarisation with new legislation, processes and requirements. The ongoing costs include the costs of calculating and claiming the relief. It is expected that less than 150 companies would fall in this category.

This measure is expected to have no impact on civil society organisations.</td></tr>
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Operational impact (£m) (HMRC or other)	The costs to HM Revenue & Customs of implementing these changes are anticipated to be negligible.
Other impacts	Small and micro business assessment: the impact on all small and micro businesses is the same as all businesses that are currently eligible for the tax-advantaged venture capital schemes. Other impacts have been considered and none have been identified.

Monitoring and evaluation

The measure will be monitored through information collected from tax returns.

Further advice

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

Declaration

David Gauke MP, Financial Secretary to the Treasury has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.