



HM Treasury



HM Revenue
& Customs

Tax-advantaged venture capital schemes:

draft legislation and
explanatory notes

March 2015



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ISBN 978-1-910835-01-2
PU1799

Contents

		Page
Chapter 1	Amendments to the tax-advantaged venture capital schemes	3
Annex A	Draft legislation	7
Annex B	Explanatory notes	31

Amendments to the tax-advantaged venture capital schemes

1

Who should read this document

1.1 This document will be of interest to 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.

Introduction

1.2 The tax-advantaged venture capital schemes – EIS, SEIS and VCTs – play an important role in facilitating access to finance and providing support for smaller businesses which otherwise have difficulty finding the necessary finance to develop and grow. The schemes offer tax reliefs to private investors, to mitigate the risks that individuals face when investing in smaller and less-established businesses, thereby addressing the so-called ‘equity gap’ in access to finance.

1.3 The UK has a long-standing history of offering tax incentives to encourage individuals to support SMEs in this way, and believes that income tax and capital gains tax reliefs provide a very effective mechanism to encourage investment behaviour and stimulate the supply of finance. The government is committed to the tax-advantaged venture capital schemes and wishes to ensure that they continue to support small and growing businesses appropriately, maintaining the overarching principles of the schemes. These are that the schemes remain: effective and targeted, affordable, simple and straightforward to administer, sustainable and not subject to abuse, and compliant with State aid rules.

Budget announcements

1.4 Budget 2015 announced a number of changes to the tax-advantaged venture capital schemes to ensure that they continue to be effective in supporting higher-risk small and growing businesses to access finance, and that they are sustainable going forwards.

1.5 The Budget announced that the government will, subject to State aid approval:

- require that all investments are made for the purpose of business growth and development
- require that all EIS investors are independent from the company at the time of the first share issue (excluding founder shares)
- introduce new qualifying criteria to limit relief to companies whose first commercial sale took place within the previous 12 years unless the company has received a previous investment under SEIS/EIS/VCT (follow-on funding is not restricted). This rule will apply except where the total investment represents more than 50% of annual turnover averaged over the preceding 5 years
- cap the total investment a company may receive at £20 million for companies that meet certain conditions demonstrating that they are ‘knowledge intensive’ and £15 million for other qualifying companies

- increase the employee limit for knowledge intensive companies to 499 employees

1.6 The Budget also announced that the government will, with effect from 6 April 2015:

- remove the requirement that 70% of SEIS money must be spent before EIS or VCT funding can be raised

1.7 These new rules will all apply in addition to current rules on the tax-advantaged venture capital schemes. Therefore, qualifying EIS and VCT companies will still be able to receive up to £5 million annual investment under the schemes. The new limits on the age of qualifying companies and the total amount of investment that they can receive will affect what investments are treated as 'qualifying investments' (or form part of qualifying holdings for VCTs) under the schemes. The changes will not affect other conditions for VCT qualifying status.

State aid rules

1.8 A State aid occurs where state resources are transferred 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 rules ensure that where State aid exists it is properly targeted on genuine market failure and common European goals. 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 schemes are subject to approval from the EU Commission under the new risk finance framework. Compliance with these rules – which are set out in Articles 107 and 108 of the Treaty on the Functioning of the European Union – is essential to preserving the schemes.

1.9 The changes announced at Budget maintain the approach set out in the new State aid rules, requiring risk finance aid to be limited to companies that are relatively unproven by reference to the age of the company after its first commercial sale, and capping the total amount of risk finance investment a company may receive. The changes provide particular support to innovative companies that often require more finance to develop and may take more time to reach a sustainable growth path, and also smooth the interactions between the venture capital schemes.

1.10 However, the limits that the government has proposed are higher than the basic limits set out in the new EU risk finance framework. These limits are provided for in the EU 'general block exemption framework' (GBER), and allow State aid to be provided to companies within 7 years of a first commercial sale, and up to a maximum total investment limit of €15 million.

Timing of the changes and legislation

1.11 Changes to the tax reliefs would normally be expected to take effect from the start of the tax year, 6 April 2015. In this case, however, many of the changes cannot take effect until State aid approval has been secured. For that reason, legislation has not been included in the Finance Bill which was published today.

1.12 It is not normal practice for the government to introduce changes that limit the availability of tax relief with retrospective effect. However, it is possible that the EU Commission could require recovery of aid (tax reliefs) given in particular circumstances where investments exceed the GBER limits described above. Investors should therefore be cautious about making investments exceeding these limits from 6 April 2015.

1.13 In addition to the provisions mentioned above, the draft legislation contains minor provisions to ensure the activities of seed enterprise investment scheme investors do not

disadvantage enterprise investment scheme investors in the same company, with effect from 6 April 2014.

Next steps

1.14 To ensure that the venture capital industry has as much information as possible about the nature of the changes that are likely to be introduced and that are intended to take effect at the earliest legislative opportunity after State aid approval is secured, this document includes the draft legislation and explanatory notes. The government hopes that this information will allow stakeholders to prepare for the introduction of the new scheme rules as far as possible.

1.15 It may be necessary to refine the legislation further to ensure that it achieves the proposed changes and aligns with the overarching principles of the tax-advantaged venture capital schemes effectively. Interested parties are welcome to provide thoughts on the draft legislation by email to venturecapitalconsultation@hmtreasury.gsi.gov.uk before 15 May 2015.

Structure of the document

1.16 The rest of this document sets out the draft legislation for the proposed changes to EIS and VCT which the government intends to introduce, subject to State aid approval, and explanatory notes.

1.17 A tax information and impact note is also published separately today (24 March 2015).

A Draft legislation

A.1 This annex contains draft schedules for amendments to the Enterprise Investment Scheme and Venture Capital Trusts.

SCHEDULE 1

ENTERPRISE INVESTMENT SCHEMES

Introductory

- 1 Part 5 of ITA 2007 (enterprise investment scheme) is amended as follows.

The investor

- 2 In section 162 (overview of Chapter 2: the investor), omit the “and” at the end of paragraph (b) and after that paragraph insert –
“(ba) existing shareholdings (see section 164A), and”.
- 3 After section 164 insert –

“164A The existing shareholdings requirement

- (1) If, at the time the relevant shares are issued, the investor holds any other shares in a company within subsection (2) (“C”), those other shares must be –
- (a) a risk-scheme investment, or
 - (b) subscriber shares which –
 - (i) were issued to, and have since they were issued been continuously held by, the investor, or
 - (ii) were acquired by the investor at a time when C had not issued any shares other than subscriber shares and had not begun to carry on or make preparations for carrying on any trade or business.
- (2) The companies referred to in subsection (1) are –
- (a) the issuing company, and
 - (b) any company which is a qualifying subsidiary of the issuing company at the time the relevant shares are issued.
- (3) Shares in a company are a “risk-scheme investment” if –
- (a) they are issued by the company to the investor, and
 - (b) (at any time) the company provides a compliance statement under section 205, 257ED or 257PB in respect of the issue of shares which includes those shares.”
- 4 In section 166 (connection with issuing company), after subsection (1) insert –
- “(1A) But see section 252A(12) for provision which disapplies section 168.”

General requirements

- 5 In section 172 (overview of Chapter 3: general requirements) –
- (a) after paragraph (aa) insert –
 - “(aaa) the lifetime maximum amount raised through risk capital schemes (see section 173AA),
 - (aab) the maximum risk capital scheme investments during period B (see section 173AB),”
 - (b) omit paragraph (ab), and

- (c) after paragraph (c) insert –
 “(ca) the status of qualifying 90% subsidiaries (see section 175A),”.
- 6 (1) Section 173A of ITA 2007 (the maximum amount raised annually through risk capital schemes requirement) is amended as follows.
- (2) In subsection (3) –
- (a) after paragraph (b) insert –
 “(ba) an investment is made in the company and (at any time) the company provides a compliance statement under section 257PB (tax relief for social investments) in respect of the investment, or”, and
- (b) in paragraph (c), for “Community Guidelines on Risk Capital Investments in Small and Medium-sized Enterprises” substitute “European Commission’s Guidelines on State aid to promote risk finance investment”.
- (3) After subsection (4) insert –
 “(5) Section 257KB applies in determining for those purposes when an investment within subsection (3)(ba) is made as it applies for the purposes of Part 5B (tax relief on social investments).”

7 After section 173A insert –

“173AA The lifetime maximum amount raised through risk capital schemes requirement

- (1) The total amount of relevant investments made in the issuing company on or before the date the relevant shares are issued must not exceed –
- (a) if the issuing company is a knowledge-intensive company at the time the relevant shares are issued (see section 252A), £20 million, and
- (b) in any other case, £15 million.
- (2) In subsection (1), the reference to relevant investments made in the issuing company includes relevant investments made in any company that is, or has at any time on or before that date been, a subsidiary of the issuing company (whether or not it was such a subsidiary when the investment was made).
- (3) “Relevant investment” has the meaning given by section 173A(3), and section 173A(4) and (5) (which determines when certain investments are made) applies for the purposes of this section.
- (4) The Treasury may by regulations amend subsection (1)(a) or (b) by substituting a different amount for an amount for the time being specified there.

173AB The maximum risk capital scheme investments during period B requirement

- (1) The requirement of this section is that the total amount of qualifying relevant investments must not exceed the permitted limit at any time in period B.

- (2) Relevant investments are “qualifying” at any time (“the relevant time”) if they are relevant investments made at or before the relevant time in –
 - (a) the issuing company, or
 - (b) a company which, at the relevant time, is a qualifying subsidiary of the issuing company.
 - (3) “The permitted limit” means –
 - (a) if the issuing company is a knowledge-intensive company at the time the relevant shares are issued (see section 252A), £20 million, and
 - (b) in any other case £15 million.
 - (4) “Relevant investment” has the meaning given by section 173A(3), and section 173A(4) and (5) (which determines when certain investments are made) applies for the purposes of this section.
 - (5) The Treasury may by regulations amend subsection (3) by substituting a different amount for an amount for the time being specified there.”
- 8 Omit section 173B (the spending of money raised by SEIS investment requirement).
- 9 (1) Section 174 (the purpose of the issue requirement) is amended as follows.
- (2) The existing text becomes subsection (1).
 - (3) In that subsection, after “activity” insert “so as to promote business growth and development”.
 - (4) After that subsection insert –
 - “(2) For this purpose “business growth and development” means the growth and development of –
 - (a) if the issuing company is a single company, the business of that company, and
 - (b) if the issuing company is a parent company, what would be the business of the group if the activities of the group companies taken together were regarded as one business.”
- 10 After section 175 insert –

“175A The status of qualifying 90% subsidiaries requirement

- (1) The requirement of this section is that, if the relevant qualifying business activity is an activity carried on by a qualifying 90% subsidiary of the issuing company, one or both of the following conditions are met.
- (2) The conditions are –
 - (a) that the qualifying 90% subsidiary made its first commercial sale in the period of 12 years ending with the issue of the relevant shares;
 - (b) that a relevant investment was made in that subsidiary before the end of the period of 12 years beginning with that sale.
- (3) In this section –

“first commercial sale” has the same meaning as in the European Commission’s Guidelines on State aid to promote risk finance investments (as those guidelines may be amended or replaced from time to time);

“relevant qualifying business activity” means the qualifying business activity for which the money raised by the issue of the relevant shares is employed;

“relevant investment” has the meaning given by section 173A(3), and section 173A(4) and (5) (which determines when certain investments are made) applies for the purposes of this section.

- (4) The Treasury may by regulations amend subsection (2) by substituting a different number of years for a number for the time being specified there.”

The issuing company

- 11 In section 180 (overview of Chapter 4: the issuing company), after paragraph (b) insert –
- “(ba) the relevant investments in the issuing company (see section 183A),”.
- 12 After section 183 insert –

“183A The relevant investments in the issuing company requirement

- (1) If the relevant shares are issued more than 12 years after the issuing company’s first commercial sale –
- (a) a relevant investment must have been made in that company before the end of the period of 12 years beginning with that sale, or
 - (b) if the condition in paragraph (a) is not met, the total amount of relevant investments made in the company in a period of 30 consecutive days which includes the day on which the relevant shares are issued must be at least 50% of the average turnover amount.
- (2) “The average turnover amount” means –
- (a) if the issuing company is a single company at the time the relevant shares are issued, the average of that company’s turnovers for each of the five consecutive years the last of which ends –
 - (i) immediately before the beginning of the last accounts filing period, or
 - (ii) if later, 12 months before the date on which the relevant shares are issued, and
 - (b) if the issuing company is a parent company at the time the relevant shares are issued, the average of the total group turnovers for each of those five years.
- (3) In this section –
- “first commercial sale” has the same meaning as in the European Commission’s Guidelines on State aid to promote

risk finance investments (as those guidelines may be amended or replaced from time to time);

“the last accounts filing period” means the last period for filing (within the meaning of section 442 of the Companies Act 2006) for the issuing company which ends before the date on which the relevant shares are issued;

“relevant investment” has the meaning given by section 173A(3), and section 173A(4) and (5) (which determines when certain investments are made) applies for the purposes of this section;

“the total group turnover” for a year is the sum of –

- (a) the issuing company’s turnover for that year, and
- (b) the turnover for that year of each company which at the time the relevant shares are issued is a qualifying subsidiary of the issuing company;

“turnover” has the meaning given by section 474(1) of the Companies Act 2006 and is to be determined by reference to the accounts of companies and amounts recognised for accounting purposes (and such apportionments of those amounts as are just and reasonable are to be made for the purpose of determining a company’s turnover for a year).

- (4) The Treasury may by regulations amend subsection (1) by substituting a different number of years for a number of years for the time being specified there.”

13 In section 186A (the number of employees requirement) –

- (a) in subsections (1) and (2) for “250” substitute “the permitted limit”, and
- (b) after subsection (3) insert –

“(3A) “The permitted limit” means –

- (a) if the issuing company is a knowledge-intensive company (see section 252A) at the time the relevant shares are issued, 500, and
- (b) in any other case, 250.

- (3B) The Treasury may by regulations amend subsection (3A) by substituting a different number for a number for the time being specified there.”

14 Omit section 200 (power to amend certain provisions of Chapter 4 of Part 5 of ITA 2007 by Treasury order).

Repayment etc of share capital

15 (1) Section 224 (repayments etc of share capital to other persons) is amended as follows.

(2) In subsection (4), after paragraph (a) insert –

- “(aa) causes any SEIS relief attributable to that person’s shares in the issuing company to be withdrawn or reduced by virtue of –
 - (i) section 257FA (disposal of shares), or

- (ii) section 257FH(2)(a) (receipt of value by virtue of repayment of share capital etc),”.
- (3) In subsection (5) –
 - (a) after “subsection (4)(a),” insert “(aa),” and
 - (b) after paragraph (a) insert –
 - “(aa) section 257FE,”.

Powers to amend Part 5 of ITA 2007

- 16 After section 251 insert –

“Powers to amend

251A Powers to amend Chapters 2 to 4 by Treasury regulations

- (1) The Treasury may by regulations add to, repeal or otherwise amend any provision of –
 - (a) Chapter 2 (the requirements to be met in relation to the investor),
 - (b) Chapter 3 (the general requirements to be met in respect of the relevant shares), or
 - (c) Chapter 4 (the requirements to be met by the issuing company for it to be a qualifying company in relation to the relevant shares).
- (2) Regulations under this section may –
 - (a) make different provision for different cases or purposes;
 - (b) contain incidental, supplemental, consequential and transitional provision and savings.
- (3) The provision which may be made as a result of subsection (2)(b) includes provision amending any provision of this or any other Act (including an Act passed after this Act).
- (4) This section is without prejudice to any other power to amend any provision of this Part.
- (5) A statutory instrument containing regulations under this section may not be made unless a draft of it has been laid before and approved by a resolution of the House of Commons.”

“Knowledge-intensive companies”

- 17 After section 252 insert –

“252A Meaning of “knowledge-intensive company”

- (1) For the purposes of this Part, the issuing company is a “knowledge-intensive company” at the time the relevant shares are issued if the company meets –
 - (a) one or both of the operating costs conditions (see subsections (2) and (3)), and
 - (b) one or both of –
 - (i) the innovation condition (see subsection (5)), and
 - (ii) the skilled employee condition (see subsection (8)).

- (2) The first “operating costs condition” is that in at least one of the relevant three preceding years at least 15% of the relevant operating costs constituted expenditure on research and development or innovation.
- (3) The second “operating costs condition” is that in each of the relevant three preceding years at least 10% of the relevant operating costs constituted such expenditure.
- (4) In subsections (2) and (3) “the relevant three preceding years” means the three consecutive years the last of which ends –
 - (a) immediately before the beginning of the last accounts filing period, or
 - (b) if later, 12 months before the date on which the relevant shares are issued.
- (5) “The innovation condition” is –
 - (a) where the issuing company is a single company, that –
 - (i) the issuing company is engaged in intellectual property creation at the time the relevant shares are issued, and
 - (ii) it is reasonable to assume that, within 12 years of the issue of the relevant shares, one or a combination of –
 - (a) the exploitation of relevant intellectual property held by the company, and
 - (b) business which results from new or improved products, processes or services utilising relevant intellectual property held by the company,will form the greater part of its business;
 - (b) where the issuing company is a parent company, that –
 - (i) the parent company or one or more of its qualifying subsidiaries (or both that company and one or more of those subsidiaries) is or are engaged in intellectual property creation at the time the relevant shares are issued, and
 - (ii) it is reasonable to assume that, within 12 years of the issue of the relevant shares, one or a combination of –
 - (a) the exploitation of relevant intellectual property held by the parent company or any of its qualifying subsidiaries, and
 - (b) business which results from new or improved products, processes or services utilising relevant intellectual property held by the parent company or any of its qualifying subsidiaries,will form the greater part of what would be the business of the group if the activities of the group companies taken together are regarded as one business.
- (6) For the purposes of subsection (5), a company is engaged in intellectual property creation if –

-
- (a) relevant intellectual property is being created by the company, or has been created by it within the previous three years,
 - (b) the company is taking, or preparing to take, steps in order that relevant intellectual property will be created by it, or
 - (c) the company is carrying on activity which is the subject of a written evaluation which—
 - (i) has been prepared by an independent expert, and
 - (ii) includes a statement to the effect that, in the opinion of the expert, it is reasonable to assume that relevant intellectual property will, in the foreseeable future, be created by the company.
- (7) For the purposes of this section—
- (a) intellectual property is “relevant” intellectual property, in relation to a company, if the whole or greater part (in terms of value) of it is created by the company, and
 - (b) intellectual property is created by a company if it is created in circumstances in which the right to exploit it vests in the company (whether alone or jointly with others).
- (8) “The skilled employee condition” is that throughout period B—
- (a) if the issuing company is a single company, the FTE skilled employee number is at least 20% of the FTE employee number, and
 - (b) if the issuing company is a parent company, the FTE group skilled employee number is at least 20% of the FTE group employee number.
- (9) But, in subsection (8), the reference to period B does not include any period during which the issuing company, by virtue of section 182 (companies in administration or receivership), is not regarded as having ceased to meet the trading requirement.
- (10) In this section—
- “FTE employee number” for a company is the full-time equivalent employee number determined in accordance with section 186A(3);
 - “FTE group employee number” means the sum of—
 - (a) the FTE employee number for the issuing company, and
 - (b) the FTE employee number for each of its qualifying subsidiaries;
 - “FTE group skilled employee number” means the sum of—
 - (a) the FTE skilled employee number for the issuing company, and
 - (b) the FTE skilled employee number for each of its qualifying subsidiaries;
 - “FTE skilled employee number” for a company is determined in accordance with section 186A(3) in the same way as the full-time equivalent employee number except that only employees of the company who—
 - (a) hold a relevant HE qualification, and

- (b) are engaged directly in research and development or innovation activities carried on –
 - (i) if the issuing company is a single company, by that company, or
 - (ii) if the issuing company is a parent company, by that company or any qualifying subsidiary of that company,

are to be taken into account;

“independent expert”, in relation to an evaluation of activity of a company, means an individual who –

- (a) is not connected with the issuing company,
- (b) holds a relevant HE qualification, and
- (c) is an expert in the area of research and development or innovation being or to be pursued by the company in question;

“intellectual property” has the meaning given by section 195(6);

“the last accounts filing period” means the last period for filing (within the meaning of section 442 of the Companies Act 2006) for the issuing company which ends before the date on which the relevant shares were issued;

“operating costs”, of a company for a period of account, means expenses of the company which are recognised as expenses in the company’s profit and loss account or income statement for that period, other than expenses relating to transactions between that company and another company at a time when both companies are members of the same group (but see also subsection (11));

“relevant HE qualification” means –

- (a) a qualification which is at level 7, or a higher level, of the framework for higher education qualifications in England, Wales and Northern Ireland (as that framework may be amended or replaced from time to time),
- (b) a qualification which is at level 11, or a higher level, of the framework for qualifications of higher education institutions in Scotland (as that framework may be amended or replaced from time to time), or
- (c) a comparable qualification to one within paragraph (a) or (b);

“relevant operating costs” means –

- (a) if the issuing company is a single company at the time the relevant shares are issued, the operating costs of that company, and
- (b) if the issuing company is a parent company at the time the relevant shares are issued, the sum of –
 - (i) the operating costs of the issuing company, and
 - (ii) the operating costs of each company which is a qualifying subsidiary of the issuing company at that time.

- (11) Such apportionments as are just and reasonable are to be made to amounts recognised in a company's profit and loss account or income statement for the purpose of determining the company's operating costs for a year.
- (12) When determining whether an individual is connected with the issuing company for the purposes of this section, section 168 is to be ignored.
- (13) The Treasury may by regulations amend this section for the purposes of adding, amending or removing a condition which must be met for a company to be a knowledge-intensive company.
- (14) A statutory instrument containing regulations under subsection (13) may not be made unless a draft of it has been laid before and approved by a resolution of the House of Commons."

Consequential repeals

- 18 (1) In consequence of paragraphs 5(b) and 8, in Schedule 6 to FA 2012, omit paragraphs 11 and 13.
- (2) In consequence of paragraph 13, in Schedule 7 to FA 2012, omit paragraph 12.
- (3) In consequence of paragraph 14, in Schedule 7 to FA 2012, omit paragraph 16.

Commencement and transitional provision

- 19 (1) The amendments made by paragraph 6 have effect in relation to shares issued on or after the day on which this Act is passed.
- (2) But nothing in sub-paragraph (1) prevents shares issued before that day constituting "relevant investments" for the purposes of determining whether the requirement of section 173A is met in relation to shares issued on or after that date.
- 20 The following provisions come into force on the day on which this Act is passed –
 - (a) the amendment made by paragraph 16,
 - (b) any power conferred on the Treasury by virtue of paragraph 7, 10, 12, 13, 17 or 23 of this Schedule to make regulations, and
 - (c) the amendments made by paragraphs 14 and 18(3).
- 21 The amendments made by paragraphs 5(b), 8 and 18(1) have effect in relation to shares issued on or after 6 April 2015.
- 22 The amendments made by paragraph 15 have effect in relation to any repayment, redemption or repurchase of share capital, or payment to a member, on or after 6 April 2014.
- 23 (1) Subject to paragraphs 19 to 22, the amendments made by this Schedule come into force in accordance with provision contained in regulations made by the Treasury.
- (2) Regulations under this paragraph may make –
 - (a) different provision for different purposes,

(b) transitional and saving provision.

SCHEDULE 1

VENTURE CAPITAL TRUSTS

Introductory

- 1 Part 6 of ITA 2007 (venture capital trusts) is amended as follows.

VCT approvals

- 2 (1) Section 280B (the investment limits condition) is amended as follows.
- (2) In subsection (4) –
- (a) omit “or” at the end of paragraph (b) and after that paragraph insert –
- “(ba) an investment is made in the company and (at any time) the company provides a compliance statement under section 257PB (tax relief for social investments) in respect of the investment, or”, and
- (b) in paragraph (c) for “Community Guidelines on Risk Capital Investments in Small and Medium-sized Enterprises” substitute “European Commission’s Guidelines on State aid to promote risk finance investment”.
- (3) After subsection (5) insert –
- “(6) Section 257KB applies in determining for those purposes when an investment within subsection (4)(ba) is made as it applies for the purposes of Part 5B (tax relief on social investments).”

Qualifying holdings

- 3 (1) Section 286 (qualifying holdings: introduction) is amended as follows.
- (2) In subsection (2), omit the “and” at the end of paragraph (a) and after paragraph (b) insert “, and
- (c) those shares or securities were first issued by the relevant company in order to raise money for the purposes of promoting growth and development of –
- (i) if the relevant company is a single company, the business of that company, and
- (ii) if it is a parent company, what would be the business of the group if the activities of the group companies taken together were regarded as one business.”
- (3) In subsection (3) –
- (a) after paragraph (ea) insert –
- “(eaa) the total risk capital investments when relevant holding is issued (see section 292AA),
- “(eab) the total risk capital investments after relevant holding is issued (see section 292AB),”
- (b) omit paragraph (eb),
- (c) after paragraph (g) insert –
- “(ga) the status of qualifying 90% subsidiaries (see section 294A),

- (gb) the relevant investments in the relevant company (see section 294B),”, and
 - (d) after paragraph (ja) insert –
 - “(jb) the proportion of skilled employees (see section 297B),”.
- 4 (1) Section 292A (the maximum amount raised annually through risk capital schemes requirement) is amended as follows.
- (2) In subsection (3) –
- (a) after paragraph (b) insert –
 - “(ba) an investment is made in the company and (at any time) the company provides a compliance statement under section 257PB (tax relief for social investments) in respect of the investment, or”, and
 - (b) in paragraph (c), for “Community Guidelines on Risk Capital Investments in Small and Medium-sized Enterprises” substitute “European Commission’s Guidelines on State aid to promote risk finance investment”.
- (3) After subsection (4) insert –
- “(4A) Section 257KB applies in determining for those purposes when an investment within subsection (3)(ba) is made as it applies for the purposes of Part 5B (tax relief on social investments).”
- (4) In subsection (5), after “205” insert “, 257ED or 257PB”.
- 5 After section 292A insert –

“292AA Total risk capital investments when relevant holding is issued requirement

- (1) The total amount of relevant investments made in the relevant company on or before the date the relevant holding is issued must not exceed –
 - (a) if the relevant company is a knowledge-intensive company at the time the relevant holding is issued (see section 302B), £20 million, and
 - (b) in any other case, £15 million.
- (2) In subsection (1), the reference to relevant investments made in the relevant company includes relevant investments made in any company that is, or has at any time on or before that date been, a subsidiary of the relevant company (whether or not it was such a subsidiary when the investment was made).
- (3) “Relevant investment” has the meaning given by section 292A(3), and section 292A(4) and (4A) (which determines when certain investments are made) applies for the purposes of this section.
- (4) Subsection (5) applies if, by virtue of the provision of a compliance statement under section 205, 257ED or 257PB, the requirement of this section is not met.
- (5) The requirement is to be treated as having been met throughout the period –
 - (a) beginning with the time the relevant holding was issued, and

- (b) ending with the time the compliance statement was provided.
- (6) The Treasury may by regulations amend subsection (1)(a) or (b) by substituting a different amount for the amount for the time being specified there.

292AB Total risk capital investments after relevant holding is issued requirement

- (1) The requirement of this section is that, at all times after the issue of the relevant holding, the total amount of qualifying relevant investments must not exceed the permitted limit.
 - (2) Relevant investments are “qualifying” at any time (“the relevant time”) if they are relevant investments made at or before the relevant time in—
 - (a) the relevant company, or
 - (b) a company which, at the relevant time, is a qualifying subsidiary of the relevant company.
 - (3) “The permitted limit” means—
 - (a) if the relevant company is a knowledge-intensive company at the time the relevant holding is issued (see section 302B), £20 million, and
 - (b) in any other case, £15 million.
 - (4) “Relevant investment” has the meaning given by section 292A(3), and section 292A(4) and (4A) (which determines when certain investments are made) applies for the purposes of this section.
 - (5) The Treasury may by regulations amend subsection (3)(a) or (b) by substituting a different amount for an amount for the time being specified there.”
- 6 Omit section 292B (the spending of money raised by SEIS investment requirement).
- 7 After section 294 insert—

“294A The status of a qualifying 90% subsidiary requirement

- (1) The requirement of this section is that, if any of the money raised by the issue of the relevant holding is employed for the purposes of a relevant qualifying activity which, at the time the money is employed, is carried on by a qualifying 90% subsidiary of the relevant company, one or both of the following conditions are met.
- (2) The conditions are—
 - (a) that the qualifying 90% subsidiary made its first commercial sale in the period of 12 years ending with the issue of the relevant holding;
 - (b) that a relevant investment was made in that subsidiary before the end of the period of 12 years beginning with that sale.
- (3) In this section—
 - “first commercial sale” has the same meaning as in the European Commission’s Guidelines on State aid to promote

risk finance investments (as those guidelines may be amended or replaced from time to time);

“relevant investment” has the meaning given by section 292A(3), and section 292A(4) and (4A) (which determines when certain investments are made) applies for the purposes of this section;

and the definition of “relevant qualifying activity” in subsection (8) of section 293 applies for the purposes of this section as it applies for the purposes of that section.

- (4) The Treasury may by regulations amend subsection (1)(a) or (b) by substituting a different number of years for a number for the time being specified there.

294B The relevant investments in the relevant company

- (1) If the relevant holding is issued more than 12 years after the relevant company’s first commercial sale –
- (a) a relevant investment must have been made in that company before the end of the period of 12 years beginning with that sale, or
 - (b) if the condition in paragraph (a) is not met, the total amount of relevant investments made in the company in a period of 30 consecutive days which includes the day on which the relevant holding is issued must be at least 50% of the average turnover amount.
- (2) “The average turnover amount” means –
- (a) if the relevant company is a single company at the time the relevant holding is issued, the average of that company’s turnovers for each of the five consecutive years the last of which ends –
 - (i) immediately before the beginning of the last accounts filing period, or
 - (ii) if later, 12 months before the date on which the relevant holding is issued, and
 - (b) if the relevant company is a parent company at the time the relevant holding is issued, the average of the total group turnovers for each of those five years.
- (3) In this section –
- “first commercial sale” has the same meaning as in the European Commission’s Guidelines on State aid to promote risk finance investments (as those guidelines may be amended or replaced from time to time);
- “the last accounts filing period” means the last period for filing (within the meaning of section 442 of the Companies Act 2006) for the relevant company which ends before the date on which the relevant holding is issued;
- “relevant investment” has the meaning given by section 292A(3), and section 292A(4) and (4A) (which determines when certain investments are made) applies for the purposes of this section;
- “the total group turnover” for a year is the sum of –
- (a) the relevant company’s turnover for that year, and

- (b) the turnover for that year of each company which at the time the relevant holding is issued is a qualifying subsidiary of the relevant company;
- “turnover” has the meaning given by section 474(1) of the Companies Act 2006 and is to be determined by reference to the accounts of companies and amounts recognised for accounting purposes (and such apportionments of those amounts as are just and reasonable are to be made for the purpose of determining a company’s turnover for a year).
- (4) The Treasury may by regulations amend subsection (1) by substituting a different number of years for a number of years for the time being specified there.”
- 8 In section 297A (the number of employees requirement) –
- (a) in subsections (1) and (2) for “250” substitute “the permitted limit”, and
- (b) after subsection (3) insert –
- “(3A) “The permitted limit” means –
- (a) if the relevant company is a knowledge-intensive company at the time the relevant holding is issued (see section 302B), 500, and
- (b) in any other case, 250.
- (3B) The Treasury may by regulations amend subsection (3A)(a) or (b) by substituting a different number for the number for the time being specified there.”
- 9 After that section insert –
- “297B The proportion of skilled employees requirement**
- (1) The requirement of this section is that, where the conditions in subsection (2) are met, at all times after the issue of the relevant holding –
- (a) if the relevant company is a single company, the FTE skilled employee number must be at least 20% of the FTE employee number, and
- (b) if the relevant company is a parent company, the FTE group skilled employee number must be at least 20% of the FTE group employee number.
- (2) The conditions are that –
- (a) one or both of the requirements in sections 292AA and 297A (the lifetime maximum amount raised through risk capital schemes and the number of employees requirement) is or are met only by reason of the relevant company being a knowledge-intensive company at the time the relevant holding was issued, and
- (b) the innovation condition in section 302B(5) was not met by the relevant company at that time.
- (3) The requirement of this section is not to be regarded as failing to be met at a time when the relevant company, by virtue of section 292 (companies in administration or receivership), is not regarded as having ceased to meet the trading requirement.

- (4) In this section “FTE employee number”, “FTE group employee number”, “FTE skilled employee number” and “FTE group skilled employee number” have the meaning given by section 302B(9) (meaning of “knowledge-intensive company”).”

10 After section 302A (but before the italic heading “Excluded activities”) insert—

“302B Meaning of “knowledge-intensive company”

- (1) For the purposes of this Chapter, the relevant company is a “knowledge-intensive company” at the time the relevant holding is issued if the company meets—
- (a) one or both of the operating costs conditions (see subsections (2) and (3)), and
 - (b) one or both of—
 - (i) the innovation condition (see subsection (5)), and
 - (ii) the skilled employee condition (see subsection (8)).
- (2) The first “operating costs condition” is that in at least one of the relevant three preceding years at least 15% of the relevant operating costs constituted expenditure on research and development or innovation.
- (3) The second “operating costs condition” is that in each of the relevant three preceding years at least 10% of the relevant operating costs constituted such expenditure.
- (4) In subsections (2) and (3)—
- “relevant operating costs” means—
- (a) if the relevant company is a single company at the time the relevant holding is issued, the operating costs of that company, and
 - (b) if the relevant company is a parent company at the time the relevant holding is issued, the sum of—
 - (i) the operating costs of the relevant company, and
 - (ii) the operating costs of each company which is a qualifying subsidiary of the relevant company at that time;
- “the relevant three preceding years” means the three consecutive years the last of which ends—
- (a) immediately before the beginning of the last accounts filing period, or
 - (b) if later, 12 months before the date on which the relevant holding is issued.
- (5) “The innovation condition” is—
- (a) where the relevant company is a single company, that—
 - (i) the relevant company is engaged in intellectual property creation at the time the relevant holding is issued, and
 - (ii) it is reasonable to assume that, within 12 years of the issue of the relevant holding, one or a combination of—

- (a) the exploitation of relevant intellectual property held by the company, and
 - (b) business which results from new or improved products, processes or services utilising relevant intellectual property held by the company,
 - will form the greater part of its business;
 - (b) where the relevant company is a parent company, that –
 - (i) the parent company or one or more of its qualifying subsidiaries (or both that company and one or more of those subsidiaries) is or are engaged in intellectual property creation at the time the relevant holding is issued, and
 - (ii) it is reasonable to assume that, within 12 years of the issue of the relevant holding, one or a combination of –
 - (a) the exploitation of relevant intellectual property held by the parent company or any of its qualifying subsidiaries, and
 - (b) business which results from new or improved products, processes or services utilising relevant intellectual property held by the parent company or any of its qualifying subsidiaries,
 - will form the greater part of the business of the group, if the activities of the group companies taken together are regarded as one business.
- (6) For the purposes of subsection (5), a company is engaged in intellectual property creation if –
 - (a) relevant intellectual property is being created by the company, or has been created by it within the previous three years,
 - (b) the company is taking, or preparing to take, steps in order that relevant intellectual property will be created by it, or
 - (c) the company is carrying on activity which is the subject of a written evaluation which –
 - (i) has been prepared by an independent expert, and
 - (ii) includes a statement to the effect that, in the opinion of the expert, it is reasonable to assume that relevant intellectual property will, in the foreseeable future, be created by the company.
- (7) For the purposes of this section –
 - (a) intellectual property is “relevant” intellectual property, in relation to a company, if the whole or greater part (in terms of value) of it is created by the company, and
 - (b) intellectual property is created by a company if it is created in circumstances in which the right to exploit it vests in the company (whether alone or jointly with others).
- (8) “The skilled employee condition” is that at the time the relevant holding is issued –

- (a) if the relevant company is a single company, the FTE skilled employee number is at least 20% of the FTE employee number, and
- (b) if the relevant company is a parent company, the FTE group skilled employee number is at least 20% of the FTE group employee number.

(9) In this section –

“FTE employee number” for a company is the full-time equivalent employee number determined in accordance with section 297A(3);

“FTE group employee number” means the sum of –

- (a) the FTE employee number for the relevant company, and
- (b) the FTE employee number for each of its qualifying subsidiaries;

“FTE group skilled employee number” means the sum of –

- (a) the FTE skilled employee number for the relevant company, and
- (b) the FTE skilled employee number for each of its qualifying subsidiaries;

“FTE skilled employee number” for a company is determined in accordance with section 297A(3) in the same way as the full-time equivalent employee number except that only employees of the company who –

- (a) hold a relevant HE qualification, and
- (b) are engaged directly in research and development or innovation activities carried on –
 - (i) if the relevant company is a single company, by that company, or
 - (ii) if the relevant company is a parent company, by that company or any qualifying subsidiary of that company,

are to be taken into account;

“independent expert”, in relation to an evaluation of activity of a company, means an individual who –

- (a) is not connected with the relevant company,
- (b) holds a relevant HE qualification, and
- (c) is an expert in the area of research and development or innovation being or to be pursued by the company in question,

and, for the purposes of paragraph (a), sections 167, 170 and 171 (but not section 168) apply to determine if an individual is connected with the relevant company (with references in those sections to the issuing company read as references to the relevant company);

“intellectual property” has the meaning given by section 306(6);

“the last accounts filing period” means the last period for filing (within the meaning of section 442 of the Companies Act 2006) for the relevant company which ends before the date on which the relevant holding was issued;

“operating costs”, of a company for a period, means expenses of the company which are recognised as expenses in the company’s profit and loss account or income statement for that period, other than expenses relating to transactions between that company and another company at a time when both companies are members of the same group (but see also subsection (10);

“relevant HE qualification” means –

- (a) a qualification which is at level 7, or a higher level, of the framework for higher education qualifications in England, Wales and Northern Ireland (as that framework may be amended or replaced from time to time),
 - (b) a qualification which is at level 11, or a higher level, of the framework for qualifications of higher education institutions in Scotland (as that framework may be amended or replaced from time to time), or
 - (c) a comparable qualification to one within paragraph (a) or (b).
- (10) Such apportionments as are just and reasonable are to be made to amounts recognised in a company’s profit and loss account or income statement for the purpose of determining the company’s operating costs for a year.
- (11) The Treasury may by regulations amend this section so as to add, amend or remove a condition which must be met for a company to be a knowledge-intensive company.
- (12) A statutory instrument containing regulations under subsection (11) may not be made unless a draft of it has been laid before and approved by a resolution of the House of Commons.”

Interpretation of Part 6

- 11 In section 313 (interpretation of Chapter), in subsection (5), at the end insert –

“But section 993 does not apply for the purposes of the definition of “independent expert” in section 302B(9).”

Power to amend Chapter 4 of Part 6 of ITA 2007

- 12 For section 311 (power to amend Chapter 4 of Part 6 of ITA 2007) substitute –

“311 Powers to amend by Treasury regulations

- (1) The Treasury may by regulations add to, repeal or otherwise amend any provision of this Chapter.
- (2) Regulations under this section may –
 - (a) make such amendments of Chapter 3 (VCT approvals) as the Treasury considers appropriate in consequence of any amendment made of this Chapter,
 - (b) make different provision for different cases or purposes;

- (c) contain incidental, supplemental, consequential and transitional provision and savings.
- (3) The provision which may be made as a result of subsection (2)(c) includes provision amending any provision of this or any other Act (including an Act passed after this Act).
- (4) This section is without prejudice to any other power to amend any provision of this Part.
- (5) A statutory instrument containing regulations under this section may not be made unless a draft of it has been laid before and approved by a resolution of the House of Commons.”

Consequential repeal

- 13 (1) In consequence of paragraphs 3(3)(b), 6 and 8—
- (a) in Schedule 6 to FA 2012, omit paragraphs 15 and 17, and
 - (b) in Schedule 8 to that Act, omit paragraph 9.
- (2) In consequence of paragraph 12, in Schedule 8 to FA 2012, omit paragraph 14.

Commencement and transitional provision

- 14 The following provisions come into force on the day on which this Act is passed—
- (a) the amendment made by paragraph 12,
 - (b) any power conferred on the Treasury by virtue of paragraph 5, 7, 8, 10 or 17 of this Schedule to make regulations, and
 - (c) the amendments made by paragraph 13(2).
- 15 (1) The amendments made by paragraph 2 have effect for the purpose of determining whether an investment made on or after the day on which this Act is passed breaches the investment limits condition.
- (2) The amendments made by paragraph 4 have effect for the purposes of determining whether shares or securities issued on or after the day on which this Act is passed are to be regarded as comprised in a company’s qualifying holdings.
- (3) Nothing in sub-paragraph (1) or (2) prevents investments made before that day constituting a “relevant investment”—
- (a) for the purposes of section 280B of ITA 2007 for the purposes of determining whether the investment limits condition in section 274 of that Act is breached by an investment made on or after the day on which this Act is passed, or
 - (b) for the purposes of section 292A of that Act for the purposes of determining whether shares or securities issued on or after that day are to be regarded as comprised in a company’s qualifying holdings.
- 16 The amendments made by paragraphs 3(3)(b), 6 and 13(1)(a) have effect for the purposes of determining whether shares or securities issued on or after 6 April 2015 are to be regarded as comprised in a company’s qualifying holdings.

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- 17 (1) Subject to paragraph 14 to 16, the amendments made by this Schedule come into force in accordance with provision contained in regulations made by the Treasury.
- (2) Regulations under this paragraph may make—
- (a) different provision for different purposes, and
 - (b) transitional and saving provision.

B Explanatory notes

B.1 This annex contains explanatory notes for the schedules in Annex A, explaining amendments to the Enterprise Investment Scheme and Venture Capital Trusts.

EXPLANATORY NOTE

ENTERPRISE INVESTMENT SCHEMES

SUMMARY

1. This clause and Schedule make amendments to the Enterprise Investment Scheme (EIS) rules, including higher limits to provide special support for knowledge intensive companies that are likely to particularly struggle to access finance, and smoothing the interaction between the Seed Enterprise Investment Scheme and EIS rules.

DETAILS OF THE SCHEDULE

2. Paragraph 1 introduces the amendments to the EIS rules in Part 5 of the Income Tax Act (ITA) 2007 that are made by the Schedule. All references are to ITA.
3. Paragraph 2 makes provision in section 162 for, and paragraph 3 inserts, new section 164A.
4. Section 164A introduces a requirement for an individual who claims tax relief under EIS to be independent from the company and hold no other shares in the company at the time the individual invests in the company. The only exception is if the existing shares are a risk-scheme investment or the shares are “founder shares” and (a) the individual holds shares in the company, all of which were issued to the individual when the company was founded, or (b) the shares were acquired when a pre-formed dormant company was bought “off the shelf”.
5. A “risk-scheme investment” is a share or shares subscribed for under the EIS, the Seed Enterprise Investment Scheme (SEIS) or the Social Investment Tax Relief (SITR) rules, for which the company submits a compliance statement to HM Revenue & Customs under section 205, 257ED or 257PB respectively. Note that this definition is more restricted than a “relevant investment” under section 173A, as amended by paragraph 6, which includes loans made under SITR.
6. The same rules apply to shareholdings of the individual in companies that are members of the same group as the issuing company at the time the shares are issued.
7. Paragraph 4 amends section 166 to take account of provisions in new section 252A(12) (see paragraph 17 of the Schedule).
8. Paragraph 5 makes a number of minor consequential changes by inserting in section 172 new paragraphs (aaa), (aab) and (ca) and omitting paragraph (ab).

FINANCE BILL 201X
CLAUSE X EIS
SCHEDULE X

9. Paragraph 6 makes a number of changes to section 173A, which limits the amount of State aid investments (referred to as “relevant investments”) a company may receive each year.
10. Paragraph 6(2)(a) inserts new paragraph (ba) in section 173A(3) to extend the definition of a “relevant investment” to an investment made under the SITR rules. SITR investments will therefore count towards a company’s annual maximum amount.
11. Paragraph 6(2)(b) updates the reference in section 173A(3)(c) to the latest Guidelines, published in 2014, by the European Commission on the rules on State aid for risk finance investments.
12. Paragraph 6(3) inserts new subsection (5) in section 173A to specify when an SITR investment, that is a relevant investment, is made.
13. Paragraph 7 introduces new sections 173AA and 173AB.
14. Section 173AA imposes a cap on the total amount of relevant investments a company and its subsidiaries may receive, of £15 million, unless the company is a knowledge-intensive company (see paragraph 17 of the Schedule), in which case the limit is £20 million.
15. A “relevant investment” means an investment under EIS, SEIS, the venture capital trust (VCT) scheme, SITR or any other risk finance scheme under the amended section 173A(3)(c). Relevant investments include investments in a company that has at any time been a subsidiary of the issuing company on or before the date of issue of the shares.
16. Section 173AB applies the cap on lifetime investments received by the company and its subsidiaries for three years following the date of issue of the shares.
17. Paragraph 8 repeals section 173B. The effect of this provision is to allow a company to raise funds under EIS without having to have spent 70% of any SEIS funds it has already raised.
18. Paragraph 9 amends section 174 by making explicit the requirement that, to qualify for State aid, a company must use funds raised under EIS to promote the growth and development of the company or, where the company is a parent company, the group.
19. Paragraph 10 inserts new section 175A, which applies the same age limit on a 90% subsidiary of the issuing company, where that subsidiary is carrying on the relevant qualifying business for which the funds raised are to be used, as applies to the issuing company under new section 183A. The issuing company must have made its first commercial sale no later than 12 years before the date of issue of the shares, or have received a relevant investment at any time before the end of that 12 year period.

FINANCE BILL 201X
CLAUSE X EIS
SCHEDULE X

20. Paragraph 11 makes provision in section 180 for, and paragraph 12 inserts, new section 183A.
21. Section 183A(1)(a) sets a limit on when an investment in a company may be eligible for tax relief under EIS. In general, if a company has not received a relevant investment within 12 years of the company's first commercial sale, the investment will not be eligible for tax relief under EIS.
22. Section 183A(1)(b) provides an exception to the rule in subsection (1)(a). Shares issued by the company will be eligible for EIS if the total funds raised from all investors under EIS, SEIS, VCT or SITR over a 30 day period are at least 50% of the company's average annual turnover, taken over the previous five years. In this case it is assumed that the company's activities are changing so substantially as to constitute a new business activity. The 30 day period provides some flexibility for a company that is assembling a number of investments from different investors.
23. Section 183A(2)(a) determines the five years over which the turnovers of the company are averaged. Where the end of the most recent accounts filing period falls within the 12 months before the date of issue of the shares, subsection (2)(a)(i) determines the end of the 5 year period by reference to the beginning of that accounts filing period. Subsection (2)(a)(ii), however, provides that where the end of an accounts filing period does not fall within the previous 12 months before the date of the issue of the shares then the 5 year period ends instead on the day 12 months before the date of issue of the shares.
24. Generally speaking, this allows for a company with consistent 12 month periods of account to determine turnover by reference to the last five complete audited accounts prior to the relevant issue.
25. Section 183A(2)(b) specifies that if the issuing company is a parent company, the turnovers of all the companies in the group at the time the shares are issued are used to determine the average turnover.
26. Section 183A(3) provides definitions of the terms used in subsections (1) and (2). In particular:
- the company's first commercial sale is defined by reference to the European Commission's Guidelines on State aid to promote risk finance investments. Paragraph 52(xi) of the guidelines defines a first commercial sale as "the first sale by [the company] on a product or service market, excluding limited sales to test the market"
 - the total group turnover for the purposes of subsection (2)(b) includes turnovers of a subsidiary company at the date of issue of the shares, including for years when it was not a member of the same group of companies.
27. Paragraph 13 amends section 186A, to specify a higher limit of 500 full time equivalent employees for knowledge-intensive companies.

FINANCE BILL 201X
CLAUSE X EIS
SCHEDULE X

28. Paragraph 14 repeals section 200, which is superseded by a wider power in new section 251A (see paragraph 16 of the Schedule).
29. Paragraph 15 amends section 224. Its effect is to treat SEIS investors whose shares are purchased or redeemed by the company in the same way as EIS investors: provided any SEIS claimed by the investor is repaid on the redemption, the EIS relief of other investors will not be reduced. This provision applies retrospectively to redemptions of shares made on or after 6 April 2014.
30. Paragraph 16 introduces new section 251A, which allows amendments to be made to Chapters 2, 3 and 4 by regulations under the draft affirmative procedure.
31. Paragraph 17 introduces new section 252A. Section 252A introduces the concept of a “knowledge-intensive company”, which is eligible for a higher lifetime maximum amount under section 173AA and a higher number of employees under section 186A (as amended under paragraph 13 of this Schedule).
32. Section 252A(1) requires a knowledge-intensive company to meet one of two operating costs conditions and at least one of the innovation condition or the skilled employee condition.
33. Sections 252A(2) and (3) specify the operating costs conditions, which compare the relevant operating costs relating to research and development or innovation to the relevant operating costs of the company (or group) over a three year period. Section 252A(4) determines the period over which the conditions must be applied, using the same method as applies for the test in new section 183A(2)(a).
34. Sections 252A(5) to (7) specify the conditions a company must meet to satisfy the innovation condition. The condition requires a company to be engaged in the creation of intellectual property which will be used for the future trade of the company (or other companies in the same group) and the activities of which will form the greater part of the company’s (or the group’s) business within 12 years of the date of issue of the shares. The condition can be met in one of three ways:
- by having created intellectual property within the last three years, or is creating intellectual property; or
 - by taking steps in order to create intellectual property; or
 - by demonstrating through a report by an independent expert that it is reasonable to assume the company will create intellectual property in the foreseeable future.
35. The innovation condition is not confined to the creation of a single item of intellectual property. Some companies may develop a range of intellectual property that, together, will form the basis of their future business.
36. Sections 252A(8) and (9) specify the skilled employee condition. If the company relies upon meeting this condition to qualify as a knowledge-intensive company at the date of

FINANCE BILL 201X
CLAUSE X EIS
SCHEDULE X

issue of the shares, it must continue to meet the condition throughout the period ending three years after the date of issue of the shares. The exception to this is where the company is in administration or receivership.

37. Section 252A(10) defines a number of terms used throughout the section.

38. In particular, “relevant operating costs” are defined by reference to the costs included in the company’s profit and loss account. Where the issuing company is a member of a group at the date of issue of the shares, the operating costs are calculated by reference to the total operating costs of all companies in the group at the date of issue of the shares, excluding transactions between companies in the same group.

39. Section 252A(11) provides for the amounts of operating costs of a company to be apportioned as is just and reasonable in determining a company’s relevant operating costs. This provision may be necessary where subsidiary companies do not share the same accounting date as the parent company.

40. Section 252A(12) excludes the application of section 168 from the definition of a person who is connected with the company when determining if the person is an independent expert for the purpose of subsection (10). It means that the expert may not be connected to the company at any time.

41. Paragraph 18 contains minor and consequential amendments to other Acts that flow from this new legislation.

42. Paragraphs 19 to 22 provide for commencement of the provisions in this Schedule.

43. The power to commence certain provisions of this Schedule, the power in new section 251A to amend chapters 2, 3 and 4 of Part 5, the powers to amend the provisions of this Schedule, and the amendments to section 173A take effect from the date of Royal Assent.

44. The repeal of section 173B (see paragraph 8) takes effect for shares issued on or after 6 April 2015.

45. The amendments to section 224 (see paragraph 15) take effect for redemptions of shares made on or after 6 April 2014.

46. The other provisions in this Schedule take effect in relation to shares issued on or after the date of the relevant commencement order bringing the provisions into effect.

EXPLANATORY NOTE

VENTURE CAPITAL TRUSTS

SUMMARY

1. This clause and Schedule make amendments to the Venture Capital Trust (VCT) rules, including higher limits to provide special support for knowledge intensive companies that are likely to particularly struggle to access finance, and smoothing the interaction between the Seed Enterprise Investment Scheme and VCT rules.

DETAILS OF THE SCHEDULE

2. Paragraph 1 introduces the amendments to the VCT rules in Part 6 of the Income Tax Act (ITA) 2007 that are made by the Schedule. All references are to ITA 2007.
3. Paragraph 2 amends section 280B.
4. Paragraph 2(2)(a) inserts new paragraph (ba) in subsection (4) to extend the definition of a “relevant investment” to an investment made under the Social Investment Tax Relief (SITR) rules. SITR investments will therefore count towards a company’s annual maximum amount.
5. Paragraph 2(2)(b) updates the reference in subsection (4)(c) to the latest Guidelines, published in 2014, by the European Commission on the rules on State aid for risk finance investments.
6. Paragraph 2(3) inserts new section subsection (6) to specify when an SITR investment, that is a relevant investment, is made.
7. Paragraph 3 amends section 286. Paragraph 3(2) introduces an explicit requirement that a company must use VCT funds to promote the growth and development of the company or, where the company is a parent company, the group. Paragraph 3(3) makes a number of minor consequential changes.
8. Paragraph 4 makes a number of changes to section 292A which limits the amount of risk finance investments (referred to as “relevant investments”) a company may receive each year.
9. Paragraph 4(2)(a) inserts new paragraph (ba) in section 292A(3) to extend the definition of a “relevant investment” to an investment made under the SITR rules. SITR investments will therefore count towards a company’s annual maximum amount.

FINANCE BILL 201X
CLAUSE X VCT
SCHEDULE [X]

10. Paragraph 4(2)(b) updates the reference in section 292A(3)(c) to the latest Guidelines, published in 2014, by the European Commission on the rules on State aid for risk finance investments.
11. Paragraph 4(3) inserts new subsection (4A) in section 292A to specify when an SITR investment, that is a relevant investment, is made.
12. Paragraph 4(4) makes a consequential change to section 292A(5).
13. Paragraph 5 inserts new sections 292AA and 292AB.
14. Section 292AA(1) imposes a cap on the total amount of relevant investments a company and its subsidiaries may receive, of £15 million, unless the company is a knowledge-intensive company (see paragraph 10 of the Schedule), in which case the limit is £20 million.
15. A “relevant investment” means an investment under EIS, SEIS, VCT scheme, SITR or any other risk finance scheme under the amended section 173A(3)(c). Relevant investments include investments in a company that has at any time been a subsidiary of the issuing company on or before the date of issue of the shares.
16. Section 292AA(4) and (5) provide that, if a company in which a VCT has a qualifying holding receives further investment that breaches the lifetime limit, the VCT’s holding will not cease to be a qualifying holding until the investee company submits a compliance statement to HM Revenue & Customs in relation to the further investment.
17. Section 292AB applies the cap on lifetime investments received by the company and its subsidiaries throughout the time a VCT’s holding in a company is a qualifying holding.
18. Paragraph 6 repeals section 173B. The effect of this provision is to allow a company to raise funds under VCT without having to have spent 70% of any SEIS funds it has already raised.
19. Paragraph 7 inserts new sections 294A and 294B.
20. Section 294A applies the same age limit on a subsidiary of the relevant company, where that subsidiary is carrying on the relevant qualifying business for which the funds raised are to be used, as applies to the issuing company under new section 294B. The relevant company must have made its first commercial sale no later than 12 years before the date of issue of the shares, or have received a relevant investment at some time before the end of that 12 year period.
21. Section 294B(1)(a) sets a limit on when a relevant holding in a company (the relevant company) may be a qualifying holding. In general, if a relevant company has not received a relevant investment under VCT, SEIS, EIS or SITR within 12 years of the relevant company’s first commercial sale, the investment will not be a qualifying holding.

FINANCE BILL 201X
CLAUSE X VCT
SCHEDULE [X]

22. Section 294B(1)(b) provides an exception to the rule in subsection (1)(a). An investment in the relevant company will be a qualifying holding if the total funds raised from all investors under VCT, SEIS, EIS or SITR over a 30 day period are at least 50% of the relevant company's average annual turnover, taken over the previous five years. In this case it is assumed that the relevant company's activities are changing so substantially as to constitute a new business activity. The 30 day period provides some flexibility for a company that is assembling a number of investments from different investors.

23. Section 294B(2)(a) determines the five years over which the turnovers of the relevant company are averaged. Where the end of the most recent accounts filing period falls within the 12 months before the investment was made, subsection (2)(a)(i) determines the end of the 5 year period by reference to the beginning of that accounts filing period. Subsection (2)(a)(ii), however, provides that where the end of an accounts filing period does not fall within the previous 12 months before the date of the investment then the 5 year period ends instead on the day 12 months before the date the investment was made.

24. Generally speaking, this allows for a company with consistent 12 month periods of account to determine turnover by reference to the last five complete audited accounts prior to the relevant issue.

25. Section 294B(2)(b) specifies that if the issuing company is a parent company, the turnovers of all the companies in the group at the time the shares are issued are used to determine the average turnover.

26. Section 294B(3) provides definitions of the terms used in subsections (1) and (2). In particular:

- the company's first commercial sale is defined by reference to the European Commission's Guidelines on State aid to promote risk finance investments. Paragraph 52(xi) of the Guidelines defines a first commercial sale as "the first sale by [the company] on a product or service market, excluding limited sales to test the market"
- the total group turnover for the purposes of subsection (2)(b) includes turnovers of a subsidiary company at the date of issue of the shares, including for years when it was not a member of the same group of companies.

27. Paragraph 8 amends section 297A, to specify a higher limit of 500 full time equivalent employees for knowledge-intensive companies.

28. Paragraph 9 inserts new section 297B, which introduces a new requirement for companies that rely upon meeting the skilled employee condition in order to qualify as a knowledge-intensive company (see paragraph 10 of the Schedule and section 302B). If the relevant company did not meet the innovation condition in section 302B(5) at the time the VCT made its investment in the relevant company then the relevant company must continue to meet the skilled employee condition throughout the time a VCT's holding in a company is

FINANCE BILL 201X
CLAUSE X VCT
SCHEDULE [X]

a qualifying holding. The exception to this is where the company is in administration or receivership.

29. Paragraph 10 inserts new section 302B. Section 302B introduces the concept of a “knowledge-intensive company”, which is a relevant company eligible for a higher lifetime maximum amount under sections 280B and 292A and a higher number of employees under section 297A (as amended under paragraph 8 of this Schedule).

30. Section 302B(1) requires a knowledge-intensive company to meet one of two operating costs conditions and at least one of the innovation condition or the skilled employee condition.

31. Sections 302B(2) and (3) specify the operating costs conditions, which compare the relevant operating costs relating to research and development or innovation to the relevant operating costs of the company (or group) over a three year period. Section 302B(4) determines the period over which the conditions must be applied, using the same method as applies for the test in new section 294B(2)(a).

32. Sections 302B(5) to (7) specify how a relevant company must meet the innovation condition. The condition requires a company to be engaged in the creation of intellectual property which will be used for the future trade of the company (or other companies in the same group) and the activities of which will form the greater part of the company’s (or the group’s) business within 12 years of the date of issue of the shares. The condition can be met in one of three ways:

- by having created intellectual property within the last three years, or creating intellectual property
- by taking steps in order to create intellectual property
- by demonstrating through a report by an independent expert that it is reasonable to assume the company will create intellectual property in the foreseeable future.

33. The innovation condition is not confined to the creation of a single item of intellectual property. Some companies may develop a range of intellectual property that, together, will form the basis of their future business.

34. Sections 302B(8) specifies the skilled employee condition.

35. Section 302B(9) defines a number of terms used throughout the section.

36. In particular, “operating costs” are defined by reference to the costs included in the company’s profit and loss account. Where the issuing company is a member of a group at the date of issue of the shares, the operating costs are calculated by reference to the total operating costs of all companies in the group at the date of issue of the shares, excluding transactions between companies in the same group.

37. Section 302B(10) provides for the amounts of operating costs of a company to be apportioned as is just and reasonable in determining a company’s relevant operating costs.

FINANCE BILL 201X
CLAUSE X VCT
SCHEDULE [X]

This provision may be necessary where subsidiary companies do not share the same accounting date as the parent company.

38. Paragraph 11 amends section 313 to make clear that the usual meaning of a connected person for Part 6 under section 993 does not apply to an independent expert for the purposes of section 302B(9). Instead the EIS definition of “connection”, at section 167, 170 and 171, applies to an independent expert.

39. Paragraph 12 substitutes a new section for section 311, which allows amendments to be made to Chapter 4 of Part 6, and any consequential amendments needed to Chapter 3 of Part 6 by regulations under the draft affirmative procedure.

40. Paragraph 13 contains minor and consequential amendments to other Acts that flow from this new legislation.

41. Paragraphs 14 to 16 provide for commencement of the provisions in this Schedule.

42. The power to commence certain provisions of this Schedule, the power in substituted section 311 to amend Chapter 3 (and 4) of Part 6, the powers to amend the provisions of this Schedule, and the amendments to section 280B by paragraph 2 and to section 292A by paragraph 4 take effect from the date of Royal Assent.

43. The repeal of section 292B (see paragraph 6) takes effect for shares issued on or after 6 April 2015.

44. The other provisions in this Schedule take effect in relation to relevant holdings made on or after the date of the relevant commencement order bringing the provisions into effect.

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