HM Revenue
& Customs

Income tax: amendments to tax-advantaged venture capital schemes

Who is likely to be affected?

This measure will affect companies and individual investors using the Seed Enterprise Investment Scheme (SEIS), Enterprise Investment Scheme (EIS) and Venture Capital Trust scheme (VCT), SEIS and EIS fund managers and VCTs.

General description of the measure

This measure makes amendments to EIS and VCT rules. The measure

- specifies the age of a company that is eligible for investment under EIS and VCT
- caps the total amount of tax-advantaged investment a company may receive over its lifetime
- stops the use of EIS and VCT money for acquisitions of businesses
- provides that investors are independent from the company in which they invest
- introduces higher limits on total investment, age of company and number of employees to provide support for knowledge-intensive companies that are particularly likely to struggle to access finance
- 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 which would otherwise struggle to access finance. At the same time, the schemes will be well-targeted and in line with state aids rules. The state aids rules are specified in the "Guidelines on State aid to promote risk finance investments" (2014/C 19/04). The measure also ensures that the UK provides extra support to innovative companies and those which are undergoing significant change.

Background to the measure

The measure was announced at Summer 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 aids 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.

Draft legislation was published for consultation on 24 March 2015 and the consultation closed on 15 May 2015.

This Tax Information and Impact Note (TIIN) updates and replaces the TIIN published on 24 March 2015.

A response document to the 2014 consultation was published on 8 July 2015.

The measure is subject to final approval by the European Commission on state aids.

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 or VCT
- Royal Assent for shares issued under 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 contained in Part 5 of the Income Tax Act (ITA) 2007.

The current VCT legislation is contained in Part 6 ITA 2007.

Section 996 ITA 2007 defines "farming" for the purposes of the Income Tax Acts.

Proposed revisions

Legislation will be published in Summer Finance Bill to make a number of changes to the EIS, SEIS and VCT rules.

If an individual subscribes for shares in a company and that 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 before Royal Assent 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).

The rule prohibiting the use of money for the acquisition of shares will be extended to all investments made by VCTs on or after the operative date and will therefore apply to non-qualifying holdings.

A new rule will be introduced to prevent companies from using EIS and VCT investments to acquire a business.

Companies must raise their first investment under EIS, VCT or other risk finance investment within 7 years of making their first commercial sale or 10 years if the company is a knowledge-intensive company. 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 five years. The age limit will apply also to any business that has been owned previously by another company.

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 £12 million or £20 million for knowledge-intensive companies. Any risk finance investments used by a business previously owned by another company will count towards the total funding limit.

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

For knowledge-intensive companies, the limit on employees will be raised from less than 250 to less than 500 employees.

Section 173B and section 292B ITA 2007 will be repealed so that companies will no longer 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.

Section 996(7) ITA 2007 will be repealed to clarify that farming outside the UK is not an eligible activity for EIS, SEIS, VCT and Enterprise Management Incentives.

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><td>2020-21</td></tr>
<tr><td>+10</td><td>+85</td><td>+15</td><td>+35</td><td>+40</td><td>+40</td></tr>
<tr><td colspan="6">These figures replace those which are set out in Table 2.1 of Budget 2015. The Office for Budget Responsibility has included these numbers in its forecast.</td></tr>
<tr><td>Economic impact</td><td colspan="6">This measure is not expected to have any significant economic impacts.</td></tr>
<tr><td>Impact on individuals, households and families</td><td colspan="6">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="6">The changes to the schemes are not likely to change the impacts of this measure on any group.

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>
</table>

Impact on business including civil society organisations	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; we estimate that more than 90% 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 fewer than 150 companies would fall in this category. Some VCTs will incur one-off administrative costs since they will need to ensure that their future investments meet the new conditions. These costs are expected to be negligible. This measure is expected to have no impact on civil society organisations.
Operational impact (£m) (HMRC or other)	The costs to HMRC of implementing these changes are anticipated to be negligible. There will be some small costs in updating forms and guidance.
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. An evaluation of the EIS and VCT schemes will be completed in accordance with the state aid evaluation requirements. This report should be published by the end of 2019.

Further advice

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

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>
</table>

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).