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

Exchequer impact (£m)	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
	+10	+85	+15	+35	+40	+40
	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.					
Economic impact	This measure is not expected to have any significant economic impacts.					
Impact on individuals, households and families	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.					
Equalities impacts	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.					

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).