



AT/BPC

HM Treasury
HMRC

By email: venturecapitalconsultation@hmtreasury.gsi.gov.uk

18 September 2014

Dear Sir/ Madam,

Tax-advantaged venture capital schemes: ensuring continued support for small and growing businesses - ICAS response

1. ICAS welcomes the opportunity to respond to this consultation. Our Charter requires us to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.
2. Overall, we are supportive of the proposals and direction set out in the consultation paper. We agree with the changes to make the tax-advantaged venture capital reliefs more sustainable and better targeted on the small and growing companies most in need of finance, consistent with the original policy intention. Our responses to the detailed questions are set out in Annex 1.
3. We trust that our comments are helpful and would be happy to discuss any aspect of our response with you.

Yours faithfully,

ALICE TELFER
Assistant Director, Business Policy and Public Sector
ICAS

Response to detailed questions

Overarching principles and updated State aid guidelines

Question 1: Are the tax-advantaged venture capital schemes currently meeting the overarching principles, as detailed in Box 2A? Have the recent reforms to the schemes resulted in more effective and well-targeted support?

Yes and yes

Question 2: Does the current limit for tax-advantaged investment into qualifying companies, of £5 million per year, achieve the same effect as a total limit of €15 million? Please provide details where you have experience with companies receiving more than €15 million under any of the schemes, and explain the need for that level of investment.

The current limit of £5m is better than a 15m euro max. We know of no company that has received 15m euros under the scheme.

Question 3: Would a total investment limit of €15 million actually offer more flexibility and simplicity than an annual investment limit?

No

Question 4: Do the qualifying companies rules and limits on company size effectively target the investment towards less established companies? How would a limit on the time that a company had been trading in the market impact on any investments made? Please provide details where you have experience with older companies, or companies with more established trades, receiving investment under the schemes, and explain the need for that investment.

7 years from the first commercial sale should be fine especially as the rules allow for follow on funding.

The impact of the 2012 reforms to the tax-advantaged venture capital schemes

Question 5: What do you think the impact of the increase to £5 million as annual limit for investment into qualifying companies has been? Has it unlocked investment throughout early and growth stages of company? Has it allowed for further rounds of funding over time?

The increase to £5m has allowed further rounds particularly for those high tech companies that have reached the commercialisation stage.

Question 6: What do you think the impact of the increased employee limit for qualifying companies has been? Has it unlocked investment throughout early and growth stages of company? Has it allowed for further rounds of funding over time?

The increase to 250 has had a beneficial effect both as to further funding rounds and to making start-ups, that will be employing more than 50 people before they reach a position of being cash flow positive, more attractive to investors.

Question 7: Do you believe that these increased limits are now supporting more established companies that are less in need of support? Please provide evidence to support your answer.

This is unlikely to be the case. Companies will not raise equity unless there is no alternative and raising equity for unquoted companies will always be difficult.

Question 8: What do you believe the impact of SEIS has been on the market more generally?

Not that significant. A 30% incentive for EIS is very good and we are not convinced that the increase to 50% for very early stage enterprises make much difference.

Investors using the schemes

Question 9: Do you believe that the type of investors using the venture capital tax reliefs is changing? What are the risks and benefits of this?

We are not aware of any evidence to suggest a change. In our experience, at present investors are typically middle aged men looking for tax free income – there hasn't been appreciable change to this.

Question 10: Is the lack of a minimum investment limit for SEIS, EIS, and VCTs a help or a hindrance for investors, companies and intermediaries including fund managers?

Individual fund managers or syndicates could set minimum limits if they felt they needed to so the lack of an investment limit is not seen as a hindrance.

Question 11: Do you believe that the recent change to allow VCT shares to be subscribed for by nominees will have a significant impact on the market going forwards?

No comment

Question 12: Is there more that the government should be doing to facilitate the use of tax reliefs by retail investors?

The current system appears to work well for syndicates.

Question 13: Do the current mechanisms for claiming tax relief create difficulties for investors or investee companies? How?

No.

Question 14: Do you believe an alternative process, such as that used for Gift Aid, would work more easily? Why? How would HMRC be able to verify the tax liabilities with this type of mechanism?

No comment

Convertible loans

Question 15: Do you agree with the summary of the issues relating to convertible loans set out at paragraphs 3.22 and 3.24?

Yes.

Question 16: Have you used an advance purchase agreement to facilitate investment? If not, would you consider doing so if the process were formalised? Why?

No, this could be considered in the future but is unlikely to be known about by those not in a syndicate or by those making very few EIS investments.

Question 17: Do you believe that a change in legislation to enable shares received on the conversion of a loan note to qualify is necessary? If so, what conditions do you believe are reasonable to ensure that the use of loans in this circumstance does not create significant opportunities to mitigate risk?

Yes, loans would have to be converted inside an agreed time limit. Three months is quite a short period, we believe that six months would be better.

Question 18: Are there other approaches that you believe would be preferable? Why?

No comment.

Qualifying investments

Question 19: Has the recent change in shares allowed to qualify under EIS been beneficial? Have investors continued to make investments in line with the overarching principles of the schemes (see Box 2A)?

Yes and yes.

Question 20: Are there cases where the current rules on qualifying shares have created barriers to investments being made? What changes to the rules could prevent these cases without creating opportunities for investors to benefit from tax relief on investments where they are protected against risk?

It is unlikely that barriers to investment have been created, although anti-dilution is a “nice to have” from an investor view point.

Question 21: Have the current rules relating to the creation of intangible assets facilitated investments?

No comment.

Question 22: Are there cases where the current rules on qualifying shares have created barriers to investments being made? What changes to the rules could prevent these cases without creating opportunities for investors to benefit from tax relief on investments where they are protected against risk?

See our response to question 20.

Other

Question 23: Are there other areas where current rules have created barriers to investments being made? What changes to the rules could prevent these cases while continuing to ensure that the overall principles, as outlined in Box 2A, are maintained?

No comment except we note that receiving 30% back on the investment, CGT and IHT relief, CGT roll over relief and income tax relief if there is a loss are altogether substantial incentives for investing. Tinkering with other incentives may cause the EIS scheme, which is already considered to be complex, to become too difficult to understand and therefore ultimately may act as a disincentive.

Current rules to target the tax reliefs

Question 24: Do the current rules for determining qualifying companies work effectively overall?

Yes.

Question 25: Do you find the flexibility offered by the interpretation of “substantial” useful in determining whether a trade can qualify? Or, would it be helpful to set this out in legislation, with rules explaining both the proportion of activities that can qualify and determining the criteria to which that applies (turnover, capital etc).

Yes it is useful.

Question 26: Considering the existing exceptions to the excluded activities list for community energy projects, AD, and hydro, do you believe there is still a strong justification for these exclusions? To what extent are these projects reliant on venture capital tax reliefs?

Yes they should be excluded. A main risk for Venture Capital is the commercial risk – can you sell the product, at what price, what is the cost of selling and marketing? This risk is absent in energy projects.

Question 27: What impact, if any, would the removal of tax relief under EIS and VCT for investment in companies receiving energy subsidies, together with the absence of SITR, have on community energy schemes?

Probably very little in our view. Venture Capital Schemes should not be used to subsidise low risk energy schemes if such schemes are low risk.

Question 28: Are there any areas where the excluded activities list precludes investment into genuinely high risk investments?

We are not aware of any.

Alternative approaches to target the tax reliefs

Question 29: Are there particular areas where low-risk investment activity is taking place and that may be diverting investment away from higher-risk, innovative companies?

A member has given an example of a television documentary where the commercial deal has been agreed in advance and then an EIS Company was set up to make the documentary. We have also heard of schemes where most of the risk has been mitigated because of the value of the property in the company. When the pension limits came into force a number of IFAs started pushing forward low risk EIS schemes but most of these were solar panel schemes which have since been stopped.

Question 30: Are there particular areas where high-risk investment activity into innovative companies with growth potential is not taking place? Are there any common features that could be used to identify these sectors, or investment opportunities?

We are not aware of instances of high risk investment in innovative companies not taking place.

Question 31: Do you believe that a new “principled” approach is necessary?

We believe that companies which are not taking a selling and marketing risk should not qualify as this dilutes the positive impact of the relief and diverts the funding from its intended target, to boost the economy.

ICAS generally favours a policy of clear legislation based on longer term principles i.e. a “principles not rules” approach. This legislation is rules based but now works in most cases so question whether much can be gained through “reverse engineering” a principles based approach in this instance.

It may be helpful to instruct HMRC staff to follow the adopted principles whilst any legislative change should only take place with a longer term time commitment and proper consultation.

Question 32: Do any of the options outlined in paragraphs 4.19 to 4.22 appeal to you? Why?

No comment.

Question 33: Are there any other approaches that you believe would be preferable? Why?

No comment.