PhilipHare&Associates

The November 2017 Budget

Chancellor's Statement of 22 November 2017

Venture Capital Tax reliefs

Seed Enterprise Investment Scheme
Enterprise Investment Scheme
Venture Capital Trusts
Social Investment Tax Relief

Summary

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Chancellor's Budget Statement of 22 November 2017

The Government has been reviewing various tax reliefs, including the venture capital tax relief schemes, and assessing their value for money. It has expressed concerns over certain types of investment which appear to be "lower risk" and there is a desire for the tax reliefs to be focussed on growing and innovative businesses. The Patient Capital Review panel conducted over the Summer of 2017 recommended expanding the schemes, to extend the scale of companies that can access EIS and VCT funding.

Today's announcements therefore have been awaited with much interest, and we now have confirmation of how the Government intends the schemes to be focussed. While the headlines are generally positive, there are a number of detailed changes which will require careful consideration.

Many will welcome that there are no changes to the rate of tax relief, nor to the minimum holding periods to retain the tax reliefs. There is a further boost for "knowledge intensive" companies.

Some of the requirements relating to VCTs are changing, and these are designed to encourage a greater level of investment, as set out below.

The first draft of the Finance Bill, providing detail of the proposed legislative changes, is due to be published on 1 December 2017.

Qualifying trades – principles based approach - SEIS, EIS and VCTs

It was thought that certain trades would be added to the list of excluded activities for SEIS, EIS and VCT investment. Instead the reliefs are to be focussed on "higher risk" investments. There will a principles based approach to identifying lower risk activities which should not benefit from the tax reliefs. This will apply to investments made on or after Royal Assent to the Finance Bill, expected during the Summer 2018. But the approach will be adopted for the processing of advance assurance applications from the date that guidance is published, expected on 1 December 2017. Further details are set out below.

The measure introduces a new condition to the EIS, SEIS and VCT rules to exclude tax-motivated investments, where the capital is not at risk, or the tax relief provides most of the return for an investor with limited risk to the original investment (that is, preserving an investor's capital). The condition depends on taking a 'reasonable' view as to whether an investment has been structured to provide a low risk return for investors.

The condition has two parts: it consider whether the company has objectives to grow and develop over the long-term; and whether there is a significant risk that there could be a loss of capital to the investor of an amount greater than the net return. The condition requires all relevant factors about the investment to be considered in the round.

A summary of the intended approach can be found in Appendix A to this document https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/661398/Patient_Capital_Review_Consultation_response_web.pdf . Some examples of companies that would and would not qualify are given. Box A.1 includes examples of a restaurant, a life sciences firm, an animation company, a film production company, a crematorium and a wedding venue. However it is stated that genuine entrepreneurial businesses will not be affected by the new requirement.

Knowledge intensive companies – EIS and VCTs

Companies which are carrying out significant levels of Research and Development can qualify for higher amounts of VCT and EIS funding than other companies. The annual limits are to be doubled for investments on or after 6 April 2018, subject to State aid rules.

- The annual maximum amount of State aid funding that “knowledge intensive” companies can receive will be increased from £5 million to £10 million.
- Individuals can invest £1 million in EIS companies in any tax year. For investment in “knowledge intensive” companies, this will be increased to £2 million, provided that any amount over £1 million is invested in “knowledge intensive” companies.
- The lifetime limit on State aid funding is not being increased. We are aware of a number of companies which have already reached the £20 million limit.

A further relaxation is to be introduced for “knowledge intensive” companies. A “knowledge intensive” company will be able to use the date from which its annual turnover exceeded £200,000, instead of the date of its first commercial sale, to determine the ten year initial investment period.

The Government is to consult on a new EIS fund structure for investment in “knowledge intensive” companies.

Venture Capital Trusts

For a company to be a VCT, it must meet a number of conditions. A number of significant changes are being made, which will come into effect in stages over the period to 5 April 2019.

VCTs - 70% qualifying holdings condition

One of the key requirements for VCTs is that they are required to hold a minimum percentage of their total investments in qualifying holdings. To date that minimum figure is 70%, but for accounting periods beginning on or after 6 April 2019 this percentage will increase to 80%.

VCTs have between two and three years to invest new funds in qualifying holdings. An additional condition will be introduced, so that at least 30% of all new funds raised in accounting periods beginning after 5 April 2018 will need to be invested in qualifying holdings within 12 months of end of the accounting period in which the VCT issues its shares.

To assist with this change, the period of disregard for the disposal of qualifying holdings will be increased from 6 months to 12 months, also to take effect from 6 April 2019.

VCTs - removing of “grandfathering” for older funds

A number of “grandfathering” provisions for VCTs will be removed.

30% eligible shares requirement

The requirement for VCTs to hold at least 30% of qualifying investments in “eligible shares” (broadly ordinary equity) from funds raised prior to 6 April 2011 will be withdrawn. All qualifying investments made by VCTs after 5 April 2018 will be included in funds which are required to comprise at least 70% of qualifying investments in “eligible shares”.

Qualifying trades and employee limits – VCT funds raised prior to 6 April 2008

Until now, older VCTs can continue to invest in companies carrying on certain trades (such as nursing homes, hotels, farms, property development, shipbuilding, and coal and steel production). The employee limit will also apply to all VCT investments; currently that limit does not apply to VCT funds raised before 6 April 2007. These changes will be made with effect for investments made on or after 6 April 2018.

The purpose of these changes is that more of a VCT's funds are invested in smaller trading companies. In meeting this requirement, VCTs will hold fewer cash and liquid resources. In the future it is likely that VCTs will seek to raise smaller amounts but more frequently.

VCT loan investments

VCTs can invest part of their qualifying investments in loans which have a term of at least five years. From Royal Assent to the Finance Bill (Summer 2018) any new loans will have to be made on an unsecured basis. Returns on loan capital above 10% are required to represent no more than a commercial return on the principal, and should not be used to return equity capital to investors.

VCT mergers

Income tax relief for investment in VCT is restricted where an investor sells shares in a VCT and also subscribes for new shares in the same VCT within a 6 month period. It also restricts income tax relief for investors who sell shares in a VCT and subscribe for new shares in another VCT within a 6 month period, where at any time those VCTs merge.

Income tax relief will no longer be withdrawn where the relevant VCTs merge more than 2 years after the latest subscription for shares, or do so where it is not one of the main purposes of the merger to obtain a tax advantage. It will take effect for VCT subscriptions made on or after 6 April 2014. This welcome measure removes a barrier for VCT mergers, and is backdated to when the anti-avoidance rules were first introduced.

Advance Assurance

Many companies are experiencing long delays in receiving responses from HM Revenue & Customs to advance assurance applications, meaning that it can take a considerable length of time before they can raise the funds they need to grow.

The Government's response to the advance assurance consultation conducted earlier this year will be published on 1 December, and it will contain further detail on improvements to the service. We understand that HM Revenue & Customs are to commit to a 15 day turnaround for the vast majority of applications by Spring 2018. If this target is achieved, it will be a very positive boost for companies raising EIS and VCT funds.

HM Revenue & Customs estimate that up to 80% of their time is taken up with reviewing applications for "lower risk" investments. They have indicated that from 1 December 2017, they will not consider advance assurance applications where they believe the "principles based approach" mentioned above is not met.

Given that there are to be further areas of judgment with the introduction of be a new principles based approach to excluding lower risk activities, the advance assurance process will continue to play a vital role to EIS and VCT investing.

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Patient Capital Review – Government response

The Government have also published their 'Financing growth in innovative firms: consultation response' in response to the Patient Capital Review which can be found at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/661398/Patient_Capital_Review_Consultation_response_web.pdf

There is a helpful sentence in the consultation response to "Financing Growth in Innovative Firms", which states "The Government will also review concerns that VCT status can be disproportionately threatened by unintentionally making a non-qualifying investment." We hope this will mean that in due course the penalty for a breach of the VCT rules will be reduced.

The response document also indicates that the Government will continue to review the use of structured investment and preference shares to reduce the risk associated with making EIS and VCT investments.

Business Property Relief from Inheritance Tax (BPR)

No changes were announced today in relation to Business Property Relief ("BPR"). As can be seen from the consultation response, the Government have announced that they will keep BPR under review, and it is committed to protecting the important role that this tax relief plays in supporting family-owned businesses, and growth investment in the Alternative Investment Market and other growth markets.

Seed Enterprise Investment Scheme

As can be seen from the consultation response, evidence for SEIS from the consultation suggests that it works well at incentivising investment into earliest stage businesses, but some respondents also suggested it is contributing to valuation bubbles in some sectors. The Government have announced that they will continue to monitor this.

Entrepreneurs' Relief

The Government is concerned that the qualifying rules of Entrepreneurs' Relief should encourage long-term business growth. They have announced that the rules will therefore be changed to ensure that entrepreneurs are not discouraged from seeking external investment through the dilution of their shareholding. This will take the form of allowing individuals to elect to be treated as disposing of and reacquiring their shares at the then market-value. The Government will consult on the technical detail.

This is a summary only, and based on the Budget announcement, rather than on any legislation that will be enacted.

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