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**SUMMARY OF VCT LEGISLATION SUMMER FINANCE BILL 2015**

**This Note summarises the legislation as published on 15 July 2015. It is expected to be enacted during October 2015. However at time of writing, it is still subject to the UK receiving State aid approval for the tax-advantaged venture capital schemes, and there may yet be changes made as it progresses through the various parliamentary stages.**

The legislation makes some very significant changes to the VCT rules, including changes and additions to the conditions for VCT approval as well as changes to the rules defining qualifying holdings.

The new legislation inserts a sunset clause, limiting income tax relief on new VCT shares to shares issued before 6 April 2025. There is a provision which allows that date to be amended by Treasury order.

Unless otherwise indicated, all changes will take place in relation to investments made by a VCT on or after the date the Finance Act receives Royal Assent (expected to be in October 2015).

"**Relevant risk finance investments**", referred to throughout this Note, includes any State aid investments which are made available under the European Commission's Guidelines on State aid to promote risk finance investment. That includes EIS, VCT, Social Investment Tax Relief (SITR) and Enterprise Capital Fund (ECF) monies as well as some regional investment aids, and can include overseas aids as well as UK aids.

"**Knowledge-intensive companies**", referred to throughout this Note, are defined in the new legislation broadly as follows:

In at least one of the 3 "relevant years" prior to investment the company or group has spent at least 15% of operating costs on R&D or innovation; or in each of those 3 years has spent at least 10% of operating costs on R&D or innovation; and either of the following conditions is also met:

- the "innovation" condition – when the investment is made, the company or group is engaged in the creation of IP from which within 10 years it is expected will derive the greater part of the company's or group's business, either from the exploitation of the IP or by the creation of new products, processes or services which use the IP.
- the "skilled employee condition" – at least 20% of the company's or group's FTE numbers are "skilled" as defined and are engaged directly in R&D or innovation activities carried on by the investee company or any qualifying subsidiary of that company. The definition of "skilled" relies on higher educational attainments.

The 3 "relevant years" prior to investment are the 3 consecutive years ending immediately before the investee company's last accounts filing period, or if later, 12 months before the date of investment.

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**RULES POTENTIALLY AFFECTING VCT APPROVED STATUS**

**Investment limits condition**

It is already a condition of continuing VCT approval that the VCT may not make an investment in a company which causes that company to receive in any 12 month period more than £5m of State aid covered by the EU's risk finance guidelines. That requirement is being extended to introduce a total investment limit as well as the annual investment limit; and to widen the list of investments which are to be counted towards the annual investment limit. In some circumstances, a VCT may also breach the approval requirements because of events taking place in the 5 years after investment.

*Annual investment limit*

The investments counting towards the annual £5m investment limit will now include:

- The current investment in the investee company
- The total amount of other relevant risk finance investments in the investee company in the 12 months up to the date of the current investment.
- The total amount of other relevant risk finance investments in any 51% subsidiary of the investee company, in the 12 months up to the date of the current investment. This is to include investments made in the subsidiary before it became a subsidiary, but not after it ceased being a subsidiary if it was no longer a subsidiary at the date of the current investment
- The total amount of any relevant risk finance investments which have been made in another company during the 12 month period and used for a trade, where the trade was then transferred during the 12 month period to the investee company, to a 51% subsidiary which remains a 51% subsidiary at the date of the current investment, or to a partnership of which the investee company or a 51% subsidiary is a member.

*Lifetime investment limit*

The lifetime limit is £12m ordinarily and £20 for a "knowledge-intensive" company. The lifetime limit is calculated by adding all of the following:

- The current investment in the investee company
- The total amount of other relevant risk finance investments in the investee up to the date of the current investment. Other relevant investments will now include SITR investment
- The total amount of other relevant risk finance investments in any 51% subsidiary of the investee company, up to the date of the current investment. This includes a subsidiary which has been a subsidiary at any time in the past, whether or not it is still a subsidiary at the investment date. It includes investments made in the subsidiary before it became a subsidiary, but not after it ceased being a subsidiary if it was no longer a subsidiary at the date of the current investment.
- The total amount of any relevant risk finance investments which have been made in another company on or before the investment date and used for a trade, where the trade was then transferred to the investee company, or to a 51% subsidiary of the investee company which

remains a 51% subsidiary at the date of the current investment, or to a partnership of which the investee company or a 51% subsidiary is a member.

*5-year post investment period*

It will also be possible for a VCT to breach the investment limits condition in some circumstances where an investee company acquires another company or trade in the 5 years after the VCT's investment.

This rule applies where:

- the investee company acquires a 51% subsidiary during the 5 year post investment period and some of the VCT's current investment in the investee company is used for an ongoing trade which the new subsidiary was carrying on before it became a subsidiary, or
- the investee company, a 51% subsidiary or a partnership of which the investee company or a 51% subsidiary is a member, acquires a trade during the 5 year post investment period and some of the VCT's current investment in the investee company is used for that trade.

In those circumstances, the following have to be taken into account at the time of acquisition and until the end of the 5 year period, and at no point during that 5 year period must the total exceed £12m (£20m for a knowledge intensive company):

- the current VCT investment in the investee company
- The total amount of any other relevant risk finance investments in the investee company
- The total amount of relevant risk finance investments during the 5 year post investment period in a company which is or has been a 51% subsidiary of the investee company, providing that it is still a subsidiary at the time the calculation is made
- The total amount of relevant risk finance investment during the 5 year post investment period which has been made in another company and used for a trade which was subsequently transferred to the investee company, a 51% subsidiary or a partnership of which the investee company or a 51% subsidiary is a member.

**The maximum age condition**

This is a new condition, which, if breached, may affect a VCT's approved status. It prohibits the VCT from investing in any company whose first commercial sale was more than 7 years prior to the VCT investment (10 years in the case of a knowledge-investment company), unless either of the following apply:

- There was a previous relevant risk finance investment in the company during the 7 (or 10) year period from first commercial sale and that previous investment was used for the same activities as the current VCT investment is to be used for. The first applicable commercial sale is the earliest such sale by:
    - The investee company
    - A company which is or has been a 51% subsidiary of the investee company, including sales before it became a subsidiary but not after it had ceased being a subsidiary

  - Any person who transferred a trade to the investee company or a 51% subsidiary, including where the trade was transferred to the subsidiary before it become a subsidiary, but not which was carried on by it only after it ceased to be a subsidiary
  - A company which becomes a 51% subsidiary after the investment date, where some or all of the current VCT investment will be used for that company's trade; or the first commercial sale by a person who previously carried on a trade which was transferred to such a subsidiary
  - If any of the money raised by the current investment is used for a trade transferred after the investment date to the investee company, a 51% subsidiary or a partnership of which the investee company or a 51% subsidiary is a member, the first commercial sale by that person

- The total amount of investment, including the current investment, in the 30 day period up to and including the investment date, is at least 50% of the average turnover. For this purpose, the average turnover is calculated as 20% of the total turnover for the 5 year period ending immediately before the last accounts filing period, or, if later, 12 months before the investment date. If the investee company is the parent company of a group, then the calculation is based on the total group turnover for the 5 year period.

**The no business acquisition condition**

This is a new condition, which, if breached, may affect a VCT's approved status.

Where a VCT invests money in any company, that investment breaches this condition if the investee company uses any of the money, whether on its own or together with other money, on the acquisition directly or indirectly of any of the following:

- Shares in another company which will result in that company becoming a 51% subsidiary of the investee company
- A further interest in any company which is already a 51% subsidiary of the investee company
- A trade
- intangible assets previously employed for the purposes of a trade
- goodwill employed for the purposes of a trade.

There is a provision which will allow Treasury to make regulations specifying types of intangible assets which are not to be caught by the above new rules.

**RULES AFFECTING QUALIFYING HOLDINGS**

There are a number of changes to the qualifying holdings definition. Probably the most straightforward of these is the removal of the requirement that any company which has had previous SEIS investment, must have spent at least 70% of the SEIS money before accepting VCT investment. This takes effect for investments on or after 6 April 2015.

Another minor change to the definitions section in the Income Tax Act 2007 makes it clear that "farming" for all purposes includes farming outside the UK, which in turn results in non-UK farming becoming ineligible for VCT investment. This takes effect for investments on or after Royal Assent.

The major changes are as follows:

**Maximum annual risk capital amount**

This existing condition already prevents a holding from qualifying if the total relevant risk finance investments in the investee company in the 12 months up to the date of the current investment, exceeds £5m. As well as the current investment and any other relevant risk finance in the investee company itself, the calculation is to include:

- Relevant risk finance investments in any company that has been a 51% subsidiary in that 12 month period, including investments before the subsidiary became a subsidiary, but not including investments after it stopped being a subsidiary.
- Relevant risk finance investments in any other company if the money raised by those investments has been employed for the purposes of a trade, and in the 12 month period up to the date of the current VCT investment, all or part of that trade was transferred to the investee company, to a 51% subsidiary or to a partnership of which the investee company or a 51% subsidiary is a member. If only a part of the money raised by an earlier relevant investment is used for a transferred trade, then only that part is taken into account for the purposes of this requirement.

**Maximum total risk capital amount when relevant holding is issued**

This is a new condition to be met at the time a VCT makes an investment. If an investment by the VCT takes the total relevant risk finance investment in that company over £12m (£20m in the case of a knowledge-intensive company) then the whole of the VCT's current investment is non-qualifying.

As well as the current investment and any other relevant risk finance investment in the investee company itself up to the date of the current investment, the calculation is to include:

- Relevant risk finance investments in any company that has been a 51% subsidiary, including investments before the subsidiary became a subsidiary, but not including investments after it stopped being a subsidiary.
- Relevant risk finance investments in any other company if the money raised by those investments has been employed for the purposes of a trade, and before the date of the current VCT investment, all or part of that trade was transferred to the investee company, to a 51% subsidiary or to a partnership of which the investee company or a 51% subsidiary is a member. If only a part of the money raised by an earlier relevant investment is used for a

transferred trade, then only that part is taken into account for the purposes of this requirement.

**Maximum risk capital amount during the 5 year post investment period**

This is a new condition which must be met at all times during the 5 years following a VCT investment. If during the 5 years following the VCT's current investment the investee company either:

- acquires a 51% subsidiary which uses some or all of the current VCT investment for a trade which it carries on and which it carried on before becoming a subsidiary, or
- has transferred to it, to a 51% subsidiary or to a partnership of which the investee company or a 51% subsidiary is a member, a trade which was previously carried on by another company and for which some or all of the current VCT investment is used

then the VCT has to calculate the total amount of relevant risk finance investment at that point. If the amount exceeds £12m (£20m in the case of a knowledge-intensive company) then the VCT's investment becomes non-qualifying. As well as the amount of the current investment and any other relevant risk finance investment in the investee company itself, the calculation is to include:

- any relevant risk finance investments in any company which has been a 51% subsidiary of the investee company, including investments before the subsidiary became a subsidiary, but not including investments after it stopped being a subsidiary.
- Any other relevant risk finance investments in a company, where those investments were used for a trade, and after the date of those investments but before the date of the current investment, that trade was transferred to the investee company, to a 51% subsidiary of the investee company or to a partnership of which the investee company or a 51% subsidiary is a member. If only a part of the money raised by an earlier relevant investment is used for a transferred trade, then only that part is taken into account for the purposes of this requirement.

**Employment of money**

Notably, the new legislation revokes the grandfathering provision for VCT funds raised pre 6 April 2012, now preventing "old money" from being used to make acquisitions.

Otherwise the existing requirement is amended in relation to how VCT monies must be used by an investee company in order for the holding to be qualifying.

The new legislation prevents the following acquisitions from being a qualifying use of money:

- An interest in another company such that that company becomes a 51% subsidiary of the investee company
- A further interest in another company which is already a 51% subsidiary of the investee company
- A trade
- intangible assets previously employed for a trade
- goodwill employed for the purposes of a trade

No change has been made to the time limits within which the monies must be used, and as previously, any amounts which are not used for a qualifying purpose within those time limits are treated as non-qualifying holdings.

There is a provision which will allow Treasury to make regulations specifying types of intangible assets which are not to be caught by the above new rules.

**Permitted age requirement**

This new requirement imposes an age limit on companies receiving any relevant risk finance investment. The age limit is 7 years from the date of first commercial sale, or 10 years in the case of a knowledge-intensive company. The age limit does not apply in either of the following circumstances:

- There was a previous relevant risk finance investment in the company during the 7 (or 10) year period from first commercial sale and that previous investment was used for the same activities as the current VCT investment is to be used for. The first applicable commercial sale is the earliest such sale by:
    - The investee company
    - A company which is or has been a 51% subsidiary of the investee company, including sales before it became a subsidiary but not after it had ceased being a subsidiary
    - Any person who transferred a trade to the investee company or a 51% subsidiary, including where the trade was transferred to the subsidiary before it become a subsidiary, but not which was carried on by it only after it ceased to be a subsidiary
    - A company which becomes a 51% subsidiary after the investment date, where some or all of the current VCT investment will be used for that company's trade; or the first commercial sale by a person who previously carried on a trade which was transferred to such a subsidiary
    - If any of the money raised by the current investment is used for a trade transferred after the investment date to the investee company, to a 51% subsidiary or to a partnership of which the investee company or a 51% subsidiary is a member, the first commercial sale by that person.

- The total amount of investment, including the current investment, in the 30 day period up to and including the investment date, is at least 50% of the average turnover. For this purpose, the average turnover is calculated as 20% of the total turnover for the 5 year period ending immediately before the last accounts filing period, or, if later, 12 months before the investment date. If the investee company is the parent company of a group, then the calculation is based on the total group turnover for the 5 year period.

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**Employee numbers at time of investment**

The existing limit of fewer than 250 employees in the company or group remains unchanged as the general requirement. A knowledge-intensive company (or group) must have fewer than 500 employees at time of investment.

**Employee numbers post investment**

If an investment in a company qualifies only because the company is a knowledge-intensive company which does not meet the innovation condition of that definition, then in the 3 years following investment the number of full-time-equivalent "skilled employees" in the company or group must be at least 20% of the total full-time-equivalent number of employees.

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