Wyndham North
Tax-advantaged venture capital schemes consultation
Enterprise and property tax team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

14 May 2015

Dear Wyndham,

Re: BVCA response to the consultation on proposed legislative amendments to the Tax Advantaged Venture Capital Schemes

Introduction

The BVCA is pleased to submit its response to the consultation on proposed legislative amendments to the tax-advantaged venture capital schemes announced in March 2015. We welcome the Government's continued commitment to the EIS, SEIS and VCT schemes which provide a well-targeted and vital flow of capital to smaller companies which are seeking to expand and develop. BVCA members manage VCTs with total assets of £2.1 billion and raised £370 million of EIS funds in the 2013/14 tax year alone. The total amount of venture capital invested in 2013 in UK equalled £406m, invested in 374 companies. The average amount invested in 2013 in later stage VC was £4.47m – in total regardless of the financing stage it amounted to £1,085m.

Overall the new proposals are positive and appear to address a number of concerns raised in our response to the July 2014 consultation on tax-advantaged venture capital schemes. The decision to seek to set a number of limits at levels more generous than the basic EU State Aid rules is particularly welcome. We do however believe that there are some areas in which the Government needs to provide further clarification to ensure fund managers can be confident in their investment decisions in the short term and guarantee long-term investor confidence in State Aid funds.

Increased lifetime investment limit / Annual investment limit

As was noted in our response to the July 2014 consultation on tax-advantaged venture capital schemes, we are concerned that the implementation of a lifetime investment limit could restrict the longer term investment requirements of both VCT and EIS-backed businesses. The proposed increase from a €15 million lifetime limit (as provided by EU State Aid rules) to a more generous £15 million, whilst a positive development, will continue to impact businesses which require higher levels of funding before they can reach adequate profitability. There are a number of companies that have had long gestation periods but still require further capital. Many life science companies especially are very

British Private Equity & Venture Capital Association
5th Floor, Chancery House, 53-64 Chancery Lane, London, Wc2A 1QS
T +44 (0)20 7492 0400 F +44 (0)20 7492 0401 bvca@bvca.co.uk www.bvca.co.uk

capital hungry and need far more than the proposed cap to achieve key milestones. The £20 million lifetime limit for knowledge-intensive companies will go some way to addressing this concern, but other capital intensive businesses could see their development hindered.

If the lifetime investment limit is to be maintained we would strongly propose that the additional £5 million annual investment limit be removed. This would ensure that fund managers have the flexibility to provide funding for companies as and when it is required over the lifetime, taking account of the non-uniform growth of businesses year on year. We believe that this would be consistent with the Government's policy aim of ensuring smaller companies have access to adequate capital and resources whilst meeting EU State Aid requirements.

Increase of investment limit and employee limit for knowledge-intensive companies

The BVCA is highly supportive of the proposals to increase the lifetime investment limit for knowledge-intensive companies from €15 million to £20 million, and raise the employee limit from 250 to 499. Both of these changes will provide much-needed flexibility for fast-growth companies in sectors such as biotech, which often require greater resources to become sustainable. They will also provide more opportunities for follow-on investments, allowing investors to continue to support companies as they mature to the next stage of growth. Some areas within the life sciences and medical technology industries, which have as of yet seen relatively modest funding through EIS and VCT, may receive greater interest from fund managers as the changes enable these sectors to present more promising investment opportunities. The Biotechnology and medical device sectors received in 2013 less than £50m of UK VC investment. To ensure that the maximum benefits of these increased limits are received by investee companies, we would welcome the extension of the knowledge-intensive company definition to their subsidiaries. We do continue to believe, however, that imposing any employee limit on businesses as a measurement for suitability of State Aid is an arbitrary and artificial measure. Companies in sectors which are not knowledge-intensive may also require higher levels of staffing to succeed whilst receiving early stage investment.

Increase of the age limit of investee companies

We are pleased to see that the Government has taken note of our concerns relating to the damaging effects of the investee company age limit. Lifting the limit from 7 to 12 years after the first commercial sale, and removing the limit completely in the case of follow-on investments and where the investment represents more than 50 per cent of the annual turnover averaged over the previous 5 years, will allow the schemes to be used to back companies for the long-term in keeping with the Government's objectives.

In relation to this change, we would appreciate clarification on the definition of "first commercial sale". This point could differ substantially depending on the type of business in question. We also note that the proposals suggest that the removal of the age limit for investments that are "more than 50 per cent of annual turnover over the preceding 5 years" only applies to investee companies. Whilst this may have not been intended, we believe this provision should also be extended to subsidiaries.

Transition between SEIS and EIS/VCT

The BVCA welcomes the removal of the requirement that 70 per cent of SEIS funds be spent before EIS funding can be raised. SEIS has significantly improved access to funding for early stage businesses, allowing them to be nurtured before moving on to receive VCT or EIS funds. Any effort to make this transition easier and quicker is a positive development, enabling companies to confidently continue their growth plans with the knowledge that further financing can be secured earlier than was previously the case.

Implementation of the draft legislation

With the proposals included in the consultation not set to be introduced until State Aid approval has been received, our members would appreciate more information so that fund managers can be confident in their investment decisions in the short term. In particular, additional clarity on whether the future implementation of the proposals would resolve any breach of the basic EU State Aid rules in the meantime would prevent any slowing of deal activity. We also believe that the new measures raise a number of issues relating to long-term investor confidence in the tax-advantaged venture capital schemes, including the creation of significant administrative burden and additional costs for companies receiving EIS or VCT funding.

Monitoring State Aid funding

The draft legislation in its current form implies that portfolio companies, in order to monitor their proximity to the annual investment limit, hold records of all State Aid funding received since their establishment. This is an incredibly demanding condition, particularly when companies are likely to have received other sources of funding (such as grants, and risk finance aid funding such as JEREMIE funds, Enterprise Capital Funds) and cannot establish whether individual investors have claimed their EIS reliefs. Such a requirement effectively dampens the impact of the venture capital schemes, with substantial resources directed towards auditing the funding process rather than developing and growing the business.

We appreciate, of course, that it is necessary for companies to monitor the amount of State Aid funds they have received in order to ensure that the venture capital schemes are not abused. To ensure this goal is achieved whilst permitting investee companies to fully benefit from the funding received through EIS and VCT, we propose that a more reasonable monitoring timeframe be set. This could be a six year period, which would match existing requirements for companies to maintain records for tax and accounting purposes. A 12 year timeframe may also be workable, matching the new age limit on qualifying investee companies. Any monitoring requirement past this period would be highly burdensome, with businesses likely to struggle to accurately monitor the amount of state aid received by themselves and any subsidiaries.

Penalties and breaches

Our members have also voiced concerns in relation to the penalties that will be incurred should any of the new rules be breached. As it stands the legislation suggests that if any company exceeds the £15 million lifetime investment limit all State Aid funding received since its inception is deemed non-qualifying. This could result in a range of undesirable situations where relief would be lost: investors who provided funding several years before the breach could have their tax relief removed due to the investment actions of a new manager; a manager could fund £15 million through EIS or VCT and then

lose its relief if the company went on to independently issue further EIS; and in M&A situations, two companies that have both previously received State Aid funds could, once combined, exceed the £15 million lifetime investment cap and become unqualifying. Additionally, historic investments which were later exited could be deemed under current rules to count towards the £15 million cap. In the context of VCTs, one company becoming non-qualifying could risk the status of the entire fund, potentially pushing the number of qualifying investments under the 70 per cent requirement.

Should any of the above situations occur companies would be obliged to recover tax relief from investors, creating a substantial administrative burden. VCTs in particular could be forced to hastily dispose of holdings to maintain their threshold of 70 per cent of funds invested in qualifying holdings, unless 'minor and inadvertent breach' provisions were considered to cover such an eventuality. Furthermore the reputation of the tax-advantaged venture capital schemes could be significantly impacted. The risk of an EIS or VCT investment losing relief in the future due to the unrelated actions of the company or a future fund manager effectively undermines the schemes' main intention – to attract new sources of capital for small businesses. It is on these grounds that we recommend the Government amend the proposals to ensure that only the investment which leads to a breach of the lifetime investment limit be deemed non-qualifying. This change would ensure that EIS and VCT retain their appeal for investors and continue to provide the funding that is so crucially required by start-ups across the country.

We would be delighted to meet you to discuss our feedback further. Please feel free to contact Marie Audren at the BVCA (maudren@bvca.co.uk).

Yours sincerely,

Patrick Reeve

Chairman – Venture Public Policy Committee, British Private Equity and Venture Capital Association