QUOTED COMPANIES ALLIANCE

Quoted Companies Alliance

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19 September 2014

Dear Sirs,

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

***Introduction***

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Tax and Corporate Finance Expert Groups have examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

***Response***

We generally believe that the current tax-advantaged venture capital schemes meet the overarching principles as stated in the Consultation Paper. We have focused our responses to specific questions below on the issues most likely to have an impact on small and mid-size quoted companies.

***Responses to specific 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?**

We believe that the current schemes generally meet the overarching principles as detailed in Box 2A of the consultation paper. Our members have identified situations where some businesses try to obtain investment qualifying for relief without it necessarily being high risk.

We consider that the schemes are effectively operated by HMRC. However, we believe that some improvements can be made regarding the accumulation and delay of EIS advance assurance applications of between 6 and 12 weeks, which has been causing difficulty to some companies.

It would be helpful if HMRC could allocate more resources to address this situation, as well as simplify some of the administrative processes.

**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.**

We believe that the UK's current EIS gross asset threshold is likely to achieve the same effect as the Commission's total investment limit of €15 million.

It would be helpful if HMRC issued guidance on what constitutes state aid for these purposes, as some companies may have difficulty tracking the amount of state aid they receive over a rolling period.

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

We consider it possible that a total investment limit of €15 million could offer more flexibility and simplicity than an annual investment limit. Replacing an annual limit with a total limit on EIS/VCT investment could assist companies looking to make a one-off significant growth in size or activities. For example, an IPO on AIM could be combined with an EIS share subscription to raise £10m or more.

**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.**

We believe that the current rules in the UK appropriately target investment towards less established companies.

We consider that, in order to meet the objectives outlined by the Commission, the focus of the rules should be on the company being a growing company in a high risk area, not on how old a company is. We have seen examples of growth companies that have sought and received investment under these schemes which would be ineligible if the time limit was imposed. A longer history of trading is not impediment to growth as opportunities may not have been previously available and the potential for growth may well still be dependent on obtaining funding for longer established companies.

Therefore, we believe that including a time limit, in line with the Commission's proposal, could exclude companies that would genuinely benefit from investment under these schemes and the funding of which would be in line with the overarching principles.

Moreover, it could also pose problems in terms of legislation drafting as it is sometimes difficult to define a precise date of commencement of trade according to UK tax rules and we believe that it may not always be possible to identify when a company had its first commercial sale (especially in cases where the company is developing different product lines or prototypes).

**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?**

We believe that the impact has been positive. The increase to £5 million has unlocked investment throughout all stages of development of the companies and allowed for further rounds of funding over time. We are aware that companies which raised close to £5 million in one year found it extremely important for the success of the fundraising and their business.

The increased limit has also proven to be an important marketing tool for the UK, for overseas companies to establish themselves and raise investment in the UK.

**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?**

We believe that the increased employee limit for qualifying companies has had a beneficial impact in helping small and mid-size companies raise equity finance. The previous limit of 50 employees was very restrictive especially for sectors with higher levels of employment (e.g. retail). Some of our members have close to 250 employees; therefore, we are generally very supportive of any increase as positive and opening funding possibilities for growth companies.

**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.**

Regarding the increased limit of £5 million per year, we do not agree that the increased limits changed the nature or type of companies that the EIS is designed to support.

We believe that most companies seeking EIS funding are looking for far less than £5 million in one year. Nevertheless, as said above in Q5, the companies raising close to £5 million were in need of the fundraising offered by the EIS. It may be that these companies could have obtained investment by other means, but it is unlikely that they would have obtained the level of investment required or the investment terms that would have made them prosper.

As stated above, some of our members have close to 250 employees. We generally support any increase as positive and opening funding possibilities for growth companies.

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

No response.

**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 believe that the typical investor in relation to traditional EIS subscriptions has not changed considerably. However, there is an additional new profile regarding crowdfunding investments as there is appetite for investment from non-high net worth individuals.

We believe that the greatest benefit that this change brings in is the fact that there is a greater pool of investors for companies to obtain funding from. As far as risks are concerned, we consider that these relate to the less experienced investors, who need to be made aware of the risk inherent in their investments.

**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?**

We believe that, while the lack of a minimum investment is sometimes a hindrance for advisors and intermediaries in relation to direct investments for SEIS and EIS (for example, in dealing with queries from inexperienced investors investing very small sums), it is also helpful not to deter genuine investors with a high threshold. Furthermore, where there is a pooling of investors into funds a minimum threshold may potentially be a disincentive to investors and reduce the capital available.

Therefore, we consider a minimum investment requirement in the tax rules to be unnecessary; also, many companies tend to have their own in order to prevent large numbers of very small shareholders.

**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, we do not believe that this change will have a significant impact on the VCT fundraising market on the whole.

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

We generally believe that the Government should encourage more equity investment into companies by promoting and actively contributing to the development of an equity culture in the UK.

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

No response.

**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 response.

**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?**

We generally agree with the summary of the issues relating to convertible loans set out at paragraphs 3.22 and 3.24.

**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?**

We believe that the practice is becoming more common among our members.

**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?**

We believe that HMRC should introduce an exclusion to allow that a loan which is replaced by shares within a reasonable period of time still constitutes 'new money' and therefore does not deny relief.

Small and mid-size companies do not have the resources to dedicate to the fundraising process. In those circumstances, there could be delays for genuine business reasons of over 3 months. Extending the appropriate maximum period of time for a loan to be outstanding to up to one year would allow companies to address the unforeseen delays and still incentivise the investors to promptly proceed with the equity subscription.

Furthermore, we believe that other amendments could be made to allow EIS or SEIS tax relief to be claimed in the period in which the loan investment is made (instead of the period in which the shares are issued), to allow the investment round to fall within a specific tax year for the investor to obtain most benefit from the reliefs.

We believe that this change of legislation would not give rise to abuse so long as it would be clear that the relief will only be available for investors if they proceed to entirely replace their loan capital with a qualifying share subscription within the maximum period of time. One suggestion for mitigating risk would be making the loans non-transferable and conversion not conditional upon certain targets being met.

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

A possible approach would be incorporating a combination of the more formalised advance purchase agreement (to deal with anticipated very short delays in determining an appropriate price for the shares) and the legislative change to permit loans from investors to deal with more complicated pricing and/or deal negotiations that delay the equity subscription for up to six months.

**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)?**

We generally agree that the change has been beneficial.

**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?**

Our members' experience makes us believe that investors appreciate the intention behind the EIS legislation and value the tax relief over any form of protected return from the investee company. On that basis, we believe that no changes are required.

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

In our members' experience, investee companies have difficulty with the excluded activity relating to income derived from IP. An example given by one of our members is the case of commercial sellers of software/IP who are essentially retailers but because their product is a download rather than a physical product it is treated as licence income.

We believe that the provision of particular examples by HMRC in the guidance would be helpful for investors and advisors.

**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?**

Please see our response to Q20.

**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 response.

**Current rules to target the tax reliefs**

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

We believe that the current rules work effectively overall. The excluded activity list is well known and adequately targets low risk activities. The exceptions are the royalty and licence fee discussed in Q21 above and the lack of clarity on what constitutes "other financial activities" for the purpose of section 192 (1) (c) ITA.

Also, we would like to point out that the rules can be problematic for joint ventures. We have seen an example of a company seeking to export its products to China and being required to set up a local company as a 50/50 joint venture with a Chinese company. As the joint venture was not a qualifying 90% subsidiary of the UK company, the funds raised to finance this venture did not qualify for EIS relief.

**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).**

We believe that investee companies would like to see greater certainty on what proportion of activities can qualify and what criteria the percentage should be applied to. We believe that it would be useful to have clearer HMRC guidance on this matter.

**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?**

No response.

**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?**

No response.

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

No response.

**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?**

No response.

**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?**

No response.

**Question 31: Do you believe that a new "principled" approach is necessary?**

We believe that a principled approach may be preferable, provided it is adequately supported by a robust guidance to provide certainty.

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

A possible option is the one outlined in paragraph 4.22: identifying companies that are reliant on guarantees of other income support (specifically government subsidies or grants) that effectively remove the risk of investment.

We believe that the threshold in relation to income that must be generated directly by the company itself would work well if the legislation defining it is clear (e.g. defining specific percentages) and is supported by clear guidance and examples.

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

We believe that keeping the existing list of excluded activities and modifying it as necessary is a good approach.

If you would like to discuss any of the responses in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

**APPENDIX A**

## Quoted Companies Alliance Tax Expert Group

| | |
|---|---|
| Neil Pamplin (Chairman) | Grant Thornton UK LLP |
| Paul Fay (Deputy Chairman) | Crowe Clark Whitehill LLP |
| Emma Bailey | Fox Williams LLP |
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## Quoted Companies Alliance Corporate Finance Expert Group

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| Laurence Sacker | UHY Hacker Young |
| Mark Percy | Cantor Fitzgerald Europe |
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| Nick Naylor | Allenby Capital Ltd |
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