Written evidence submitted by the Association of Taxation Technicians (ATT)

Finance (No.2) Bill: Clause 14 (EIS, SEIS and VCT reliefs: risk to capital)

A. Executive Summary

1. In the words of the Summary in the published Explanatory Note, Clause 14 "amends the requirements for investments to qualify for relief under the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) or the Venture Capital Trusts (VCT) scheme. It introduces a new overarching risk-to-capital condition' [the 'condition'] 'to prevent investment in companies whose activities are mostly geared towards the preservation of the capital invested rather than the long -term growth and development of the company."

2. As currently drafted, the condition will be met if, "having regard to all the circumstances existing at the time of the issue of the shares, it would be reasonable to conclude that:

   (a) the issuing company has objectives to grow and develop its trade in the long term, and

   (b) there is a significant risk that that there will be a loss of capital of an amount greater than the net investment return."

3. Our primary concerns are that:
   - The imprecise wording and subjective nature of the condition will make it difficult for companies to demonstrate it is met.
   - The commencement provisions for the condition are unclear.

4. We think that Clause 14 should be amended to clarify how the condition will apply in practice and to provide certainty as to its commencement date.

B. Imprecise wording and subjective nature of condition

1. The new sections proposed by Clause 14 incorporate imprecise wording and undefined terms which result in the application of the condition being unclear and highly subjective. The wording quoted in point A.2 above is identical for the purposes of both EIS (new section 157A(1) of ITA 2007) and SEIS (new section 257AAA(1) of ITA 2007). With minor modification, it applies also for the purposes of VCT (new section 286ZA(1) of ITA 2007).

2. We identify the following as contributing to the imprecision of the condition:

   2.1 It is unclear what the requirement (in new sections 157A(1)(a), 257AAA(1)(a) and 286ZA(1)(a)) for the company's objectives to ***grow and develop its trade*** means in practice. The linking of the two active verbs by the conjunction '*and*' indicates that the objectives must encompass both but the two verbs appear to be synonyms. Neither verb is defined in the legislation so both must therefore take their ordinary meaning.

   2.1 If ***grow*** and ***develop*** are indeed synonyms, there is an unnecessary and unhelpful duplication.

   2.2 If, however, there is an intended distinction in the meaning of the two words, it is essential that the distinction is clear and readily understandable. Without such clarity, it

will be difficult to determine whether the condition is met in any particular case. That may lead in turn to:

- Potential investors being reluctant to invest as they would be uncertain as to whether the relevant tax relief might be denied or withdrawn;
- Commitment of HMRC and professional resources to protracted correspondence;
- Time consuming litigation for HMRC and claimants of the relevant reliefs.

2.3 If, for example, the term ***grow*** is intended to convey a quantitative change whereas ***develop*** is intended to convey a qualitative change, that intention should be on the face of the legislation. Otherwise, a company might conclude that investors would be eligible for relief because its objectives very clearly involved *increasing the number of its employees or the turnover of its trade*[1] only to find that HMRC also required evidence of some qualitative development. Conversely, a business might wish to respond to foreign competition by investing significantly in new technology (so, developing its trade) but without the objective of growing in terms of staff numbers or turnover. Would investment in such a company be denied relief on the basis that the growth element of the condition was not met?

2.4 The imprecision introduced by the phrase ***grow and develop its trade*** is compounded by the addition of the words ***in the long-term****.* Searching on the internet for a definition of ***long-term*** within a business and financial context, we found conflicting authorities with definitions varying from 'more than a year' to '20 years or more'. The introduction of such an imprecise timescale is in our view going to increase the uncertainty of whether the condition is met and lead to the bulleted consequences in B.2.2 above.

2.5 Leaving aside the precise meaning of ***in the long-term***, it is unclear whether a company which had objectives to grow and develop its trade in the short or medium term (however defined) would meet the condition quoted in point A.2(a) above. Does the phrase in ***the long-term*** qualify the type of growth and development which is required or simply permit the objectives to relate to a distant time as well as a more immediate time?

2.6 Given (in the specific context of EIS) that (existing) section 174, ITA 2007 (as amended by section 25 and Schedule 5 paragraph 10) already requires the shares in respect of which relief is claimed to "be issued in order to raise money for the purposes of a qualifying business activity *so as to promote business growth and development*", does the requirement in the (new) condition for the company to have objectives to grow and develop its trade in the long-term add anything at all? If the new money raised by the share issue is to be used in a manner which satisfies section 174, the company would (subject to point 2.5 above) appear to automatically meet the additional requirement imposed by new section 157A(1)(a). If that is the case, it would (in the context of EIS) make for simpler legislation, more straightforward compliance obligations for the relevant companies and less essential policing by HMRC to dispense with the introduction of an additional but redundant provision.

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[1] This is one of the circumstances to which regard may be had – see new sections 157A(3)(a), 257AAA(3)(a) and 286ZA(3)(a).

3. It is unclear what evidence HMRC will require to confirm the objectives of the company? We are concerned that excessive emphasis may be placed on the form and presentation of the evidence as distinct from its substance. A glossy company brochure which ticks all the right boxes in terms of identifying *objectives to grow and develop its trade in the long-term* might in reality be less reliable than a simple spreadsheet projecting turnover growth as a result of investment. It is important that professional and HMRC resources are not committed unproductively to demonstrating and testing the evidence of a company's objectives. In this connection, we think that consideration is needed to the adaptation of HMRC's standard forms in order to identify the evidence required to determine whether the condition is met.

   These issues are not addressed in Clause 14 or the draft guidance on the condition published by HMRC on 4 December 2018[2]

4. Many companies already find it difficult to comply with the large number of conditions imposed by the EIS / SEIS / VCT regimes and require professional assistance when seeking advance assurance or preparing compliance statements. The introduction of the new condition in its current form will further complicate this process and may act to exclude small businesses which are unable to afford additional professional assistance.

5. The subjective nature of the condition will also place more demand on HMRC's *Advance Assurance* Service. As acknowledged in the Government' s response to the consultation on streamlining this service[3], that service is already under considerable strain, with growing demand lengthening the time taken to respond. It is essential for the continued success of the tax-advantaged venture capital schemes that adequate HMRC resources are committed to both the *Advance Assurance Service* and the additional demands imposed on the department by the new condition.

C. Commencement date

1. Sub-clauses (4) and (5) of Clause 14 (on page 11 of the Bill is originally published) indicate that the commencement date for the new condition will be set by Regulations. This may be earlier than the date on which those Regulations are made, but not before the date the Finance Bill receives Royal Assent.

2. However, this position is not reflected in the accompanying *Policy Paper*[4] or HMRC's draft guidance which state that the new condition will apply to all investments made on or after the date of Royal Assent.

3. The position is confused further by the statement in HMRC's *Policy Paper* that:

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[2] The draft guidance is currently contained in HMRC's Venture Capital Schemes Manual at VCM8510 onwards. See https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm8500

[3] See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/663935/Tax-advantaged_venture_capital_schemes-streamlining_advance_assurance_service-Gov_response.pdf

[4] See https://www.gov.uk/government/publications/income-tax-venture-capital-schemes-risk-to-capital-condition

"HMRC will cease to provide advance assurances on proposed investments that would appear not to meet the new condition from the date of the publication of draft guidance, which will be alongside the Finance Bill publication process."

4. If the intention is for the condition to apply from Royal Assent, this should be clarified by removing the reference to Regulations specifying the commencement date from Clause 14.

5. We note with concern that HMRC's cessation of providing relevant advance assurances in advance of Royal Assent (see point C.3 above) appears to be an attempt to apply the new condition in anticipation of legislation which cannot apply before Royal Assent.

Appendix:

1. The Association of Taxation Technicians

The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 8,300 members and Fellows together with over 5,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.

Association of Taxation Technicians

3 January 2018