

VENTURE CAPITAL SCHEMES: RISK-TO-CAPITAL CONDITION DRAFT GUIDANCE

Response by the Association of Taxation Technicians

1 Introduction

- 1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to provide comments on *Venture Capital Schemes: Risk-to-capital condition draft guidance* ('the draft guidance') which was published by HMRC in its Venture Capital Schemes Manual on 4 December 2017.¹
- 1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.
- 1.3 We have split our comments into sections. Section 2 sets out our main observations on the draft guidance. Sections 3 to 7 set out our detailed comments on specific sections of the draft guidance.

2 Overall observations on draft guidance

- 2.1 Our main observation is that the draft guidance contains insufficient detail in several important areas. In particular, there is little to illustrate the meaning of key terms such as *grow and develop* or *long term* or to identify what practical steps companies will need to take to demonstrate that the risk-to-capital condition ('the condition') is met.
- 2.2 As noted in the ATT's written evidence to the Public Bill Committee on Clause 14 of Finance (No.2) Bill ('our written evidence')², the use of such imprecise terms as *grow and develop* and *long term* coupled with a lack of guidance on their interpretation will make it difficult for companies to self-assess whether the condition is met, and could put more strain on the advance assurance service.

¹ The draft guidance is at VCM8500 onwards - see <https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm8500>

² The written evidence can be found at <https://www.att.org.uk/technical/submissions/finance-no2-bill-clause-14-eis-seis-vct-reliefs-risk-capital>

2.3 We therefore believe it would be helpful for the guidance in these areas to be expanded, in particular to:

- Clarify whether *grow* and *develop* are to be read as encompassing different requirements and, if so, how the two terms are distinguished.
- Provide more guidance as to the interpretation of *long term*, including some examples of what would, and would not, be considered long term in the context of specific investments.
- Clearly set out the practical steps which businesses can take to demonstrate compliance with the condition.

3 **VCM8530: Venture Capital Schemes: risk-to-capital draft guidance: an overview of the risk-to-capital condition**

3.1 As noted in our written evidence, it is unclear what the requirement for the company's objectives to *grow and develop* its trade means in practice. The draft guidance does not address this, but merely repeats the requirement to *grow and develop* without discussing what the difference is between the two terms and why both are needed.

3.2 The distinction (if there is one) between *grow* and *develop* is not at all clear from the draft guidance. For example, in this section (VCM8530) the third paragraph under *How the condition will be applied* refers to '*the investee company's growth ambitions*' as if the phrase embraces both growth and development.

3.3 It would be helpful if the final guidance could provide further explanation as to the distinction (if indeed there is one) between the terms *grow* and *develop* and how they overlap.

3.4 The draft guidance states in this section (and elsewhere) that the condition will have effect in relation to investments made on or after Royal Assent. As set out in our written evidence, this is not what the legislation actually states. Sub-clauses (4) and (5) of Clause 14 indicate that the commencement date 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. If the commencement date is definitely (and understandably) to be the date of Royal Assent, it would be helpful if the Regulations were made simultaneously with Royal Assent in order to avoid uncertainty.

3.5 We welcome the fact that the draft guidance reinforces that, when determining whether the condition is met, all factors will be considered together, and that even one or more indicators of potential capital preservation does not necessarily mean the condition will not be met (and vice versa).

4 VCM8540: 'Venture Capital Schemes: risk-to-capital draft guidance: the two parts of the risk-to-capital-condition'

- 4.1 This section of the draft guidance states that there is no definition of *growth and development* or *long term* which instead take their normal meaning. As mentioned in our written evidence, the use of such imprecise and subjective wording will make compliance difficult to assess.
- 4.2 We further note that this section of the draft guidance refers to '*Generic indicators of growth ambition*' (*emphasis supplied*), as does VCM8130 (to which the footnote cross-refers). No comparable indicators of *development* ambition are given in either section of the draft guidance. The absence of any indication of what constitutes and distinguishes *development* lends support to the impression that *growth* is likely to encompass *development*. If that interpretation is incorrect, then the guidance, as currently drafted, could quite reasonably be seen to be misleading.
- 4.3 We note that the draft guidance does not set out in any detail what practical steps companies can take to demonstrate that the condition is met. This is an important point given the imprecision and subjectivity noted above, and more guidance on this area would be welcome.

5 VCM8542: Venture Capital Schemes: risk-to-capital condition draft guidance: factors to be considered

- 5.1 We have concerns over a number of statements in this section of the draft guidance under *Increasing numbers of employees or turnover*:
- '*The company will need to set out its growth and development objectives in its business plan*'. We note that there is no requirement in the legislation for a business plan to be drawn up. If a formal business plan is not drawn up, will alternative evidence be accepted by HMRC? If not, this would effectively impose an extra cost on companies wishing to benefit from the venture capital schemes – particularly companies seeking investment under SEIS.
 - '*The company must have objectives to grow well beyond any holding periods associated with the scheme under which the investment is made.*' We note that the relevant holding period for SEIS and EIS is three years; that for VCTs is five years. The section is therefore implying that the legislation requires the application of a different meaning to 'long-term' depending on whether the relevant holding period is three or five years. There is, however, no indication in the legislation that any such different meaning is required. In the absence of any such indication, a common meaning must be assumed where the same term is repeatedly used within the same legislative provision.
 - The assertion that the company must have objectives to grow '*well beyond*' any relevant holding period adds additional uncertainty, again without any statutory authority. Even assuming that *well beyond* might be as little as an additional two years, the section gives the misleading impression that meeting the new condition will require the preparation of a business plan showing forecast growth beyond five years (for SEIS or EIS) or seven years for VCTs. In many cases, the credibility of such a five or seven-year plan would need to be questioned.
 - '*An increase in employees from one to two people might not be indicative of growth and development, whereas an increase from 10 employees to 15 employees might be a stronger indicator*': We would query whether this statement is appropriate for the following reasons:
 - Going from 1 to 2 employees represents a 100 percent increase, whereas from 10 to 15 employees only represents a 50 percent increase.
 - Knowledge intensive hi-tech firms may not need large numbers of employees.

- An increase in employee numbers may be an indicator of growth, but does it also necessarily imply development?

5.2 The guidance states that the capital preservation test *'does not prevent companies from using money raised to buy or create assets, so long as the intention is to make use of the asset in the company's trade'*. How will this operate in practice if a company invests temporarily surplus cash, or, for example, rents out excess space in its trading premises?

5.3 The *Ownership or management structure* section appears to partially contradict itself:

- At the beginning, it states *'One of the indicators of capital preservation activity is where the investee company's investor base consists largely of individuals who are using a tax-advantaged scheme alongside the promoter and their associates, with little or no entrepreneurial involvement.'*
- However, the section goes on to say that the fact that *'a majority of investors in a company are investing through a tax-advantaged scheme does not in itself indicate capital preservation.'*

If the key point in the first quote is the involvement of the promoter and their associates, then this should be made clearer.

6 VCM8550: Venture Capital Schemes: risk-to-capital condition draft guidance: advance assurance and compliance checks

6.1 This section of the draft guidance states that HMRC will not provide advance assurance from the date of publication of the draft guidance where they believe the condition is not met. As set out in our written evidence, we note with concern that this appears to be an attempt to apply the new condition in anticipation of legislation which cannot apply before Royal Assent.

6.2 In the *Compliance checks* section, it states *'these post-compliance checks will determine whether a company has used the money it has raised for the purposes stated at the time of the investment (for example, in its EIS or SEIS compliance statement).'* We are unclear as to what would be the implications if an intention at the time the statement was submitted was not fulfilled due to unforeseeable circumstances. What basis would HMRC have to challenge relief if that original declaration was made in good faith on the basis of evidence available at that time? We note that the test imposed by Clause 14 involves making a judgement based on the facts available at the time the shares are issued and does not require this position to be revisited or monitored over time.

6.3 It is important that the phrase *'including information that subsequently comes to light'* is read in the context of whether the risk to capital condition was met at the time of the share issue. Only information which was or could have been established at that time can fall within what was *'all the circumstances existing at that time'*.

7 VCM8560: Venture Capital Schemes: risk-to-capital draft guidance: risk-to-capital examples

7.1 We have no specific comments on the examples set out in this section, other than to note they illustrate relatively clear cut cases of where the condition is met or is not met. It would be helpful to include further examples where the situation is more uncertain in order to illustrate how the condition should be assessed in practice.

8 Contact details

- 8.1 We would be pleased to join in any discussion relating to this consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Emma Rawson, on 07773 087111 or at erawson@att.org.uk

Yours sincerely

Yvette Nunn

Co-Chair of ATT Technical Steering Group

9 Note

- 9.1 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 8,000 members and Fellows together with over 5,700 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.