VCTA 2023 Budget submission

Summary

- Venture Capital Trusts (VCTs) invest in high-growth small businesses, supporting jobs and investment across the UK. The VCT scheme sets out defined rules applied through State Aid criteria and UK legislation, providing tax reliefs in exchange for long-term, patient capital investment in businesses that would struggle to attract conventional funding.
- The VCTA welcomed the government's reaffirmed support of the Venture Capital Trust Scheme in the Chancellor's Autumn statement last year. The crucial role that high-growth, early-stage businesses play in the UK economy was once again recognised by the Chancellor, who committed to ensuring that innovation and growth are placed at the forefront of the government's agenda and extending the VCT scheme beyond 2025. We look forward to the government setting out a timeline and details for how it plans to implement the extension of the scheme.
- HMRC officials have recently informed the VCTA and a number of VCT and EIS advisors that they are now applying the financial health requirement more rigidly for investee companies which are outside of the initial investing period of 7 years from the company's first commercial sale (for a Knowledge Intensive Company ten years from the first commercial sale or when the annual turnover first exceeded £200,000) and have lost more than half of their subscribed share capital. This poses a huge challenge for companies, which can fail the test despite having great growth prospects. This is despite that the policy position and direction from government is that these high-potential, innovative companies should be supported most.

1. How VCTs support jobs and growth

Venture Capital Trusts (VCTs) invest in high-growth small businesses, supporting employment and investment across the whole of the UK through the long-standing VCT scheme.

- **VCTA members have made 1,500 individual investments, totalling over £1.95bn in capital** into high growth companies over the last five years, averaging **£400m** per annum.
- Over the last financial year, VCTA-backed businesses delivered **£12.5 billion in revenues**, generating **£3 billion in exports** and **investing £548 million in R&D.** 76% of post-2015 VCT investee companies have invested in R&D.
- Our investments help businesses to grow fast, helping to tackle the scale up challenge. The **average revenue growth following investment from a VCTA**

member fund was 82% and exits from successful VCTA backed businesses valued those businesses at £7.6bn in H1 2021.
- Since 2018, VCTA backed businesses have on average **increased export sales by 275% to £1.1m** in 2021.

VCTs provide an **essential source of patient capital** to innovative high-growth small businesses, enabling them to access the support and funding they need to grow, enter new markets, and drive employment in all parts of the UK.

VCTs **support early-stage businesses that would otherwise struggle to access commercial investment** and offer intensive business support in addition to investment.

VCT funds play a vital role in the UK funding ecosystem, supporting businesses to move from earlier stage investment towards fully commercial investment. VCT funds are invested and managed by independent fund managers through an extensive regional network of **local offices in more than 15 towns and cities around the UK**, supporting growth in all parts of the country stimulating **well-paid jobs** in innovative, fast-growing industries across the UK.

Figure 1: Average VCTA-backed business salary across UK regions and nations, compared to average for all businesses in that region

Region/Nation	Average VCTA-backed business salary, GBP (source, VCTA annual return)	Average salary in region for full time employees, GBP (source, Statista)
Greater London	58,000	39,716
South East	47,219	32,810
Scotland	44,781	31,672
East of England	52,256	30,867
West Midlands	40,854	30,000
South West	42,813	29,080
North West	38,896	29,529
Northern Ireland	61,940	29,109
Wales	31,838	28,506
East Midlands	52,688	28,416
North East	35,446	27,515
Yorkshire and The Humber	35,088	28,808

VCTs provide extensive business support and advice to help their companies develop new products, enter new markets, and create new jobs. VCT funds have a network of specialists who can help investee companies scale and grow, for example advising how to hire and build effective boards, or to rapidly scale a sales team.

2. Policy recommendations

1. Timeline and details for the extension of the VCT scheme

Given the VCT scheme's proven track record, it stands as an effective vehicle through which private investment can be directed to those businesses most in need. We welcome the Government's recognition of this in its commitment to extending the scheme beyond the 2025 'sunset clause' as contained in the 2015 Finance Bill. It is now important that, to give the sector confidence, the Government sets out a timeline and details of how it plans to implement the extension of the scheme.

2. Financial Health Requirement

We recommend that the financial health requirement for VCT and EIS investment should be reviewed as a matter of urgency and revised to help the UK's businesses to raise vital growth capital.

The financial health requirement of s.180B and s.286B ITA 2007 was introduced in 2011 and it states that a company must not be an undertaking in difficulty at the time of the investment. The reason originally given for this rule was that if a company qualifies for restructuring aid, then it should not also be able to receive risk finance state aid.

Changes
HMRC have recently informed members of the VCT Association and EIS Association that they have changed their approach to this requirement, even though there has been no change in the UK law since 2011. This affects businesses who are outside of the initial investing period for EIS and VCT investment, but which meet Conditions A, B or C of the permitted maximum age requirement. Where such companies' financial statements show they have lost more than half of the share capital they have raised, they are now being refused the ability to raise funds from EIS and VCT investors, even though until recently they have been given approval in exactly the same circumstances.

Impact
This sudden and recent change of approach is having a severe impact on EIS and VCT backed businesses who have already developed business and funding plans based on previous assurances from HMRC. Companies will no longer be able to hire staff, will have to scale back expansion plans and even have to reduce their R&D work. It will also penalise companies for example in the life sciences space and those which are heavily R&D focussed to a greater degree – and these are the companies for which VCT and EIS investment is especially intended.

Our efforts to invest in companies to help level up every region of the UK will also be severely impacted. VCTA data collated from every VCT investment between November 2015 and March 2021 shows that there is a high differential on age of business when considering Greater London (5.1 years) vs. Rest of UK (7.02 years), as businesses in the regions take longer to mature. Because the new enforcement will only affect those companies outside of the initial investment period for VCT and EIS investment, this data suggests that businesses outside of London will be more affected by the change in approach from HMRC than those in the capital.

VCTs and EIS investors are not looking to invest in failures, but they are helping to fill the equity gap in growing companies which are still loss making, but are growing headcount, creating valuable intellectual property, and looking to export.

Recommendation

We do not consider that the financial health requirement should be used to deny access to tax advantaged funding merely on account of age. There is a separate maximum permitted age requirement which assesses the age of a company, and if Parliament had intended the financial health requirement to be part of the age requirement, it would have been in the same section of legislation. A company which is a going concern with growth prospects, and meets the age and size limits, ought not to be disqualified by the financial health requirement. Indeed, it is these very companies that might otherwise struggle to raise funds, which are intended to be supported by EIS and VCT investment.

We recommend that the financial health requirement is therefore amended to allow companies to receive EIS and VCT investment where they have genuine growth prospects, and which meet the permitted maximum age requirement and the other criteria of the EIS and VCT legislation.

3. About the VCTA

The VCTA represents twelve of the largest Venture Capital Trust (VCT) funds across the UK, which together represent more than 90% of the VCT industry by value.

The businesses we support range across sectors as diverse as digital technology, medicine development, specialist manufacturing and online retailing.

The twelve funds we represent are Octopus, Gresham House, Albion Capital, Foresight Group, Beringea, Mercia, Maven Capital Partners, YFM Private Equity, Canaccord Genuity, Molten Ventures, Pembroke VCT and Puma Investments.