



**The Quoted  
Companies Alliance**

---

**27 April 2009**

**Donald Stewart, [GrowthBusiness.co.uk](http://GrowthBusiness.co.uk)**

**VCTs and EIS: the future**

*In recent years, venture capital trusts (VCTs) and the Enterprise Investment Scheme (EIS) have been in decline, writes Donald Stewart, a partner at law firm Faegre & Benson.*

One reason for that decline is that eligibility criteria for investment have been tightened. The aim of these changes is to ensure that the tax breaks the schemes offer are properly targeted, but they have had the effect of making them less attractive to investors.

Originally, companies could qualify for the schemes if their gross assets exceeded £15 million. In 2006, that figure was reduced to £7 million. To make matters worse, further restrictions were introduced in 2007 to prohibit more than £2 million being invested per company, and qualifying companies had to employ fewer than 50 people.

In addition, since 2005 the Prospectus Directive has virtually ruled out public offers of EIS-eligible shares, as compliance costs are prohibitively expensive for the sums involved.

As for VCTs, the figures speak for themselves. In tax year 2005/6 VCTs raised about £790 million while for the recently ended tax year 2008/09 commentators have estimated that a mere £50 million was raised. This reflects a decline in investor tax relief from 40 to 30 per cent as well as the more stringent company tests mentioned above.

There were hopes that the Budget would do something to remedy this situation. There have been a number of changes:

- Before the Budget both the EIS and VCT schemes broadly required that 80 per cent of the money raised be spent within the first 12 months, with the rest being spent within the following 12 months. The Budget allows all the money be spent within two years of being raised.
- It decouples the use of EIS monies from other amounts raised by the issue of the same type of shares on the same day.

- It also tweaks the carry back of EIS relief to previous tax periods and the availability of roll-over relief on a share-for-share exchange.

These reforms will help, but a big chance has been missed.

Many organisations and lobby groups including the London Stock Exchange, the Quoted Companies Alliance and the British Venture Capital Association have stressed the important role the EIS and VCT schemes could play in revitalising the wounded venture capital market. They pointed to the equivalent French scheme which provides investors with relief against income and wealth taxes. Under that scheme there is an asset test of €43 million, a turnover test of €50 million and an employment limit of 2,000.

When challenged on the increased restrictions imposed on the UK schemes, HMRC and the Treasury blame the EU, claiming that the rules forbidding “state aid” have forced their hand.

But the French scheme, which is available to companies having their head office in any European member state, seems to work at the EU state aid level. In spite of the breadth of the scheme it is estimated that about 90 per cent of investment made under it remains in France.

The EU state aid rules apply when competition is distorted by national governments discriminating between businesses through selective support. The wider the rules of any particular tax incentive scheme, the less likely they are to offend the state aid rules.

So the solution for the EIS and VCT schemes is plain. By making the rules wider, rather than narrower, new life might be breathed into tax-inspired equity investment. Whether the government will recognise and act on this is, of course, another matter.

*Shortly after this article was published, the European Commission requested a number changes to VCTs and the EIS to ensure compliance with state aid rules.*