Summary: Intervention & Options

Department /Agency: HM Treasury/ HM Revenue and Customs	**Title:** Impact Assessment of Changes to the Tax-based Venture Capital Schemes and Enterprise Management Incentives	
Stage: Final	**Version:** 1	**Date:** 7 June 2010
Related Publications:		

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What is the problem under consideration? Why is government intervention necessary?

This impact assessment covers legislative changes announced at PBR 2009 and proposed in Finance (No 2) Bill 2010 for the Venture Capital Schemes - the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) - and Enterprise Management Incentives (EMI). The venture capital schemes give tax relief to investors in small companies that otherwise have difficulty raising finance. EMI gives tax advantages to some employee share options, to help smaller companies, particularly in the riskier areas of the economy, recruit and retain the staff they need to grow. The changes are needed to ensure the schemes comply with the European State Aid Risk Capital guidelines and EU fundamental treaty freedoms while remaining effective and attractive means of levering risk capital.

What are the policy objectives and the intended effects?

State aid approval was received for the schemes in 2009. The objective is to meet commitments given to the European Commission, as a basis for the approval, that they would comply with the Risk Capital Guidelines and the fundamental freedoms. Complying will secure the future of the schemes and ensure they remain an effective means of promoting business growth and enterprise among small higher risk trading companies. This is especially important given the current challenging economic conditions which are making access to finance problems more acute.

What policy options have been considered? Please justify any preferred option.

Option 1: Ensuring compliance with the state aid guidelines by: (a) making the venture capital schemes and EMI more flexible by relaxing the limitations on where target companies can carry on their activities and where VCTs can be listed; (b) excluding enterprises in difficulty from the venture capital schemes and (c) changing the minimum equity requirements for VCTs.

Option 2: Doing nothing. Failure to take action could result in state aid approval being withdrawn. Operation of the schemes would then be suspended and relief already given might have to be repaid.

Option 1 is preferred as the best way of meeting the policy objectives.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? Impacts will be assessed on an ongoing basis. Any significant impact on VCT fundraising will be seen by 2011. EIS will take several years because of the long time lags for company returns as will EMI, due to time lags between grant and exercise of share options.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the impact assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs'.

Signed by the responsible Minister:

Date: 7 June 2010

Summary: Analysis & Evidence

Policy Option: 1 | **Description: Amend the schemes to improve flexibility and achieve compliance with state aid rules**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	Relaxing territorial restrictions should see more companies and individuals using the schemes and incurring average annual costs in providing information. VCTs will incur one-off costs from adapting investment strategies to the need to hold a greater share of new qualifying investments in eligible shares.
£ 200,000-300,000		
Average Annual Cost (excluding one-off)		
£ 100,000-120,000		**Total Cost** (PV) **£ see evidence base**

Other **key non-monetised costs** by 'main affected groups' Allowing VCTs to list on any European Union Regulated Market is not expected to significantly increase compliance costs. Overall, the net increase in the value of tax relief claims is forecast to be around £20m in 2011-12, £30m in 2012-13, and £40m per annum thereafter.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	There may be a reduction in VCT fundraising due to the change to the minimum equity requirement. If this occurs, it will marginally reduce the volume of information VCTs and their investors need to pass to HMRC each year.
£ 0		
Average Annual Benefit (excluding one-off)		
£ 35,000-45,000		**Total Benefit** (PV) **£ see evidence base**

Other **key non-monetised benefits** by 'main affected groups' Companies gain improved access to finance. Investors gain additional tax relief of around £20m in 2011-12, £30m in 2012-13, and £40m per year therafter by making higher risk investments than they might otherwise have done. Average investment returns are particularly uncertain and are therefore not monetised.

Key Assumptions/Sensitivities/Risks The extent to which increased flexibility will lead to a net increase in investment is uncertain, as is the ability of VCTs to adapt to being required to hold a greater proportion of qualifying holdings in eligible shares for new investments. It is assumed that there are no cost implications from relaxing the territorial rule for EMI and excluding companies in difficulty.

Price Base Year 2009	Time Period Years p.a	**Net Benefit Range** (NPV) **£ See evidence base**	**NET BENEFIT** (NPV Best estimate) **£ See evidence base**

What is the geographic coverage of the policy/option?			United Kingdom	
On what date will the policy be implemented?			2010	
Which organisation(s) will enforce the policy?			HMRC	
What is the total annual cost of enforcement for these organisations?			£ 0	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ 0	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro As small	Small **<£750**	Medium **N/A**	Large N/A
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)				(Increase - Decrease)
Increase of £ 50,000		Decrease of £ 5,000	**Net Impact**	£ 45,000 increase

Key: **Annual costs and benefits:** **(Net) Present**

Evidence Base (for summary sheets)

THE ISSUE

The Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) are tax-based venture capital schemes. They aim to improve small higher risk trading companies' ability to secure longer-term financial support in the form of equity investments.[1] They do this by offering investors income, capital gains and corporation tax reliefs in return for investing in small companies undertaking an activity (trade) that qualifies under either scheme.

Enterprise Management Incentives (EMI) are tax advantaged employee share schemes, under which companies can offer their employees share options with income tax and National Insurance contribution advantages. EMI is designed to help smaller companies, particularly in the riskier areas of the economy, to recruit and retain the staff they need to grow.

The EIS has raised almost £6.3 billion, which has been invested in around 14,500 small companies. VCTs have raised £3.5 billion and invested in over 1,500 small companies.

Access to finance is currently a particular concern to many businesses: the availability of capital is limited and banks have changed their approach to risk, tightening lending conditions. It is therefore important to ensure the venture capital schemes remain an effective and attractive means of levering risk capital into small companies, which now face further difficulties in securing appropriate levels of finance than previously.

The schemes were notified to the European Commission as state aids in May 2007. They received approval in 2009, subject to a number of changes being made at the first opportunity to ensure that the rules governing the schemes comply with the State Aid Risk Capital guidelines and the EU fundamental treaty freedoms. Failure to comply could jeopardise the approval, leading to the schemes having to be suspended. This would have a negative impact on the supply of risk capital flowing to small companies.

For the State Aid Risk Capital guidelines, published in 2006, please see: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:194:0002:0021:EN:PDF.

POLICY OBJECTIVES AND INTENDED EFFECTS

The main policy objective is to ensure the venture capital schemes remain an effective and attractive means of incentivising investments in smaller companies that might otherwise struggle to raise appropriate levels of finance and that EMI continues to be effective. This is particularly important given the current challenging economic conditions. The Government intends to achieve this by securing state aid approval for the schemes.

This will secure the future of the schemes, ensuring that they play as active a role as possible in supporting small companies during the downturn. This is also important to ensure the stability of the EIS and VCT sectors, allowing them to plan for the future and continue to play a role in the economic recovery.

Changes to secure this approval will involve relaxing the limitations on where the trade is carried on. This presents the additional benefit of increasing the number of small companies eligible for investments under the schemes. Some companies which may previously have been ineligible as a result of their international activity may now be able to qualify for investments. It will also allow companies, already benefiting from investments under the schemes, to take greater advantage of the international opportunities to expand.

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[1] The schemes' rules outline what is meant by a small higher risk trading company in this impact assessment. Small companies are defined as having gross assets not exceeding £7 million before the share issue and £8 million after; employment must be less than 50 full-time equivalent employees when shares are issued. There are also rules to ensure companies are independent and trading. Certain activities are excluded from the schemes in order to target higher risk trades more in need of support. (For details, please see: http://www.hmrc.gov.uk/manuals/vcmmanual/index.htm).

In the same vein, the Government also intends to allow VCTs to list elsewhere in Europe, should that make most commercial sense.

OPTIONS

Option 1 Amend the schemes' rules:

(a) Relax the rule requiring investee companies' activities to be carried on "wholly or mainly" in the UK (common to both schemes and EMI) and the requirement for VCTs to be UK-listed;

(b) Exclude "Enterprises in Difficulty" from the venture capital schemes; and

(c) Change the minimum equity requirements for VCTs.

Option 2 Do nothing

The Government prefers option 1 because it is expected to deliver the policy objectives, whereas option 2 clearly would not.

Option1: Amend the Scheme Rules

(a) Relax the rule requiring investee companies' activities to be carried on "wholly or mainly" in the UK (common to both schemes and EMI), and the requirement for VCTs to be UK-listed.

- Companies qualifying to receive investments under the schemes are currently required to carry out their qualifying activities "wholly or mainly" in the UK as are companies benefiting from EMI. HMRC interpret the requirement as meaning that more than 50 per cent of the qualifying activities should be in the UK.
- The Government now intends to relax this rule to simply require any company receiving investments under the tax-based venture capital schemes to have a permanent establishment in the UK. The definition used will be based upon that contained in Article 5 of the OECD Model Tax Convention on Income and on Capital (2003).
- There is also currently a requirement for VCTs that "the shares making up the company's ordinary share capital...have been or will be included in the official UK list throughout the relevant period".
- The Government now proposes to relax this rule. Instead, the shares making up the company's ordinary share capital will be required to be admitted to trading on a European Union Regulated Market. A "European Union Regulated Market" is any regulated market named under the Markets in Financial Instruments Directive (MiFID).

This option is preferred as it also responds to calls from small business and the venture capital sector to make the schemes more flexible. It will also play a part in the broader efforts to improve access to finance, as more UK companies would qualify for investments under the schemes. This will stimulate investment activity by providing more investment opportunities for individuals and facilitating cross-border activity.

The Government therefore intends to introduce legislative changes in Finance Bill 2010 to give effect to these relaxations.

(b) Exclude "Enterprises in Difficulty" from the venture capital schemes

- There is currently no exclusion of enterprises "in difficulty" from benefiting from either of the schemes

- The Government now proposes to introduce a rule excluding companies that are "in difficulty" according to the criteria set out in the Commission's guidelines on State aid for rescue and restructuring from the benefit of the venture capital schemes

This option gives a simple test, based on the Commission's own guidance. The Government considers it unlikely that companies genuinely in difficulty according to these criteria would be able to raise equity funding.

(c) Change the minimum equity requirements for VCTs

VCTs are currently obliged to onward invest a minimum of 70 per cent of their total fund in 'qualifying holdings'. Of that 70 per cent, a minimum of 30 per cent (i.e. 21 per cent of the total fund) must be in 'eligible shares', which the Commission accepts constitutes 'equity' according to the definitions in the State Aid Risk Capital guidelines. However, these guidelines require that 70 per cent of qualifying holdings be invested in 'equity' or 'quasi-equity'.

The Government therefore intends to introduce legislation in Finance Bill 2010 to require that a minimum of 70 per cent VCTs' qualifying holdings (i.e. 49 per cent of the total fund) must be in a form that the Commission would accept as 'equity' or 'quasi-equity'. The Government does not propose to use the term 'quasi equity' but legislation will define the sorts of instrument that will count towards the new requirement.

This option is preferred as the Government is legally obliged to ensure the rules governing the VCT scheme comply with the State Aid Risk Capital guidelines. Failure to do so would result in state aid approval for the scheme being withheld and the suspension of the schemes.

Option 2: Do Nothing

Failure to implement these changes could result in the European Commission revoking state aid approval and operation of the schemes being suspended. The UK Government would probably at this stage be forced to abolish the schemes. This impact assessment considers only the cost of the schemes having to be closed to new investments. However, the European Commission could in principle also potentially require the UK Government to reclaim some relief already given under the schemes. This would apply to relief given directly to investors, which the small companies benefited from indirectly.

CONSULTATION

HMRC published draft legislation at PBR and consulted stakeholders on its detail. Stakeholders were generally content with the suggested approach. The legislation to be proposed takes account of a number of points of detail, in particular by relaxing the rule that determines when a VCT "controls" a company in which it requests, reflecting the changes described at (c) above.

COSTS & BENEFITS

The compliance costs and benefits of the policy options are estimated based on the expected impact on normally efficient and compliant businesses and individuals. Compliance costs are likely to consist of either:

- the average time taken by individuals, small companies, and VCTs to complete tasks themselves charged at an average wage rate; or
- the average increases in professional fees where tasks are likely to be undertaken by an agent.

The wage rate used is £12.50. This is based on the 2008 average gross hourly rate for clerks and bookkeepers, uplifted for overheads (taken from the Annual Survey of Hours and Earnings).

Option 1: One-Off Costs

Businesses

Some small companies and VCTs seeking investment as well as professional advisers will be directly affected by the relaxation of the "wholly or mainly" in the UK rule. They will incur learning costs in understanding the impact of the new rule and the new opportunities it may present. As a proxy for this we assume that each company/VCT raising funds in the first year incurs an average cost of £50 each in time and/or a marginal increase in professional fees. The total cost of this is estimated at around £100,000.

We do not expect established VCTs to move to another European Union Regulated Market because of the costs of moving relative to any benefits. Estimated cost is negligible.

Increasing the minimum equity requirement for all new VCT investments should only result in significant one-off costs for VCTs raising funds. The cost per VCT of learning of the change is assumed to cost an average of £50. Implementing the change will be more costly because many VCTs looking to raise funds will have to amend their investment strategy for new investment in terms of how they structure their qualifying holdings in small companies. The information received by HMRC on the composition of VCT qualifying holdings has only partial coverage, but suggests that some trusts already appear to exceed 70 per cent equity. These are mainly AIM quoted plus some specialist VCTs. Meanwhile, those closer to the current 30 per cent rule appear to be mainly generalist VCTs. Without scope for consultation on the likely implementation costs, we assume that the one-off costs of implementation in terms of time and other costs will on average be around £5,000 per VCT raising funds. We assume this applies to around three-quarters of those raising funds. These costs are in addition to any learning costs. There have been around 40 VCTs per year raising funds on average while income tax relief has been at 30 per cent (see http://www.hmrc.gov.uk/stats/venture/table8.6.pdf). Total cost is estimated at around £150,000.

Individuals

We expect the one-off costs for individuals to be negligible from the relaxation of the "wholly or mainly" in the UK rule because they are only indirectly affected by what amounts to the reworking of an existing rule. There will be more companies that can use EIS and more companies for VCTs to invest in. However, the learning and search costs per individual are unlikely to be significantly different for investors who would have invested through the schemes anyhow. Evidence that only a minority of investors keep abreast of changes to the scheme rules once they have invested would tend to support this (see http://www.hmrc.gov.uk/research/report.pdf).

We expect the one-off costs for individuals to be negligible from changing the minimum equity requirement for VCTs because they are only indirectly affected by what amounts to the reworking of an existing rule. Therefore, learning costs per investor are unlikely to change significantly as a result.

Option 1: Average Annual Costs

Businesses

Relaxation of the "wholly or mainly" in the UK rule should result in more small companies raising equity through the schemes. This will result in a flow of additional information having to be provided to HMRC each year by the additional companies and the VCTs in respect of these extra investments. Providing such information constitutes an average annual cost. Based on existing estimates for the administrative burden of the schemes, we calculate the costs to be around £55,000. This is based on additional activity equivalent to around 10-15 per cent more companies and VCTs raising funds through the schemes. Although this cannot be reliably forecast, it would imply around 250 more EIS companies and around 5 more VCTs than would otherwise have been the case. (For overall activity in the schemes, see http://www.hmrc.gov.uk/stats/pensions/index.htm).

The change to the minimum equity requirement is a change to an existing rule, and so should not generate significant additional burdens in providing information to HMRC. Any new VCTs entering the market would have to apply one threshold rather than another. Therefore, the average annual costs to VCTs are estimated to be nil or negligible.

Individuals

Consistent with the increase in the number of companies raising equity through the schemes, we also expect additional investors. Although it is difficult to predict with any accuracy, we assume the policy change will attract around 2,000 additional EIS investors and around 2,500 more in VCTs (i.e. an increase of around 15 per cent). These taxpayers will need to provide information to HMRC in order to obtain their tax relief. These additional claims and additional people learning about the schemes each year form an average annual cost. Income tax claims are typically relatively simple and straightforward. They are claimed either via Self Assessment, a scheme specific form or a PAYE coding notice. We therefore assume the cost to be an average of £12.50 per additional claim to proxy for the individual's time or a marginal increase in professional fees for those represented by an agent. Claims will predominantly be from higher rate taxpayers and often those already on SA with relatively complex tax affairs. The total cost is estimated at around £55,000.

For changing the minimum equity requirement for VCTs, we expect the average annual costs for individuals to be negligible. This is because they are only indirectly affected by what amounts to the reworking of an existing rule. The tasks undertaken to make an investment and claim relief would remain the same.

Option 1: Benefits

There are no one-off benefits anticipated. The average annual benefits of improving the flexibility of the schemes are potentially:

- Businesses – More companies will be able to attract risk capital using the schemes and those with a significant share of their trade carried out overseas will no longer see their potential limited in scope by a "wholly or mainly" in the UK rule. The ability of the schemes to address the 'equity gap' encountered by small, higher risk trading companies will therefore be improved. Empirical evidence suggests that the schemes may have a positive effect on the investment levels of EIS/VCT companies (see http://www.hmrc.gov.uk/research/report44.pdf).
- Individuals – Investors will be able to obtain tax relief on a wider range of risk capital investments through the schemes, which may lead to better post-tax rates of return on capital that may have been invested elsewhere.

The only anticipated on-going benefits to business and individuals from changing the minimum equity requirement for VCTs are from compliance cost savings due to a reduction in VCT fundraising:

- Businesses: Although it is speculative, we have estimated that there will be around 5 fewer VCTs raising funds each year, which will reduce the cost of providing information to HMRC by around £5,000 per annum.
- Individuals: We have assumed a similar proportionate reduction for individuals claiming tax relief each year, reducing the need to provide information to HMRC by around £35,000 per annum.

The above benefits do not include the forecast value of additional tax relief claims. This is because in cost-benefit analysis terms tax relief represents a transfer payment from one group in society to another rather than a net increase in the welfare of society as a whole. Instead, any positive impact on output in the economy due to the additional tax relief or any reductions in compliance costs count as benefits. The cost of tax relief is incurred from 2011-12 rather than 2010-11 due to the time lags involved in administering the reliefs.

The difficulty here is that while we can make reasonable estimates of compliance cost savings, any positive impact on the economy of more investment through the schemes cannot be reliably measured. This is because the schemes are just one factor affecting small company performance relative to the alternative investment choices that could have been made instead (i.e. in the absence of the venture capital reliefs). The economic impact of more investment through the schemes is not quantified as a monetised benefit and is instead described qualitatively in the non-monetised box on page 2. Research evidence points towards the tax relief being the primary attraction of investments through the schemes in many cases (see http://www.hmrc.gov.uk/research/report.pdf and http://www.hmrc.gov.uk/research/cgt-final-report26.pdf). However, given the risky nature of the investments, many are loss-making in pre-tax terms.

The table below summarises the above monetised costs and benefits. Estimates have not been produced on a net present value basis both because the schemes have no end date and because the main benefits of option 1 could not readily be monetised.

Option 1: Monetised Costs and Benefits			
Impact:	**Impact on:**	**Estimate:**	**Published Range:**
One-Off Cost	**Businesses**	£250,000	-
	Individuals	£0	-
	TOTAL	**£250,000**	**£200,000-£300,000**
Average Annual Cost	**Businesses**	£55,000	-
	Individuals	£55,000	-
	TOTAL	**£110,000**	**£100,000-120,000**
One-Off Benefit	**Businesses**	£0	-
	Individuals	£0	-
	TOTAL	**£0**	**£0**
Average Annual Benefit	**Businesses**	£5,000	-
	Individuals	£35,000	-
	TOTAL	**£40,000**	**£35,000-45,000**

Option 2: Do Nothing

As already outlined, this option would lead to the suspension of the schemes. Investors would lose tax relief and small, higher risk trading companies would find it more difficult to secure the funds they need to invest and grow.

One-Off Costs

It is likely that most VCTs would incur the one-off costs of running down in the years after the scheme closes to new investment. The majority are unlikely to be sustainable without tax relief. Such costs cannot be readily quantified and are thus non-monetised in our estimates.

Average Annual Costs

As discussed under the benefits of option 1, any investment returns accruing to investors and other shareholders cannot be readily estimated and generalised. With option 2, therefore, the cost of suspension in these terms is likewise difficult to quantify.

One-Off Benefits

There would be no one-off benefits of suspension.

Average Annual Benefits

Suspending the schemes would mean that small companies, VCTs and their investors would no longer incur the average annual costs of providing information to HMRC each year. Based on current populations of companies, VCTs and investors using the schemes each year and the same assumptions used for option 1, the average annual cost savings of suspending the schemes would be around £700,000.

Although it has not been possible to quantify all of the cost and benefits, the benefits in terms of the additional investment returns generated by the schemes are still likely to outweigh the compliance cost savings of suspension. For example, in 2006-07 total funds raised through the venture capital schemes were almost £1billion versus compliance costs per year of less than £1million. Therefore, the schemes would only have to generate additional pre-tax investment returns of around 0.1 per cent for the benefits to businesses and individuals from retaining them to exceed the costs each year.

The table below summarises the above monetised costs and benefits. Estimates have not been produced on a net present value basis both because the schemes have no end date and because the main costs of option 2 could not readily be monetised.

Option 2: Monetised Costs and Benefits			
Impact:	**Impact on:**	**Estimate:**	**Published Range:**
One-Off Cost	**Businesses**	£0	-
	Individuals	£0	-
	TOTAL	**£0**	**£0**
Average Annual Cost	**Businesses**	£0	-
	Individuals	£0	-
	TOTAL	**£0**	**£0**
One-Off Benefit	**Businesses**	£0	-
	Individuals	£0	-
	TOTAL	**£0**	**£0**
Average Annual Benefit	**Businesses**	£400,000	-
	Individuals	£300,000	-
	TOTAL	**£700,000**	**£600,000-800,000**

ADMINISTRATIVE BURDEN

HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular; the admin burden of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model' (SCM), an activity based costing model which identifies what activities a business has to do to comply with HMRC's obligations, and which estimates the cost of these activities, including agent fees and software costs.[2]

[2] The 'Standard Cost Model' (SCM) has been used to derive an estimate of the costs to business of complying with HMRC obligations to disclose information to HMRC or to third parties. The SCM considers which activities a business has to do to comply with an HMRC obligation, how many businesses have to comply, and how often they need to comply. The SCM considers the burdens applying to different sizes of business.

The SCM estimates the costs of using agents; the costs of undertaking work in-house; and the costs of actually transmitting the information. The SCM does not consider one-off costs or transitional costs. The SCM does not consider costs which a business would have incurred anyway had the relevant HMRC obligation not existed. It considers the costs which apply to a normally

Central estimates of admin burdens are £50,000 per annum for part (a) of option 1, £0 for part (b) and -£5,000 per annum for part (c). These are burdens incurred by companies and VCTs. Burdens borne directly by individuals who are a separate legal entity to the business, such as directors, employees and shareholders, are not included under the SCM. A 2005 wage rate of £11.70 is assumed for in-house tasks. As described under average annual costs, part (a) of option 1 should result in additional burdens due to more activity through the schemes, whereas part (c) should result in a reduction in VCT fundraising.

On the same basis, the administrative burden savings from option 2 is estimated at around £385,000 per annum.

Assumptions & Risks

With option 1, the main risk is that the measure has less of a positive overall impact on small companies' ability to raise risk capital. The negative effect on VCTs could be greater, whereas the increase in funds raised because of increased flexibility could be less than assumed here. The extent of the impact of the changes is difficult to predict in advance. The timing of the tax effects is on a National Accounts basis.

Equity and fairness

These changes will affect small companies (with fewer than 50 employees and gross assets of less than £7 million before investment) that receive, or may seek to receive investments under the EIS and VCT schemes. Individuals who make investments in these small companies, either through the EIS or through a VCT, will also be affected as will the VCT and EIS Fund industries. These changes should not disproportionately affect any other sectors.

Implementation plan, monitoring and evaluation

The changes will be legislated in 2010. Guidance will be published on the HMRC website. Implementation of the policy will not require additional resources for HMRC. National Statistics on the schemes are published annually on the HMRC website and the impact of these changes should be reflected in this monitoring data. Statistics on VCT fundraising are currently published within 6 months of the end of the tax year. EIS statistics take three years to compile due to the time companies have to file those returns. Further evaluation studies may be commissioned to assess the overall impact of the schemes in addition to those already published by HMRC.

Small Firms Impact Test

These options affect only small companies (with a headcount of fewer than 50 employees and gross assets of less than £7 million before investment) that receive or may seek to receive equity investments benefiting from tax relief under the tax-based venture capital schemes.

With option 1, the relaxation of the "wholly or mainly" test described should benefit small companies receiving investments under the venture capital schemes, by improving their ability to take advantage of opportunities to expand internationally. Changing the VCT minimum equity requirement should have no direct impact on small companies, as they apply to requirements governing VCTs.

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efficient business and the costs to businesses which comply. The SCM does not consider wider compliance cost issues, such as the costs of business uncertainty, cash flow costs, or the costs of deciding whether or not to do something.

The Impact Assessment template requires SCM figures to be presented in May 2005 prices, as admin burden reduction targets relate to a May 2005 baseline. The Impact Assessment also uplifts those figures to current day prices.

Under option 2, small companies would be harmed by the reduction in the availability of equity finance that would ensue from the suspension of tax relief offered by the schemes.

It was not possible to carry out a consultation among small companies on the effect of these changes prior to their announcement. This was due to the confidential nature of negotiations between the UK Government and the European Commission, and due to market sensitivities.

Competition Impact Test

The proposed changes are not expected to have any adverse impacts on competition. Neither option should:

- directly limit the number or range of suppliers;
- indirectly limit the number or range of suppliers;
- limit the ability of suppliers to compete; nor
- reduce suppliers' incentives to compete vigorously.

Under option 1, the changes are required to ensure compatibility with state aid guidelines. State aid control is intended to ensure that Government interventions do not distort competition or intra-community trade. The tax-based venture capital schemes are interventions intended to correct for 'equity gap' market failures whereby small companies in qualifying trades can struggle to raise appropriate finance compared to larger businesses or lower risk trades. They should have a positive effect on competition in markets by supporting new entrants.

Relaxing the territorial requirements of the schemes should have a positive effect on the competition process by opening the schemes up to more business opportunities that may face an 'equity gap'. Raising the minimum equity requirement for VCTs (from 30 per cent to 70 per cent) should also aid the competition process by reducing any distortions caused by the scheme; it should better focussing VCT portfolios on those companies most likely to be both eligible for the schemes and facing an equity gap. Even if some VCTs that already meet the 70 per cent requirement gain a head start or some exit the market, competition between VCTs is unlikely to be significantly diminished. This is because the change is not expected to significantly raise barriers to entry, meaning that the threat of new VCTs entering the market will remain a constraint on the behaviour of incumbents.

Under option 2, suspension of the schemes would remove any competitive distortions caused by the schemes favouring small companies in qualifying trades over other businesses, large and small. However, it would exacerbate the 'equity gap' in the UK, making it harder to raise the equity needed for small companies to enter markets, compete and grow.

Other Impact Tests

Competition assessment

We have applied the Office of Fair Trading competition filter to these changes and concluded they have no impact on competition

Small Firms Impact test

The changes ensure that the Venture Capital Schemes – which support small companies in raising finance – will continue to be available. After consultation the sector, based on draft legislation, the original proposals have been modified to take account of view received

Legal aid

There will be no need for new criminal sanctions or civil penalties

Sustainable development

The changes will be in accordance with the principles of sustainable development

Race equality, disability equality, gender equality and human rights

An initial equality impact assessment has confirmed that the changes have no negative impacts

Rural issues

The changes will not have a significantly different effect in rural areas. Neither will they significantly impact carbon emissions, other environment or health.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes