Written evidence submitted by The Association of Investment Companies

The Venture Capital Trust (VCT) scheme is currently subject to a 'sunset clause' (the clause). Without government action, the clause will stop the 30% income tax relief received by retail investors subscribing for VCT shares on or after 6 April 2025. This relief is critical to the success of the scheme. Its removal threatens VCTs and their capacity to fund small growing businesses. The government has committed to addressing the clause and ensuring the continuation of the VCT reliefs. The position agreed via the Windsor framework (the framework) provides the basis to do so now, without the need to go through the process of seeking European Commission approval.

Before the framework was agreed it seemed likely that the government would require approval from the European Commission to address the clause. The main reason being the possibility that VCT-backed businesses in the UK might sell goods into Northern Ireland which could be considered to affect trade in the single market. The framework resolves this issue.

The other consideration is the ability of VCTs to invest in small businesses in Northern Ireland. As this activity is insignificant in terms of the Northern Ireland economy and trade, this should not be a barrier. The impact of VCT backed businesses on trade with the single market is immaterial. The AIC therefore **recommends** that the government should remove the clause, leaving the scheme unchanged.

Alternatively, were the capacity to make investment into businesses based in Northern Ireland considered grounds for potentially requiring European Commission approval, the AIC **recommends** that qualifying investment conditions be modified to prohibit VCT investment in businesses based in Northern Ireland. This would have no practical effect as the overwhelming majority of VCT investment is in Great Britain. Given the political imperative of the UK government being able to achieve its UK-wide economic goals in Northern Ireland, the AIC **recommends** that a replacement scheme devoted to small business risk financing in Northern Ireland be developed and submitted to the European Commission (if required) for approval.

The AIC **recommends** that the Chancellor confirms his approach in the forthcoming Budget Statement, with a view to introducing necessary legislative measures to address the clause in the Finance Bill.

Application of State aid rules in Northern Ireland

State aid rules govern subsidies where they affect trade between Member States within the single market. Northern Ireland is in the single market and EU State aid rules continue to apply. In particular, the State aid rules apply to UK subsidies that could affect trade between Northern Ireland and the EU.

The framework clarifies how goods sold into Northern Ireland should be considered for the purpose of assessing trade with the single market. This is critical. It is this agreement which gives the UK government latitude to extend the VCT scheme without European Commission approval.

The Joint Declaration on the application of Article 10(1) confirms that State aid rules will continue to apply but also explains how trade between Great Britain and Northern Ireland should be considered to affect an assessment of trade within the single market. It states.

> *"For a measure to be considered to have a* ***genuine and direct link to Northern Ireland*** *and thus to have an effect on the trade between Northern Ireland and the Union that is subject to the Windsor Framework, that measure needs to have real foreseeable effects on that trade.* ***The relevant real foreseeable effects should be material, and not merely hypothetical or presumed****.*
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> *"For measures granted to any beneficiary that is located in Great Britain, factors relevant to materiality may include the size of the undertaking, the size of the subsidy, and the market presence of the undertaking in the relevant market in Northern Ireland. While* ***the mere placement of goods on the Northern Ireland market is not sufficient, on its own, to represent a direct and genuine link engaging Article 10(1)*** *of the Windsor Framework,* ***measures that are granted to beneficiaries located in Northern Ireland are more likely to have material effects.***
>
> *"For* ***measures granted to any beneficiary that is located in Great Britain that have a material effect, it must be further demonstrated that the economic benefit of the subsidy would be wholly or partially passed on to an undertaking in Northern Ireland****, or through the relevant goods placed on the market in Northern Ireland, for example through selling below market price, for there to be a direct and genuine link engaging Article 10(1) of the Windsor Framework."* **[Emphasis added.]**

This interpretation eliminates virtually all of the impacts of the VCT scheme on trade with the single market.

Beneficiaries of State aid provided under the VCT scheme

The EU Commission found (para 24) that the VCT scheme constitutes State aid to investors and investee companies.

Aid to investors

The aid provided to individual retail investors provides the basis for VCTs to raise capital for investment into target companies. The location of these recipients has no impact on trade between the UK and the single market.

Any impact would only arise where the companies invested in by VCTs have a material impact on trade. As discussed below, this is not the situation.

Aid to investee companies

The relevant beneficiaries of State aid provided via VCTs are the investee companies. These companies are small and therefore inherently unlikely to have a material effect on trade between Northern Ireland and the single market.

Business receiving VCT funding must:

- have no more than £15 million of gross assets before the investment is made by the VCT and no more than £16 million of gross assets immediately afterwards;
- not raise more than £5 million (or £10 million for knowledge-intensive companies (KICs)) in total from State aided investments in any 12 month period;
- not raise more £12 million (£20 million if a KIC) in State aided investments at any time in a 5 year period.

These businesses, when considered individually, have very little potential to have a material impact on trade between the UK and the single market. This conclusion is supported by the framework and the geographical range of VCT investment.

Investee companies in Great Britain

The EU's ability to initiate new procedures for aid granted before the end of the transition period which followed the withdrawal of the UK from the EU (i.e. the end of 2020) had a duration of four years. Its competence for aid provided to companies receiving VCT investment prior to January 2021 expires before the date currently scheduled for the application of the clause (5 April 2025).

Since January 2020 competence for UK state aid arrangements has resided with the Competition and Markets Authority (CMA). Were the UK government to continue aid to companies in Great Britain via the VCT scheme, competence for this would remain with the CMA.

EU State aid oversight would only apply were the activities of these companies to affect trade with the single market. The framework clarifies that this would not be relevant to continuing the VCT scheme. VCT investee businesses would trade with Northern Ireland (and directly with the single market) in exactly the same way as any other business located in Great Britain.

As the government's paper explaining the framework puts it "*This agreement ... imposes a stringent set of tests to ensure that there must be a proven real, genuine and material link to Northern Ireland's trade with the EU for any proposed aid to even be in scope. This rules out all but the largest subsidies and those where firms have no material presence in the Northern Ireland market, keeping the overwhelming majority of subsidies to companies in Great Britain solely under the UK's own subsidy control regime at a stroke."* (Paragraph 42).

Some VCT backed companies may place goods into Northern Ireland. However, the framework clarifies that "*the mere placement of goods on the Northern Ireland market is not sufficient, on its own, to represent a direct and genuine link".*

Nor is there any reason to believe, or evidence, that any company that has received VCT investment has, or would, sell goods in Northern Ireland at an undervalued price. Such practices would, in any event, be very unlikely. VCTs make investments on a commercial basis. The VCT is seeking growth, a commercial return and eventual exit. The amount which can be invested is limited. Investee companies do not have the resources to sell

products at undervalued prices. They are capital constrained (which is why they are eligible for VCT investment in the first place).
Also, there is no reason to conclude that a VCT-backed business based in Great Britain would be "*wholly or partially*" passing on the benefits of that investment to an undertaking in Northern Ireland. Were this a relevant consideration for addressing the clause, the AIC **recommends** that assurance on this matter could be achieved by revising the use of capital provisions to prevent benefits being passed on in this way.

Investee companies in Northern Ireland

An AIC survey identified 532 small businesses which received funds from VCTs between 1 January 2018 until the end of March 2022. A review of the next six month's investment activity identified a further 60 small businesses which received investment. Of the 592 companies identified as having received VCT funding, only three were located in Northern Ireland. This, combined with the restrictions on the size of companies receiving VCT investment, indicates that the VCT scheme in its current form does not have a material impact on trade.

The draft declaration considers the circumstances when subsidies granted within the UK do have a direct link to Northern Ireland (which would be the position for an investee company based in Northern Ireland). It says that the *"measure needs to have real foreseeable effects on that trade. The relevant real foreseeable effects should be material, and not merely hypothetical or presumed."* (Page 1 final paragraph.)

Since 2018, the AIC is aware of only 7 investments made by VCTs into 3 Northern Irish companies, totalling just over £10 million. This level of investment makes it reasonable to assume that VCT backed businesses in Northern Ireland would not have a foreseeable impact on trade. Also, EU rules exempt risk finance aid of up to Euro 15 million (Article 4, 1(g). Investee companies are limited to £12 million in investment (except KICs, which have a £20 million limit).

The extent of State aid made under the VCT scheme since 2018 into Northern Ireland is not material. It has not been shown to have any impact on trade with the single market. There is no reason to presume this will change in the future. The AIC therefore **recommends** that the government continues the VCT scheme without altering the ability of VCTs to invest in entities based in Northern Ireland. If such investment is assessed to be an issue, then the AIC **recommends** that the qualifying investment rules be altered to exclude such investment. If this approach is adopted, the AIC **recommends** that the UK introduce a successor scheme for financing SMEs in Northern Ireland. A dedicated Northern Ireland scheme may offer new opportunities to mobilise capital for this part of the market. Northern Ireland is within the EU's Regional aid Guidelines framework. These set out the rules governing state support to the least favoured regions of the single market and allow more generous aid to enhance regional development.

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