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Dear Kathryn Robertson

Draft guidance on advance assurance and ‘disqualifying arrangements’ for EIS

The British Screen Advisory Council (BSAC) is an independent, industry-funded umbrella group bringing together many of the most influential people in the audiovisual industry. Audiovisual material encompasses broadcasts, films and video games. Stakeholders across the value chain for audiovisual material are represented by BSAC. Please find a list of our membership enclosed. BSAC has worked closely with policymakers in various government departments including HMRC, DCMS, BIS and UK IPO to provide an informed lead on emerging business trends and to provide advice on policy. BSAC worked closely over an extended period of time with HM Treasury in developing the Film Tax Credit.

I am writing to you on behalf of BSAC Members as we have had sight of draft guidelines on ‘disqualifying arrangements’ and advance assurance for EIS relief, and understand that HMRC have asked for comments in short order. We are therefore pleased to be able to provide views.

We previously wrote to HM Treasury¹ in response to the consultation on tax-advantaged venture capital schemes on 28 September 2011 to raise concerns about the proposed criteria in Section 4 of the Treasury consultation, which would have made the majority of film production companies ineligible for EIS relief. In our letter, we welcomed the reforms to the Enterprise Investment Scheme (EIS) in order to further incentivise investment, and

¹ See <http://www.bsac.uk.com/2011.html> to download the letter.

recognised that, given this increased investment, it is important to ensure that the EIS is effective in targeting genuine risk capital investments and is not open to abuse. We raised concerns that the criteria did not take into account the high level of risk which characterises the majority of creative businesses leading to a predominance of micro-businesses operating in a project-oriented manner and relying on sub-contracting, and would therefore disqualify them from using EIS relief. We welcome the revision of the proposed criteria and the bringing forward of legislation without the eligibility clauses with which we took issue, and understand that more general guidelines on 'disqualifying arrangements' will apply.

However, BSAC is concerned that the way in which the guidelines are drafted concerning where 'disqualifying arrangements' apply so that advance assurance will not be given (section VCM21035) is far too broad, and is therefore likely to give rise to uncertainty. It is crucial that companies seeking to use EIS are able to gain advance assurance in order to be able to provide potential investors with a level of comfort that they will be eligible for tax relief. Creating uncertainty concerning advance assurance will lead to a stymieing of investment activity. In order to avoid such an outcome, more specific guidance should be issued. HMRC must clearly state that the factors pointing to a decision not to grant advance assurance are only indicators that a company may be ineligible to use EIS. We understand the need to ascertain that a company seeking to use EIS is taking a legitimate business risk and to 'prevent the schemes being used primarily for the purpose of delivering a tax mitigation product to investors', and are not averse to the implementation of guidelines to measure this. A clearer indication of how HMRC plans to interpret the guidelines in practice, with detailed examples, would be extremely helpful for companies intending to use EIS. We would also recommend that it be made clear that HMRC cannot raise issues or questions after the advance assurance has been given if such issues or questions could have been raised at the time that the initial application was made. HMRC can only raise issues or questions in respect of information that was not provided at the time of the initial application. This clarification will provide further certainty to investors.

At present, there is a risk that the factors which could lead to a rejection of companies for advance assurance do not sufficiently take into account the manner in which small high risk businesses operate. If implemented without regard for this, the guidelines could disqualify many SME and start-up enterprises, at whom the relief is targeted, from being able to receive advance assurance. For example, in bullet 1, the suggestion that a situation where shares are held for investors by a nominee or where the investment opportunity has been made available to them via an independent financial advisor could be a contributory factor to 'disqualifying arrangements' is unhelpful. We would argue that it is an established practice for companies seeking to raise capital to engage an expert intermediary to do so. Indeed, for the producer of a film, for example, this is the only way to raise capital as they will not generally know or have access to potential investors and have no choice but to approach an intermediary to raise capital on their behalf. We would recommend that a condition be introduced that if the management of the company is entitled to a meaningful share of revenues once the investors are repaid and have received a return, this would not constitute a 'disqualifying arrangement'. Similarly, in reference to bullet 2, it is a common practice that the majority of shareholders

will not be involved in the day to day management of the business. We do not see the purpose of disqualifying companies that operate in this manner from receiving advance assurance and would recommend the removal of this factor.

We are concerned that some of the factors which could lead to a rejection of a company for advance assurance would fall particularly heavily on creative businesses. It is imperative that creative businesses not be excluded from the relief as EIS has been invaluable in providing equity finance to these risk-intensive high growth businesses. Lord Smith recommended in his 2011 independent report on film policy, commissioned by DCMS, that Government should ensure that any changes to the EIS rules should not adversely affect the opportunity for independent film production companies to apply'.² We would add that it is also essential that film companies are able to claim both the Film Tax Credit and EIS relief, a view expressed by HM Treasury when developing the Tax Credit.

We previously noted in our 28 September 2011 letter to HM Treasury that 'in order to create high quality cost-intensive content, production businesses must operate in a project-based manner, employing very few staff and outsourcing work to sub-contractors.' Therefore, we would also raise concerns with the stipulation in bullet 3 that the majority of activities be carried out by employees of the relevant trading company, as this does not take into account the necessary prevalence of sub-contracting in the audiovisual sector. Sub-contracting is a vital commercial practice on which creative businesses subject to high levels of risk rely in order to keep overhead costs to a minimum. Similarly, the suggestion in bullet 4 that paying the monies raised by the share issue to a party subcontracted or commissioned in advance, whilst the company will not be paid by its customer until the work has been completed could be a factor contributing to a rejection is troubling. In the film industry, often a commissioning entity will commission another to carry out all or part of the production work, pay that company upfront and will not receive any monies itself until the work is completed and delivered to distributors. This is the structure used by most film productions because many accountants advise film producers to use a commissioning structure to preserve the value of the Tax Credit. Furthermore, the recoupment period for monies invested into a creative product, such as a film, is normally far longer than the '90 days of the goods or services being provided' specified in bullet 5 due to the cost-intensive nature and long life-cycle of creative content products, meaning this factor could be prejudicial to creative content businesses receiving advance assurance. We would also raise concerns relating to bullet 6 that the purchase and re-sale of intangible assets could be a 'disqualifying factor'. For example, if a commissioning structure is used and the commissioning entity then sells the film to distributors, this would amount to purchase and re-sale of intangible assets. Finally, the stipulation in bullet 7 that information presented to potential investors should not include statements indicating the likely or targeted return on investment does not take into account the fact that revenue streams have varying degrees of risk. Such revenue streams exist in the normal course of the activities of a creative business. For example, receipt of the Film Tax Credit will be a more certain portion of an EIS company's cash flows than equity finance.

² 'A Future for British Film: It begins with the audience' UK Film Policy Review, p48

Limiting the ability of a company to describe the risk/return objectives of their business will impact on their ability to attract investment.

In conclusion, we understand from conversations with the relevant officials that the intention of the guidelines is not to exclude specific industries, such as the creative industries, from being able to use the relief. However, we are concerned that if the guidelines are implemented in their current form, they could be interpreted in such a way as to disqualify the majority of creative businesses from accessing the relief. Such an outcome would be antithetical to the Government's Plan for Growth which aims to ensure that smaller businesses have access to a wide range of financing sources. The way that the guidelines are drafted is likely to create high levels of uncertainty in the industry which would have a chilling effect on investment. We urge HMRC to undertake further open consultation with industry before proceeding and would be happy to provide suggestions with drafting which would remedy some of the issues we have raised if invited to do so.

We look forward to continuing to engage with HMRC on this issue.

Yours sincerely

A handwritten signature in black ink, appearing to read 'F. Clarke-Hackston', with a long horizontal stroke extending to the right.

Fiona Clarke-Hackston
Chief Executive
British Screen Advisory Council (BSAC)