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In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […]		PUBLIC VERSION This document is made available for information purposes only.

Subject: State Aid SA.107221 (2023/N) – United Kingdom (Northern Ireland) Prolongation of the Enterprise Investment Scheme (EIS) and the Venture Capital Trust scheme (VCT)

Dear Foreign Secretary,

The European Commission ('the Commission') wishes to inform the United Kingdom ('UK') that, having examined the information supplied by your authorities on the State aid measure referred to above, it has decided not to raise objections to it as it is compatible with the internal market pursuant to Article 107(3), point (c), of the Treaty on the Functioning of the European Union ('TFEU') ([1]).

The Commission has based its decision on the following considerations:

([1]) As applicable under Articles 10(1) and 12(4) of the Protocol on Ireland/Northern Ireland Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (OJ L 29, 31.1.2020, p. 7).

The Rt Hon David Lammy
Secretary of State for Foreign, Commonwealth and Development Affairs
King Charles Street
London SW1A 2AH
United Kingdom

1. PROCEDURE

(1) On 20 April 2023, the UK authorities pre-notified under the Risk Finance Guidelines ([2]) the prolongation of two risk finance measures, namely the Enterprise Investment Scheme (the 'EIS') and the Venture Capital Trust (the "VCT") (together referred to as the 'EIS/VCT schemes').

(2) The EIS/VCT schemes were first approved in April 2009 ([3]), and amendments thereof were authorised by the Commission in 2011 ([4]) and 2012 ([5]). Further amendments were authorised in 2015 ([6]) (the '2015 Decision') following the revision of the Risk Finance Guidelines and most recently in 2018 ([7]) (the '2018 Decision').

(3) During the pre-notification procedure, the Commission asked for supplementary information on 15 May 2023, which was provided by the UK authorities on 21 June 2023. The Commission asked for additional information on 14 July 2023, on 28 September 2023 and on 4 December 2023 to which the UK authorities responded, on 5 September 2023, on 11 October 2023 and on 30 January 2024, respectively.

(4) On 25 October 2023, the UK authorities notified a prolongation of the existing EIS/VCT schemes for another ten years after their due expiry, i.e. from 6 April 2025 until 5 April 2035, in accordance with Article 108(3) TFEU. Apart from the prolongation, the UK has not notified any other amendment of the existing EIS/VCT schemes.

2. DETAILED DESCRIPTION OF THE MEASURE

2.1. Objective of the measure

(5) The existing EIS/VCT schemes aim to promote investments in early-stage small and medium-sized enterprises ('SMEs') and knowledge-intensive SMEs and mid-caps (see recital (7)) ([8]), which according to the UK authorities have difficulties accessing finance. For these types of companies, asymmetries of information between the investor and the investee could indeed be more pronounced as compared to larger and more established companies. The rather limited size of the

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([2]) Communication from the Commission, Guidelines on State aid to promote risk finance investments (OJ C 508, 16.12.2021, p. 1).

([3]) State aid cases NN42a/2007 and NN42b/2007 (OJ C 145, 25.6.2009, p. 6).

([4]) State aid case SA.33376 (OJ C 343, 23.11.2011, p. 12).

([5]) State aid case SA.33849 (OJ C 196, 4.7.2012, p. 4).

([6]) State aid case SA.40991 (OJ C 425, 18.11.2016, p. 1).

([7]) State aid case SA.49923 (OJ C 360, 5.10.2018, p. 1).

([8]) The definition of SMEs corresponds to the definition laid down in Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36-41) and Annex I of Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187, 26.6.2014, p. 1). The definition of mid-caps falls within the definition laid down in the Risk Finance Guidelines in paragraph 35(23).

investments might make it difficult for investors to earn back the search, due diligence and monitoring costs associated with smaller investments.

(6) The EIS/VCT schemes also intend to stimulate a culture of entrepreneurship and greater risk-taking amongst investors.

(7) Further, the focus of the EIS/VCT schemes on knowledge-intensive undertakings aims at fostering an increase in research and development ('R&D') and patent applications, which in turn is expected to have a positive effect on the overall economy. In that context, the definition of 'knowledge-intensive SMEs and mid-caps' encompasses enterprises that meet at least one of the following two alternative criteria ([9]):

(a) research and development costs (which can include seeking patents, resources required to develop and test prototypes, other) represent at least 15% of total operating costs in at least one of the accounting periods ending in the three years preceding the accounting period in which the investment under the risk finance State aid measure is made; or

(b) research and development costs represent at least 10% per year of total operating costs in each of the accounting periods ending in the three years preceding the accounting period in which the investment under the risk finance State aid measure is made.

2.2. Form of aid

(8) The tax incentives provided by the EIS/VCT schemes, as described in recitals (11) to (13) of the 2015 Decision, and as amended, described in recitals (14) to (27) of the 2018 Decision, remain unchanged.

2.3. Eligible undertakings (investees)

(9) The EIS/VCT schemes target the following undertakings (investees):

(a) unlisted non-knowledge intensive SMEs, up to seven years after their first commercial sale or where the initial risk finance investment, based on a business plan prepared in view of entering a new product or new

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([9]) In addition, eligible companies must also fulfil one of the two following conditions: At least 20% of the workforce is required to have a level 7 (Masters) or 8 (Doctoral) or equivalent qualification as defined by the Framework for Higher Education Qualifications (FHEQ) or an equivalent framework, and are engaged in R&D activity; or the company can demonstrate that it is intending to innovate, or develop new patents, where the exploitation of these innovations will represent the greater part of its business activity within the next 10 years, as validated by an external expert evaluating the company and confirming that the enterprise will in the foreseeable future develop new products, services or processes, or as evidenced where the company has already begun the process of making patent applications. (A company will meet the innovation condition if it is engaged in carrying out work to create intellectual property at the time when the investment is issued and that it is reasonable to assume that within 10 years of the investment most of the company's or group's business activities will consist of the exploitation of that intellectual property or business which uses the intellectual property (or both).)

geographic market, is higher than 50% of their average annual turnover in the preceding five years ([10]);

(b) unlisted knowledge-intensive SMEs and mid-caps, up to ten years after their first commercial sale or where the initial risk finance investment, based on a business plan prepared in view of entering a new product or new geographic market, is higher than 50% of their average annual turnover in the preceding five years ([11]).

(10) Under the prolonged EIS/VCT schemes, no risk finance aid will be granted to undertakings in difficulty, as defined in paragraph 28, point (a), of the Risk Finance Guidelines. The EIS/VCT schemes also exclude aid to undertakings that have received illegal aid that has not yet been fully recovered. Furthermore, the schemes do not concern aid to export-related activities towards third countries or Member States, namely aid directly linked to the quantities exported, the establishment and operation of a distribution network or to other current costs linked to the export activity, as well as aid contingent upon the use of domestic over imported goods.

(11) The UK authorities have only notified the prolongation of the EIS/VCT schemes as regards aid granted to beneficiaries located and registered in Northern Ireland. The Commission's assessment applies thus only to this part of the prolongation of the two schemes, accepting that the evaluation and ex ante assessment of the measure, carried out for the entire UK as geographic scope of the schemes, is also valid for this part (see recital (25)).

2.4. Eligible investors

(12) The EIS/VCT schemes provide tax incentives to private individuals (natural persons who are not undertakings for the purposes of Article 107(1) TFEU) investing in eligible undertakings (EIS), or in financial intermediaries (VCT), which carry out the eligible investments.

(13) Under the EIS measure, private individuals must invest directly into the eligible undertaking.

(14) Under the VCT measure, individuals must invest indirectly and collectively via investment funds, the managers of which invest on their behalf in a portfolio of companies. VCTs are managed by independent fund managers and may be formed by legal trust or by statute.

2.5. Legal basis, granting authority, budget, duration, transparency, cumulation and evaluation

(15) The legal bases for the existing EIS/VCT schemes are Parts 5 and 6 of the Income Tax Act (ITA) 2007 and Part C, Chapter 5 of the Income Tax (Trading and Other Income) Act 2005, both as last amended. Both Acts will be amended to prolong the schemes until 5 April 2035.

([10]) Recital (26) of the 2015 Decision.

([11]) Recitals (28) and (29) of the 2015 Decision.

(16) The tax relief is granted automatically, on a non-discretionary basis, by HM Revenue & Customs ("HMRC"), the granting authority, once the qualifying objective criteria are fulfilled.

(17) The expected budget of the measure for companies located in Northern Ireland is GBP 10 million annually (approximately EUR 11.5 million ([12])).

(18) The Commission in its 2015 Decision approved the existing EIS/VCT schemes until 5 April 2025. In the 2018 Decision, the Commission approved certain amendments to the EIS/VCT schemes but did not modify the duration of the schemes.

(19) The UK authorities have committed to publish the information required by the Transparency Communication ([13]) on the Commission's website ([14]). The UK authorities undertake to publish, on a website, the scope and the technical parameters (incl. ceilings and caps, maximum investment amount) of the EIS/VCT schemes.

(20) The UK authorities have committed to respect the provisions on cumulation specified in section 3.2.4.4 of the Risk Finance Guidelines.

(21) The performance indicators as listed in recitals (42), (44), (47) and (49) of the 2015 Decision remain valid as performance indicators. The UK authorities have based the ex ante assessment of the notified prolongation on these indicators and will use them in future evaluations, which will be conducted every five years. The UK authorities will, when evaluating the measures, look at the UK-wide implementation but also specifically at the use of the scheme in Northern Ireland. The UK authorities will also look at the specific impacts of the part of the measure that is within the limits of the General Block Exemption Regulation (the 'GBER') ([15]) and of the part that is outside the GBER limits.

2.6. New ex ante assessment of the EIS/VCT schemes

(22) The current EIS/VCT schemes and their approval under State aid rules will expire on 5 April 2025, while the UK authorities seek to prolong the EIS/VCT schemes until 5 April 2035. The Risk Finance Guidelines require that the Member State, if it proposes to extend a measure to a total duration of more than ten years, must carry out a new ex ante assessment, together with an evaluation of the effectiveness of the scheme during the entire period of its implementation ([16]).

([12]) Based on the exchange rate on 30 October 2023.

([13]) Communication from the Commission, amending the Communications from the Commission on EU Guidelines for the application of State aid rules in relation to the rapid deployment of broadband networks, on Guidelines on regional State aid for 2014-2020, on State aid for films and other audio-visual works, on Guidelines on State aid to promote risk finance investments and on Guidelines on State aid to airports and airlines (OJ C 198, 27.6.2014, p. 30).

([14]) https://webgate.ec.europa.eu/competition/transparency/public?lang=en

([15]) Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187, 26.6.2014, p. 1).

([16]) Paragraph 126 of the Risk Finance Guidelines.

2.6.1. *Submitted evidence*

(23) The UK authorities have submitted a new ex ante assessment and an evaluation of the effectiveness of the scheme for the prolongation of the measure.

(24) The new ex ante assessment comprises the following documents:

(a) the ex ante assessment submitted for the amendment and prolongation in 2015 (the '2015 ex ante assessment'), together with an explanation of why the findings of the 2015 ex ante assessment with respect to the funding gap estimate are still relevant ([17]);

(b) market research, stemming mainly from the years 2022 – 2023, including the Innovation and Growth Report 2022/23 ([18]); the World Intellectual Property Office's Global Innovation Index 2022 ([19]); the Global Intellectual Property Centre (GIPC) International IP Index 2023 ([20]); AON's 2023 Funding Innovation report ([21]); the 2020 ONS report on investment in intangible assets in the UK ([22]); data from Pitchbook on UK private equity deals in 2023 ([23]); a S&P Global report from 5 December 2023 ([24]); the 2022 British Venture Capital and Private Equity Association's report on Investment Activity ([25]); Marek Kacer and Nick Wilson (2023), "Equity Finance for Start-up and Growing Businesses: Recent Trends", December 2023 ([26]); the 'Patient Capital Review' ([27]), a review of barriers that small companies face when seeking risk finance which was submitted for the amendment of the EIS/VCT schemes in the 2018 Decision;

(c) evidence on the risk finance market of Northern Ireland, including Marek Kacer, Nick Wilson and Mike Wright (2019), "Equity Finance and the UK Regions Understanding Regional Variations in the Supply and Demand of

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([17]) The key report in that ex ante assessment was the report "The Equity Gap and Knowledge-based Firms", Nick Wilson and Mike Wright, July 2015.

([18]) The Intellectual Property Office, Innovation and Growth Report 2022/23, 12 September 2023, https://www.gov.uk/government/publications/promoting-innovation-and-growth-the-ipo-at-work-2022-23/innovation-and-growth-report-202223-html.

([19]) https://www.wipo.int/global_innovation_index/en/2022/

([20]) https://www.uschamber.com/intellectual-property/2023-international-ip-index

([21]) https://www.aon.com/getmedia/211b5ead-06a8-45e7-8b11-6092dfe671d5/AON_Funding-Innovation-Report_Digital_10-11-23.pdf

([22]) https://www.ons.gov.uk/economy/economicoutputandproductivity/productivitymeasures/articles/experimentalestimatesofinvestmentinintangibleassetsintheuk2015/latest

([23]) 2023_UK_Private_Capital_Breakdown.pdf (pitchbook.com)

([24]) https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/private-equity-megabuyouts-in-europe-uk-show-higher-value-fewer-deals-79637170

([25]) https://www.bvca.co.uk/Portals/0/Documents/Research/Industry%20Activity/BVCA-Report-On-Investment-Activity-2022.pdf

([26]) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4657150#:~:text=After%20sizeable%20increases%20during%20the,the%20third%20quarter%20of%202023

([27]) https://www.gov.uk/government/publications/patient-capital-review

Equity and Growth Finance for Business", BEIS Research Paper Number 2019/012 (the '2019 Equity Finance and the UK Regions research paper') ([28]); and the data collection by the UK authorities and published annual statistics regarding companies and investors using the schemes ([29]).

(25) The UK authorities seek approval for the schemes insofar as they concern aid to eligible undertakings permanently established in Northern Ireland. The UK authorities have based the ex ante assessment on the entire geographical scope of the EIS/VCT schemes i.e. the UK, but also examined the situation in Northern Ireland to assess whether the market failure applies similarly to Northern Ireland than to the rest of the UK. The UK authorities note that Northern Ireland is a much smaller market than the rest of the UK (in 2022, less than [1-5]*% of knowledge-intensive companies and less than [1-5]% of non-knowledge-intensive companies were based in Northern Ireland and the GDP of Northern Ireland is around 2% of total UK GDP). Fewer than five companies incorporated and registered in Northern Ireland received VCT funding and 40 companies received funding from the EIS. Whilst there are fewer companies in scope of the schemes in Northern Ireland, owing to its relatively small size, there is no evidence to suggest that the market failure is not experienced by companies based there ([30]). The UK authorities refer to evidence from the 2019 Equity Finance and the UK Regions research paper, which shows a significant equity gap in Northern Ireland. Northern Ireland was found to have a 408% gap between the actual equity flow and the estimated equity needs. It was also found to have the fourth largest relative demand for additional equity in relation to the actual equity stock in the UK. Given the small number of companies receiving funding from the schemes in Northern Ireland and the evidence that the equity gap is not lower, or likely to be higher, in Northern Ireland than in the rest of the UK, the UK authorities consider that the cost and resource of undertaking a new assessment only with respect to Northern Ireland is disproportionate and that the continued provision of the EIS/VCT schemes in Northern Ireland, as also provided in the rest of the UK, remains appropriate.

(26) The UK authorities submitted an evaluation of the effectiveness of the EIS/VCT schemes during the entire period of its implementation, consisting of the ex-post evaluation of the existing EIS/VCT schemes as required in recital (24) of the 2015 Decision ([31]) and an ex post evaluation carried out in 2022 (the '2022 ex post evaluation').

([28]) https://assets.publishing.service.gov.uk/media/5d4023c9e5274a4016893bc7/sme-equity-finance-regions-research-2019-012.pdf

([29]) https://www.gov.uk/government/statistics/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-may-2022/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-statistics-2022

([30]) UK government data shows that in 2021/22, over 60% of the companies in Northern Ireland that had received funding from the EIS scheme were conducting R&D activities, indicating that they are likely to be innovative companies.

([31]) "Evaluation of the Tax-advantaged Venture Capital Schemes", Kantar Public, December 2018.

* *Confidential information.*

2.6.2. *Evidence on the market failure*

(27) The UK authorities explain that key aspects of the 2015 ex ante assessment are still accurate and valid for the measure.

(28) First, the UK authorities recall the explanation in the 2015 ex ante assessment that the equity gap resulting from asymmetric information tends to be persistent and is not the result of transitory credit rationing, which is due to disequilibrium in credit markets related to excess demand and reduced supply.

(29) A commonly recognised cause of information asymmetry is the lack of a track record for young SMEs, who may therefore struggle to demonstrate their creditworthiness or the soundness of their business plan to investors. To overcome this market failure, investors would need to perform detailed screening of the business proposal. As set out in paragraph 3 of the Risk Finance Guidelines, the cost of the required due diligence is often high relative to the size of the investment. The disproportionate costs can result in viable businesses being unable to obtain the funding they require to develop and grow as investors are deterred from undertaking due diligence on smaller investments, as for the same cost they are able to undertake due diligence on much larger investments. This leads to a reluctance to make smaller investments. This constrains the supply of finance for viable SMEs seeking finance for growth. Recent evidence has confirmed this finding ([32]).

(30) The UK authorities also recall the findings of the 2015 ex ante assessment that the market failure likewise impacts early-growth and later-stage firms, particularly if they are knowledge-intensive.

(31) The UK is particularly exposed to problems faced by knowledge-intensive companies. The population of knowledge-intensive companies is higher in the UK than the Union average, as described in the European Innovation Scoreboard 2023 country report ([33]). The UK is ranked fourth in the World Intellectual Property Office's Global Innovation Index 2022 ([34]) and second in the Global Intellectual Property Centre (GIPC) International IP Index 2023. The UK explains that the conclusion that UK companies are particularly affected by problems faced by knowledge-intensive companies, as summarised in recital (91) of the 2015 Decision, is still valid. As knowledge-intensive companies are more severely afflicted by an access-to-finance-problem than non-knowledge intensive companies, UK companies tend to be more exposed to access-to-finance problems than companies in countries with lower innovation activity. The UK

([32]) In 2022 the Venture Capital Trust Association conducted research among a sample of 240 senior decisionmakers at UK SMEs in August 2022. 43% identified difficulty in providing a business model as being a main reason that makes it difficult to access external finance. 42% identified having an insufficient business track record as a main reason and 37% identified lack of collateral.

([33]) In a 2023 country report, the European Innovation Scoreboard describes the UK as a strong innovator, with a performance at 117.8% of the EU average (https://ec.europa.eu/assets/rtd/eis/2023/ec_rtd_eis-country-profile-uk.pdf). UK official statistics from 2019 show that 49% of people in employment in Great Britain work in knowledge-intensive services or high-tech or knowledge-intensive financial and market services. The 2022 Global Innovation Index ranks the UK as 4th globally.

([34]) wipo.int/edocs/pubdocs/en/wipo-pub-2000-2022-en-main-report-global-innovation-index-2022-15th-edition.pdf

authorities deem that innovation will continue, and that innovative companies will be crucial over the next 10 years and beyond. They cite the 2022/23 Innovation and Growth Report ([35]), which sets out the UK's focus and ambition on innovation, noting that 'boosting innovation in the private sector is an essential part of the UK's future prosperity.'

(32) The UK authorities note that a particularly important factor affecting such companies' ability to attract finance is the intangibility of assets, which do not constitute good collateral to obtain external financing. The higher proportion of intangible assets and the innovative nature of activities undertaken by knowledge-intensive companies create more difficulties in valuing them. As a result of adverse selection and moral hazard, projects with positive net present value may not at all be successful in attracting sufficient external financing, resulting in an 'equity gap' (see recital (94) of the 2015 Decision).

(33) Second, as regards the market failure afflicting knowledge-intensive companies, the UK authorities recall the findings of the 2015 ex ante assessment that knowledge-intensive companies may also need to shift from their initial trajectory and reposition themselves in order to develop a successful business model that is consistent with market demand. For smaller firms which are yet to reach a sustainable growth path and who lack collateral, repositioning may not be possible without being able to attract further external finance. Furthermore, as Wilson and Wright (2015) discuss, "new players in the market have 'deep pocket' competitors that may act as a barrier to the entry and growth of emergent firms that require equity funding beyond the initial stages". The 2015 ex ante assessment continued that, "an absence of follow-on funding may mean that ventures are unable to implement the lessons learnt from initial interactions with the market". Whilst this problem could potentially affect all types of SMEs seeking to develop an innovative approach within their product or service market, it may be more of problem for knowledge-intensive businesses due to the typically longer lead times to bring products to market.

(34) The UK authorities are of the view that the specific information asymmetry that the EIS/VCT schemes seek to address is essentially irresolvable. A large, established multinational corporation with a long track record will always have vast amounts of publicly available information for analysts and investors to consider, whereas a new start-up business will never have this information available. The UK authorities consider that this fundamental characteristic difference will never substantially change, and that the identified market failure is expected to be persistent.

(35) With regard to the equity gap identified in the 2015 ex ante assessment, the UK authorities deem that evidence points to the persistence of this gap in the funding of high-risk innovative companies. The Patient Capital Review found that growing UK businesses 'struggle to secure investment of between GBP 5 million and GBP 20 million'. An article by Wilson, Wright and Kacer published in 2017 considered the equity gap and knowledge-based firms, estimating the size of the equity gap in total and that knowledge-intensive companies face. They estimate

([35]) https://www.gov.uk/government/publications/promoting-innovation-and-growth-the-ipo-at-work-2022-23/innovation-and-growth-report-202223-html

that there is a sizable equity gap in the UK of between GBP 2 billion to GBP 20 billion for knowledge-intensive companies, which is higher than the estimate of the Wilson and Wright 2015 paper ([36]). The 2020 ONS report on investment in intangible assets in the UK shows a reduction since 2016 in investment in capitalised intangible UK assets. AON's 2023 Funding Innovation report suggest a significant equity demand stemming from intellectual property (IP) rich companies. AON sets out that 2% of the IP rich population, corresponding to 381 companies which are both equity backed and classified as scale-ups, have raised GBP 15.7 billion in total equity funding. This shows that there is significant demand for equity funding from IP rich companies, and as an innovation heavy economy the UK government expects this to continue to grow over time. Further, the behaviour the UK authorities observed in the EIS/VCT schemes prior to 2018 strongly suggests that investment naturally flowed to businesses that presented lower risk in the absence of State intervention. The introduction of the 2018 'risk-to-capital' condition (see recital (17) of the 2018 Decision) addressed this tendency, but the behaviour in question further suggests that without the support of the EIS/VCT schemes, investment would flow to businesses that present lower risk and are potentially less innovative. The authors of the 2019 Equity Finance and the UK Regions research paper set out that 'Although policy interventions have stimulated the supply of equity finance by providing tax advantages for investors, evidence on the existence and nature of an 'equity-gap' suggests that there is a problem of access to finance among existing smaller firms (particularly high technology and knowledge-intensive firms) beyond start-up, the constraints of which could prevent firms from reaching their growth potential and necessitating further support and policy intervention.'

(36) The UK authorities explained that the UK banking sector has remained concentrated, despite policy initiatives by the UK Government to improve the levels of competition in that sector. The UK authorities referred to an analysis of the European Parliament, published in June 2021 ([37]), which set out that 'the UK sector remains moderately concentrated compared to euro-area countries. Additionally, the UK authorities submitted data indicating that bank concentration rose between 2018 and 2020, the last year for which data is available ([38]). The UK authorities consider that bank concentration is likely to continue to play a role in access to finance issues for SMEs in the near term.

(37) The UK authorities expect that the current economic environments will make access to finance for eligible companies more challenging in the near and medium term due to external factors including high levels of inflation, rising interest rates and residual impacts from the COVID-19 pandemic ([39]). The UK government further believes that the interest rate environment will have an impact on the

([36]) Wilson, N. Kacer M. and Wright M (2018), "The equity gap and knowledge-based firms," Journal of Corporate Finance, vol. 50(C), pages 626-649.

([37]) https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/689438/IPOL_IDA(2021)689438_EN.pdf

([38]) https://fred.stlouisfed.org/series/DDOI01GBA156NWDB

([39]) Residual impacts include earlier than anticipated follow-on funding of existing companies, crowding out new project, a lower merger and acquisition activity that diminished exit options and limited the capital available to invest in new companies.

ability of companies to raise funds over the next 10 years ([40]). A higher interest rate means that consumers face higher interest payments on any debt they hold, reducing the capital that these consumers have to invest into higher risk investments. They may also choose to put money in savings accounts, which may offer a higher savings rate in response to the higher interest rate, instead of investing it in companies.

(38) The UK Government also notes that recent volatility in inflation and interest rates can impact businesses' ability to raise equity because investors are less likely to make significant investments. The National Institute of Economic and Social Research argues that there have been economic shocks in the UK, including in relation to the COVID-19 pandemic and to Russia's military aggression against Ukraine, which have had an impact on real incomes of households in the UK ([41]). These were unforeseen shocks which possibly will have a long-term impact on investor confidence in the UK. Further evidence on the negative impact of uncertainty stems from the Interim report of Equity Finance for Start-up and Growing Businesses of December 2023 by Marek Kacer and Nick Wilson([42]). The authors find that the equity funding ecosystem grew from 2011 to 2017, and, experiencing a phase of uneven development and COVID-19 related shocks, until the beginning of 2022. Equity investments fell from 2022 and over the entire year 2023, which the authors described as a 'worrying phenomenon', suggesting that 'ever-increasing uncertainty caused by combination of several crises' could be having an impact on these investments.

(39) The UK authorities submitted evidence showing that access to finance from financial market remains challenging. The British Business Bank's Small Business Finance Market report for 2022/23 shows that in 2022 there was 'a fall in the number of smaller businesses accessing external finance, with only a third of businesses doing so compared to 44% in 2021'. Additionally, this report tracks a decline in UK equity markets over 2022. Whilst investment growth at the start of 2022 was strong, this slowed substantially in the third quarter of 2022, showing a reduction of 51% in investment and 11% in deal numbers compared to the third quarter of 2021. The report also sets out that, whilst there has been some resilience in UK Venture Capital (VC) returns, 'there is widespread expectation from market stakeholders that fund valuations will decline over the next 12 months due to lower portfolio company valuations and reduced exit opportunities. This is also likely to result from economic factors such as increased interest rates, which raise the risk-free rate of return and therefore weigh upon VC fund valuations'([43]).

([40]) The UK Bank of England Base rate (Bank Rate) was below 1% from March 2009 to May 2022. Since then, it has steadily risen to a high of 5.25%, where it has been set since August 2023. See https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp.

([41]) https://www.niesr.ac.uk/blog/outlook-uk-economy#:~:text=The%20three%20shocks%20of%20Brexit,substantial%20fall%20in%20real%20incomes

([42]) Equity Finance for Start-up and Growing Businesses: Recent Trends by Nick Wilson, Marek Kacer :: SSRN

([43]) https://www.british-business-bank.co.uk/wp-content/uploads/2023/02/J0189_BBB_SBFM_Report_2023_AW.pdf

(40) The UK authorities are of the view that the market failure and the resulting equity gap that relates to SMEs and knowledge-intensive mid-caps remains unchanged. The UK authorities therefore see the need for a prolongation of the measure beyond 2025.

(41) The UK authorities consider that a prolongation for 10 years, until 5 April 2035 is appropriate for two reasons.

(42) Firstly, the funding cycle and structure of VCTs requires a sufficient duration and certainty of operation for these financial intermediaries within which funds can be raised and deployed and eligible undertakings taken through the pipeline from start-up to scale-up. For undertakings seeking finance the process will take several months at a minimum and for many up to 18 months or more before investment is finally obtained. Similarly, financial intermediaries within the EIS typically require between 12 and 18 months to deploy funds they have raised and VCTs take up to 3 years. The effective duration of the measure is shorter than the formal duration because the uncertainty on whether the scheme will be continued or not starts to be felt in investment decisions many months before the end of the EIS/VCT scheme. Even in a 'benign' market, a shorter prolongation than 10 years would limit the ability for longer term investment planning and would impact on the confidence and commitment required to support patient capital and meet the capital intensive and longer growth stage of knowledge-intensive companies.

(43) Secondly, the longer time period can help with the establishment of a funding ecosystem and builds upon the UK authorities' objectives of delivering patient finance, in particular to support knowledge-intensive companies with their longer expansion/growth stages. A shorter duration would encourage shorter term investment decisions and would impact on the commercial viability of the VCT intermediaries, reducing their ability to develop economies of scale, demonstrate their own track record to raise funds and so limit the opportunity for new entrants into the financial ecosystem. The UK authorities cite evidence from the 2019 Equity Finance and the UK Regions research paper that an established eco-system and/or momentum is correlated with the number of equity deals in regions, and that 'the development of these eco-systems of 'funders and new ventures' creates a gravity that attracts both firms looking for funds and new funds to the region'.

2.6.3. Evidence on the effectiveness of the measure

(44) The 2022 ex post evaluation focused, as a basis for the justification of the prolongation of the EIS/VCT schemes on the following objectives of the measure: (a) incentivising private investment into eligible companies; (b) development of eligible undertakings and their ability to access funding; (c) impact on the equity funding gap and the development of a VC market; and (d) impact on competition in the sectors targeted by the EIS/VCT schemes.

2.6.3.1. Evidence on investor incentives

(45) The 2022 ex post evaluation has shown that the EIS/VCT schemes have incentivised additional investment into target companies. In the absence of the

schemes, most investors would have invested in less risky ways and over three-quarters would not have invested in the same or similar companies ([44]).

(46) In general, the investors accepted some risk in their investments. Most agreed that they were 'comfortable with the idea of their investments falling and rising rapidly' (87% of EIS investors, 84% of VCT investors), including more than half that strongly agreed (59% of EIS investors, 55% of VCT investors). Most also agreed that they 'like investing in higher risk markets to potentially gain higher returns' (73% of EIS investors, 72% of VCT investors). The 2022 ex post evaluation found that around three-quarters (71% of EIS investors, 78% of VCT investors) said they preferred a mix of low- and high-risk investments. EIS investors tended to be slightly more open to risk. One in five EIS investors (21%) expressed a preference for high-risk investments, compared with 15% of VCT investors.

(47) The 2022 ex post evaluation found that investors in VCTs were distinct from EIS investors in a number of ways. On risk, fewer VCT investors expressed a preference for high-risk investments and were more likely to change their investing habits when presented with the counterfactual of lower tax incentives or the removal of the schemes. VCT investors valued the increased diversification of investing in a VCT, rather than the underlying portfolio of companies and did not value the ability to invest in a specific company as much as EIS investors. Only 25% of the investors surveyed for the 2022 ex post evaluation invested in both, indicating that the two investor groups remain somewhat distinct.

(48) More than half (57%) of EIS investors said the tax incentive was one of the most important reasons they invested through the scheme. Similarly, investors acknowledged that the most important reason for investing in VCT schemes were the tax incentives available. The latter tended to be more important amongst VCT investors, with nine in ten (89%) saying they were one of the most important reasons for investing in a VCT.

(49) Significantly less prominent than the tax incentives, investors regarded the 'potential return on the investment' (26% of EIS investors, 32% of VCT investors) and the 'diversification of investments' (20% of EIS investors, 28% of VCT investors) as other reasons for investing through VCTs.

(50) When presented with a counterfactual of no tax incentive scheme or one that was less generous, investors indicated that they would change their investing habits and/or withdraw some or all of the investment from targeted companies. The UK authorities conclude from this that an equity gap would likely develop if the schemes were withdrawn or scaled backed. This gap could also be exacerbated by wider venture capital market conditions, i.e. dampened investor interest due to heightened current and expected interest rates (recitals (37) and (39)). If the tax

([44]) The survey explored probable uses for investor money had the EIS or VCT schemes not been available. Most VCT investors would still have invested, but two-thirds (66% of both EIS and VCT investors) would have done so in less risky ways. More than half said they would have invested in different companies (62% of EIS investors, 70% of VCT investors). Around a third said that they would have invested in the same companies but would have invested a lesser amount (31% of EIS investors, 34% of VCT investors). Just over a quarter said they would have invested in the same or similar companies, even without VCT (28% of EIS investors, 26% of VCT investors).

incentives were to be reduced, the number of investors using the schemes would thus certainly decrease.

2.6.3.2. Evidence on the development of eligible undertakings

(51) The UK authorities report in the 2022 ex-post evaluation that investment through the EIS/VCT schemes has been concentrated in businesses that either meet the statutory definition of a knowledge intensive company or belong to more innovation-driven sectors, such as the Professional, Scientific and Technical sector. Investments via the EIS/VCT schemes have increasingly been concentrated in young, start-up businesses. This is in line with the policy objectives for those schemes.

(52) The 2022 ex-post evaluation showed that the majority of investees surveyed, in particular knowledge-intensive investees and investees seeking more finance, agreed that the EIS/VCT schemes were either essential or very important to raising finance. Businesses surveyed reported difficulties raising other forms of finance and agreed that the schemes helped catalyse funding rounds and drawing in additional investment.

(53) Econometric analysis conducted in the 2022 ex-post evaluation found evidence that EIS investment drove increases in key business metrics when compared to a control group of businesses that did not raise EIS investment. Companies that received EIS investment saw increases in turnover, assets and employment of 88%, 132% and 39% respectively compared to businesses that did not receive EIS investment. Whilst the econometric evidence related to the impact of EIS investment on business survival was inconclusive, over half of EIS businesses surveyed thought it was unlikely they would still be in business without the EIS.

(54) The schemes continue to target businesses where market failures are considered most acute. Of the companies surveyed, around half met the statutory definition of a knowledge-intensive company. HMRC statistics for 2020/21 show that companies from the Manufacturing, Wholesale and Retail Trade, Repairs, the Information and Communication and the Professional, Scientific and Technical sectors accounted for around GBP 1.2 billion of investment and made up 71% of all EIS investment. This has remained consistent since 2019/20. ([45]) The Association of Investment Companies (AIC) reports that almost half of all funding deployed by VCTs since 2018 has gone into knowledge-intensive companies ([46]).

(55) Companies reported that other avenues of finance remained inaccessible to them. Companies that had unsuccessfully sought debt finance reported that the immaturity of the businesses and the lack of tangible assets, particularly amongst knowledge-intensive companies, had prevented them from securing a loan.

([45]) https://www.gov.uk/government/statistics/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-may-2022/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-statistics-2022

([46]) https://www.theaic.co.uk/aic/news/press-releases/new-report-shows-why-government-is-right-to-back-venture-capital-trusts

Similarly, companies surveyed were unable to raise funds through other forms of private equity as they either lacked the necessary track record or they could not project rapid enough growth to attract non-tax advantaged venture capital.

(56) The EIS/VCT schemes are designed to attract investment into the same types of businesses from different sub-sectors of investors. Previous studies commissioned by the UK government have found evidence that prior to 2018 VCTs did not improve access to risk finance for SMEs and did not incentivise new and additional investment by private investors. The UK authorities responded by making a number of notified changes to the schemes, including new risk-to-capital conditions to cut out low-risk 'capital preservation' investments (see recital (17) of the 2018 Decision). Initial market intelligence suggests that these changes have better targeted funds raised through the schemes towards the stated market failure.

2.6.3.3. Evidence on the equity funding gap and development of VC market

(57) The 2022 ex-post evaluation showed that EIS/VCT schemes incentivised additional investment into target companies. When presented with a counterfactual of no scheme or one that was less generous, investors indicated that they would change their investing habits and/or withdraw some or all of the investment from targeted companies. The UK authorities concluded that an equity gap would likely develop if the schemes were withdrawn or scaled back. This gap could also be exacerbated by wider venture capital market conditions that is seeing dampened investor interest due to heightened current and expected interest rates, as also mentioned in recital (39).

2.6.3.4. Evidence on the impact on competition

(58) The 2022 ex-post evaluation has shown that investments through the EIS/VCT schemes have been concentrated in companies that either meet the statutory definition of a knowledge intensive company or belong to more innovation driven sectors, such as the Professional, Scientific and Technical sector. Investments via the schemes have increasingly been concentrated in young start-up companies. The UK authorities note that is in line with the policy objectives for the scheme.

2.6.4. Descriptive elements related to the appropriateness of the scheme

(59) The UK authorities consider that, to address the clearly defined market failure, a tax subsidy is the most effective and least distortive tool. As the market failure is about asymmetry of information, there is no clear regulatory reform which would help companies or investors to overcome this barrier.

(60) Further, the nature of the fiscal incentives as requiring investment from an individual means that, even with the presence of information asymmetry, there is a degree of informed decision making from the investor. This suggests that companies lacking credible propositions and business plans will not receive investment, and therefore neither aid. This is therefore a more effective distribution system than a grant-based system, which could result in subsidy money going to inappropriate companies. The recent evaluation specifically looked at alternative policy delivery mechanisms. Investees gave the sense that

'[grants] were not the ideal way of raising funds for a business'. Specific issues raised were related to resource intensity of applying for grants, longer timescales compared to direct access to investors from the EIS/VCT schemes and issues with grant specificity.

(61) There are features of the schemes' design which further ensure the appropriateness of the aid, through putting limits on the tax relief individuals can access. Investors are only able to claim income tax relief of 30% of their investment, to the extent that they have a UK income tax liability. There is also an absolute limit on the amount an investor can invest into any eligible companies in any one tax year (GBP 1 million for EIS investments (or GBP 2 million for knowledge-intensive companies) and GBP 200 000 for VCT investments).

(62) The UK authorities provide a number of different means of support to SMEs, reflecting the importance of SMEs to the growth of the economy. The range of SME support schemes reflects the variance in types of finance sought, from short-term overdrafts, to working capital, to equity for growth and development, each designed to provide a slightly different offer to companies, and to target different types of SMEs in different situations and with different business needs. In recognition of this, the UK has a range of interventions which provide a combination of tax incentives, grants and matched funding to support SMEs depending on the need and stage of development ([47]). The design of the scheme ensures that the cumulation of support provided to SMEs in the UK does not lead to over-subsidisation or breaches of cumulation rules where relevant ([48]). The non-State aid fiscal incentives are also available to companies receiving financing under the EIS/VCT scheme ([49]). The UK authorities believe that intervention through tax measures provides an incentive effect that allows the market to operate efficiently in the provision of risk finance.

2.6.5. *Descriptive elements related to the proportionality of the scheme*

(63) The UK authorities consider that the EIS/VCT schemes' design ensures the proportionality of aid through the lifetime cap on company investment. For non-knowledge-intensive companies this is GBP 12 million (approximately EUR 13.8 million), which is less than the EUR 16.5 million under Article 21 of GBER. For knowledge-intensive companies the lifetime company investment limit is GBP 20 million (approximately EUR 23 million). The UK Government believes that this amount of investment is commensurate to the size of the funding gap identified in the ex-ante assessment, as set out in recital (35).

([47]) In addition to the EIS/VCT schemes, the available fiscal measures benefiting SMES are the 'Seed Enterprise Investment Scheme' (SEIS), 'Enterprise Management Incentives' (EMI), Research and Development tax credits, a VAT registration threshold, an 'Employment Allowance', a 'Corporation Tax (CT) Small Profits Rate', 'Small Business Rates Relief' and an 'Annual Investment Allowance (AIA)'. Except for the EIS/VCT schemes and SEIS, the fiscal incentives apply directly to the companies (and not to investors in the companies).

([48]) SEIS is a *de minimis* scheme, EMI is a notified State aid measure (case SA.47789). Companies that have used the EIS or VCT scheme are not able to use the SEIS. EMI targets a different market failure than the EIS/VCT schemes. EMI is targeted at SME related labour market and capital market failures directly related to recruiting and retaining key staff.

([49]) For instance, a company that is raising money through the EIS/VCT schemes and has taxable profits of up to GBP 20 000 would be eligible for the Corporation Tax Small Profits Rate in that tax year.

(64) Further, eligible shares for the schemes are full-risk, ordinary shares; newly issued by an eligible undertaking as defined in the ex-ante assessment. These shares must be held for at least three years for EIS shares or five years for VCT shares, else the income tax relief will be clawed back. There are also restrictions on investors, who must not be connected to the investee company if they are investing through EIS and VCTs are strictly regulated and must meet a number of conditions, including that 80% of investments must be in qualifying holdings.

(65) Regarding the size of the fiscal incentives, the UK authorities report findings of the ex ante assessment that, overall, 73% of EIS investors and 81% of VCT investors felt that reducing the maximum amount of income tax relief available on a VCT investment from 30% to 10% would make it ‘a lot less likely’ for them to invest in eligible companies. 59% of EIS investors and 66% of VCT investors felt that having to pay capital gains tax on any gains made on investments would make them ‘a lot less likely’ to invest in eligible companies. Over half of EIS investors (56%) felt that removing loss relief from the measure would make them ‘a lot less likely’ to invest in eligible companies.

3. ASSESSMENT OF THE MEASURE

3.1. Lawfulness of the aid

(66) By notifying the measure before putting it into effect, the UK authorities have respected the notification and standstill obligations laid down in Article 108(3) TFEU.

3.2. Existence of State aid

(67) The notified prolongation of the EIS/VCT schemes does not change the Commission's previous assessment with respect to the existence of aid, within the meaning of Article 107(1) TFEU ([50]).

3.3. Compatibility assessment of the aid

(68) Since the notified measure constitutes State aid, the Commission must examine whether that aid is compatible with the internal market. The Commission notes that the measure does not fall entirely within the scope of Article 21a GBER.

(69) The Commission recalls that in recital (78) of the 2015 Decision it was explained that the EIS/VCT schemes complied with the GBER, insofar as they related to non-knowledge-intensive SMEs.

(70) However, the Commission also notes that the following features of the EIS/VCT schemes concerning knowledge-intensive companies are not in line with the Article 21a(2) GBER and thus require an assessment of those schemes in their entirety under the Risk Finance Guidelines:

(a) allowing risk finance support under the EIS/VCT schemes to knowledge-intensive mid-caps (i.e. not only to SMEs);

([50]) State aid case SA.33849 (OJ C 196, 4.7.2012, p. 4).

(b) allowing risk finance support under the EIS/VCT schemes to knowledge-intensive companies up to ten years after first commercial sale or where they undertake an investment that is higher than 50% of the average turnover in the preceding five years ([51]), including a greater flexibility of the age test ([52]);

(c) increasing the total investment threshold beyond the EUR 16.5 million limit established by the GBER and up to GBP 20 million (approximately EUR 23 million), in respect of knowledge-intensive SMEs and mid-caps.

(71) The Commission will therefore examine whether the prolongation of the existing EIS/VCT schemes, given that they fall outside the scope of the GBER, continue to be compatible with the internal market.

(72) Article 107(3), point (c), TFEU provides that State aid that facilitates the development of certain economic activities may be considered to be compatible with the internal market, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.

(73) The notified measure aims at providing fiscal incentives to private investors for leveraging more private capital into the risk capital market. The notified measure thus constitutes a risk finance measure and has to be assessed in accordance with the Risk Finance Guidelines.

(74) The Risk Finance Guidelines outline how the Commission will apply Article 107(3), point (c), TFEU with regard to aid measures that qualify as risk finance measures.

(75) Paragraph 126 of the Risk Finance Guidelines stipulates that “if the Member State proposes to extend a measure to a total duration of more than ten years (including predecessor schemes, if any), it must carry out a new ex ante assessment, together with an evaluation of the effectiveness of the scheme during the entire period of its implementation”. Since the scheme will be prolonged for another ten years, the UK authorities are required to carry out such an ex ante assessment, together with an ex post evaluation of the EIS/VCT schemes.

(76) The Commission notes that the following conditions of the Risk Finance Guidelines continue to be met:

(a) in compliance with paragraph 23 of the Risk Finance Guidelines, Companies listed on the official list of a regulated market are excluded as eligible undertakings. That requirement is met (see recital (9));

(b) in compliance with paragraph 26 of the Risk Finance Guidelines, risk finance aid where private investors do not undertake any appreciable risk and/or where the benefits flow entirely to the private investors are excluded. That requirement is met, since the income tax relief only concerns 30% of the amounts invested (see recital (61));

([51]) Recitals (28) and (29) of the 2015 Decision.

([52]) Recitals (28) to (33) of the 2018 Decision.

(c) in compliance with paragraph 27 of the Risk Finance Guidelines, risk finance aid covered by those Guidelines may not be used to support buy-outs. That requirement is met, since the eligible shares must be newly issued (see recital (64));

(d) in compliance with paragraph 28 of the Risk Finance Guidelines, risk finance aid must not be awarded to: (a) undertakings in difficulty, or (b) undertakings which are subject to an outstanding recovery order following a previous Commission decision declaring an aid granted by the same Member State illegal and incompatible with the internal market. That requirement is met (see recital (10));

(e) in compliance with paragraph 29 of the Risk Finance Guidelines, aid to export-related activities towards third countries or Member States are excluded. That requirement is equally met (see recital (10)).

(77) Under the Risk Finance Guidelines, a series of conditions laid down in their section 3 has to be verified by the Commission and if it can be ascertained that the aid is in line with all of them, the Commission can declare it compatible with the internal market, as analysed in the following recitals.

3.3.1. The aid facilitates the development of an economic activity

3.3.1.1. Identification of the supported activity (section 3.1.1 of the Risk Finance Guidelines)

(78) As indicated in paragraph 42 of the Risk Finance Guidelines, risk finance aid measures cover companies from a wide range of economic sectors, ensuring that certain SMEs and mid-caps have access to the necessary amount and form of finance to perform or further develop their respective economic activities.

(79) Eligible undertakings under the measure are unlisted SMEs and knowledge-intensive SMEs and mid-caps up to ten years after the first commercial sale (recital (9) - (11)). The Commission considers the activity supported by this measure is identified.

3.3.1.2. Incentive effect (section 3.1.2 of the Risk Finance Guidelines)

(80) Paragraphs 43 and 44 of the Risk Finance Guidelines specify that "*aid can only be found compatible with the internal market if it has an incentive effect ... [that] induces the aid beneficiary to change its behaviour by undertaking activities which it would not carry out without the aid or would carry out in a more restrictive manner due to the existence of a market failure*".

(81) The Commission notes that by improving the investment returns for the investors via fiscal incentives, the measure encourages investors to make risk finance investments which they would not have made without the incentives. At the same time, the measure still ensures that investors are sufficiently exposed to the future performance of their investments, thereby encouraging them to make efforts to find the investments with the best risk/return characteristics.

(82) In the ex ante assessment, the UK authorities have provided evidence that most investors would have invested in less risky ways and over three-quarters would not have invested in the same or similar companies (recital (45)).

(83) The Commission thus concludes that the requirement that the measure has an incentive effect is respected, in line with section 3.1.2 of the Risk Finance Guidelines.

3.3.2. The aid does not adversely affect trading conditions to an extent contrary to the common interest

(84) In accordance with paragraphs 50 to 52 of the Risk Finance Guidelines, the Commission will assess whether the positive effects of the aid outweigh its negative effects on competition and trading conditions. The Risk Finance Guidelines clarify that "*in order to establish if the distortive effects of the aid are limited to the minimum, the Commission will verify whether the aid is necessary* (see Section 3.2.2), *appropriate* (see Section 3.2.3), *and proportionate* (see Section 3.2.4). *To enable it to carry out that verification, the Commission requires that Member States submit evidence in the form of an ex ante assessment as described in Section 3.2.1".* The Risk Finance Guidelines further clarify, in paragraph 126 that "*If the Member State proposes to extend a measure to a total duration of more than ten years [...], it must carry out a new ex ante assessment, together with an evaluation of the effectiveness of the scheme during the entire period of its implementation*".

3.3.2.1. Need for State intervention (section 3.2.2 of the Risk Finance Guidelines)

(85) The Commission firstly notes under paragraph 74 of the Risk Finance Guidelines that "*in certain circumstances, mid-caps could also face financing constraints comparable to those affecting SMEs. That may, for example, be the case for mid-caps carrying out R&D and innovation activities alongside initial investment in production facilities, including market replication, and whose track record does not enable potential investors to make relevant assumptions as regards the future market prospects of the results of such activities, as these markets are being developed or contain an advanced technological element of which the risk is difficult to assess (e.g. aerospace and defence). In such cases, risk finance State aid may be necessary for innovative mid-caps to increase their production capacities to a sustainable scale where they are able to attract private financing on their own*".

(86) Secondly, the Commission observes that, in paragraph 75 of the Risk Finance Guidelines, it is acknowledged that "*certain types of undertakings may be regarded as still being in their expansion/early growth stages if, even though they have been in existence for a considerable amount of time, they have not yet sufficiently proven their potential to generate returns or do not have a sufficiently robust track record and collateral*". In paragraph 76 of the Risk Finance Guidelines, the Commission provides for the possibility to "*allow measures whereby the initial investment is carried out after the eligibility period fixed in Article 21 of the General Block Exemption Regulation. In such circumstances, the Commission may require that the measure clearly defines the eligible categories of undertakings, in the light of evidence provided in the ex ante assessment regarding the existence of a specific market failure affecting such undertakings*".

(87) Finally, in line with paragraph 77 of the Risk Finance Guidelines, the Commission acknowledges that "*in certain industries where the upfront research or investment costs are relatively high, for example in aerospace, defence, life sciences or green technology or energy,* [the GBER cap on the total amount of risk finance per eligible undertaking of EUR 16.5 million] *may not be sufficient to achieve all the necessary investment rounds and set the start-up or SME on a sustainable growth path*". As laid down in paragraph 78 of the Risk Finance Guidelines, "*risk finance measures may provide support above the maximum total amount specified in the General Block Exemption Regulation provided the envisaged amount of funding reflects the size and nature of the funding gap identified and quantified in the ex ante assessment with respect to the target sectors or territories. In such cases, the Commission will take into account the capital- intensive nature of the targeted sectors and/or the higher costs of investments in certain geographic areas*".

(88) In recitals (88) and (91) to (100) the 2015 Decision, the Commission accepted the UK's arguments that in the UK, the market failure affecting provision of finance extends beyond SMEs and also affects knowledge-intensive mid-caps, and that within this targeted group of companies, not only SMEs up to seven years from first commercial sale (as covered by the GBER) but also knowledge-intensive SMEs and knowledge-intensive mid-caps at a growth stage until ten years from first commercial sale are affected by the market failure.

(89) The UK authorities explain that the market failure of asymmetric information continues to apply in this form, arguing that the market failure is essentially irresolvable (recitals (28) to (34)).

(90) The Commission notes that the UK, and specifically Northern Ireland for the purpose of this decision, continues to be particularly affected by problems faced by knowledge-intensive companies, as the population of knowledge-intensive companies is higher in the UK than the Union average (recital (31)). The dominant feature of knowledge-intensive companies continues to be that they have a high proportion of intangible assets and that intangible assets typically do not constitute good collateral to obtain external financing (recital (32)), which results in an equity gap. Furthermore, knowledge-intensive companies may also need to shift from their initial trajectory and reposition themselves in order to develop a successful business and the presence of deep pocket competitors may act as a barrier to the entry, implying that such companies need longer lead times to bring products to markets (recital (33)). It is also noted that the "gross asset test" ([53]) de-facto reduces the potential group of companies that exceed the GBER definition of SMEs only with respect to the headcount number.

(91) In summary of the considerations set out in recitals (28) to (34), the Commission finds that, limiting support to knowledge-intensive SMEs and mid-caps up to ten years from first commercial sale, is in line with paragraphs 74, 75 and 76 of the Risk Finance Guidelines, taking into account the market failure which the measure is designed to address and the time required for these knowledge-intensive companies to reach sustainable growth levels and a sufficiently robust track record to attract private financing.

([53]) See recitals (34) and (35) of the 2015 Decision.

(92) In the recitals (89) and (101) to (109) 2015 Decision, the Commission accepted the UK's arguments that, due to the nature of business activities, knowledge-intensive companies up to ten years from first commercial sale suffer from a much higher equity gap in comparison to non-knowledge-intensive companies, raising their financing needs from GBP 12 million to GBP 20 million.

(93) In light of the persistent market failure and new evidence, the UK authorities explain that the equity gap continues to apply (recitals (35) - (40)).

(94) The Commission notes that the UK banking sector has remained concentrated (recital (36)), that the access-to-finance problem for the eligible companies remains challenging, due to the current economic situation (recitals (37) and (38)) and the situation of financial markets financing including the venture capital market (recital (39)).

(95) Overall, the Commission considers that the ceiling of GBP 20 million (approximately EUR 23 million) continues to be justified within the meaning of paragraphs 77 and 78 of the Risk Finance Guidelines taking into account the specific market failure affecting the knowledge-intensive SMEs and mid-caps in Northern Ireland, as targeted by the EIS/VCT schemes.

(96) The Commission concludes that the existence of the market failure, which the measure aims to address, is sufficiently demonstrated and that the proposed prolongation of the EIS/VCT schemes, as described in recital (4), can be considered as necessary.

3.3.2.2. Appropriateness of the aid (section 3.2.3 of the Risk Finance Guidelines)

(97) Paragraph 91 of the Risk Finance Guidelines states that "*The proposed aid measure must be an appropriate policy instrument to achieve the intended objective of the aid, that is to say, there must not be a better placed and less distortive policy instrument or aid instrument capable of achieving the same outcome*".

(98) In the 2015 Decision, the Commission concluded that the tax incentives provided under the EIS/VCT schemes are well targeted and have been appropriately designed to overcome the market failure demonstrated on the basis of the ex ante assessment (recitals (115) to (121) of the 2015 Decision.

(99) The Commission accepts the renewed explanation of the UK authorities that the tax subsidy is the most effective and least distortive tool to address the identified market failure, compared to non-State aid tools (recital (59)), and also compared to State aid involving grants (recital (60)). The Commission considers thus that paragraphs (93) and (94) of the Risk Finance Guidelines are complied with.

(100) The EIS/VCT schemes in Northern Ireland continue targeting their instrument towards a well-defined category of eligible undertakings (recitals (25) to (33) of the 2015 Decision). In addition, the 'growth and development rule' as described in paragraph (37) of the 2015 Decision, which aims at ensuring that the finance provided under the EIS/VCT scheme is effectively used to support the growth and the development of the targeted companies contributes to a strengthening of the

appropriate character of the measure (recital (117) of the 2015 Decision). Paragraph 123 of the Risk Finance Guidelines thus continues to be met.

(101) The Commission notes that the provisions of the EIS/VCT schemes with regard to the eligible investors and invested amounts are still applicable (see recital (13) of the 2015 Decision for the relevant provisions), as assessed in recital (118) of the 2015 decision. Paragraph 124 of the Risk Finance Guidelines thus continues to be met.

(102) The UK authorities have demonstrated that the selection of the eligible undertakings in Northern Ireland is based on a well-structured set of investment requirements and have committed to making the details of the measure public through adequate publicity (see recital (19)), in accordance with paragraph 125 of the Risk Finance Guidelines.

(103) By carrying out an ex post evaluation and providing a new ex ante assessment, the UK authorities have fulfilled their obligation for the prolongation of the EIS/VCT schemes for another ten years. Paragraph 126 of the Risk Finance Guidelines thus continues to be met.

(104) The Commission takes into account the submission of the UK that it provides for a differentiated set of means to support SMEs, including fiscal incentives, reflecting the differences in types of demanded financing and in the types of SMEs (recital (62)). The UK authorities have ensured that companies cannot make use of different fiscal incentives which target similar market failures (i.e. the SEIS and the EIS/VCT schemes). Companies receiving financing under the EIS/VCT schemes may also benefit from other non-aid tax measures. However, these other fiscal incentives have a different basis, addressing different objectives. The Commission thus considers that the EIS/VCT measure has a specific focus and that there is no undue interplay between the different incentives of the different measures. Paragraph 127 of the Risk Finance Guidelines is thus met.

(105) The Commission furthermore notes that under the measure the State plays no role in the selection of the target undertakings. The tax relief is open to all investors fulfilling the required criteria and the UK authorities have undertaken to publish, on a public website, the scope and the technical parameters (incl. ceilings and caps, maximum investment amount) of the EIS/VCT schemes (recitals (16) and (19)). Accordingly, the tax relief is applied without discrimination as to their place of establishment and the adequate publicity regarding the scope and the technical parameters of the measure is ensured. Paragraph 128 of the Risk Finance Guidelines is thus met.

(106) Based on the above, the Commission concludes that the measure remains an appropriate instrument compared to other policy instruments that may or may not involve aid.

3.3.2.3. Proportionality of the aid (section 3.2.4 of the Risk Finance Guidelines)

(107) In paragraph 132 of the Risk Finance Guidelines, the Commission holds that "*State aid must be proportionate to the market failure which it is intended to address in order to achieve the relevant policy objectives ... [and] the aid must be*

limited to the strict minimum necessary to attract funding from the market to overcome the market failure […] without generating undue advantages".

(108) The Commission considers, taking into account the assessment of the 2018 Decision as regards the proportionality of the amendments (recitals (58) to (63) of the 2018 Decision), the proportionality of the measure as assessed in the 2015 Decision (recital (126) and (127) of the 2015 Decision), and the evidence provided in the ex ante assessment (recital (65), that the proportional character of the measure is ensured.

(109) Paragraph 133 of the Risk Finance Guidelines states "*For risk finance measures where the risk finance investment per eligible beneficiary exceeds the cap fixed in the General Block Exemption Regulation, the higher risk finance investment per beneficiary must, furthermore, be commensurate to the size of the funding gap quantified in the ex ante assessment*". Further, the Risk Finance Guidelines state in paragraph 151 that "*the total investment for each beneficiary undertaking must not exceed the maximum amount fixed by Article 21 of the General Block Exemption Regulation unless a higher amount can be justified on the basis of the market failure identified in the ex ante assessment and a fiscal instrument is the most appropriate tool*".

(110) The Commission considers that the higher risk finance investment cap remains commensurate to the size of the funding gap, as explained in recital (40)). The Commission also considers the measure to be appropriate (see recital (106)). Paragraphs 133 and 151 of the Risk Finance Guidelines are thus met.

(111) The Commission notes that the eligible shares for the scheme continue to be full-risk, ordinary shares, newly issued by an eligible undertaking as defined in the ex ante assessment, and that they must be held for at least three years for EIS shares and five years for VCT shares. EIS investors must also be independent from the companies they are investing (recital (64)). Paragraph 152 of the Risk Finance Guidelines is thus met.

(112) The Commission further notes that the tax income relief is capped at 30 % of the invested amount (recital (61)). Paragraph 153 of the Risk Finance Guidelines is thus met.

(113) Dividends received on shares held in a VCT fund are free from tax (recital (13) of the 2015 Decision). Paragraph 154 of the Risk Finance Guidelines is thus met.

(114) The Commission notes that investors benefit from a full capital relief from capital gains tax on gains from shares that have qualified for income tax relief and which are disposed of at least three years (EIS) or at least five years (VCT) after the investment. Paragraph 155 of the Risk Finance Guidelines is thus met. ([54])

([54]) Where the investor has made a taxable capital gain on the disposal of any other asset, the tax charge arising on this gain can be deferred if the gain is invested in shares under the EIS/VCT (see recitals (3) and (13) of the 2015 Decision). The Commission acknowledges the UK authorities' explanation that this provision aims at facilitating the rollover of redeemed capital into new investments.

(115) The Commission notes that investments made under the measure are made by private investors without any direct participation of public investors (except for the fiscal benefit).

(116) In light of the foregoing, the Commission considers that the measure remains proportionate.

3.3.2.4. Cumulation (section 3.2.4.4 of the Risk Finance Guidelines)

(117) As indicated in recital (20), the UK authorities committed to respect the provisions on cumulation, specified in section 3.2.4.4 of the Risk Finance Guidelines.

3.3.3. Avoiding undue negative effects of risk finance aid on competition and trade (section 3.2.5 of the Risk Finance Guidelines)

(118) In accordance with paragraph 161 of the Risk Finance Guidelines, *"[F]or the aid to be compatible, the negative effects of the aid measure in terms of distortions of competition and impact on trade between Member States must be limited and must not outweigh the positive effects of the aid to an extent that would be contrary to the common interest*".

3.3.3.1. Positive effects to be taken into account

(119) As explained in paragraph 162 of the Risk Finance Guidelines, "*the main positive effect that risk finance aid aims to bring about is to improve access to finance for the undertakings concerned*".

(120) The Commission, in accordance with paragraphs 162 of the Risk Finance Guidelines, notes that the measure, by providing increased access to risk finance for knowledge-intensive companies, supports undertakings that are active in innovative activities.

(121) The UK has confirmed that the relevant performance indicators (see recital (21)) to assess whether the objectives (as set out in recital (44)) of the measure have been met. In line with the assessment of the performance indicators (recital (13) of the 2015 Decision), the Commission considers that the performance indicators defined by the UK authorities have been appropriately chosen to estimate the measure's direct and indirect impact on the market and possible distortions of competition.

(122) The Commission considers that the prolongation of the measure until 5 April 2035 and the estimated budget of GBP 100 million for the ten-year period is adequate to meet the objective of the scheme, in the light of the persistent nature of the market failure (recital (34)), the long funding cycle of VCTs and financial intermediaries within the EIS scheme which implies that the effective duration of the measure is shorter than the formal duration (recital (42)), and the objective to help establishing a funding ecosystem in which intermediaries are incentivized to invest with a longer time horizon and establish can establish track records (recital (43)).

(123) The Commission concludes that the measure meets the criteria laid down in paragraphs 164 and 165 of the Risk Finance Guidelines.

3.3.3.2. Negative effects to be taken into account

(124) In accordance with paragraph 167 of the Risk Finance Guidelines, "[*T]he State aid measure must be designed in such a way that it limits distortions of competition and trade within the internal market. In the case of risk finance measures, the potential negative effects have to be assessed at each level where aid may be present*".

(125) The Commission holds that the assessment of the avoidance of undue negative effects on competition trade as carried out in recitals (131) to (134) of the 2015 Decision continues to be valid, with the effect that paragraphs (169) and (174) of the Risk Finance Guidelines are met:

(a) the EIS/VCT measure is designed to assure its targeted character at growth-oriented companies which suffer from a market failure by providing a fiscal incentive to investors to enable the market to operate efficiently;

(b) the State aid provided through fiscal incentives to individual investors, under the EIS/VCT measure, ensures that all resources invested under the EIS/VCT measure are private and that no crowding out of private investment takes place;

(c) in the case of the VCT scheme, there is no limit on the number of financial intermediaries which can operate under the scheme and, hence, the VCT scheme does not discourage any expansion of existing competitors. The Commission also observes that the UK authorities are not involved in the investment decisions of the VCT and have placed no limits as to the region of establishment for investee companies. In fact, the investment decisions under the EIS/VCT scheme are entirely left to the market and the selection of investments is based on commercial logic;

(d) UK authorities have also excluded under the EIS/VCT scheme companies which should be able to access finance by traditional routes (for example if the undertaking is clearly asset-backed), as they are likely to be unaffected by any potential information asymmetry problem.

(126) In sum, the measure meets the criteria laid down in section 3.2.5.2. on the "*Negative effects to be taken into account*" of the Risk Finance Guidelines.

3.3.3.3. Balancing of the positive effects against the negative effects of the aid

(127) Paragraph 177 of the Risk Finance Guidelines requires the Commission to balance "*the identified negative effects of the aid measure in terms of distortions of competition and impact on trade between Member States against the positive effects of the aid*".

(128) The Commission notes that, as regards competition distortions at the level of the investors, the measure targets a well-defined market failure, which substantially

reduces the risk of crowding out. Private investors are still incentivised to focus on the performance of their investments, the risk investment amounts per undertaking are not excessive, as there is a maximum percentage of the tax reliefs to be provided in relation to the invested amount, and the measure targets a specific category of undertakings.

(129) In addition, as regards competition distortions at the level of the target undertakings, the measure explicitly excludes undertakings in difficulty and focuses on undertakings which are SMEs seven years after the first commercial sale and knowledge intensive SMEs and mid-caps up to ten years after first commercial sale (recitals (9) to (11)). The measure is thus reaching out to growth-oriented undertakings that are unable to attract an adequate level of financing from private resources but may become viable with risk finance aid. The nature and conditions of the fiscal incentives incentivises private investors to select the eligible undertaking or the fund they will invest in, based on commercial logic, as they bear the biggest part of the risk of such investment.

(130) The Commission notes that the ex ante assessment presented by the UK relates to the EIS/VCT schemes in their entirety. The Commission considers that it can base its assessment of the notified prolongation on this evidence given that the market failure afflicting eligible companies in Northern Ireland is expected to be the same as the one afflicting eligible companies in the rest of the UK. In addition, the Commission also took into consideration that the notification only concerns eligible beneficiaries in Northern Ireland, which reduces the size of the schemes, in terms of budget and the historic number of beneficiary companies, in comparison to the entire EIS/VCT schemes that was subject to the ex post evaluation.

(131) In light of the foregoing, the measure can be considered to be designed in such a way so as to limit the distortion to competition and minimise undue advantages and its positive effects may be considered to outweigh any potential negative effects on competition in the internal market.

3.3.4. Transparency (section 3.2.6 of the Risk Finance Guidelines)

(132) Paragraphs 179 to 184 of the Risk Finance Guidelines require for the Commission to ensure that the aid complies with its transparency requirement.

(133) As indicated in recital (19), the UK has committed to fulfil the transparency requirement specified in section 3.2.6 of the Risk Finance Guidelines.

(134) In light of all the foregoing, the Commission concludes that the measure fulfils the conditions set out in the Risk Finance Guidelines for a risk finance aid to be deemed compatible with the internal market.

3.3.5. Evaluation (section 4 of the Risk Finance Guidelines)

(135) Paragraph 185 of the Risk Finance Guidelines stipulates that "*To further ensure that distortion of competition and trade is limited, the Commission may require that certain aid schemes are subject to an ex post evaluation. Evaluations will be required for schemes where the potential distortion of competition and trade is particularly high* […]".

(136) Given the limited scope of the schemes to be prolonged, which only apply to eligible undertakings permanently established in Northern Ireland, and the annual budget of GBP 10 million (recital (17)), the Commission does not require an ex post evaluation of the measure on the grounds that the potential distortion of competition and trade is not particularly high. However, if the UK authorities would want to further prolong the measure, an ex post evaluation of the measure covering the period 2025 to 2035 would be required, as per paragraph 126 of the Risk Finance Guidelines.

4. Conclusion

The Commission has accordingly decided not to raise objections to the aid on the grounds that it is compatible with the internal market pursuant to Article 107(3), point (c), of the Treaty on the Functioning of the European Union.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: https://competition-cases.ec.europa.eu/search?caseInstrument=SA.

Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully,

For the Commission

Margrethe VESTAGER
Executive Vice-President

CERTIFIED COPY
For the Secretary-General

Martine DEPREZ
Director
Decision-making & Collegiality
EUROPEAN COMMISSION