Summary of legislative changes impacting EIS/VCT schemes – Summer Finance Bill 2015

Some of the other changes that were announced, and confirmed at the Summer Budget 2015, which will take effect from the date of Royal Assent of the Summer Finance Bill 2015, once the proposed legislation receives EU State Aid approval, include:

•A lifetime limit for the issuing company will be introduced to cap the maximum amount it can raise under the venture capital schemes. This limit will be £12 million for most companies, but there will be an enhanced £20 million for 'knowledge intensive' companies.

•EIS relief will not be available for share issues in companies which have been trading for more than 7 years (10 for knowledge intensive companies), unless:

- There has been a previous issue of shares under EIS/VCT/SEIS
- There has been a fundamental change in the nature of the business

•The maximum number of employees will increase to 499 (previously 249) for 'knowledge intensive' companies.

•A restriction on existing shareholders claiming relief will be introduced, and going forward an existing shareholder will only be able to claim relief if all of the existing shares:

- Were issued under EIS, SEIS or SITR
- Are subscriber shares (i.e. the original shares issued on incorporation)

•EIS/VCT will no longer be able to be used to fund the acquisition of an existing company or trade.

Benefits

There are a number of potential tax reliefs associated with EIS:

Income Tax Relief

•Individuals who subscribe for shares in an EIS qualifying company will receive tax relief of 30% (20% for years up to 2010/11), on the cost of the shares which is offset against the individual's Income Tax liability for the year in which the investment was made..

•It is possible to 'carry back' all or part of the investment to the preceding tax year as long as the limit for relief is not exceeded for that year.

•An individual may carry-back current year EIS investments to the previous year, provided that the limit in the previous year is not exceeded. The effect being that a subscription of £2 million EIS shares may be made in 2014/15 with a carry back of £1 million to 2013/14.

•An individual is able to reduce his tax liability to zero through EIS relief, allowing the taxpayer to claim back any repayable tax deducted at source, such as bank interest or PAYE.

Qualifying conditions

Note that there are several important qualifying conditions attached with EIS Income Tax relief:

1. Restriction for connected individuals

Between the period commencing two years before the issue of EIS shares and the later of three years after the investment was made and the date the company commences trading, an individual investor cannot be 'connected' with the qualifying EIS company. He or she cannot:

•Be remunerated as a company employee, partner, or director (unless an unremunerated director, or potentially a paid 'business angel' investor), or

•Directly or indirectly possess or be entitled to acquire more than: 30% of the ordinary share capital, or

30% of voting rights, or

30% of the rights to assets on a winding up

◦of the company or any subsidiary.

These rules are subject to exceptions for unpaid directors, and paid business angel investors (see s167-s169 ITA 2007), which broadly permit payment for services as a director once the shares have been issued. It is advisable to become a director only once shares have been issued. Any director involved in the company's trade prior to issue is likely to be connected and relief will be denied.

2. Three year holding period

The individual must retain the shares for a minimum of three years (possibly up to five if the trade commenced after the share issue date). If the shares are disposed of within this minimum holding period, the relief will be clawed back (unless the disposal was to a spouse or civil partner, in which case the spouse or civil partner is deemed to have subscribed for them). See note on 'Relief Clawback.'

3. Investing via partnerships

Investors who invest in start-ups or other small companies through a partnership structure are not eligible for EIS relief.

Capital Gains Tax Exemption

•There will be no CGT charged on any gain of EIS shares disposed after the minimum holding period on which Income Tax relief was given and not withdrawn.

Capital Gains Tax Deferral Relief

•CGT can be deferred if capital proceeds are invested in EIS shares - even if the investor is connected (see above). The gain can be realised from any asset but the share investment must take place in the period of one year before or three years after the disposal of the asset. The minimum or maximum EIS investments do not apply to deferral relief.

•Gains realised on or after 3 December 2014 which qualified for Entrepreneurs' Relief may be reinvested in EIS (or Social Investment Tax relief) and will still remain eligible for ER when the deferred gain is realised.

Loss Relief

•If EIS shares are disposed of at a loss at any time, the loss (after any Income Tax relief has been taken into account) can be offset against income for that year and the previous year instead of being offset against capital gains.

Relief Clawback

The clawback of relief works in one of several ways depending on the nature of the disposal.

•Where the individual gifts the shares within three years, all of the original relief obtained will be withdrawn and an assessment made in respect of the relief given.

•Where the individual sells the shares within three years for a profit, again the original relief obtained will be withdrawn and an assessment made in respect of the relief given.

•Where the individual sells the shares for a loss the relief clawed back will be the proceeds of the sale multiplied by 30% (20% if the investment was made before 6 April 2011).

Qualifying companies

To qualify for the EIS scheme companies must fulfil certain criteria. The issuing company must be:

•A trading company: most trades qualify but 'excluding activities' include property development, farming and market gardening, coal and steel production, hotel and nursing home operation and management, and many financial activities. From 6 April 2015 the list includes subsidised generation of electricity involving a) contracts for difference or b) renewable sources where anaerobic or hydroelectric power is involved.

•Unquoted at the time of the share issue. This means the company cannot be listed on the London Stock Exchange or any other recognised stock exchange. The Alternative Investment Market (AIM) is not treated as a recognised market under EIS rules.

•A 'small company'. Gross assets cannot exceed £15 million (£7 million before April 2012) before the share issue, or £16 million (£8 million before April 2012) immediately after the use.

•A company that employs fewer than 250 (50 before April 2012) full-time employees at the time of the share issue.

•Carrying out the trade for which the money was raised for at least four months before an investor is eligible for EIS relief.