



tax | EIS and VCTs

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Various changes have been made by the Finance Act 2009 to the tax benefits of these investments with effect from 22 April 2009. This fact sheet summarises the current tax position and considers the distinctions between the two types of investment.

the gross assets test

Since 6 April 2006, the relevant assets of the company raising money under EIS or VCT must not exceed £7m before the investment and £8m immediately afterwards.

application of money raised

The time limit for employment of money invested under EIS or VCT from 22 April 2009 is simplified. All of the money raised must be employed within a qualifying activity of the company concerned within 24 months of the later of the date on which the shares are issued or the date the company commences a qualifying activity. Previously, 80% of the money raised had to be so employed within 12 months.

enterprise investment scheme

The EIS was introduced in the 1994 Finance Act as a successor to the *Business Expansion Scheme*. The tax reliefs only apply when the investor subscribes for newly issued shares in a qualifying company. To qualify, the company must be unquoted (although a listing on AIM is acceptable) throughout the initial three year period, carrying on a trade in the UK which is not, in broad terms, a financial or professional activity. There is no restriction on the company owning land and frequently companies will acquire real estate assets to reduce the level of risk.

It is also possible to invest in a discretionary portfolio service whereby investment is made in a series of qualifying companies selected by the manager. This spread will also help to reduce risk but tax relief is not available until investment in the qualifying companies has been made. Alternatively an approved EIS fund will split investment between a number of companies and will qualify for income tax relief at the outset, although CGT deferral will not be available until investment in the qualifying companies has been made.

There are four potential elements of EIS tax relief:

- **Income tax relief** at 20% on investments of up to £500,000 in any tax year from 2008/09 (£400,000 previously), i.e. a tax saving of up to £100,000. The shares must be held for a minimum of three years to maintain qualification for this relief. It is also possible to claim for EIS investments made during 2009/10 onwards to be treated as if made in the previous tax year (previously the investment had to be before 6 October in the current tax year and the amount so carried back was limited to the lesser of 50% of the subscription and £50,000). Thus, assuming each year's maximum is so far unutilised, an investment of up to £1 million in the current tax year, of which £500,000 could be carried back to the previous tax year, could secure an income tax reduction of up to £100,000 for each tax year. An investor cannot claim EIS income tax relief if interested in more than 30% of the company's capital (as defined) during the three year relevant period.
- **Tax free capital** gains on the investment itself (on which EIS income tax relief has been given) provided the shares are held for at least three years and the company continues to qualify.
- **Capital gains tax deferral** - if an individual has a taxable capital gain, the gain can be re-invested under the EIS and the tax payable will be deferred for the life of the investment. The EIS investment must be made in the period beginning 12 months before and ending three years after the date of the disposal that has given rise to the gain (or, as the case may be, the date when a previously deferred gain crystallises). There is no maximum amount for CGT deferral, neither does the above 30% limit on the investor's interest in the company's capital apply to this relief. Where the income tax relief is available and the deferral is of a capital gain realised on or after 6 April 2008 (from which date a flat CGT rate of 18% normally applies), the combined discount on the initial net cost of the investment will be 38%. (This assumes entrepreneur's relief would not otherwise be claimed.) EIS investments made in advance of the third anniversary of a CGT disposal arising prior to 6 April 2008 can enable a higher overall discount to be achieved, unless full business asset taper relief is otherwise due on that disposal.
- **Inheritance tax exemption** without limit provided the investment has been held for at least two years.

venture capital trusts

VCTs are investment trusts quoted on the *London Stock Exchange* investing in small to medium-sized qualifying companies. Each qualifying company must be unquoted or AIM listed and carry on a trade in the UK which is not, in broad terms, a financial or professional activity. Approval by HMRC of a VCT requires at least 70% by value of its investments (inclusive of cash holdings) to comprise securities of qualifying companies, of which at least 30% by value must comprise eligible shares. Also, no holding in a single company (other than in another VCT, or equivalent unquoted company) may comprise more than 15% of the VCT's investments.

The tax benefits of VCT investment can be summarised as follows:

- **Income tax relief** at 30% on investments of up to £200,000 in any tax year. The shares must be held for a minimum of five years to maintain qualification for this relief.
- **Tax free dividends** on VCT shares acquired within the above income tax annual limit.
- **Tax free capital gains** on VCT shares acquired within the above income tax annual limit, provided VCT approval has remained uninterrupted since their acquisition.
- **Tax free capital gains** realised within the VCT on disposals of investments in qualifying companies.
- **The CGT deferral relief**, similar to that for EIS above, has been abolished as regards VCT shares issued on or after 6 April 2004.

choice of investment

EIS and VCT are not suitable for certain investors, given the tax reliefs are intended to be directed towards higher risk businesses. Unquoted company shares are more difficult to value and can be difficult to sell, so the possibility of not being able to realise the investment at the end of the qualifying period must be considered. Although VCT shares are quoted, there may not be a ready market for substantial disposals. However, for the right investor, the tax benefits remain significant.

about haysmacintyre

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Around 50% of the firm's business is within the corporate sector – small and medium sized enterprises, many of which are in the property, media and entertainment, technology, sports and business services sectors. The firm acts for a number of listed companies and assists new companies raise initial funds on the capital markets and through private equity. 35% of the firm's business is for charitable and not for profit organisations and the remainder is for professional practices and private individuals – whether senior executives, entrepreneurs or those with significant land or wealth at home or overseas.

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