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Venture Capital Schemes SEIS/EIS/VCT

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Delivering professional tax advice with clear conclusions

Quick poll

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- In what capacity are you interested in Venture Capital Schemes?
  - An investor
  - Company seeking investment
  - Advising on equity raise
  - Advising on tax relief
  - Preparing the legal documentation

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Background

Background & history

What they are

- Tax-advantaged & HMRC approved
- High risk!
- Aimed principally at wealthy investors
- Provide tax relief for investments into "qualifying companies"

The three schemes

1. Enterprise Investment Scheme (EIS) - 1994
2. Venture Capital Trust (VCT) - 1995
3. Seed Enterprise Investment Scheme (SEIS) - 2012

Tax relief for the investors

EIS

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Income Tax

- 30% tax reduction!
- Claim in the current or previous tax year
- Beware of possible clawback of IT relief

CGT

- CGT exemption where shares sold at a gain
- Reinvestment relief – deferring the gain (not the tax) by way of “freezing” it for a period

Losses - if it goes wrong!

- Can offset against income
- Net cost only - any income tax relief obtained reduces the loss
- Any deferred gain (reinvestment relief) comes back into charge

SEIS

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Income Tax

- 50% tax reduction!
- Claim in the current or previous tax year
- Beware of possible clawback of IT relief

CGT

- CGT exemption where shares sold at a gain
- Reinvestment relief – 50% of a gain is exempt

Losses - if it goes wrong!

- Can offset against income
- Net cost only - any income tax relief obtained reduces the loss
- Any exempt gain (Reinvestment Relief) does not come back into charge (if no proceeds)

VCT

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Income Tax

- 30% tax reduction!
- Current year only
- Beware of possible clawback of IT relief
- Dividends received are exempt (on the first £200k invested)

CGT

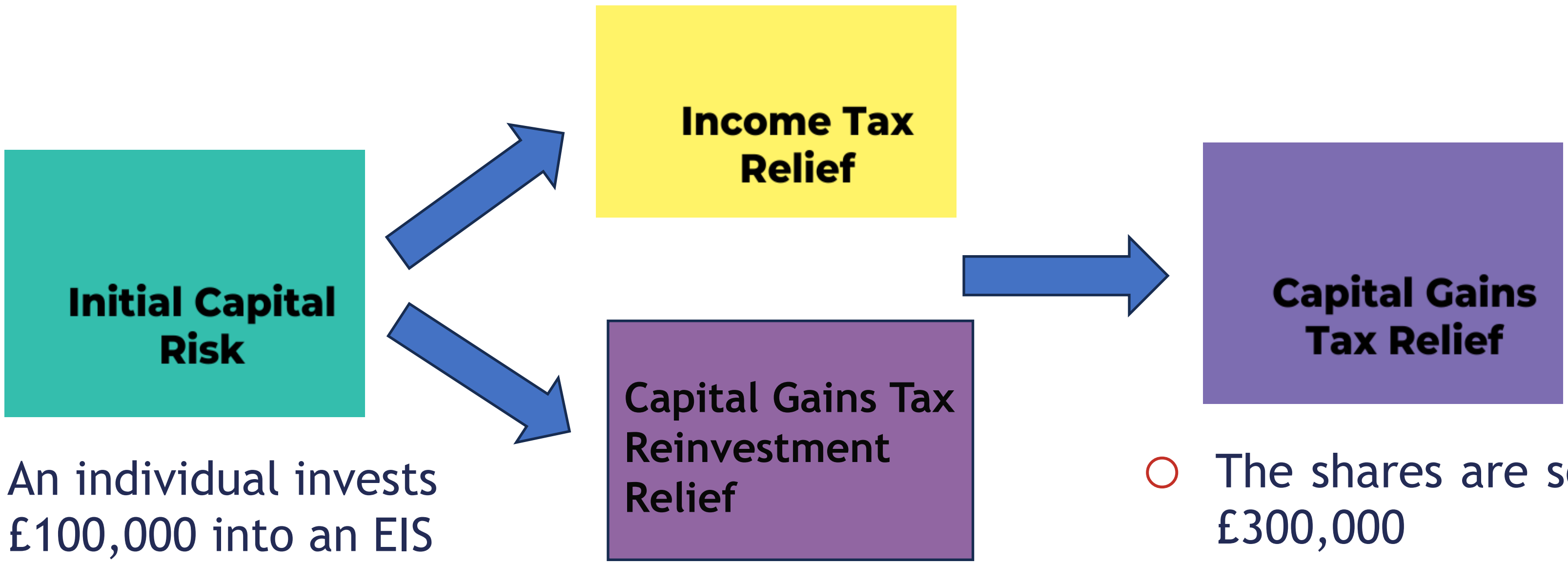
- CGT exemption where shares sold at a gain (ignore ownership period)
- No reinvestment relief

Losses

- Losses are never “allowable” (because of the reduced risk)
- VCT shares = exempt assets

Example - EIS (gain)

- 30% Income Tax Relief (£30,000)



- An individual invests £100,000 into an EIS qualifying company

- Defer other chargeable gains up to £100,000
- If 20% CGT rate: £20,000 of CGT deferred

- The shares are sold 4 years later for £300,000
- £200,000 growth is not chargeable to CGT (if made IT claim) = £40,000 tax saving

Example - EIS (loss)

Initial Capital Risk

- An individual invests £100,000 into an EIS qualifying company

- 30% Income Tax Relief (£30,000)

Income Tax Relief

Capital Gains Tax Reinvestment Relief

- Defer other chargeable gains up to £100,000
- If 20% CGT rate: £20,000 of CGT deferred

Loss relief

- Company has gone into liquidation 4 years late – receives £nil
- £70,000 net cost reduces taxable income (if 45% taxpayer, then £31,500 tax saving)
- Deferred gain comes back into charge at CGT rates

Summary - table

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	EIS	SEIS	VCT
Income Tax Relief	30%	50%	30%
Holding Period	3 years	3 years	5 years
Maximum Investment (per tax year)	£1,000,000 *(+ £1,000,000 in Knowledge Intensive Company ("KIC")*	£200,000 *(£100,000 pre-April 2023)*	£200,000
Carry back 1 year?	Yes	Yes	No
Dividends	Taxable	Taxable	Exempt
Capital Gains Tax	Gain Exempt after 3 years	Gain Exempt after 3 years	Gains Exempt
CGT Deferral Relief	Yes	No	No
Tax Free Gain – 50%	No	Yes	No

Benefits for the companies

Company benefits

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Access to:

- A wider range of investors
- Investors who can provide their expertise
- Funding for start-ups – accelerate growth

- Not just once, could be multiple rounds of investment

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Qualifying conditions

Qualifying Conditions

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Three areas:

- Company conditions
- Investor conditions
- General conditions (inc cash + shares)

Only covering some of the conditions today ….. there are lots!

Important Note:

- Legislation is prescriptive
- Fail a condition + Investment made = No relief/clawback of relief

  (often can't rectify afterwards)

Cash / share criteria

Cash conditions

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Timing is key!

- Cash received **<u>before</u>** shares are issued – but not too long!

Documentation is essential

- HMRC can (and do!) ask to see company bank statements

Separate bank account

- Keep SEIS/EIS funds in a separate bank account!

Share conditions

Share rights

- Shares must be:
  - Newly issued (not transferred);
  - Ordinary;
  - Not carry any present/future preferential right to:
    - Dividends; or
    - Assets on a winding up
  - *Preference on a sale is ok*
  - Have no present or future rights to be redeemed

Company conditions

Company conditions (1)

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- **Qualifying activity**
  - Can't carry on "excluded activity" (i.e. low risk)
- **Age condition**
  - SEIS : trade less than 3 years old
  - EIS/VCT : less than 7 years (from first commercial sale)

    Exceptions to 7 year ……

    - KICs
    - Follow on funding
    - New market - geographical / product (?)
    - Follow on funding for a previous new market
- **Use of funds**
  - Objectives to grow the business

    (not for working capital, can't buy a business)
  - Must use all within required timeframe
- **Risk to capital -** Significant risk of loss of capital to the investor

Company conditions (2)

- **Ownership**
  - Can’t be controlled by another company
    (or arrangements)

- **Subsidiaries**
  - All subsids must be controlled by issuing company
    (> 50%, JV can be an issue!)
  - To use funds, must be ≥ 90% subsid

- **Take care with any changes to shares – can impact relief**
  - Share buybacks
  - Share for share exchanges (inserting a new HoldCo)
  - Any changes to share rights – preference?

Company conditions - Size (3)

Qualifying conditions	SEIS	EIS/VCT	EIS/VCT Knowledge Intensive Companies ("KIC")
Gross Assets before investment	< £350,000	< £15m	< £15m
Gross assets immediately after investment	< £350,000	< £16m	< £16m
Employees maximum (Full Time Equivalent)	< 25	< 250	< 500
Annual fundraising limit	£250,000	£5m	£10m
Lifetime fundraising limit	£250,000	£12m	£20m
Minimum Qualifying holding period	3 years	3 years EIS 5 years VCT	3 years EIS 5 years VCT

Investor conditions

Investor conditions (1)

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Connection

- Investors can’t be connected with company during “Period A”

- Period A

  - Starts : incorporation date *(EIS - if later, 2 yrs pre-share issue)*

  - Ends : on the “termination date”

  (typically 3 yrs, but can be later)

Investor conditions (2)

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What is connected?

- > 30% share capital (issued/ordinary), voting rights
- An employee <u>unless</u> also a director (director status overrides)
- Directors maybe – generally :
  - SEIS : unpaid or remuneration is deemed reasonable ☑
  - EIS : unpaid ☑ *(exceptions)*

Associates – inc in connection tests:

- spouse, civil partners, ancestors & lineal descendants
- business partners
- trusts, personal representatives re estates

Investor conditions (3)

Other areas:

- Value received (12 mths before, to termination date)?
  - No dividends during this time – inc AoA

- Loans - Approach with caution!
  - Company ⇒ individual/associate
    (more favourable terms?)
  - Investor/associate ⇒ Company
    (value received on payments?)

The process - from start to finish!

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Quick poll

- Have you been involved with an EIS/SEIS process before?
  - Yes - often
  - Yes - but only once or twice
  - Yes - but was a while ago
  - No - not yet

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The Process

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1. Advance Assurance (AA)

2a. Investor pays the cash to the company
2b. The company issues shares to investor

3. EIS1/SEIS1

4. EIS2/SEIS2 and blank EIS3/SEIS3

5. Investor uses EIS3/SEIS3 for tax return

Advanced Assurance (AA) - online

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- Can't be speculative
- Small boxes - attach detailed covering letter!
  - *Set out clearly how company meets all requirements*
  - *Full position minimises risk*
    (risk of delay/subsequent challenge)
- Documentation required – **Review before sending**
  - Business Plan
  - Cashflow Forecasts
  - Proposed use of funds
  - Legal documentation
    e.g. articles of association, investor agreements
    Review drafts - do they meet requirements?
    Any amendments needed?
- HMRC response – it may not be quick!
- SEIS1/EIS1 stage – factual & any changes from AA

HM Revenue & Customs

Summary

Summary

Thank you!

Any Questions?

Case Studies

Company 12 years old

- Age – advised by another party they wouldn’t qualify
- If didn’t qualify, no investment
- We reviewed position:
  - Confirmed it met KIC conditions; and
  - met extended age condition
  - Submitted AA to HMRC

  Thus £2m investment received

Company less than 2 years old - £500k investment

- We advised to separate the investment (different dates):
  - SEIS on initial investment (up to max); and
  - EIS on subsequent investment
- Advised on timing and shareholdings, so no-one went over 30% at any stage
- Advised on various other matters – inc use funds (non-qualifying expenditure) and to keep SEIS/EIS funds separate to demonstrate use

Save the date

Appendices

Appendix 1 - Excluded Activities overview

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(Note – always read in conjunction with the guidance as there are exceptions to several of the below areas)

- dealing in land, in commodities or futures or in shares, securities or other financial instruments.
- dealing in goods otherwise than in the course of an ordinary trade of wholesale or retail distribution.
- banking, insurance, money-lending, debt-factoring, hire-purchase financing or other financial activities,.
- leasing (including letting ships on charter or other assets on hire).
- receiving royalties or licence fees.
- providing legal or accountancy services.
- property development.
- farming or market gardening.
- holding, managing or occupying woodlands, any other forestry activities or timber production.
- shipbuilding.
- producing coal.
- producing steel.
- operating or managing hotels or comparable establishments or managing property used as an hotel or comparable establishment.
- operating or managing nursing homes or residential care homes or managing property used as a nursing home or residential care home.
- all energy generating activities.
- any activities which are excluded activities under ITA07/S199 (provision of services or facilities for another business).

Appendix 2 - Knowledge Intensive Company ("KIC")

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Definition

The issuing company is a KIC if:

- one or both of the "operating cost conditions" arere met; and
- At least one of the following are met:
  - "the innovation condition", or
  - "the skilled employee condition"

Appendix 2 - Knowledge Intensive Company ("KIC")

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Operating cost conditions (one or both)

- The company must spend at least the following amount of its overall operating costs on R&D or innovation:
  i) 10% a year for 3 years; or
  ii) 15% in one of 3 years

Innovation condition

- The issuing company is engaged in IP creation (specific criteria); and
- Reasonable to assume that within 10 years of the share issue the greater part of the company's business activities will be from the exploitation/use of the IP

Skilled employee condition

- At least 20% of the company's full time equivalent employees are "skilled employees"
- *Skilled employees* = hold a relevant higher education qualification (e.g. a relevant master's degree, postgraduate certificate etc.), and are engaged directly in R&D or innovation activities carried on in the company

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Liability

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