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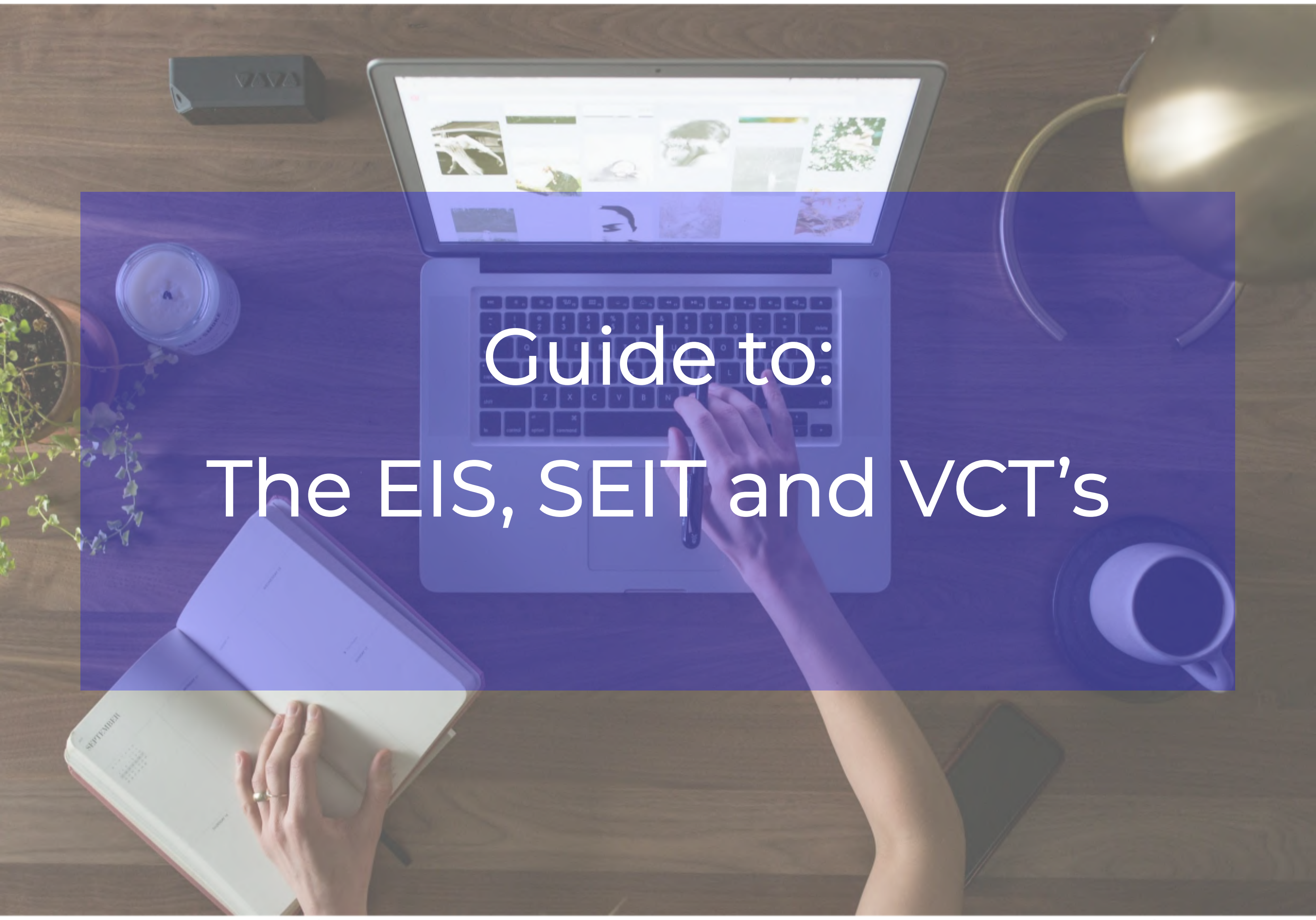
Investments • Pensions • Financial Planning



Guide to:

The EIS, SEIT and VCT's

Introduction

What are the EIS, the SEIS and VCT's?

Introduction

While a complex tax regime, such as we have here, is not something to celebrate, the complexity does include a range of measures introduced by governments over the years to enjoy a tax benefit in exchange for taking action which is deemed to be helpful for the economy or the nation generally.

We are all familiar with the most popular of these, ISAs, which encourage people to save rather than spend, and pension investments designed to help ensure people pay their own way in retirement.

Without the tax benefits attached to these, it is fair to assume there would be far more people who had not saved enough for the future and, hence, far more people who, eventually, became temporarily or permanently dependent on state benefits.

Taking this into account, it is easy to see how offering tax incentives to savers is a two-way arrangement between the government and those it governs. Atkins Bland has a range of guides looking at the tax planning benefits, and other features, of ISAs and pension investments, and these are available on request.

This guide is dedicated to the less well-known government initiatives designed to encourage investment through generous tax incentives. These are the:

- Enterprise Investment Scheme (EIS);
- Seed Enterprise Investment Scheme (SEIS);
- Venture Capital Trusts (VCTs)

Unlike their more common relations, these are designed to encourage investment in specific types of enterprise deemed to be of benefit to the country in one way or another, for instance by contributing to economic growth but principally in terms of encouraging smaller businesses and helping them grow into bigger businesses.

All this makes the idea of taking advantage of the schemes really quite appealing, but they do, of course, come with a catch: investments in smaller businesses are far more risky than investments in well-established and larger businesses.

This increased level of risk can potentially yield higher returns for investors, but only if an investor is comfortable with these risks should they consider taking advantage of the tax benefits and investment opportunities of any of the three types of investment looked at in this guide.

Background to the EIS

What is the EIS and how does it work?

The EIS is designed to help individuals grow their business by offering tax relief to investors who buy new shares in their company. Launched in 1994, the scheme was designed to encourage investment in small, unquoted companies in the UK. Businesses can raise up to £5 million a year, up to a maximum of £12 million over the lifetime of the company. These totals include other schemes and trusts, such as those addressed in this guide.

This money *must* be used to:

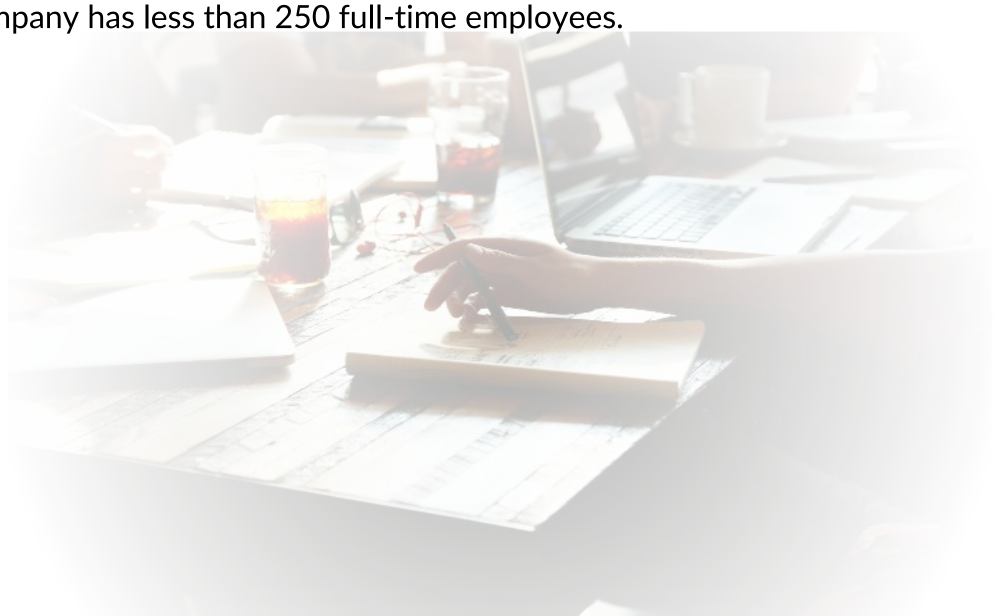
- develop a qualifying trading practice – most trades will qualify, but there are list of excluded trades such as coal production, property development and running a hotel.
- prepare for operating a qualifying trade (within 2 years of investment)
- fund research and development which is intended to lead to a qualifying trade

This money *must* also:

- be used within 2 years of the investment, or the date trading started if later
- not be used to buy part/all of another company
- be used with the intention to grow or develop an individual business

A company can qualify for the EIS *if*:

- it is an established UK company, not recognised on the stock exchange and doesn't control or isn't controlled by another company
- the company has been trading for at least 4 months and only as long as it's within 7 years of the company's first commercial sale
- The company has less than 250 full-time employees.



Background to the SEIS

What is the SEIS and how does it work?

The SEIS is similar to the EIS. Launched in April 2012, the main difference between the two is that the SEIS is intended to encourage investors to invest in very new and small companies, often called 'startups'.

Due to the nature of startup companies, in that they are new businesses requiring capital to get off the ground, the maximum a company can receive is £150,000. This investment includes any state aid awarded in the 3 years up to and including the investment. This limit is also carried over to any other schemes the company may take up in the future (e.g. contributing to the £5 million and £12 million EIS totals). Also, as with the EIS, there are rules a company must follow in order to stay qualified.

As would be expected of a startup, to qualify for SEIS, the company must be established in the UK, not be trading on a recognised stock exchange and have been trading for less than 2 years. The company cannot have gross assets exceeding £200,000 at the time of the share issue and can't control or be controlled by another company. The company must also have less than 25 full time employees.

When issuing shares, the SEIS has the same requirements as those in the EIS. The money raised from share issue must be spent within 3 years, and must be used under the same criteria as the EIS, which are:

- used within 2 years of the investment, or the date trading started if later
- be used to buy part/all of another company
- be used with the intention to grow or develop an individual's business

The benefits for an investor include the potential for significant growth, combined with tax benefits that are addressed later in the guide.

Background to VCTs

What are VCTs and how do they work?

Whereas the EIS and SEIS are concerned with individuals buying new shares in unquoted companies, a VCT is listed on the London Stock Exchange (LSE), investing in other companies which are not listed on the LSE that wish to develop their business. VCTs were introduced in 1995, and have since proven a useful and lucrative way to encourage investment in new UK businesses.

While an EIS or SEIS is an investment in a single company, a VCT is an investment in a managed portfolio of different companies, so creates the benefit of spread. This reduces risk, although it by no means removes it.

As with the EIS and SEIS, there are certain rules the VCT must follow in order to trade. The fund managers have 3 years to choose which companies to invest in. Within 3 years of the share issue, the VCT must have at least 70% of its assets in qualifying holdings, meaning shares or securities of at least 5 years in duration, in companies traded on the alternative investment markets (AIM). These investments must be made in companies that are established in the UK.

There are limits on how much the VCT can invest in one company, how much of one company can make up the VCT's assets and the type of company it can invest into. VCTs are concerned primarily with small companies as a requirement, but smaller companies that begin to be traded on the LSE can continue to be held in the VCT for up to 5 years.

VCTs are run by a fund manager, much the same as any other Investment Trust or Unit Trust, who searches for opportunities to invest in. VCTs are run either on a 'generalist' basis, whereby shares in a variety of different sectors are held, or 'specialist', in which one or two specific sectors are focused on.

They may also be described as 'evergreen', which means they invest in new companies indefinitely, rotating the companies the trust is invested in, or as 'limited life', which means the trust is wound up after the minimum holding period with assets distributed to shareholders.

Tax relief for investors

What are the benefits for investors for the different schemes?

This section outlines the tax benefits of investing in these schemes. There are certain requirements and limitations for the investor which are outlined in a later section.

	EIS	SEIS	VCTs
Income tax	30% of the amount invested, provided at least this amount of tax has been paid Dividends paid are taxable New investments can be treated as applying to the preceding tax year for tax relief and allowance purposes	50% of the cost of shares subscribed for provided at least this amount of tax has been paid Dividends paid are taxable New investments can be treated as applying to the preceding tax year for tax relief and allowance purposes	30% of the amount invested provided at least this amount of tax has been paid Dividends exempt from income tax if market value of qualifying shares is not £200,000+. Any amount over this is taxable.
Minimum holding or qualifying period to retain the tax relief	3 years	3 years	5 years
Capital Gains Tax (CGT)	Exempt from CGT on disposal of shares (if held for 3 years)		Exempt from CGT on disposal of shares within maximum permitted £200,000 a year (if held for 5 years)
Relief for capital losses on disposal	Relief for allowable losses on disposal of shares against either income of the tax year of disposal (or previous tax year) or chargeable gains, subject to conditions stated later in guide Capital loss reduced by any income tax relief obtained under EIS/SEIS and not withdrawn		None
CGT deferral relief or reinvestment relief available?	Yes, subject to certain conditions		No
Business property relief for Inheritance Tax purposes	Shares in EIS/SEIS companies held for at least 2 years normally qualify for 100% business property relief.		None

Key points and conditions

What issues do prospective investors need to be aware of with these schemes?

EIS

Key points

An investor can invest an annual amount of £1 million in an EIS company. This allowance is individual, so a married couple could invest up to £2 million.

There is a 'carry back' available . This means investors, can elect to use their allowance as if it was the preceding tax year.

There are 'disqualifying arrangements tests' which exclude EIS companies that do not invest in qualifying companies to protect investors from tax fraud.

Income tax relief is only available to the extent that tax has actually been paid in the relevant year.

Conditions

No partner or associate of the investor (e.g. spouse, family, extended family, business partners (existing and prior), trustees of settlements of which you are the beneficiary) may have other interests in the company.

The investor and associates must not have more than a 30% interest in the company for example in shares, assets or voting rights.

Investors with connection to the company cannot claim income tax relief, but may qualify for CGT deferral.

The investor must not have any form of preferential shares.

The investor must not have any other form of controlling interest in the company or be employed by the company. They can be directors if they meet certain conditions. An investor must not receive any remuneration as a director that is excessive in comparison to services performed.

The scheme must not be used for the purposes of avoiding tax.

Key points and conditions

What issues do prospective investors need to be aware of with these schemes?

SEIS

Key points

A person can invest an annual total amount of £100,000 in SEIS companies in a single tax year.

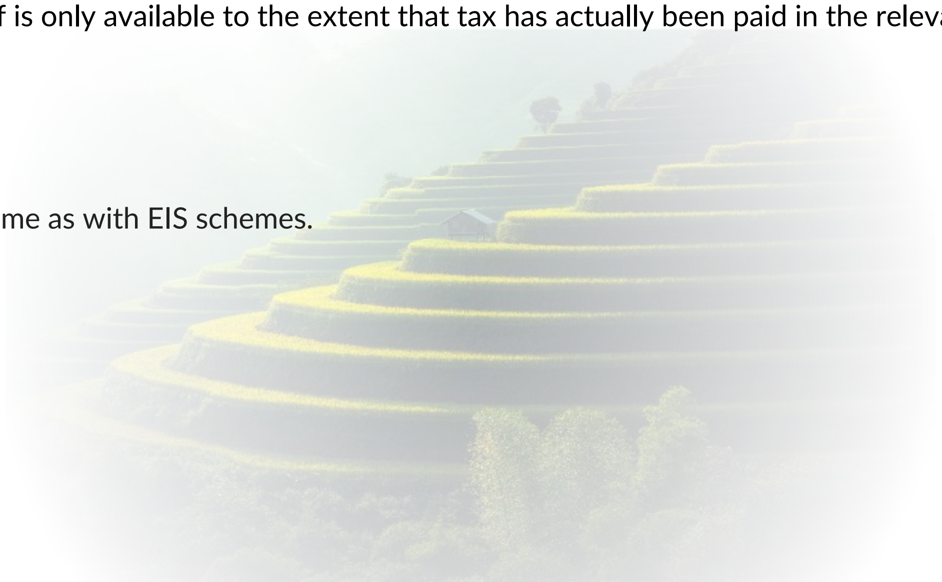
There is a ‘carry back’ available for investors. This means they can elect to invest their allowance as if it was in the preceding tax year, using the allowance for that tax year.

There are ‘disqualifying arrangements tests’ which exclude SEIS companies that do not invest in qualifying companies to avoid tax fraud. SEIS companies can obtain ‘advanced assurance’, a certificate sent from HMRC which provides an opinion as to whether the company the investment is proposed for will qualify.

Income tax relief is only available to the extent that tax has actually been paid in the relevant year.

Conditions

These are the same as with EIS schemes.



VCTs

Key points

An investor can invest a maximum of £200,000 annually.

There are ‘disqualifying arrangements tests’ which exclude VCT companies that do not invest in qualifying companies to avoid tax fraud.

Income tax relief is only available to the extent that tax has actually been paid in the relevant year.

Conditions

There are no specific conditions the investor must abide by other than those previously stated in the guide.

Summary and important notes

Summary

EIS, SEIS and VCT schemes are a tax efficient way for speculative investors to invest in small businesses. Each of the investment methods are, by their nature, high risk, though for those with surplus capital comfortable to take the risk, the tax benefits of the investments helps to mitigate part of this.

The investments do have a potential for high growth, with exemptions and deferments on CGT payments making this growth even more profitable.

However, as stated earlier, risk should be considered first. Only those comfortable with the risk of losing their stake should consider investing in any of these vehicles.

Important notes

Any opinions expressed on the merits or disadvantages of any options are intended as a general comment only and not as specific advice to the reader.

This document is intended as a supplement to full independent advice and not as a replacement for it and should be read in conjunction with any personalised recommendations provided by Atkins Bland Ltd and with any product brochures supplied.

The value of investments will fall as well as rise, as can any income produced.

Inflation can reduce the real value of capital and the income it generates.

Past investment performance is not a reliable guide to the future.

Any reference to taxation, regulation or legislation is based on our current understanding and details should be checked before any reliance is placed upon its accuracy.

The impact of taxation and tax planning depends on individual circumstances and may be subject to change, which can be retrospective.

Errors and omission excepted.

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The value of most investments will fall as well as rise, as can any income generated. An investor may, therefore, get back less than invested.