SHOOSMITHS

EIS / VCT

A summary

FOR WHAT MATTERS

To encourage investment by UK taxpayers into the economy, especially during times of economic uncertainly where higher-risk start-ups and fast-growing business may require the largest cash injections, the UK government introduced the Enterprise Investment scheme ("EIS") and Venture Capital Trust ("VCT") schemes.

The tax relief for individual investors

The schemes provide individuals with reductions and deferrals to income tax and capital gains due on funds they inject into a 'qualifying company' or the VCTs themselves, and on any growth realised from their investments which encourages investors to make investments that they may otherwise have been unwilling to make. A summary of the relief for individual investors are as follows:

Tax	EIS	VCT
Income tax	Reduced by 30% of the sums invested up to £1m (or up to £2m invested in knowledge intensive companies ("KIC") (see below)). Shares need to be held for the relevant "three" year period. e.g. A person invests £100k in a qualifying company and their income tax liability is reduced by £30k.	Reduced by 30% of the sums invested up to £200k. Shares in the VCT need to be held for 5 years. Dividends received from a VCT are tax exempt. e.g. A person invests £100k into a VCT and their income tax liability is reduced by £30k.
Capital gains	On investment, can defer CGT up to the amount of their EIS investment. On disposal, if qualify for income tax relief then there is no CGT on any gain. On disposal, share loss relief should be available where an investment makes a capital loss.	On disposal, if income tax relief is maintained then there is no CGT on any gain (although shares in VCT are generally illiquid so this benefit is rarely utilised)

VCT/EIS conditions

In order for an investment to qualify for EIS or be eligible for an investment from a VCT there are number of factors that need to be met by the investor seeking the tax relief, the company receiving investment and in relation to the type of investment and shares that the investor would receive.

The key in each of these areas has been summarised in the table below:

Investor	Company	Shares
No connection with issuing company*	Cannot be under the control of another company and subsidiaries must be qualifying*	Ordinary shares without preferential rights re winding up and dividends (but may be a drafting workaround). No loan notes or "true" preference shares.*
No linked loan	Carries on a qualifying activity*	Not redeemable*
Subscribe for genuine commercial reasons	Unquoted at the time EIS/VCT shares are issued	Must be fully paid up and subscribed for in cash
Subscribe for eligible shares on own behalf (or through nominee)	Gross assets test (£15m immediately pre-investment; £16m immediately post investment)	No pre-arranged exits – anti-dilution is the key share right which is not allowed for EIS but is possible for a VCT investment.
Must hold shares for "three" years from later of share issue date or commencement of trade (the "Three-Year Window")	Less than 250 full-time employees when EIS/VCT shares are issued (500 if KIC)	
Other shares held by investor in company must be subscriber shares or EIS/SEIS/SITR shares	Annual limit of £5m (£10m if KIC)	
	EIS/VCT investment within seven years (10 if KIC) of first commercial sale (or end of accounting period in which turnover reached £200k if KIC) or exclusion applies	
	Must have a UK permanent establishment.*	
	Cannot be in 'financial difficulty'	
	No disqualifying arrangements	
	Must meet 'risk to capital' condition	
*These conditions must continue to be met for the whole of the Three-Year Window for EIS and on an ongoing basis for VCT purposes (to remain a VCT qualifying company).		

Knowledge Intensive Companies

A KIC is one that qualifies for more favourable conditions in certain circumstances as set out above. To be considered a KIC, the company must meet the "operating costs" condition and either the "innovation condition" or the "skilled employee" condition. Each of these is summarised further below:

Operating Costs Condition:
The company must have spent either 10% of its total operating costs on research and development activities in each of the three years before the EIS/VCT investment or 15% of its total operating costs in one of those three years.

Or, where a company has not been trading for 3 years on the date of the investment it must spend more than 10% on R&D in all three years immediately following the investment or 15% in one of those years.

Innovation Condition:
To meet the innovation condition, the company should be involved in creating intellectual property at the time of the EIS/VCT investment. It should be reasonable to expect that within ten years of the investment, most of the company's activities will involve using or exploiting that intellectual property.

Skilled Employee Condition:
The skilled employee condition is met if, at the time of the EIS investment and for the following three years, at least 20% of the company's full-time equivalent employees are directly engaged in research and development or innovation activities. These employees should hold a relevant higher education qualification at the Master's level or above, and their job roles must require such qualifications.

Dealing with HMRC

The advance assurance process is a procedure that allows companies to seek confirmation from HM Revenue and Customs ("HMRC") that their activities and proposed share issuances meet the requirements of the EIS / VCT schemes.

The process requires you to submit information to HMRC that will then allow them to determine if the relevant EIS/VCT conditions would be met in relation to any investment based on the details provided. HMRC will only provide assurance that the company itself will qualify and won't consider the conditions in relation to each individual investor.

There is no requirement to apply for advance assurance under EIS or VCT, but it is a non-statutory discretionary service, meaning that HMRC can decide not to provide an opinion if they decide there is any uncertainty.

Following an investment under the EIS, a company must complete an EIS1 compliance statement even if the company has received an opinion from HMRC using the advance assurance service that the particular share issue would meet the requirements of the scheme. There is not an equivalent requirement for a company which has raised an investment from a VCT.

How can we help

The Shoosmiths tax team have extensive experience advising both companies and investors on the availability of EIS/VCT reliefs and the potential impact of proposed changes to a business can have on your existing EIS/VCT investors.

Disclaimer: the above is accurate at the time of writing and is provided for general guidance purposes only and should not be considered as legal or tax advice. The EIS/VCT regulations may change, and it is advisable to consult HMRC guidelines or seek professional advice for further specific guidance.