10 the triangle ng2 business park nottingham ng2 1ae
t (0115) 986 2411 f (0115) 986 2412
e info@tcp.uk.com w www.tcp.uk.com

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Tax incentives for investors
– getting the most out of investment schemes

A number of Government approved investment schemes are available to encourage private individuals to invest in smaller high risk unquoted trading companies, and with effect from 2014/15 in social enterprises.

This briefing outlines the tax incentives available to a qualifying investor in making and realising an investment in one or more of the available schemes as well as some key points to ensure pitfalls are avoided in securing the tax reliefs.

The investment schemes are:

- Enterprise Investment Scheme (EIS)
- Venture Capital Trust Scheme (VCT)
- Seed Enterprise Investment Scheme (SEIS)
- Social Investment Relief (SIR)

Each particular scheme has a number of very detailed rules and it is important that specific advice should be sought to ensure these conditions are complied with.

The available tax reliefs differ according to the particular scheme invested in.

EIS

The purpose of the EIS is to help certain types of small higher risk unquoted trading companies raise capital. This is achieved by providing income tax and Capital Gains Tax (CGT) reliefs for investors in qualifying shares in these companies. Investment can be made directly into the company or through an EIS fund.

All shares must be paid up in full, in cash when they are issued. HMRC advise that a common reason for some investments failing to qualify is that the shares are issued to the investors without the company receiving payment for them at that time. This sometimes happens when a new company is being registered but the shares are not paid for until sometime later.

Income tax (IT) relief

Investors may be given IT relief at 30% on their share investments of up to £1m a year giving a maximum tax reduction in any one year of £300,000 providing you have sufficient income tax liability to cover it. A carry back facility exists which will allow all or part of the share investment acquired in one year to be treated as though made in the preceding tax year. Tax relief will then be given in that earlier year.

The IT relief will be withdrawn if the shares are not held for a period of three years from the date that the shares are issued or three years after the trade actually started if later.

Furthermore, IT relief is only given where you are not connected with the company. This condition applies throughout the period commencing two years before the issue of the shares and ending three years after that date, or three years from the commencement of the trade if later. You can be connected by virtue of the size of your stake in the company or by virtue of a working relationship between you and the company. In both cases the position of your associates are taken into account.

Size of stake – you are connected if at any time you control the company or hold more than 30% of the share capital or voting rights of the company.

Working relationship – you are connected if you have been an employee or a paid director of the company.

CGT

On the eventual disposal of the EIS shares any capital gains will be exempt if you received IT relief on the cost of the shares, unless the IT relief is withdrawn.

If no claim to IT relief is made then this exemption will not apply.

If the shares are disposed of at a loss then the loss is allowable but the loss is restricted by the amount of the IT relief given on the subscription of the shares. This loss can be set against income of the year in which the shares are disposed of, or income of the previous year instead of being set against any capital gains.

Another very important advantage is CGT deferral relief. Payment of tax on a capital gain can be deferred where the gain is invested in shares in an EIS company. The gain can arise from the disposal of any asset but the investment must be made within the period one year before to three years after the disposal occurred.

It is not necessary for the individual to have received IT relief on the shares in order to qualify for deferral relief and it does not matter whether the investor is connected with the company or not.

When the shares are disposed of the deferred gain will become chargeable in the same tax year in which the shares are disposed of.

Relief reduced or withdrawn

IT relief will be withdrawn if during the general three year holding requirement:

- you or an associate become connected with the company
- the company loses its qualifying status. This could include a situation where the company does something over which is outside your control.

In addition IT relief will be reduced (or withdrawn) if during the general three year holding requirement:

- any of the shares are disposed of (unless disposed to a spouse or civil partner)
- you or an associate receive value from the company.

Examples of receiving value from the company include where the company:

- buys back shares from you
- makes a payment to you for giving up the right to payment of a debt (other than an ordinary trade debt)
- repays a debt owed to you that was incurred before you subscribed for the shares
- provides you with certain benefits or facilities
- lends you money which has not been repaid before the shares are issued.

Receipts of insignificant value will not cause the withdrawal of the relief.

VCT

VCTs are companies admitted to trading on a regulated market and are run by fund managers who are usually members of larger investment groups. The scheme is designed to encourage individuals to invest indirectly in a range of small higher risk trading companies by spreading the investment risk over a number of companies.

IT relief

IT relief is available at 30% of the amount subscribed for VCT shares up to a limit of £200,000 per tax year. The shares must be held for five years.

Investors are exempt from tax on any dividends that they receive from a VCT although the tax credits are still notional and so not repayable. This is a contrast to the other schemes where dividend income is taxable.

If you dispose of your shares within five years you will have to repay some or all of the IT relief. This does not apply if the disposal is a transfer between spouses.

CGT

Capital gains arising on the disposal of the shares are exempt and there is no minimum period of ownership for this exemption to apply. There are no reliefs available if the shares are sold at a loss.

SEIS

This is a junior version of the EIS and was introduced from 2012/13. It is intended to benefit small, early stage companies by encouraging investment in equity finance. The rules generally mirror those of the EIS.

All shares must be paid up in full, in cash when they are issued otherwise investments will fail to qualify (as above).

IT relief

The investor will be able to invest up to £100,000 in qualifying shares into qualifying companies in a tax year and receive IT relief of up to 50% of the sum invested providing there is sufficient tax liability against which to set it. If there is unused relief in one tax year this can be carried back to the preceding tax year if there is unused relief available.

The shares must be held for a three year period from the date of issue.

If the shares are disposed of or the investor becomes connected with or receives value from the company (generally as per EIS above) then the income IT relief will be withdrawn.

CGT

On the eventual disposal of the SEIS shares any capital gains will be exempt unless the IT relief is withdrawn.

If the shares are disposed of at a loss then the loss is allowable but the loss will be restricted by the IT relief given on the subscription of the shares. As with EIS this loss can be set against income of the year in which the shares are disposed of, or income of the previous year instead of being set against any capital gains.

There is also an additional exemption where assets are disposed of at a gain in that year and an investment equal to the gain is invested in SEIS shares. Reinvestment relief is available at 50% of the gain reinvested up to a maximum gain of £100,000. For example, £80,000 of a £100,000 gain is reinvested so £40,000 (50% of the reinvestment) is exempt from CGT. This could save £11,200 (28% x £40,000).

The relief will only be allowed where the investment also qualifies for IT relief and a claim is made. If SEIS relief is withdrawn on the shares then the gain will be reinstated.

If you make use of the carry back facility any claim for Reinvestment relief must match the year in which the shares are then treated as issued.

SIR

This is a new relief that was introduced from 6 April 2014 and will run to 5 April 2019. Tax relief is given for individuals who support social enterprise being carried on through specified organisations.

IT relief

IT relief will be given at the rate of 30% on the amount of investment subscribed for in qualifying shares or qualifying debt investment in the tax year up to a maximum of £1m providing there is sufficient tax liability against which to set it. If there is unused relief in one tax year this can be carried back to the preceding tax year if there is unused relief available. However, this is not available for investments made in 2014/15.

The IT relief will be withdrawn if the investment is disposed of within three years or the investor becomes connected with or receives value from the social enterprise (generally as per EIS above).

CGT

On the eventual disposal of the investment any capital gains will be exempt unless the IT relief is withdrawn. If no IT relief claim is made then any subsequent disposal of the investment will not qualify for exemption from CGT.

If the investments are disposed of at a loss then the loss will be restricted by the IT relief given on the investment. Losses on shares in some cases may be set against income of the year in which the shares are disposed of, or income of the previous year, instead of being set against any capital gains. Losses on qualifying debt investment can only be set against capital gains. There is no extension of the relief to enable a loan loss to be relieved against income.

Additionally, where an individual has made a chargeable gain in the period 6 April 2014 to 5 April 2019 and makes an investment that qualifies for SIR the gain may be held over, i.e. reduced by the amount of the gain invested. The investment must be made in the period one year before to three years after the gain arose. The gain held over will become chargeable where a chargeable event occurs such as where the investment is disposed of or any of the conditions for SIR fail to be met.

For this relief it is not necessary for the investor to have made a claim for IT relief.

In summary, although the investment schemes carry a degree of risk the tax reliefs available are generous and may suit your individual circumstances.
Please contact us for further advice.