

## Venture Capital Trust and Enterprise Investment Scheme Tax Incentives

### Background

There are currently two tax incentives specifically aimed at benefitting smaller companies, particularly start-ups seeking investment capital from private investors. A third tax incentive is presently under consultation and is intended to be introduced in 2012. The incentives are:

### Venture Capital Trust (VCT)

This tax relief is aimed at investors in a quoted VCT which then invests money in small companies by way of equity shares and/or loans. Therefore, this relief is aimed at encouraging private investors to buy shares in a VCT which in turn invests in a number of small companies. The rules are complex and any investee company looking to attract investments from a VCT should seek expert advice first, but brief details are shown below (the figures shown in brackets throughout this note are proposed revised amounts due to come into effect from 6 April 2012).

To qualify to attract investment from a VCT an investee company:

- must meet a number of requirements but in essence it must be a small independent company, for example its gross assets cannot exceed £7 million (£15 million) immediately before the investment and £8 million (£16 million) immediately afterwards and it must have less than 50 (250) full time employees. The independence requirement means the investee company cannot be controlled by another company so the maximum equity investment by a VCT is 49.9% of the issued share capital of the investee company.

- The investee company must be carrying on (or preparing to carry on) trading activities or certain research and development activities, in each case wholly or mainly in the United Kingdom. There is a list of proscribed activities which will bar an investee company from raising finance under the Enterprise Investment Scheme (EIS). One of these is receiving royalties or licence fees but that does not disbar a technology company as long as the royalties or licence fees arise from exploiting intellectual property which the investee company itself has created.

Other points:

- Each investee company can raise up to £2 million (£10 million) from a VCT and/or under the EIS (see below) in any 12 month period.
- The investment can be a mixture of equity investment and loans but each VCT investment in an investee company must comprise a minimum of 10% in equity.
- Each VCT must hold a minimum percentage, currently 70%, of its total investments by way of equity shares and must meet certain other criteria which need not concern investee companies but which will influence the investment offered by a VCT.

### Enterprise Investment Scheme

The EIS is aimed at providing a tax incentive to individual private investors in small companies aiming to raise equity finance (ie it is not available to companies seeking to invest in other companies). It is available only for new cash injections in return for the issue of ordinary share capital in the investee company. It is not available for the purchase of existing shares or for loans made to an investee company.

The requirements for a successful EIS investment are complex and a complete review is outside the scope of this article. As with VCT relief, some of the relevant limits are proposed to be increased from 6 April 2012. The present features/requirements are shown below (the figures in brackets are the proposed revised figures from 6 April 2012):

- An investor obtains an income tax deduction of 30% on investments made up to a total of £500,000 (£1 million) each tax year.
- The shares must be held for a minimum of three years or the income tax relief will be recaptured.
- If after three years the shares are sold at a capital gain, the gain is exempt and gains made on other assets may be "rolled" into the EIS shares if the proceeds of sale which gave rise to that gain are reinvested into the EIS shares. If the shares are so sold at a loss, a capital loss is available to set against other capital gains, but is reduced by the amount of the income tax relief obtained on the EIS shares sold.

- The relief is available only for investors who have no previous connection with the investee company and "connection" is strictly defined.
- Investee companies must meet the same requirements as for an investment by a VCT set out above.

Although a powerful incentive for private investors to invest money in small technology companies, the rules of the EIS are very complicated and it is therefore essential that appropriate advice is obtained by an investee company before an attempt is made to attract investors under the EIS.

The reforms to the EIS and VCTs are subject to EU State aid approval.

### Business Angel Seed Investment Scheme (BASIS)

BASIS does not exist at present but the Government is consulting on its possible introduction. The current tentative proposal is that income tax relief would be available to serial "business angels" to encourage them to seed money into start-up companies. Therefore, the current proposal is that the investee company must not yet have commenced trading when the investment is made and the "business angel" must have a track record of making these investments and will be expected to have significant involvement with the investee company (for example by being on the board of directors).

Therefore, in contrast to the EIS which makes it difficult for an investor to have too much past or present involvement with the investee company, BASIS will actively encourage hands on involvement by the investor. The Government envisages that once seed investment has been made into an investee company under BASIS then, if further injections of capital are required in the future in order to develop activities further, the investee company could be eligible to raise further funds under the EIS.

In addition to the schemes referred to in this note, there are a number of other ways companies may raise finance. Expert legal and tax advice on raising finance under the EIS and from a VCT and other methods can be obtained by contacting us.

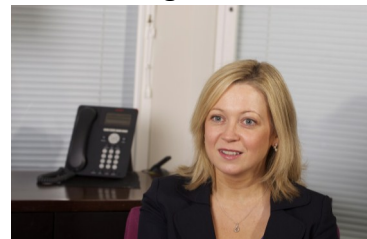
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