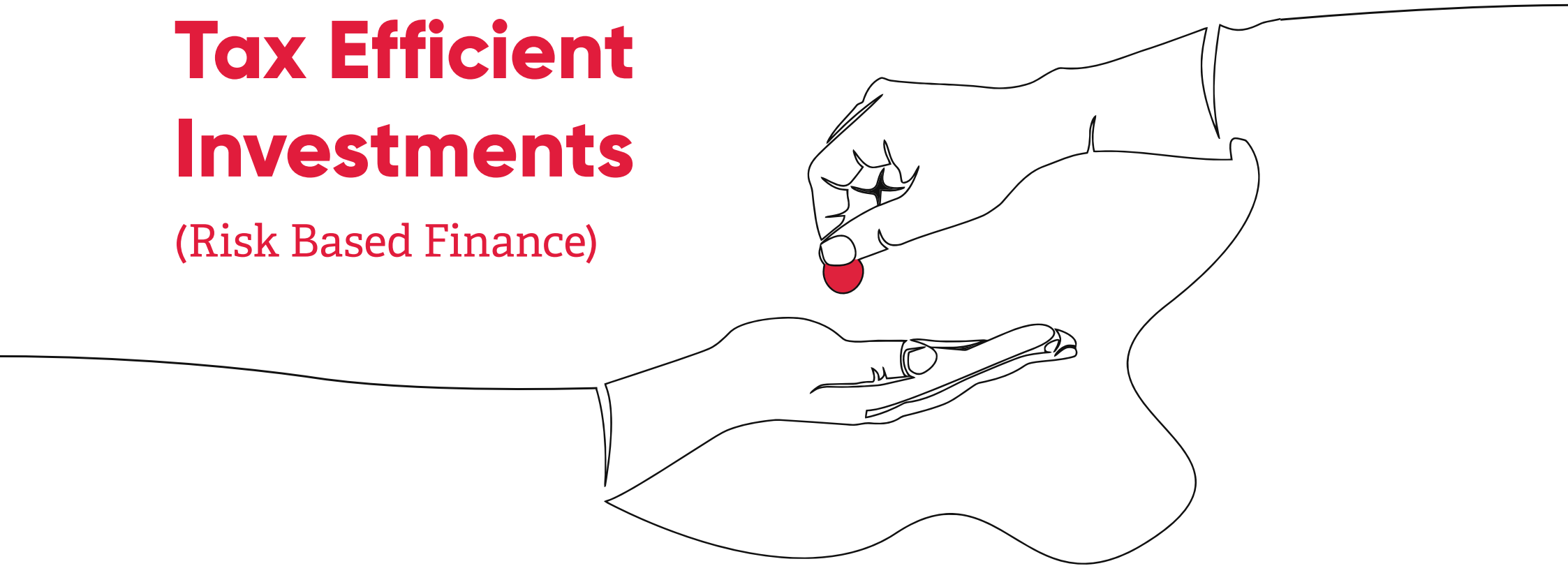


# Tax Efficient Investments

(Risk Based Finance)



**There are some very attractive schemes in the UK which help reduce your tax bill as you invest – read our quick guide to find out more.**

**Or, listen to our Audio Quick Guide on the subject [here](#)**

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There are 4 types of relief for investment into qualifying companies.

EIS, SEIS, VCT and SITR

They are all fairly similar and incredibly attractive, with a range of tax reliefs connected around making investments in risky young businesses, or investing in a social enterprise.

A word of warning however. The schemes are by their definition applicable to start ups and can therefore put your capital at risk. They are incredibly complicated and with strict rules. Once you are invested in or offer such a scheme, relief can easily be lost or withdrawn either by the actions of the company or the investor.

### **Benefits of EIS**

EIS Tax relief is designed to encourage investment in small high risk companies. Advantages include:

- 30% income tax relief for investor. For investments up to £1 million, relief can be carried back to the previous tax year.
- Shares can be sold, after a qualifying period, free of Capital Gains Tax. This relief from Capital Gains Tax is contingent on claiming the Income Tax Relief and may be restricted if full Income Tax Relief is not obtained or is withdrawn on the amount invested. (The qualifying period is normally 3 years from date of investment or, if trade began later, 3 years from the date commencement of trade);
- Capital losses on disposal of EIS shares can be offset against income (a very rare benefit);
- EIS Deferral relief allows you to defer any gain made on disposal of an asset by investing an amount at least equal to the chargeable gain in EIS shares (1 year before or 3 years after the disposal) .
  - With Deferral relief the rules of “connection” for income tax relief do not apply. This means that you can invest in your own company (which you could own 100%) and defer any gain provided the other rules of EIS are met. The “connection” test however means that no income tax relief would be available on such a subscription.

## Rules for the company:

The company cannot be controlled by any other company;

- Investment must be in ordinary shares that do not have a preferential right over other shares. This is a thorny area – be careful.
- The company must be either a UK resident incorporated company or a foreign company with a UK permanent establishment.
- The shares cannot be trading on a recognised stock exchange. They can be listed on AIM and some international stock markets;
- Gross assets must be less than £15 million before the investment and less than £16 million after the investment;
- Must have fewer than 250 full time employees;
- Must be a trading company, carrying out a qualifying trade, or the parent company of a qualifying trading group (subsidiaries must be owned by >50%);
- Trades considered low risk, or asset backed are ineligible. These are broadly:-
  - leasing activities
  - letting ships on charter
  - receiving royalties or license fees
  - dealing in financial instruments like commodities, futures, shares and securities
  - dealing in land
  - running a nursing home or residential care home
  - managing property used as a nursing home or residential care home
  - banking, insurance, money-lending, debt-factoring, hire-purchase financing or other financial activities
  - property development
  - fishery and aquaculture
  - agriculture
  - Production of gas or other fuel
  - generating energy like electricity or heat

- exporting electricity
- road freight transport for hire
- It must be within 7 years of the company's first commercial sale, except if Knowledge intensive (see below), or when it is follow on funding and previous EIS investments have been made.
- The investment must meet the risk to capital condition:
- The company must use the money for growth and development
- The investment must be a risk to the investor's capital.
- Maximum capital raised under EIS and similar tax favourable schemes must not exceed £5 million in any 12 month period;
- Lifetime limit of £12 million of capital raised
- Companies can apply to HMRC for assurance that they qualify, once they have a shareholder they can name.

*You may not qualify if your enterprise provides services to another business and both of the following apply:*

- that business's trade consists mostly of excluded activities
- a person has a controlling interest in both your enterprise and the other business

## Knowledge Intensive Companies:

- A number of the requirements and restrictions are relaxed if the company qualifies as 'knowledge intensive'.
- Benefits of being a Knowledge Intensive Company:
  - Investor annual limit increases to £2 million.
  - Time limit is within 10 years of first commercial sale or annual turnover over £200,000
  - Annual Investment Limit is increased to £10 million and Lifetime Limit is increased to £20 million
- To qualify as knowledge intensive the following must be fulfilled:
  - Less than 500 employees at time of share issue

- One of the following conditions must be fulfilled:
- The Innovation Condition - Be carrying out work to create intellectual property and expect the majority of your business to come from this within 10 years, or
- The Skilled Employees Condition - Have 20% of employees carrying out research for at least 3 years from the date of investment. These employees must be in a role that requires a relevant Master's degree or higher.
- One of the following Operating Cost conditions must be fulfilled:
  - 10% of overall operating costs spent on research, development or innovation for each of the last 3 years, or
  - 15% of overall operating costs spent on research, development or innovation in one of the last 3 years
- If the company is at least 3 years old, the spend should have been in the 3 years before the investment, otherwise this must occur in the 3 years following the investment. (You will need to submit a schedule, supported by accounts to show that you have)
- Companies can apply to HMRC for advance assurance that they qualify.
- **Rules for the individual (these do not apply for EIS Deferral relief only):**
- Cannot be connected to the company, by virtue of holding 30% of the company's share capital in the period beginning 2 years before the investment and ending 3 years after. Shares held by associates (close family or business partners) are included;
- Cannot be a director or employee of the company, exception is available in certain situations for an unpaid director, and after investment you can be appointed and paid as a Director);
- Cannot be an existing shareholder unless shares obtained from EIS or other Risk Finance Investment, or shares obtained on formation of the company or purchase of an 'off the shelf' pre-formed dormant company.
- It is possible to make an EIS investment through a fund in order to reduce risk, or through a nominee.

## SEIS (Seed Enterprise Investment Scheme):

Works in a very similar fashion to EIS

- Available to very small start-up companies
  - less than 25 employees,
  - assets up to £200,000 (pre-investment);
  - investment spent on a qualifying business activity within 3 years
  - the activity must be a new trade that is less than 2 years old
- The investor gets 50% of the amount invested as income tax relief in either the current or preceding tax year;
- Maximum investment £100,000 per investor;
- Maximum company can raise is £150,000
- Investors and their associates can be company directors but can't own more than 30% of the company.
- Gains rolled into SEIS investment under SEIS Reinvestment relief can shelter 50% of the gain invested (permanently, not a deferral).

## Social Investment Tax Relief

SITR is a state aid designed to help you raise money to support the trading activity of your:

- community interest company
- community benefit society, with an asset lock
- charity, which can be a company or a trust
- It follows the same rules as EIS for the company in terms of size, age and ineligible trades.
- It allows the investor to invest in shares or debt
- Shares must be ordinary new shares, paid in full, without any preferential rights – as per EIS
- Debt needs to be a new loan, made in cash, not secured against any assets, and not paid back until at least 3 years later, and not have an unreasonable commercial rate of interest

## VCTS (Venture Capital Trust Scheme):

- Available to investors who subscribe for shares in qualifying Venture Capital Trusts
- 30% income tax relief for investor, for investments up to £200,000. Relief is given in the year of investment with no carry back permitted.
- You must hold your shares for 5 years (rather than the usual 3 years) in the VCT otherwise income tax relief will be clawed back.
- The dividends on the first £200,000 invested in a VCT in a tax year are exempt from tax, regardless of eligibility for Income Tax relief.
- Capital gains tax free from day 1.
- To be approved by HMRC, a VCT must fulfil the following:
  - Be traded on a regulated market such as the UK Stock Exchange or an

appropriate European exchange.

- Derive more than 70% of its income wholly or mainly from shares or securities
- Have at least 80% of its investments in qualifying companies with at least 70% of such holdings in the form of eligible shares
- Cannot invest more than 15% of its funds in any one company and must distribute at least 85% of its profits to its shareholders
- For the purposes of VCTS a qualifying company is one which meets the conditions to be an EIS or SEISS company.

Companies can apply to HMRC for assurance that they are qualifying and this may be a condition of obtaining investment.

- Unlike EIS - VCT have an ability to hold equity and use some debt instruments when they invest into a company.

Scheme	Investment type	Maximum annual investment for individual	Maximum Annual investment for company	Maximum Lifetime investment for company	% of investment you can claim as a tax CREDIT	Number of years investment must be held	Tax relief on Dividends?	Capital Gains Tax relief on reinvestment of any gain
EIS	Ordinary Equity Shares without preferential rights	£1,000,000	£5,000,000	£12,000,000	30%	3 years	No	Yes on 100% of investment (deferral)
SEIS	Ordinary Equity Shares without preferential rights	£100,000	£150,000	£150,000	50%	3 years	No	Yes on 50% of investment, capped at £50,000 (exemption)
SITR	Ordinary Equity Shares without preferential rights or Debt	£1,000,000	£1,500,000	£1,500,000	30%	3 years	No	Yes on 100% of investment (deferral)
VCT	Ordinary Equity Shares without preferential rights	£200,000	£5,000,000 or 15% of the fund	£12,000,000	30%	5 years	Yes	N/A

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