IEP FINANCIAL

KEY GUIDE

Investing in VCTs, EISs and SEISs

Introduction

Governments of both hues have introduced (and closed down) a variety of schemes to encourage investment in new and small businesses. A key feature of all of these schemes has been tax relief, which the Treasury views as necessary to encourage private investors to accept a high level of risk.

In the past, the creative minds of the financial services industry went to great lengths to devise structures which retained the tax benefits while minimising the risk. The result was normally a Budget announcement bringing the bright idea to an abrupt end. This cat and mouse game has now finished, but as a consequence of it the rules which govern the three current schemes – enterprise investment schemes (EISs), seed enterprise investment schemes (SEISs) and venture capital trusts (VCTs) – are highly complex.

The enterprise investment scheme

The EIS structure first appeared in 1994 as a replacement for the business expansion scheme (BES). There are currently two main types of EIS offerings available to investors:

- Individual unlisted companies which meet the EIS requirements; and
- Funds which invest in a portfolio of EIS-qualifying companies. These are quite rare.

Focus point

Investment in an EIS also allows capital gains to be deferred, to the extent that the gain is matched by the EIS investment. The gain deferred is the gross gain, after deduction of any annual exemption. There is no upper limit for this relief.

The main tax reliefs in 2013/14 for EIS investment are income tax and capital gains tax (CGT) reliefs.

Income tax reliefs

Tax relief is given at the rate of 30% on investment in newly issued shares in EISs.

The relief is given as a tax credit against the investor's tax liability, so you must have an income tax liability at least equal to the tax credit claimed for the full relief to be obtained. Relief is clawed back if the shares are disposed of within three years.

The maximum investment that can qualify for income tax relief is £1 million a tax year, while the minimum investment in any one EIS company is £500.

Subject to the current £1 million maximum a tax year, it is possible to carry back some or all relief to the previous tax year. This option is available for shares issued at any time during the tax year. If shares are disposed of at a loss after three years, then the amount of the loss, less the initial income tax relief, can be set against taxable income or capital gain.

Capital gains tax reliefs

The first disposal of shares is exempt from CGT, provided income tax relief has not been withdrawn. As mentioned above, a loss may be offset against other capital gains.

Investment in an EIS also allows capital gains to be deferred, to the extent that the gain is matched by the EIS investment. The gain deferred is the gross gain,

after deduction of any annual exemption. There is no upper limit for this relief. On disposal, the deferred gain becomes chargeable to tax at current rates. The advantage of this relief is now limited, given the changes to CGT in June 2010.

The seed enterprise investment scheme

The SEIS was introduced from 6 April 2012. The main tax reliefs in 2013/14 for SEIS investment are income tax and CGT reliefs.

Income tax reliefs

Tax relief is given at the rate of 50% on investment in newly issued shares in SEISs.

The relief is given as a tax credit against the investor's tax liability, so you must have an income tax liability at least equal to the tax credit claimed for the full relief to be obtained. Relief is clawed back if the shares are disposed of within three years.

The maximum investment that can qualify for income tax relief is £100,000 a tax year, while the maximum SEIS investment any one company can raise is £150,000.

The first tax year to which you can carry back relief is 2012/13. If shares are disposed of at a loss after three years, then the amount of the loss, less the initial income tax relief (and any CGT relief), can be set against taxable income or capital gain.

Focus point

Tax relief is given at the rate of 30% on investments of newly issued VCT shares. The relief is given in the same way as through the EIS, so you do not need to be a higher rate taxpayer to benefit from the full relief.

Capital gains tax reliefs

The first disposal of shares is exempt from CGT, provided income tax relief has not been withdrawn. As mentioned above, a loss may be offset against other capital gains.

A CGT liability from another asset disposed of in the tax year 2012/13 could be eliminated by reinvesting the gain into SEIS shares in the same tax year. It was announced in the 2013 Budget that the gains made in the tax year 2013/14 and that are reinvested in SEIS shares will qualify for a 50% exemption from CGT provided the reinvestment is made in the 2013/14 or the 2014/15 tax year.

Levels, bases and reliefs from taxation are subject to change.

Venture capital trusts

VCTs are listed investment companies which invest in unlisted companies. They were first launched in 1995 and were given a major, but temporary, boost in 2004/05 and 2005/06, when income tax relief was raised to 40%.

The main tax reliefs in 2013/14 for VCT investment are income tax and CGT reliefs.

Income tax reliefs

Tax relief is given at the rate of 30% on investments of newly issued VCT shares. The relief is given in the same way as through the EIS, so you do not need to be a higher rate taxpayer to benefit from the full relief. Relief is now clawed back if the VCT shares are disposed of within five years. The maximum investment that can qualify for income tax relief is £200,000 each tax year, and there is no carry back option.

Dividends on VCT shares (up to the £200,000 each tax year acquisition limit) are free of personal higher rate tax. However, the 10% tax credit cannot be reclaimed.

Capital gains tax reliefs

Any disposal of VCT shares (up to the £200,000 each tax year acquisition limit) is exempt from CGT. Losses are not allowable.

Capital gains made within a VCT are also free of CGT, and can be distributed as dividends.

Risk and liquidity

Focus point

SEIS investment is particularly risky, because the companies involved must be no more than two years old and have gross assets of not more than £200,000.

The very small size of the companies involved in EIS, SEIS and VCT investment means that these schemes are high risk investments and, for most investors, should form only a small part of their overall investment portfolio. SEIS investment is particularly risky, because the companies involved must be no more than two years old and have gross assets of not more than £200,000.

Liquidity for EIS (and, in future, SEIS) investments is usually very limited. Even if an EIS company is listed on AIM or PLUS (formerly OFEX), trading is likely to be minimal. In theory, VCTs should be more liquid, as they are generally larger and listed on the main stock exchange. In practice, many VCT issues suffer from poor liquidity. As a result, some VCTs operate share buyback schemes to enable disinvestment, albeit usually at a discount to the underlying asset value.

Investment in EIS, SEIS and VCT should be regarded as long term. The timescale needed to avoid clawback of income tax relief should not be regarded as the investment's natural term.

Levels and bases of, and reliefs from, taxation are subject to change.

How we can help

VCT, EIS and SEIS investment is a specialist area, and can only be conducted by authorised advisers. We can:

- Make specific VCT, EIS and SEIS recommendations as part of your overall tax and investment planning.
- Work with your accountant to ensure that our recommendations fit in with your overall tax position.
- Keep you informed of new EIS, SEIS and VCT investment opportunities.
- Advise you on other tax strategies linked to EIS, SEIS and VCT investments.

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