

Using venture capital reliefs

(Lecture P10188 – 11.56 minutes)

Over recent years, restrictions on the tax reliefs for pension contributions have meant that more and more high net worth individuals have started looking at venture capital investments as an alternative to the hitherto conventional forms of provision for retirement.

The purpose of this article is to outline the main tax attractions of three venture capital reliefs, viz:

- the Enterprise Investment Scheme (EIS);
- the Seed Enterprise Investment Scheme (SEIS); and
- Venture Capital Trusts (VCTs)

The EIS legislation, which has been available for many years, offers significant tax incentives to investors in the unquoted trading companies that qualify. These will typically be young high-risk businesses. It should be emphasised that there are stringent conditions associated with this and the other venture capital reliefs. In summary, the principal EIS tax benefits are:

- income tax relief of up to 30% of the amount invested;
- no CGT if EIS shares are disposed of at a profit after three years;
- a form of CGT deferral which allows investors to hold over gains on any kind of chargeable asset against subscriptions in EIS shares;
- losses on EIS shares may be eligible for income tax relief under S131 ITA 2007; and
- EIS investments should attract 100% business relief under IHT after two years of ownership.

The SEIS regime was introduced in FA 2012 as a special relief to encourage investment in new start-up companies. The rules are largely based on the EIS and contain many of the same features.

As far as the SEIS is concerned, the key differences in the reliefs available are:

- an income tax reduction of 50%, regardless of the investor's marginal income tax rate; and
- gains arising on the disposal of any kind of chargeable asset can be exempted from CGT (up to a maximum of one half of the SEIS investment) by virtue of a targeted reinvestment relief.

This means that an investor could receive 50% income tax relief and 10% CGT relief (i.e. $\frac{1}{2} \times 20\%$) on a £100,000 SEIS investment, reducing his net cost to just £40,000. However, while

the SEIS reliefs may appear to be more attractive in percentage terms, the overall amount of relief available is substantially less, given that the maximum SEIS investment in any one tax year is limited to £100,000. On the other hand, with an annual limit of £1,000,000, which can rise to £2,000,000 for 2018/19 onwards if investments are made in 'knowledge-intensive' companies, £600,000 of relief is potentially available through the EIS.

The background rationale for the introduction of VCTs has been explained as follows:

'To overcome the expected difficulty of some investors meeting the conditions for relief under the EIS, an investment vehicle similar to an investment trust (known as a VCT) was devised in 1994. An individual investor can acquire shares in a VCT whose professional managers will use the funds to make and manage investments in a range of unquoted companies.'

A VCT is a quoted company that has been approved as such by HMRC. There are currently three forms of tax relief available to an investor in a VCT:

- an investment relief, given by way of a 30% income tax reduction, can be claimed on the amount subscribed for new shares in a VCT, up to a maximum of £200,000 per tax year;
- a dividend relief provides an exemption from income tax on dividends received from shares in a VCT (it should be noted that this relief applies to shares acquired by purchase as well as by subscription, provided that the annual value limit of £200,000 was not exceeded); and
- disposals of shares in a VCT which qualified for investment relief are CGT exempt.

As a final point, it should be borne in mind that investment relief can be clawed back in whole or part if VCT shares are disposed of within five years.

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