HM Revenue & Customs

New procedures for the Enterprise Investment Schemes (EIS) and Venture Capital Trusts (VCTs)

Summary

HM Revenue and Customs (HMRC) is introducing new processes to help manage applications for advance assurance and EIS compliance statements from companies for investments made on or after 6 April 2015 that fall outside certain limits.

With immediate effect, HMRC will not process advance assurance applications in respect of companies that, in general:

- are more than 7 years old and have not received a risk finance investment in the past (see definitions on page 4)
- have received more than £10 million risk finance investment funding (formerly known as risk capital investment funding)

HMRC will process Form EIS1 compliance statements in respect of investments into companies whose age or total risk finance investment exceed these limits, if the company wishes. However such companies and their investors should be aware there is a risk that HMRC may have to recover any tax relief claimed on investments made on or after 6 April 2015.

HMRC may need to check that investors are 'independent' (see definition on page 5).

For VCTs there is a risk that investments made on or after 6 April 2015 in companies exceeding these limits may count as non-qualifying holdings.

The existing annual investment limit of £5 million on amounts raised through risk capital schemes remains in place.

Procedures for EIS and VCT investments made before 6 April 2015, and for Seed Enterprise Investment Scheme (SEIS) investments and for Social Investment Tax Relief (SITR), are not affected.

This guidance will be updated as necessary.

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Background to the new procedures

Budget 2015 announced that the EIS and VCT rules would be changed to ensure they are compliant with the latest State aid rules, and to increase support to high growth companies.

Draft legislation was published on 24 March 2015 setting out the government's proposals[1] (Tax-advantaged venture capital schemes: draft legislation and explanatory notes). The proposed new rules are more generous than the basic State aid limits and they are subject to change, depending on the details of the State aid approval. The new rules will be legislated once State aid approval of the schemes is received.

The current legislation continues to apply to investments made before the new rules are legislated. However, investors and companies should be aware that it is possible that the EU Commission may require recovery of tax reliefs given in particular circumstances where investments exceed the basic limits of 7 years and €15 million.

This guidance uses a limit of £10 million to make allowance for fluctuating exchange rates. Investments that exceed the £10 million limit may still qualify, depending on the exchange rate on the date an investment was made.

What are the new procedures?

Advance assurances (EIS and VCT)

The following additional information must be provided in respect of any company for which an advance assurance application is submitted:

If the company is a single company:

- the date when the company first started to trade
- the amount of risk finance investments (formerly known as risk capital investments) the company has received

If the company is a parent company of a group of companies:

- the date when the company first started to trade (if appropriate) and, if the funds are to be used for a subsidiary company's trade, the date that company first started to trade
- the amount of risk finance investments the company and all its subsidiaries have received (whether or not any company was a member of the group at the time the investment was received

HMRC will not process advance assurance applications in respect of companies that:

- are more than 7 years old and have not received a risk finance investment in the past
- have received more than £10 million risk finance investment funding

There is one exception to the age limit of 7 years. HMRC will provide an advance assurance to a company more than 7 years old that has not previously received a risk finance investment, if it meets the 50% turnover condition. The condition is met if total funds raised from all investors under EIS, SEIS, VCT or SITR over a 30 day period are at least 50% of the company's average annual turnover, taken over the previous five years.

[1] https://www.gov.uk/government/consultations/tax-advantaged-venture-capital-schemes-draft-legislation-and-explanatory-notes

A company that does not meet the general age limit but can show it will meet the 50% turnover condition should provide all the relevant information to demonstrate its compliance with the condition. The draft legislation and explanatory notes specify more details, including how the average is to be calculated.

HMRC will ask any applicant that does not include the necessary information in respect of the company with their advance assurance application to provide it before processing the application.

More guidance on risk finance investments and start of trading can be found below.

Form EIS1 compliance statements

Companies are asked to provide the following additional information when submitting a Form EIS1 compliance statement in respect of shares issued on or after 6 April 2015.

If the company is a single company:

- the date when the company first started to trade
- the amount of risk finance investments (formerly known as risk capital investments) the company has received

If the company is a parent company of a group of companies:

- the date when the company first started to trade (if appropriate) and, if the funds are to be used for a subsidiary company's trade, the date that company first started to trade
- the amount of risk finance investments the company and all its subsidiaries have received (whether or not any company was a member of the group at the time the investment was received)

If a company does not provide this information with its EIS1 compliance statement, and it appears that the company or its group may exceed the following limits:

- more than 7 years old
- has received more than £10 million risk finance investment funding

HMRC will ask it to provide the information.

Risk finance investments of more than £10 million but less than €15 million (by reference to the sterling-euro exchange rate as on the date of issue of the relevant shares) will not exceed the limits. Companies should provide HMRC with information about the risk finance investments to date and the exchange rate on the date of the issue of shares to HMRC if this situation applies.

Where a company exceeds, or appears likely to exceed, the limits, HMRC will write to the company to check if the company wishes HMRC to process the compliance statement, given the risk that any tax relief may be recovered in future.

HMRC will maintain a record of investments that exceed or appear to exceed the limits for which a Form EIS2 is issued and Forms EIS3 compliance certificates are provided.

More guidance on risk finance investments and start of trading can be found below.

Venture capital trusts

VCT fund managers should be aware that there is a risk that investments made on or after 6 April 2015 in companies exceeding the following limits may be found to count as non-qualifying holdings:

- the company, or the subsidiary company which will use the funds, is more than 7 years old and has not received a risk finance investment in the past
- the company (and all its subsidiaries, if the company is a parent company) have received more than £10 million in risk finance investment funding

There is one exception to the age limit of 7 years. A company over 7 years old, that hasn't previously received a risk finance investment, will be eligible for investment if total funds raised from all investors under EIS, SEIS, VCT or SITR over a 30 day period are at least 50% of the company's average annual turnover, taken over the previous five years. The draft legislation and explanatory notes specify how the average is to be calculated.

Risk finance investments of more than £10 million but less than €15 million (by reference to the sterling-euro exchange rate as on the date the investment is made) will not exceed the limits. VCTs and investee companies should keep a record of the company's risk finance investments to date and the exchange rate on the date the investment was made if this situation applies.

To avoid future problems VCTs may wish to manage investments outside the above limits within their non-qualifying holdings.

If a VCT treats an investment that falls outside the above limits as a qualifying holding, it is asked to keep a record of the investment as follows:

- name and company registration number of the company
- name and company registration number of the subsidiary company (if the funds are to be used for the subsidiary company's activities)
- date of investment
- age of company (and subsidiary company, if appropriate)
- total amount of risk finance investments received by the company (or group)
    - before the investment
    - after the investment

More guidance on risk finance investments and start of trading can be found below.

Definitions

A risk finance investment includes any investment received under the SEIS, EIS or VCT schemes. See VCM12030 for more details on what a risk finance (risk capital) investment is.

Start of trading and first commercial sale

The EU rules apply the 7 year time limit from the date of the company's first commercial sale. In most cases the date of starting to trade is a reasonable approximation but for some companies, especially those developing new products, the first commercial sale may take place some time after the company started to trade.

Companies that started to trade more than 7 years before the date of the proposed investment, but that will receive the proposed investment before, or within 7 years after, their first commercial sale should provide the date of the first commercial sale (if a commercial sale has taken place) and include an explanation of the circumstances.

The first commercial sale is the first sale by the company on a product or service market, excluding limited sales to test the market. The date of a company's first commercial sale will depend on the facts.

Example 1

Company A set up a shop to sell sweets. It opened the shop on 31 May 2014 and received lots of customers. The first commercial sale took place on 31 May 2014.

Example 2

Company B set up a shop to sell menswear. The public opening was set for 31 May 2014 but the company held a reception the evening before for invited guests, many of whom bought clothes on the evening. The first commercial sale took place on 30 May 2014.

Example 3

Company C was set up on 1 January 2010 to develop, manufacture and sell portable medical testing equipment. The first design of the product was manufactured and sold to a medical charity on 31 October 2014. The first commercial sale took place on 31 October 2014.

Example 4

Company D was set up on 1 January 2014 to develop, make and sell premium ice cream. Small batches of a number of ice cream varieties were made and the food hall of a local department store agreed to allow the company to test the different varieties on their customers for a week in April 2014. Customers were asked to complete a survey form and most of the ice cream was sold. The company used the customers' views to decide which varieties to go ahead with, and make changes to some of the recipes. It followed up with a further test week in May 2014. The food hall ordered batches of the most popular varieties on 1 June 2014. The first commercial sale took place on 1 June 2014.

Independent investors

Investors who claim tax relief under EIS must be independent from the company and hold no other shares in the company at the time they first invest in the company unless:

- the individual has made a previous risk finance investment in the company
- the existing shares were issued to the individual when the company was founded
- the existing shares were acquired when a pre-formed dormant company was bought 'off the shelf'

Further Information

If you have any questions about the new procedures, please contact the Small Company Enterprise Centre on Telephone: 03000 588907 or email: enterprise.centre@hmrc.gsi.gov.uk.