

## **Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs): better focus**

## **1 Enterprise investment scheme**

Schedule 1 contains provision about the enterprise investment scheme (including provision about deferral relief under Schedule 5B to TCGA 1992).

## SCHEDULE 1

Section 1

## ENTERPRISE INVESTMENT SCHEME

## PART 1

## ENTERPRISE INVESTMENT SCHEME

*Introduction*

- 1 Part 5 of ITA 2007 (enterprise investment scheme) is amended as follows.

*Increase in amount of relief*

- 2 (1) In section 158 (form and amount of EIS relief), in subsection (2)(b) for “£500,000” substitute “£1 million”.
- (2) Accordingly, section 31 of FA 2008 is repealed.

*Loan capital*

- 3 In section 170 (person interested in capital etc of company)–
- (a) in subsection (1)(b), omit “loan capital and”, and
  - (b) omit subsections (8) and (10).

*Overview of Chapter 3*

- 4 In section 172 (overview of Chapter 3), omit the “and” at the end of paragraph (e) and after paragraph (f) insert “, and
- (g) no disqualifying arrangements (see section 178A).”

*Relaxation of the shares requirement*

- 5 (1) Section 173 (the shares requirement) is amended as follows.
- (2) In subsection (2), for paragraph (a) (but not the “or” after it) substitute–
- “(a) any present or future preferential right to dividends that is within subsection (2A),
  - (aa) any present or future preferential right to a company’s assets on its winding up,”
- (3) After that subsection insert–
- “(2A) A preferential right to dividends carried by a share in a company is within this subsection if–
- (a) the amount of any dividends payable pursuant to the right, or the date or dates on which they are payable, depend to any extent on a decision of the company, the holder of the share or any other person, or

- (b) the amount of any dividends that become payable at any time pursuant to the right includes any amount that became payable at any earlier time pursuant to the right, but has not been paid.”

*Increase in the maximum amount permitted to be raised annually*

- 6 In section 173A (the maximum amount raised annually through risk capital schemes requirement), in subsection (1) for “£2 million” substitute “£10 million”.

*No disqualifying arrangements requirement*

- 7 After section 178 insert—

**“178A The no disqualifying arrangements requirement**

- (1) The relevant shares must not be issued in consequence of, or otherwise in connection with, disqualifying arrangements.
- (2) Arrangements are “disqualifying arrangements” if—
  - (a) the main purpose, or one of the main purposes, of any person (“P”) in being a party to them is to secure—
    - (i) that the issuing company, or a qualifying 90% subsidiary of that company, carries on a business which consists of or includes the relevant qualifying business activity, and
    - (ii) that one or more persons (whether or not including P) may obtain relevant tax relief in respect of shares issued by the issuing company which raise money for the purposes of that activity or that such shares may comprise part of the qualifying holdings of a VCT, and
  - (b) one or both of conditions A and B are met.
- (3) Condition A is that, as a (direct or indirect) result of the money raised by the issue of the relevant shares being employed as required by section 175, an amount representing the whole or the majority of the amount raised is paid to or for the benefit of a party to the arrangements or a person connected with such a party.
- (4) Condition B is that, in the absence of the arrangements, it would have been reasonable to expect that the component activities of the relevant qualifying business activity would have been carried on as part of another business (whether by P or any other person).
- (5) For the purposes of this section it is immaterial whether the issuing company is a party to the arrangements.
- (6) In this section—
  - “component activities” means—
    - (a) if the relevant qualifying business activity is activity A (see section 179(2)), the carrying on of a qualifying trade, or preparing to carry on such a trade, which constitutes that activity, and

- (b) if the relevant qualifying business activity is activity B (see section 179(4)), the carrying on of research and development which constitutes that activity;
- “qualifying holdings”, in relation to the issuing company, is to be construed in accordance with section 286 (VCTs: qualifying holdings);
- “relevant qualifying business activity” means the activity for the purposes of which the issue of the relevant shares raised money;
- “relevant tax relief”, in respect of shares, means one or more of the following –
- (a) EIS relief in respect of the shares;
  - (b) SEIS relief under Part 5A in respect of the shares;
  - (c) relief under Chapter 6 of Part 4 (losses on disposal of shares) in respect of the shares;
  - (d) relief under section 150A or 150E of TCGA 1992 (enterprise investment scheme) in respect of the shares;
  - (e) relief under Schedule 5B to that Act (enterprise investment scheme: reinvestment) in consequence of which deferral relief is attributable to the shares (see paragraph 19(2) of that Schedule).”

#### *Qualifying business activity*

- 8 (1) Section 179 (meaning of “qualifying business activity”) is amended as follows.
- (2) In subsection (1), for “subsections (3) and (5)” substitute “subsection (2A)”.
- (3) After subsection (2) insert –
- “(2A) But activity A is not a qualifying business activity if, and to the extent that –
- (a) it consists of an acquisition of shares or stock in a company, and
  - (b) the acquisition is not an acquisition of shares or stock by subscription –
    - (i) immediately before which the company is not a qualifying 90% subsidiary of the issuing company or carrying on, or preparing to carry on, a qualifying trade, and
    - (ii) immediately after which the company is a qualifying 90% subsidiary of the issuing company.”
- (4) In subsection (6)(a), after “subsection (2)(b)” insert “(but not subsection (2A)(b)(i))”.

#### *Increase in the gross assets limits*

- 9 In section 186 (the gross assets requirement) –
- (a) in subsections (1)(a) and (2)(a), for “£7 million” substitute “£15 million”, and

- (b) in subsections (1)(b) and (2)(b), for “£8 million” substitute “£16 million”.

*Relaxation of restriction on number of employees*

- 10 In section 186A (the number of employees requirement), in subsections (1) and (2), for “50” substitute “250”.

*Subsidised generation or export of electricity*

- 11 (1) Section 192 (meaning of “excluded activities”) is amended as follows.
- (2) In subsection (1), omit “and” at the end of paragraph (k) and after that paragraph insert –
- “(ka) the subsidised generation or export of electricity, and”.
- (3) In subsection (2), omit the “and” at the end of paragraph (e) and after paragraph (f) insert “, and
- (g) section 198A (subsidised generation or export of electricity).”
- 12 After section 198 insert –

**“198A Excluded activities: subsidised generation or export of electricity**

- (1) This section supplements section 192(1)(ka).
- (2) Electricity is exported if it is exported onto a distribution system or transmission system (within the meaning of section 4 of the Electricity Act 1989).
- (3) The generation of electricity is “subsidised” if a person receives a FIT subsidy in respect of the electricity generated.
- (4) The export of electricity is “subsidised” if a person receives a FIT subsidy in respect of the electricity exported.
- (5) But the generation or export of electricity is not to be taken to fall within section 192(1)(ka) if Condition A, B or C is met.
- (6) Condition A is that the generation or export is carried on by –
- (a) a community interest company,
- (b) a co-operative society,
- (c) a community benefit society, or
- (d) a NI industrial and provident society.
- (7) Condition B is that the plant used for the generation of the electricity relies wholly or mainly on anaerobic digestion.
- (8) Condition C is that the electricity is hydroelectric power.
- (9) For the purposes of this section –
- “anaerobic digestion” means the bacterial fermentation of organic material in the absence of free oxygen (excluding anaerobic digestion of sewage or material in a landfill);
- “community benefit society” means –
- (a) a society registered under the Co-operative and Community Benefit Societies and Credit Unions Act 1965 as a community benefit society, or

- (b) a pre-2010 Act society (as defined at section 4A(1) of that Act) which meets the condition in section 1(3) of that Act;

“co-operative society” means –

- (a) a society registered under the Co-operative and Community Benefit Societies and Credit Unions Act 1965 as a co-operative society, or
- (b) a pre-2010 Act society (as defined at section 4A(1) of that Act) which meets the condition in section 1(2) of that Act;

“FIT subsidy” means –

- (a) a financial incentive under a scheme established by virtue of section 41 of the Energy Act 2008 (powers to amend licence conditions etc: feed-in tariffs) to encourage small-scale low-carbon generation of electricity, or
- (b) a financial incentive under a similar scheme established in a territory outside the United Kingdom to encourage small-scale low-carbon generation of electricity;

“NI industrial and provident society” means a society registered under the Industrial and Provident Societies Act (Northern Ireland) 1969 (c. 24 (N.I.));

“small-scale low-carbon generation” has the meaning given by section 41(4) of the Energy Act 2008.”

- 13 In section 199 (excluded activities: provision of services or facilities for another business), in subsection (1)(a), for “(k)” substitute “(ka)”.

#### *Powers to amend*

- 14 In section 200 (power to amend by Treasury order), the existing provision becomes subsection (1) and after that subsection insert –
- “(2) An order under this section may –
- (a) make different provision for different cases or purposes, or
  - (b) include such transitional provision as the Treasury consider appropriate.”

#### *Information*

- 15 In section 243 (power to require information in other cases) –
- (a) in subsection (1), omit the “or” at the end of paragraph (d) and after that paragraph insert –
    - “(da) section 178A (no disqualifying arrangements), or”,
    - and
  - (b) in subsection (4), at the appropriate place in the table, insert –

“Subsection (1)(da)	The claimant, the company, any person controlling the company and any person whom an officer of Revenue and Customs has reason to believe may be a party to the arrangements in question”
---------------------	-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

### *Interpretation*

- 16 In section 257 (minor definitions etc), in subsection (1), for the definition of “arrangements” substitute –
- ““arrangements” includes any scheme, agreement, understanding, transaction or series of transactions (whether or not legally enforceable);”.

### *Commencement and transitional provision*

- 17 (1) The amendments made by paragraphs 2 to 10 and 15 have effect in relation to shares issued on or after 6 April 2012.
- (2) For the purposes of paragraphs 4, 7 and 15 it does not matter whether the disqualifying arrangements were entered into before or on or after 6 April 2012.
- 18 (1) Subject to sub-paragraph (2), the amendments made by paragraphs 11 to 13 have effect in relation to shares issued on or after 23 March 2011.
- (2) Those amendments do not have effect in relation to shares issued before 6 April 2012 if the issuing company, or a qualifying 90% subsidiary of that company, first began to carry on activities of the kind mentioned in section 192(1)(ka) of ITA 2007 before that day.
- (3) Until such time as section 1 of the Co-operative and Community Benefit Societies and Credit Unions Act 2010 comes into force, section 198A(6) of ITA 2007 (inserted by paragraph 12 of this Schedule) has effect as if for paragraphs (b) and (c) there were substituted –
- “(b) a society registered under the Industrial and Provident Societies Act 1965,”.
- 19 (1) The amendment made by paragraph 16 is to be treated as having come into force on 6 April 2012.



PART 2

ENTERPRISE INVESTMENT SCHEME: REINVESTMENT RELIEF

*Introduction*

- 20 Schedule 5B to the TCGA 1992 (enterprise investment scheme: reinvestment) is amended as follows.

*Maximum annual investment*

- 21 In paragraph 1 (application of Schedule), in sub-paragraph (2)(da), for “£2 million” substitute “£10 million”.

*No disqualifying arrangements*

- 22 After paragraph 11 insert—

*“Disqualifying arrangements*

11A (1) Where an individual subscribes for eligible shares (“the shares”) in a company (“the company”), the shares are to be treated as not being eligible shares for the purposes of this Schedule if the shares are issued in consequence of, or otherwise in connection with, disqualifying arrangements.

(2) Arrangements are “disqualifying arrangements” if—

(a) the main purpose, or one of the main purposes, of any person (“P”) in being a party to them is to secure—

- (i) that the company, or a qualifying 90% subsidiary of the company, carries on a business which consists of or includes the relevant qualifying business activity, and
- (ii) that one or more persons (whether or not including P) may obtain relevant tax relief in respect of shares issued by the company which raise money for the purposes of that activity or that such shares may comprise part of the qualifying holdings of a venture capital trust, and

(b) one or both of conditions A and B are met.

(3) Condition A is that, as a (direct or indirect) result of the money raised by the issue of the shares being employed as required by paragraph 1(2)(g), an amount representing the whole or the majority of the amount raised is paid to or for the benefit of a party to the arrangements or a person connected with such a party.

(4) Condition B is that, in the absence of the arrangements, it would have been reasonable to expect that the component activities of the relevant qualifying business activity would have been carried on as part of another business (whether by P or by any other person).

(5) For the purposes of this paragraph, it is immaterial whether the company is a party to the arrangements.

(6) In this paragraph—

“component activities” means –

- (a) if the relevant qualifying business activity is activity A (see section 179(2) of ITA 2007), the carrying on of a qualifying trade, or preparing to carry on such a trade, which constitutes that activity, and
- (b) if the relevant qualifying business activity is activity B (see section 179(4) of that Act), the carrying on of research and development which constitutes that activity;

“qualifying holdings”, in relation to the issuing company, is to be construed in accordance with section 286 of ITA 2007 (VCTs: qualifying holdings);

“qualifying 90% subsidiary” has the meaning given by section 190 of ITA 2007;

“relevant qualifying business activity” means the activity for the purposes of which the issue of the shares raised money;

“relevant tax relief”, in respect of shares, means one or more of the following –

- (a) relief under this Schedule in consequence of which deferral relief is attributable to the shares;
- (b) relief under section 150A or 150E (enterprise investment scheme or seed enterprise investment scheme) in respect of the shares;
- (c) relief under Chapter 6 of Part 4 of ITA 2007 (losses on disposal of shares) in respect of the shares;
- (d) EIS relief (within the meaning of Part 5 of that Act) in respect of the shares;
- (e) SEIS relief (within the meaning of Part 5A of that Act) in respect of the shares.”

### *Information*

23 In paragraph 16 (information) –

- (a) in sub-paragraph (6), for “or 11(1)” substitute “, 11(1) or 11A”,
- (b) in sub-paragraph (7), omit the “and” at the end of paragraph (b) and after that paragraph insert –
  - “(ba) in relation to paragraph 11A, the claimant, the company, any person controlling the company and any person whom an officer of Revenue and Customs has reason to believe may be a party to the arrangements in question; and”, and
- (c) in that sub-paragraph, for “and (b)” substitute “, (b) and (ba)”.

### *Meaning of “arrangements”*

24 In paragraph 19 (interpretation), in sub-paragraph (1) for the definition of “arrangements” substitute –

““arrangements” includes any scheme, agreement, understanding, transaction or series of transactions (whether or not legally enforceable);”.

*Commencement*

- 25 (1) The amendments made by paragraphs 21 to 23 have effect in relation to shares issued on or after 6 April 2012.
- (2) For the purposes of paragraphs 22 and 23 it does not matter whether the disqualifying arrangements were entered into before or on or after that date.
- 26 The amendment made by paragraph 24 is treated as having come into force on 6 April 2012.

**EXPLANATORY NOTE**

**ENTERPRISE INVESTMENT SCHEME**

**SUMMARY**

1. This clause and Schedule make a range of changes to the Enterprise Investment Scheme (EIS). This increases the annual amount an investor may invest under the EIS, and provides for two simplifications to the EIS rules. The acquisition of shares will become a non-qualifying activity, as will trades which consist substantially in the receipt of feed-in tariffs (with certain exceptions). A “no disqualifying arrangements” test is introduced. The Schedule also raises the thresholds for eligible companies under the scheme. The increases in these thresholds are subject to State aid approval.

**DETAILS OF SCHEDULE**

*Part 1*

2. Paragraph 1 introduces the changes to be made to Part 5 of the Income Tax Act 2007, dealing with EIS income tax relief.
3. Paragraph 2 of the Schedule increases from £500,000 to £1million the annual amount that an investor may invest under the EIS.
4. Paragraph 3 amends the EIS “connected person” rules so that any loan capital that the investor has in the company is not taken into account when computing whether they are excluded from EIS income tax relief through having a 30 per cent interest in the company.
5. Paragraph 5 widens the definition, for EIS, of the sorts of shares for which investors can subscribe under the scheme to include shares carrying certain preferential rights to dividends. Shares are still excluded if: a) they carry preferential right to assets on winding up; or b) if the amount and timing of the dividends depend on a decision of the company or any other person; or c) if the rights to dividends are cumulative (that is, the right to receive a dividend rolls forward to future periods if the company has insufficient profits to pay the dividend) The new definition is the same as that introduced, for VCTs, in Finance (No 3) Act 2010.
6. Paragraph 6 increases, for EIS, the annual amount of investment that a company may raise under the VC schemes from £2million to £10million. The increase is subject to State aid approval.
7. Paragraph 7 introduces a “no disqualifying arrangements” requirement. Arrangements are “disqualifying” if they are entered into with the purpose of ensuring that any of the venture capital

## FINANCE BILL

schemes tax reliefs are available in respect of the relevant company's business, and either: all or most of the monies raised under the scheme are paid to or for the benefit of a party to the arrangements; or in the absence of the arrangements, it would be reasonable to expect that the business would be carried on as part of another business.

8. Paragraph 8 amends the definition of “qualifying business activity” at section 179 Income Tax Act 2007, to exclude the acquisition of shares other than shares by subscription in a new 90 per cent qualifying subsidiary.
9. Paragraph 9 increases the gross assets limit for EIS from £7million before the EIS investment and £8million afterwards to £15million and £16million respectively. The increases are subject to State aid approval.
10. Paragraph 10 increases the limit on the number of employees that a qualifying company may have from fewer than 50 to fewer than 250. The increase is subject to State aid approval.
11. Paragraphs 11 and 12 exclude as qualifying trades, any which consist substantially in the generation or export of electricity in respect of which the company receives a feed-in tariff under a UK government scheme or a similar overseas scheme. This applies generally where the relevant shares are acquired on or after 6 April 2012. For shares issued on or after 23 March 2011 and before 6 April 2012, a holding will still qualify providing the subsidised generation or export begins before 6 April 2012. Trades where the electricity is generated by anaerobic digestion or hydroelectric power are not excluded by the legislation. Irrespective of the means by which electricity is produced, trades carried on by community interest companies, co-operative societies, community benefit societies or Northern Irish industrial and provident societies are not affected by the legislation.
12. Paragraph 15 amends the information powers at section 243 of the Income Tax Act 2007, to allow HMRC to seek information in relation to the “disqualifying arrangements” requirement from relevant parties.
13. Paragraph 16 amends the existing definition of “arrangements” to make it clear that “arrangements” includes a single transaction or a series of transactions.

### **Part 2: Enterprise Investment Scheme: Reinvestment Relief**

14. Paragraph 20 introduces the changes to be made to Schedule 5B to the Taxation of Chargeable Gains Act 1992, dealing with EIS deferral relief.

## FINANCE BILL

15. Paragraph 21 increases, for reinvestment relief under Schedule 5B TCGA 1992, the annual amount of investment that a company may raise under the VC schemes from £2million to £10million. The increase is subject to State aid approval.
16. Paragraph 22 introduces a “no disqualifying arrangements” requirement. Arrangements are “disqualifying” if they are entered into with the purpose of ensuring that any of the venture capital schemes tax reliefs are available in respect of the relevant company’s business, and either: all or most of the monies raised under the scheme are paid to or for the benefit of a party to the arrangements; or in the absence of the arrangements, it would be reasonable to expect that the business would be carried on as part of another business.
17. Paragraph 23 amends the information powers at Paragraph 11 of Schedule 5B, to allow HMRC to seek information in relation to the “disqualifying arrangements” requirement from relevant parties.
18. Paragraph 24 amends the existing definition of “arrangements” to make it clear that “arrangements” includes a single transaction or a series of transactions.

## BACKGROUND NOTE

19. The Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) encourage investment into small, higher risk trading companies by offering tax incentives to investors in qualifying companies.
20. Following consideration of responses to a consultation document "Financing a Private Sector Recovery", published on 26 July 2010 and to a further consultation, “The path to strong, sustainable and balanced growth” (the “Growth Review”), published on 29 November 2010, the Chancellor announced in his Budget on 23 March 2011 that subject to State aid approval, limits on the size of companies which can benefit under the schemes would be increased.
21. A further consultation document, "Tax-advantaged venture capital schemes: a consultation" was published on the Treasury website on 6 July 2011 seeking views on ways in which the EIS and VCTs might be improved.
22. If you have any questions about this change, or comments on the draft legislation, please contact Kathryn Robertson on 020 7147 2589 (email [KathrynRobertson@hmrc.gsi.gov.uk](mailto:KathrynRobertson@hmrc.gsi.gov.uk)) or Des Ryan on 020 7147 0818 (email [Des.Ryan@hmrc.gsi.gov.uk](mailto:Des.Ryan@hmrc.gsi.gov.uk)).