IWCAPITAL
INVESTED INTEREST

EIS IN 2016
LEGISLATIVE CHANGES

JANUARY EDITION

EIS in 2016 Legislative Changes

The Enterprise Investment Scheme (EIS) is one of the UK Government's leading initiatives to promote private investment into particular industries, via tax incentivisation. Since the scheme's inception in the early 1990s, it has helped to fund around 22,900 individual companies and raised over £12.2 billion. By offering investors Income Tax relief of 30% on investments of up to £1,000,000 per tax year, the scheme has proved integral for growing British businesses that have received much-needed private capital as a result.

Last year, IW Capital's Future of EIS Report 2015 provided a timely insight into the key legislative amendments proposed in the 2015 Finance Bill. In this year's iteration, we discuss the subsequent changes that have come to light since our last update, highlighting the specifics of the Finance Act 2015, the proposed Finance Bill 2016 and the respective impact both will have on EIS.

The rapid and responsive growth of the UK's alternative finance industry has triggered further government amendments to EIS, some of which were introduced in the Finance Act 2015 and some of which have been proposed in the draft clauses of the 2016 Finance Bill. These changes reflect the Government's overall objective to align national legislation with new European Union (EU) regulations on state aid. Additionally, the final amendments contained in the 2016 Finance Bill reflect the Conservatives' long-term goal to exempt all energy-generation activities from venture capital schemes, including EIS.

For effective planning in the 2016/2017 tax year, it is imperative to understand forthcoming changes to legislation pertaining to tax-related policy and schemes. To ensure that investors and businesses are well-versed in EIS and fully prepared for the year, this report also lists the key venture capital tax-efficient schemes available and the factors that set them apart.

Finance Act 2015

The Finance Act 2015 received royal assent on 30 November 2015. The Act made a number of changes to EIS to ensure its compliance with new EU regulations on state aid money:

- The amount of funding that a company can receive through EIS has been reduced to £12 million, or £20 million for knowledge intensive companies
- To qualify for EIS, companies will need to have made their first commercial sale in the past seven years, or ten years for knowledge intensive companies
- Companies involved in the subsidised generation of renewable energy, or the provision of a reserve energy generating capacity, are now exempt from EIS investment
- EIS capital cannot be used to fund management buyouts or acquisitions

These new amendments allow EIS to be geared towards small high-growth companies and industries in need of private capital investment. Investors that already hold shares in an EIS-qualifying company will not be affected by these new arrangements.

2016 Finance Bill: Energy Generation Activities to be Exempt from EIS Investment

On 9 December 2015, HM Treasury published draft clauses for the forthcoming 2016 Finance Bill. Consultation on the draft legislation will run until Wednesday 3 February. Subject to their final review, the contents of the Finance Bill will be confirmed in the Government's next Budget, to be announced on 16 March 2016.

The 2016 Finance Bill proposes further amendments to EIS, targeting specifically the types of companies that qualify for EIS investment.

Background

In the Summer Budget 2015, the Government announced that it would continue to monitor the use of venture capital schemes, including EIS, by community energy schemes. In accordance with its long-term commitment to exclude energy generation activities from venture capital schemes, the Finance (No. 2) Act 2015 introduced the following amendment to EIS, which took effect on 30 November 2015:

"*…the subsidised generation of renewable energy by community energy organisations and activities concerning the provision of reserve energy generating capacity would cease to be qualifying activities for the venture capital schemes.*"

This amendment has been designed to shift capital investment from energy generation activities into other high-growth industries.

Proposed Changes

In light of the changes to EIS introduced by the Finance Act at the end of last year, the 2016 Finance Bill proposes further amendments to the venture capital schemes' excluded activities list, as detailed below:

"*Activities involving the generation of any form of energy, including the generation or export of electricity, the generation of heat and the production of gas or other fuel will be added to the excluded activities list.*"

Should this proposed amendment be enacted into law, all companies whose trade consists substantially of energy generation activities will be excluded from all venture capital schemes, including EIS, by April 2016.

Impact

The proposed amendments will limit the number of British companies able to qualify for EIS. Furthermore, individuals will not be eligible for tax relief on investments made on or after the amendments to the excluded activities list take effect. The Government estimates that this will have a negligible impact on businesses and investors.

Planning for 2016/2017 Tax Year

Alternative finance is revolutionising the banking sector by diversifying the range of lending opportunities available to SMEs. Government-backed initiatives in particular, such as EIS, continue to incentivise the private lending of capital into industries that offer high-growth potential. Furthermore, venture capital tax-incentive schemes not only support business progression, but also broaden the tax planning options available to British tax-payers.

In light of the Self-Assessment Tax Return deadline - 31 January - now is an opportune moment to reflect on the lessons learned from the tax year passed, and implement an improved strategy for the 2016/2017 tax year.

To ensure that tax-planners are fully informed about the range of schemes available and the distinctions between them, we have provided an overview below:

Enterprise Investment Scheme

EIS encourages private investment into early-stage companies by offering tax relief to investors on new shares in qualifying companies. Income Tax relief of 30% can be claimed on investments (up to £1,000,000 in a single tax year) giving a maximum tax reduction in any one year of £300,000. Any return is exempt from Capital Gains Tax if the shares are held for at least three years and the Income Tax relief was claimed on them. It also provides 100% Inheritance Tax relief, as long as the investments have been held for at least two years at the time of death.

Seed Enterprise Investment Scheme

The Seed Enterprise Investment Scheme (SEIS) complements EIS by also offering tax relief to investors in higher-risk small companies. Income Tax relief is available at 50% of the cost of the investment, with the maximum annual investment capped at £100,000. Similar to EIS, any return is exempt from Capital Gains Tax if the shares are held for at least three years and the Income Tax relief was claimed on them.

Venture Capital Trust

Venture Capital Trusts (VCTs) encourage individuals to invest indirectly in a range of small trading companies whose shares and securities are not listed on a recognised stock exchange. The VCT scheme offers Income Tax relief at the rate of 30% of the amount subscribed for shares issued in the tax year 2006/2007 and onwards (for subscriptions for shares issued in previous tax years the rate is 40%). Based on the type of shares held, an investor could be exempt from Capital Gains Tax on any gain made when the VCT shares are disposed of. A maximum of £200,000 can be invested through this scheme.

Social Investment Tax Relief

The Government’s Social Investment Tax Relief (SITR) scheme encourages individuals to support social enterprises and helps them access new sources of finance. These social enterprises are recognised as charities, community interest companies or community benefit societies carrying out a qualifying trade. To be eligible, the social enterprises must have fewer than 500 employees and gross assets of no more than £15 million.

Individuals making an eligible investment can deduct 30% of the cost of their investment from their Income Tax liability, either for the tax year in which the investment is made or the previous tax year (if 2014/2015 or later). The investment must be held for a minimum period of three years for the relief to be retained.

IW Capital's Tax Planning Index 2016

There are multiple layers to navigate when considering tax-efficient schemes. To help you with this process, IW Capital is excited to announce the forthcoming release of its Tax Planning Index for 2016. Surveying a large sample of high-net worth individuals spread across the British Isles, this insightful index reveals the tax planning behaviour of high-tax payers. The findings will provide individuals with a useful reference point from which to assess whether tax-efficient schemes are effectively incorporated into a tax strategy.

Looking Forward into 2016

The recent legislative changes announced in the Budget reinforce the importance of utilising tax-efficient products to support both the investor community, and the stimulation of the UK's private sector. In order to navigate these changes and to ensure an EIS investment is performing to its maximum potential, expert support is essential.

When managed correctly, tax-efficient schemes fulfil numerous objectives; serving as a means to support early-stage businesses and to minimise risk for investors. For initiatives like EIS to prove beneficial for both businesses and investors, the utmost levels of due diligence and targeted guidance are paramount. As regulatory amendments to government-backed schemes are inevitable, possessing the most relevant knowledge around legislation is key. IW Capital's private equity team will continue to provide regular and relevant updates on EIS, to support the investment decisions of our clients and the operations of our portfolio companies.

To find out more about the investment opportunities on offer at IW Capital, speak to a member of our team on 0207 015 2250, or email info@iwcapital.co.uk.

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