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## Enterprise Investment Scheme (EIS)

# Introduction

The Enterprise Investment Scheme (EIS) is designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies.

This guide provides an overview for companies and potential investors who have heard of the Scheme and want to know more about it and how it works. **It does not cover all the detailed rules, so companies and investors should not proceed solely on the basis of the information in it, and should consider seeking professional advice.**

The information in this guide relates only to shares issued on or after 6 April 2012.

It does not cover the legislation relating to shares issued before that date. Also readers must bear in mind that the reliefs and legislation relating to them may change in the future.

HM Revenue & Customs provides more detailed guidance in the Venture Capital Schemes Manual (VCM), to which this guide occasionally refers.

This guide is divided into two parts:

- **Part one** focuses on the investor
- **Part two** focuses on the company

And there are pointers to additional sources of information at the end.

**It is strongly advised that you read both parts, irrespective of whether you are a potential investor or a company considering using the Scheme.**

It is important that investors are aware of the rules the company has to observe, not just at the time of the investment but for at least three years afterwards. If it fails to meet those rules tax relief will not be given, or, if it has already been given, will be withdrawn. Similarly, it is important that companies appreciate the conditions to be met by investors, so that shares are not issued on which the investor expects to be able to claim tax relief, only to find that no relief is due.

Both investors and companies should note that no relief will be given (or if it has been given, it will be withdrawn) if any scheme has as its main purpose, or one of its main purposes, the avoidance of tax. (The tax reliefs available under the EIS are of course not considered to be avoidance of tax.)

# 1.1 The investment

All shares must be paid up in full, in cash, when they are issued.

**Please note**: One of the most common reasons for investments failing to qualify for relief under EIS is that shares are issued to investors without the company having received payment for them. This sometimes happens when a new company is registered at Companies' House and shares are issued to members as part of the registration process, but the company then takes some time to set up a bank account and the shares are not paid for until that has happened. We would advise companies and investors to ensure that any shares, on which it is intended EIS relief will be claimed, are not issued during the company registration process but are issued only at a later date when the company is able to receive payment for them.

Shares must be full-risk ordinary shares, and may not be redeemable or carry preferential rights to the company's assets in the event of a winding up. Shares may carry limited preferential rights to dividends, but may not include rights where either:

- the rights attaching to the share include scope for the amount of the dividend to be varied based on a decision taken by the company, the shareholder or any other person. (**Please note**: this exclusion covers only those shares which carry preferential rights and does not therefore prevent the voting of dividends in respect of non-preferential shares, nor does it prevent shareholders from choosing to waive a dividend payment should they wish to do so)
- the right to receive dividends is 'cumulative' - that is, where a dividend which has become payable is not in fact paid, the company is obliged to pay it a later time, normally once funds become available

There must be no arrangements to protect the investor from the normal risks associated with investing in shares, and no arrangements at the time of investment for the shares to be sold at the end of the relevant period.

The shares may not be acquired using a loan made available on terms which would not have applied other than in connection with the acquisition of the shares in question.

The shares must not be issued under any 'reciprocal' arrangements, where company owners agree to invest in each other's companies in order to obtain tax relief.

There must be no arrangements (either at the time of issue of the shares or later) to structure a company's activities with the main purpose of allowing a party other than the company to benefit from the tax advantaged finance which the scheme is intended to incentivise; or where those activities have no commercial purpose other than to generate tax relief.

Investment can be directly into the company, or through an EIS Fund. For more on EIS Funds see paragraph 1.6.

For more information see VCM12000

# 1.2 The Tax Reliefs available

## 1.2.1 Income Tax Relief

This is available to **individuals** only, who subscribe for (although this can be through a nominee), shares in an Enterprise Investment Scheme (EIS). Relief is at 30 per cent of the cost of the shares, to be set against the individual's Income Tax liability for the tax year in which the investment was made.

Before 6 April 2011 relief was at 20 per cent of the cost of the shares, and before 6 April 2012 there was a minimum investment of £500.

Relief can be claimed up to a maximum of £1,000,000 invested in such shares, giving a maximum tax reduction in any one year of £300,000 providing you have sufficient Income Tax liability to cover it.

There is a 'carry back' facility which allows the all or part of the cost of shares acquired in one tax year, to be treated as though those shares had been acquired in the preceding tax year. Relief is then given against the Income Tax liability of that preceding year rather than against the tax year in which those shares were acquired. This is subject to the overriding limit for relief for each year.

See VCM10530 for more information about how the relief works to reduce Income Tax liability.

The shares must be held for a certain period or Income Tax relief will be withdrawn. Generally, this is three years from the date the shares were issued. But if the qualifying trade started after the shares were issued, the period is three years from the date the trade actually started.

Income Tax relief can only be claimed by individuals who are not 'connected' with the company. (See 'Connection with the company' at paragraph 1.3)

## 1.2.2 Capital Gains Tax exemption

If you have received Income Tax relief (which has not subsequently been withdrawn) on the cost of the shares, and the shares are disposed of after they have been held for the period referred to at paragraph 1.2.1 Income Tax Relief above, any gain is free from Capital Gains Tax.

**Note**: if no claim to income tax relief is made, then any subsequent disposal of the shares will not qualify for exemption from capital gains. This is because of the difficulty in establishing perhaps many years after the investment, whether both the investor and the company met all of the qualifying conditions not only at time of investment but for a continuous period of several years after investment. Entrepreneur's relief may be available in certain circumstances - see Capital Gains Tax reliefs on shares.

## 1.2.3 Loss Relief

If the shares are disposed of at a loss, you can elect that the amount of the loss, **less any Income Tax relief given**, can be set against income of the year in which they were disposed of, or any income of the previous year, instead of being set off against any capital gains.

See VCM70000 for more information about share loss relief.

### 1.2.4 Capital Gains Tax deferral relief

This is available to individuals and trustees of certain trusts. The payment of tax on a capital gain can be deferred where the gain is invested in shares of an EIS qualifying company. The gain can arise from the disposal of any kind of asset, but the investment must be made within the period one year before or three years after the gain arose.

There are no minimum or maximum amounts for deferral. And it does not matter whether the investor is connected with the company or not. Unconnected investors may claim both Income Tax and capital gains deferral relief.

There is no minimum period for which the shares must be held; the deferred capital gain is brought back into charge whenever the shares are disposed of, or are deemed to have been disposed of under the EIS legislation.

**The Budget on 22 June 2010 announced changes to the capital gains rules.**

After that date it is no longer possible both to defer such gains under the EIS rules, and for them to qualify for Entrepreneur's Relief. If you think that you may be affected by this you should seek advice before proceeding with investment under EIS.

See VCM23000 for more information about capital gains deferral relief.

## 1.3 Connection with the company

You are not eligible for Income Tax relief on the cost of your shares if you are connected with the company. You can be connected in two ways.

### 1.3.1 Connection by financial interest in the company

A financial interest in the company, or in any subsidiary of the company, can make you connected with it. If you control the company, or hold more than 30 per cent of the share capital or voting rights, you are connected with the company. If you are entitled to more than 30 per cent of the assets in the event of a winding up you are also connected; note that in looking at entitlement to assets, loans to the company are taken into account.

These conditions apply throughout the period beginning two years before the issue of the shares and ending three years after the issue (or three years after the commencement of the trade if that followed the share issue). So if you take a 15 per cent stake and are given Income Tax relief, and a year later you take an additional 20 per cent stake, you have become connected, and the relief will be withdrawn.

Shareholdings/voting rights/rights to assets in a winding up held by your **associates** are also taken into account. Associates are defined as business partners, trustees of any settlement where you are a settlor or beneficiary, and relatives. Relatives are spouses or civil partners, parents and grandparents, and children and grandchildren; brothers and sisters are not counted as associates for the purpose of the Enterprise Investment Scheme (EIS).

## 1.3.2 Connection by employment

If you are a partner, director (though see 'Business Angels' below) or an employee of the company, you are connected with it. You are also not eligible for relief if an associate (see above) is so connected. As with connection because of an interest in the company, this restriction applies not only at the time the shares were issued but to the two year period before the shares were issued and the three years after the issue (or the three years after the commencement of the trade if that followed the share issue).

## 1.3.3 Business Angels

However there is an exception for directors who are 'Business Angels'. Where your **only** connection with the company is as a director who **receives no remuneration (and is not entitled to such remuneration)**, and you had not previously been involved in carrying on the trade the company is carrying on at the time it issues the relevant shares, an investment may qualify for Income Tax relief.

That relief is not withdrawn if you **subsequently** become a paid director, providing the remuneration is reasonable. You can also claim Income Tax relief on investments made **after** becoming a paid director, providing that either:

- those shares are issued during the period as covered at paragraph 1.2.1 above relating to the shares issued before you became a paid director
- or that the shares are issued before the third anniversary of the date of issue of shares in respect of which you qualified for relief under the Seed Enterprise Investment Scheme (SEIS)

See VCM11000+ for further information about the connection rules.

## 1.3.4 Summary of tax reliefs

Reliefs available depend on whether an investor is connected with the company

| Item | Unconnected | Connected |
|---|---|---|
| **Income Tax Relief** on subscriptions | Yes | No |
| **Capital Gains exemption** on disposal of shares eligible for income tax relief | Yes | No |
| **Loss Relief** on disposal of shares disposed of at a loss | Yes | In some cases |
| **Capital Gains Deferral** (unlimited) | Yes | Yes |

# 1.4 How to claim tax relief

You cannot claim relief until the company sends you a form EIS3. (See Part 2 for an explanation of what the company has to do to put itself in that position.) If you invest through an Approved Enterprise Investment Scheme (EIS) Fund you will receive a form EIS5; see paragraph 1.6.

Your claim can be made on the Self Assessment tax return for the tax year in which the shares were issued. If the shares were issued in a previous year, and/or if the claim is for capital gains deferral relief, the claim part of the form EIS3 must also be completed and sent to your tax office.

If you have an EIS3 for a year for which you have not yet received a tax return, you can request a change to your PAYE tax code, or an adjustment to any Self Assessment payment on account due. You will still have to make the claim itself on your tax return when you get it.

Claims to relief can be made up to five years after the first 31 January following the tax year in which the investment was made.

# 1.5 When is relief reduced or withdrawn?

Tax relief will be **withdrawn** if, during the period set out at paragraph 1.2.1:

- You or an associate become connected (see above) with the company.
- The company loses its qualifying status. The circumstances in which this can happen are set out in Part 2. It is important to realise that the company may do something over which you have no control which results in its losing its qualifying status, and your relief being lost. But if a company ceases trading as a result of going into liquidation and the liquidation is for genuine commercial purposes, any Income Tax relief is **not** withdrawn.

Tax relief will be **reduced or withdrawn if**, during that period:

- Any of the shares are disposed of (**unless** the disposal is to a spouse or civil partner - in those circumstances the shares are treated as if the spouse or civil partner had subscribed for them).
- You (or an associate) 'receive value' from the company (or a person connected with that company). What constitutes receiving value is set out at VCM15060. It includes receiving a loan or benefit from the company, or the company selling an asset to you at less than market value (or you selling an asset to the company at more than market value). Relief can also be withdrawn if the company repays or repurchases its own share capital from **any** shareholder. How much Income Tax relief is withdrawn will depend on the amount of the value received, but the whole of any deferred capital gain will be brought back into charge. However, 'insignificant' amounts of value

received can be ignored, and there is also a facility in some circumstances whereby if the value received is replaced as soon as is practicable, relief will not be withdrawn.

Please note that you are required by law to inform your tax office within 60 days of any of the events above occurring.

For more information on withdrawal or reduction of relief, see VCM15000.

# 1.6 Investment through EIS Funds

You can also invest through an Enterprise Investment Scheme (EIS) Fund, which will invest on your behalf in a number of qualifying companies. You are still the owner of the shares, and the process for claiming relief is as set out above.

Some Funds, set up in a particular way, are approved by HM Revenue & Customs (HMRC). If you invest through one of these funds, then providing certain conditions are met, there is no minimum investment per company requirement, and you can claim Income Tax relief as if the shares were subscribed for on the date the Fund closed, rather than the date when they were actually purchased. (Capital gains deferral relief is still claimed by reference to the date the investment in the EIS qualifying company was made.) In these cases, instead of you receiving an EIS3 for each investment, the managers of approved Funds will send you a form EIS5 covering all the investments made on your behalf.

Please note that 'approval' by HMRC is relevant only to the tax treatment of the investments. It in no way bears on the commercial viability of the investments, and you are as liable to have relief reduced or withdrawn on any particular investment in the same way as anyone who invests directly into the company.

# Part 2 - EIS and the company

In order for its investors to be able to claim, and keep, the Enterprise Investment Scheme (EIS) tax reliefs relating to their shares, the company which issues the shares has to meet a number of rules regarding the kind of company it is, the amount of money it can raise, how and when that money must be employed for the purposes of the trade, and the trading activities carried on.

The company must satisfy HM Revenue & Customs that it meets these requirements, and is therefore a qualifying company. The process for doing this is set out at paragraph 2.5.

# 2.1 The kind of company which can use the Scheme to raise money

- Must be an unquoted company at the time the shares are issued. That means it cannot be listed on the London Stock Exchange or any other recognised stock exchange. It can subsequently become a quoted company without the investors losing relief, but only if there were no arrangements for it to become quoted in existence when the shares were issued. For the EIS rules the Alternative Investment Market (AIM) and the PLUS Markets (with the exception of PLUS-listed) are not considered to be recognised exchanges, so a company listed on those markets can raise money under the EIS if it satisfies all the other conditions. The PLUS-listed market is regarded as a recognised stock exchange and shares listed on that market at the time of issue will not qualify for EIS.
- Must not control another company without that company being a qualifying subsidiary. Nor must there be arrangements in existence at the time the shares are issued which could result in that being the case.
- Must not be controlled by another company (or another company and any person connected with that company). Nor must there be any arrangements in existence at the time the shares are issued for it to be controlled by another company. However, where a company needs, for commercial reasons, to put a new holding company above itself and:
    - all the shares in the old company are exchanged for shares of the same kind in the new holding company
    - various other conditions, set out at VCM16030, are met then the tax relief applicable to the old shares is effectively transferred to the new shares
- May have subsidiaries, but if it does they must all be qualifying subsidiaries ie, the company has more than 50 per cent of the ordinary share capital of the subsidiary, and it is not controlled (by other means) by another company. (If the EIS company has a property management subsidiary that must be at least a 90 per cent subsidiary).
- The Gross Assets of the company - or of the whole group if it is the parent of a group - cannot exceed £15 million immediately before any share issue and £16 million immediately after that issue. VCM13110 and Statement of Practice 2/06 explain how assets are valued for the purpose of this test.
- Must have fewer than 250 full-time employees (or their equivalents) at the time the shares are issued.
- Can be either a company carrying on the qualifying trade, or the parent company of a trading group. The trade can be carried on either by the company issuing the shares or a subsidiary, but if it is carried on by a subsidiary, it must be at least a 90 per cent subsidiary. **Note**: the rule is worded so as to prevent any party other than the company issuing the shares or its 90 per cent subsidiary, from carrying on the trade for which the monies have been raised. That means that if the trade is being carried on in partnership then the company will not qualify. See VCM13080.

The rules regarding not being controlled by another company, qualifying subsidiaries and the company carrying on the trade must be met throughout the period outlined in Part 1. If they are not, then the investors will lose their reliefs.

For more detailed information on all the company conditions, see VCM13000.

# 2.2 Limit on money raised

Companies are not allowed to raise more than £5 million in total in any 12 month period from the venture capital schemes. The schemes are the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs). Investments from any of these schemes must fall within the £5 million limit. The £5 million limit must also take into account any other investment which the company has received in the relevant 12 month period which is an investment deemed to be State Aid under any other scheme covered by the European Commission's Guidelines on State Aid to promote Risk Capital Investments in Small and Medium-sized Enterprises.

**If any share issue breaks that limit, none of the investors in that issue will be able to claim any of the EIS tax reliefs**.

For more information, see VCM12030.

# 2.3 How and when money raised by the share issue must be used

The money raised by the share issue can be used either for the purpose of an existing qualifying trade or for the purpose of **preparing to carry on** such a trade. Where the shares are issued before 6 April 2011 the trade, or the preparation for it, must be carried on wholly or mainly in the UK. That requirement is removed for shares issued on or after 6 April 2011.

Alternatively it can be used to carry on research and development intended to lead to such a qualifying trade being carried on.

The money raised by the share issue must also be employed for the purposes of the trade or research and development within two years of the shares being issued (or within two years of the trade commencing, if that is later). From 6 April 2012, using the money to acquire shares in another company does not, of itself, count as 'employment' for this purpose. However, if the money is used to acquire shares in a company which after the investment is a 90 per cent qualifying subsidiary, and that subsidiary uses the monies within the appropriate timescale for the purposes of its qualifying activity, then that will be regarded as 'employment' of the monies.

If these requirements are not met then the investors will not be eligible for relief on the cost of their shares, and any relief given will be withdrawn. **It is therefore important that companies do not raise money under the EIS unless they are reasonably confident of meeting these requirements.**

For more information, see VCM12060.

# 2.4 Trading activities

The trade must be conducted on a commercial basis with a view to the realisation of profits.

Most trades qualify, but some do not. Those that do not are termed 'excluded activities' and are:

- dealing in land, in commodities or futures in shares, securities or other financial instruments
- dealing in goods, other than in an ordinary trade of retail or wholesale distribution
- financial activities such as banking, insurance, money-lending, debt-factoring, hire-purchase financing or any other financial activities
- leasing or letting assets on hire, except in the case of certain ship-chartering activities
- receiving royalties or licence fees (though if these arise from the exploitation of an intangible asset which the company itself has created, that is not an excluded activity)
- providing legal or accountancy services
- property development
- farming or market gardening
- holding, managing or occupying woodlands, any other forestry activities or timber production
- shipbuilding
- coal production
- steel production
- operating or managing hotels or comparable establishments or managing property used as an hotel or comparable establishment
- operating or managing nursing homes or residential care homes, or managing property used as a nursing home or residential care home
- generating or exporting electricity which will attract a Feed-in Tariff, unless generated by hydro power or anaerobic digestion, or unless carried on by a community interest company, a co-operative society, a community benefit society or a Northern Irish industrial and provident society
- providing services to another person where that person's trade consists, to a substantial extent, of excluded activities, and the person controlling that trade also controls the company providing the services

A company can carry on some excluded activities, but these must not be 'substantial' part of the company's trade. HM Revenue & Customs take 'substantial' to mean more than 20 per cent of the company's activities. See VCM3000.

There is no requirement that the qualifying company is resident in the UK, but for shares issued on or after 6 April 2011, the company must have a 'permanent establishment' in the UK. See VCM13030.

If the company fails to meet these requirements throughout the period referred to at paragraph 1.2.1, relief will be withdrawn from investors.

Please note that companies that have raised money under the Scheme are required by law to inform their Small Company Enterprise Centre (SCEC) office (see paragraph 2.5) if they fail to meet any of the above requirements, or an investor 'receives value' (see Part 1) from the company or an associate, within 60 days of the event which led to that failure.

# 2.5 How a company qualifies

The Enterprise Investment Scheme (EIS) is administered in HM Revenue & Customs (HMRC) by the Small Company Enterprise Centre (SCEC) - see contact details at the end of this guide.

The SCEC decides if a company and a share issue qualifies. If they do, the SCEC then takes responsibility for checking the accounts etc of the company to ensure that it continues to meet the requirements of the Scheme.

The SCEC also operates an advance assurance scheme, whereby companies can submit their plans to raise money, details of their structure and trade etc. before the shares are issued, and the SCEC will advise on whether or not the proposed issue is likely to qualify. Information on the advance assurance procedure and the kind of information the SCEC will need to have to consider an application is at VCM14000. Although companies are not required to use it, we recommend using the Form EIS(AA) to make such an application. That form can be printed off the HMRC website. Guidance on what kind of information the SCEC need to consider an application for an advance assurance can be found at VCM14040.

Companies are not required to obtain such an assurance, but companies, particularly those using the EIS for the first time, may consider it prudent to do so. It gives an opportunity to spot any problems before shares are issued, and an assurance from the SCEC is also useful for companies to show to potential investors.

Once the shares are issued – irrespective of whether or not an advance assurance has been given – the company has to complete form EIS1 and send it to the SCEC. This form can be got from the SCEC, or downloaded from the HMRC website. A separate form EIS1 must be submitted for each share issue.

Please note that a form EIS1 cannot be accepted by the SCEC unless the company has been trading for at least four months. And it also cannot be accepted if it submitted later than two years after the end of the year of assessment in which the shares were issued (or two years after the end of the four month period if that is after the end of that year of assessment).

If the SCEC accepts that the company, its trade, and the shares all meet the requirements of the Scheme, it will issue a form EIS2 to that effect, and supply sufficient forms EIS3 for the company to send to the investors so they can claim tax relief (see Part 1).

This process is repeated each time a company issues shares which it wishes to attract EIS reliefs for investors.

# VCM10010 - Enterprise Investment Scheme: overview of EIS reliefs

The Enterprise Investment Scheme (EIS) is designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies.

Investors should be aware that the company has to observe certain rules, not just at the time of the investment but for at least three years afterwards. If it fails to meet those rules tax relief will not be given, or, if it has already been given, will be withdrawn. Similarly companies should appreciate that investors must meet certain conditions for tax relief to be due.

## Income Tax relief

Income Tax relief is available to individuals who subscribe for shares in an EIS. See VCM10100 onwards.

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## Capital Gains Tax exemption

Investors who have received Income Tax relief (which has not subsequently been withdrawn) on the cost of the shares, and the shares are disposed of after they have been held for a qualifying period, any gain is free from Capital Gains Tax. See VCM20000 onwards.

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## Share loss relief

If the shares are disposed of at a loss, investors can elect that the amount of the loss, less any Income Tax relief given, can be set against income of the year in which the shares were disposed of, or any income of the previous year, instead of being set off against any capital gains. See VCM70000 onwards.

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## Capital Gains Tax deferral relief

This is available to individuals and trustees of certain trusts. The payment of tax on a capital gain can be deferred where the gain is invested in shares of an EIS qualifying company. The gain can arise from the disposal of any kind of asset, but the investment must be made within the period one year before or three years after the gain arose. See VCM22000 and VCM23000 onwards.

# VCM10100 - Enterprise Investment Scheme: income tax relief: contents

## Contents



# VCM10500 - Introduction to EIS income tax relief: contents



# VCM10510 - Introduction to EIS income tax relief: overview

The Enterprise Investment Scheme (EIS) makes relief from Income Tax available to individuals in certain circumstances. The legislation is at Part 5 Income Tax Act 2007 starting at ITA07/S156.

The basic rule is that an individual is eligible for the relief if he or she subscribes in cash for, and is issued with, full-risk ordinary shares (see VCM12020) in a qualifying company (see VCM13010).

The legislation sets out:

- requirements to be met by the individual investor (see VCM11000+),
- 'general' requirements as to the investment (see VCM12000+)
- certain conditions relating to the way the company raises and uses the money that need to be satisfied (see VCM13000+ for requirements and VCM3000+ for excluded activities).

This basic rule is extended and restricted in various circumstances. See VCM10520 regarding the identity of the investor and certain situations in which an individual cannot be eligible for relief.

Attribution of EIS relief to shares, requests for advance assurance, company procedures and how individual investors can claim relief are set out at VCM14000+.

Guidance on the withdrawal or reduction of EIS relief is at VCM15000+.

Guidance on what the legislation calls 'supplementary and general' such as transfers between spouses or civil partners, identification of shares on a disposal, acquisition of issuing company, the involvement of nominees and bare trustees, and the use of an approved investment fund are at VCM16000+.

This part of the manual deals with just the Income Tax aspects of the EIS. The capital gains aspects are dealt with elsewhere:

VCM20000 Disposal relief
VCM22000 Deferral relief - shares issued before 6 April 1998
VCM23000 Deferral relief - shares issued on or after 6 April 1998
VCM25000 Taper relief for serial investments

# VCM10520 - Introduction to EIS income tax relief: eligibility for EIS relief

## ITA07/S157; ITA07/S250

To be eligible for Income Tax relief the investor must be an individual. The individual must make the subscription on his or her own behalf. Thus relief cannot be claimed by an individual subscribing in the capacity of a nominee or a trustee.

There are, however, two exceptions:

1. Individuals who use another person as a nominee to subscribe for the shares, or be registered as the holder of them, on their behalf, are treated as themselves being the subscriber - ITA07/S250(1). See VCM16040.
2. Where a joint subscription is made, with the result that the subscribers are in law acting as bare trustees (whether for themselves or for others), the beneficiaries are treated as being the subscribers.

### Joint subscriptions - ITA07/S250(2)

Where shares are subscribed for jointly,each of the owners is to be treated as having subscribed an equal amount in respect of those shares. So if spouses or civil partners each subscribe £5000 for 5000 shares and the shares are registered in their joint names they are

each treated as having subscribed £2500 for 5000 shares and each is entitled to relief on £2500. This is the case even if all of the funds were provided by one of them.

### Other conditions

Where an individual subscribes for an issue of shares in a company, the individual is eligible for EIS income tax relief only if certain conditions are met by the investor (see VCM11000+) and by the company issuing the shares (see VCM13000+). In addition, there are other general requirements (see VCM12000+).

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## Minimum subscription - for shares issued before 6 April 2012

For shares issued before 6 April 2012 there was a minimum subscription amount of £500 unless the investment was made via an approved investment fund (ITA07/S157(2), see VCM16050). This requirement was removed in Finance Act 2012 for investments made on or after 6 April 2012.

# VCM10530 - Introduction to EIS income tax relief: form and amount of EIS relief

## ITA07/S158

The relief takes the form of a reduction in the individual's Income Tax liability. Except where it is restricted, as explained below, the amount of the reduction is equal to tax at the EIS rate, currently 30% (20% for shares issued before 6 April 2011) on the amount of the subscription (this excludes any costs incidental to the subscription) or, if that would exceed the liability for the year, whatever amount will reduce that liability to nil.

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## ITA07/Ss22 - 32

The relief reduces tax liability in accordance with the steps explained in Chapter 3 of Part 2 ITA07. First of all, total income chargeable to income tax is calculated. Then personal allowances and other reliefs (such as loss relief) are deducted. Income tax liability is then calculated by applying the appropriate income tax rates to the result. Finally EIS relief is used to reduce that tax liability.

To decide whether a reduction equal to tax at the EIS rate would eliminate the tax liability, it may be necessary to decide in which order reliefs taking the form of reductions in liability should be taken. ITA07/S27 provides that reliefs are to be deducted in the following order: first of all, VCT relief, then EIS relief, then SEIS relief, then various others as listed in S27.

The circumstances in which the amount of the reduction may be restricted are:

- where the individual has received value from the company (see VCM16030+), and
- where the aggregate amounts on which the individual has claimed relief exceed the limit for the year (see below).

In the first case the amount on which the reduction is calculated is the amount of the subscription less the amount of the value, and in the second case it is the amount of the limit for the year.

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# Limit on relief

There is a limit on the amount on which relief can be obtained for any year of assessment.

- The maximum amount for 2012-13 onwards is £1 million.
- The maximum amount for 2008-09 to 2011-12 is £500,000.
- The maximum amount for 2006-07 and 2007-08 is £400,000.
- The maximum amount for 2004-05 and 2005-06 is £200,000.
- The maximum amount for years up to and including 2003-04 is £150,000.

An individual who would, but for this restriction, be able to claim relief on more than that amount cannot carry forward the excess. But it may be possible for the claimant to treat some or all of the shares as having been issued in the previous year, as explained below.

For details of how relief can be attributed to shares when this restriction applies see VCM14020.

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# Year for which relief is due, ITA07/S158

The relief is available for the year of assessment in which the shares are issued (the claimant can find the date of issue recorded on the company's certificate on form EIS3 - see VCM14090). However, there are two situations in which shares may be treated as issued on some earlier date. The rules relating to the carry back of relief changed with effect from 2009/10.

- In certain cases where the subscription is made through the medium of an approved investment fund (see VCM16050), the shares are treated as issued on the date when the fund closes.

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# For shares issued in tax year 2009/10 and later years

- The investor may claim to have some or all of the relief in the year preceding that in which the shares were issued. There is no limit on the amount which may be carried back, but the relief available in the earlier tax year will be subject to the overriding limit for relief for that year.

**Example**

Mr Shah subscribes £750,000 for shares issued on 10 October 2009. He has already had relief of £100,000 in 2008/09, and the maximum relief available for that year is £500,000, so he elects to carry back £400,000 to 2008/09. He uses the balance of £350,000 in 2009/10.

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## For shares issued up to and including tax year 2008/09

- Where the shares are issued before 6 October in any year of assessment, the individual can treat up to half of those shares as having been issued in the previous year. But the total amount which can be treated in this way for any year is limited to:
  - 
  - £25,000 for years up to and including 2005-06,
  - £50,000 for 2006-07 and later years.

Any repayment supplement ('RPS') relating to a repayment arising from such a carry-back of relief will run from the year of assessment in point, rather than from the year of assessment in which the shares were subscribed for.

**Example**

Mrs Higgins subscribes £500,000 for shares issued on 4 July 2006, so she obtains relief on £400,000 for 2006-07 only and there is an excess of £100,000. For 2005-2006 she has already had relief on £60,000. Although that is £140,000 less than the maximum for that year, the amount she can regard as relating to shares issued in that year is limited to £50,000, and she cannot get relief on the remaining £50,000.

See VCM14170 for details of how to claim for an earlier year.

# VCM10540 - VCM: Introduction to EIS income tax relief: periods A, B and C

## ITA07/S159

Qualification periods are periods for which a provision applies.

As part of the HMRC tax law rewrite the names of these periods have changed, though the periods themselves have not. They are described below - ITA07 applies for shares issued after 6 April 2007 and ICTA88 applies for shares issued before that date.

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# Period A - Section 159(2)

This starts with the incorporation of the company, or two years before the date on which the shares are issued if that is later, and ends the day before the termination date. It is also referred to as the 'relevant period' in the legislation. (This was called the 'three year straddling period' under ICTA88/S312(1A)(a).)

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# Period B - Section 159(3)

This is the period beginning with the issue of the shares and ending immediately before the termination date (see below). This is also referred to as the 'relevant period' in the legislation. (This was called the three year period under ICTA88/S312(1A)(b).)

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# Period C - Section 159(4)

This starts twelve months before the issue of the shares, and ends immediately before the termination date. (This was called the period of restriction under ICTA88/S312(1).)

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# Termination date

The termination date is:

- the third anniversary of the date of issue of the shares, or
- if the money raised by the issue was for the purpose of a trade (one that is a qualifying business activity within ITA07/S179(2)) and the company has not begun to carry on that trade on the date of issue of the shares, it is the third anniversary of the date on which the company begins to carry on the trade in question (as regards the date when a company begins to carry on a trade see BIM80505).

So, if a company which is already trading issued shares on 10 April 2010, the termination date is 10 April 2013 and the three year period ends at midnight on 9 April 2013.

# VCM11000 - EIS: income tax relief: the investor: contents



# VCM11010 - EIS: income tax relief: the investor: overview

## ITA07/S162

Chapter 2 of Part 5 deals with the requirements relating to the investor. There are three main requirements:

- 
  - The investor must have no 'connection' with the issuing company (see VCM11020),
  - The investor or any associate must not have received a loan which would not have been made, or would not have been made on the same terms, were it not for the EIS investment (see VCM11030), and
  - The investor must have subscribed for the shares for genuine commercial reasons and not as a part of a scheme or arrangement the main purpose or one of the main purposes of which is the avoidance of tax (see VCM11040).

Guidance on the meaning of 'connection' is at VCM11050 to VCM11090.

See VCM11100 for the meaning of 'associate'.

See VCM14210 for the obligations imposed on investors to notify HMRC of certain events which should result in relief being reduced or withdrawn, and VCM15170 for HMRC's powers to obtain information.

# VCM11020 - EIS: income tax relief: the investor: no connection with the issuing company

## ITA07/S163

An individual will qualify for relief if he or she subscribes for the shares on their own behalf, or is treated as doing so (see VCM10520), and:

- is not 'connected' with the company (see VCM11050+) at any time during period A - (see VCM10540 for periods),

or

- is so connected by virtue of being a paid director of the company, but satisfies the conditions in ITA07/S169, see VCM11060.

# VCM11030 - EIS: income tax relief: the investor: no linked loans

## ITA07/S164

No relief is available if in period A (see VCM10540), the investor, or any associate (see VCM11100), receives a loan from any person which would not have been made, or would not have been made on the same terms, were it not for the EIS investment. This includes cases where credit is given or a debt due from the investor or associate is assigned.

Our interpretation of these provisions is given in SP6/98 - reproduced below for convenience.

Any individual who receives a loan which is caught by the provision is obliged under ITA07/S240 to give notice of the fact to an officer of HMRC within 60 days of the date when the loan was made.

As regards claims to interest relief in respect of loans used to acquire shares in close companies where EIS relief is claimed, see SAIM10210.

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## SP6/98 (30 November 1998) Enterprise Investment Scheme, Venture Capital Trusts, Capital Gains Tax

# Reinvestment Relief and Business Expansion Scheme - Loans to Investors

## Introduction

1. The rules for the enterprise investment scheme, venture capital trusts, the business expansion scheme, and capital gains tax reinvestment relief each make provision for the tax relief in question to be withdrawn (or to be unavailable) in certain circumstances where a loan is made to the investor or to an associate of the investor.
2. The circumstances in which these rules apply are where the loan would not have been made, or would not have been made on the same terms, if the investor had not made the investment in the shares for which the relief was to be claimed, or had not been proposing to make that investment. This statement explains HMRC's understanding of the way in which the provisions operate, and gives examples of instances where the rules have effect to deny or withdraw relief and of instances where they do not.

## Application

3. The way in which these rules are applied in any particular case will depend on the precise facts and circumstances. However, in looking to see whether a given loan falls within the scope of the legislation, HMRC's primary concern will be with the reason why the lender made the loan rather than why the borrower applied for it. The rules do not necessarily have effect to deny or withdraw relief just because a loan is used to finance the acquisition. Moreover, if the lender learns that the purpose, or one of the purposes, of the loan application is the financing of the acquisition, that does not necessarily mean that the rules have effect to deny or withdraw relief. The test is whether the lender makes the loan on terms which are influenced by the fact that the borrower, or an associate of the borrower, has acquired, or is proposing to acquire, the shares.
4. The rules would not have effect to deny or withdraw relief where a person proposing to acquire shares receives a loan from a bank, if the bank would have made a loan on the same terms to a similar borrower who was intending to use it for a different purpose. But if, for example, a loan is made on a specified security which consists of, or includes, the shares in question, it would be one which would not otherwise have been made on the same terms. In such a case, the loan would be linked with the shares, and the investor would not qualify for relief in respect of them. This would apply only where the shares, or any rights associated with them, are specified as all or part of the security. It would not apply, for example, in any case where the lender had recourse against the borrower's assets generally.
5. In considering the terms of any particular loan, HMRC will have regard to such features as the qualifying conditions which must be satisfied by the borrower, the existence of incentives or benefits offered to the borrower, the time allowed for repayment, the amount of repayment and interest charged, the timing of interest payments, and the nature of the security pledged.

## Note

6. The business expansion scheme came to an end for new investment at the end of 1993, and capital gains tax reinvestment relief is not available for shares acquired after 5 April 1998.

**Note-**

This statement superseded SP3/94.

# VCM11040 - EIS: income tax relief: the investor: no tax avoidance

## ITA07/S165

An investor in a company is not eligible for relief unless the subscription is made for genuine commercial reasons and not as part of a scheme or arrangement the main purpose or one of the main purposes of which is the avoidance of tax.

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## Commerciality

This requirement rules out any subscription which is motivated by considerations of benevolence. This could be the case if, for example, the company were the proprietor of an unsuccessful professional football club and a supporter of the club paid a large premium for shares in the company; that may well not be a commercial subscription. Similarly, if the company is owned by a person whom the investor wishes to benefit, and the investor pays a large premium for the shares with the object of increasing the value of the other person's shares, that too would not be a commercial subscription.

Deathbed investments are unlikely to be made for genuine commercial reasons.

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## Avoidance schemes

The subscription for the shares of the company must not form part of a scheme or arrangement the main purpose, or one of the main purposes, of which is the avoidance of tax.

The reduction of an investor's tax liability which flows from the schemes in the circumstances intended by Parliament is obviously not a tax advantage at which this rule is aimed. We therefore do not have to judge whether a subscription for eligible shares would have been made if it had not attracted relief.

The scope of the provision cannot be described precisely, but it may apply in any situation where there are grounds for thinking that the circumstances are not ones in which Parliament intended the relief to be available.

Before any case is challenged solely on these grounds a report should be made to CTIAA (CT Structure, Incentives & Reliefs team).

# VCM11050 - EIS: income tax relief: the investor: connection: employees, directors and partners

## ITA07/S167

As confirmed in Wild v Cannavan [1997] STC 966, in order to qualify for EIS relief the investor cannot be connected with the company at any time in period A (see VCM10540).

An individual is connected with a company if he or she, or any associate (see VCM11100), is:

- an employee, or
- a partner, or an employee of a partner, or
- (subject to VCM11070)
    - 
    - a director, or
    - a director of a company which is a partner of the company, or of any company which is at any time in Period A, a subsidiary of that company.

For this purpose, 'director' has the wide meaning given in CTA10/S452 - see CTM60180

(reproduced below:

"'Director' includes any person occupying the position of director by whatever name called and any person in accordance with whose directions or instructions the directors are accustomed to act. It also includes any person who:

- 
    - is a manager of the company or otherwise concerned in the management of the company's trade or business, and
    - is either on their own or with one or more of their associates the beneficial owner of, or able, directly or through the medium of other companies, or by any other indirect means, to control not less than 20% of the ordinary share capital of the company.

The expression 'with one or more of his or her associates' means that a person is treated as owning or, as the case may be, controlling, what any associate owns or controls, even if he or she does not own or control share capital of his or her own.

'Ordinary share capital' means all the issued share capital, by whatever name called, of the company other than share capital carrying a right to a dividend only at a fixed rate. 'Associate of a person' has a similar meaning to associate of a participator. See CTM60150 to CTM60170, substituting 'person' for 'participator'."

# VCM11060 - EIS: income tax relief: the investor: connection: directors excluded

## ITA07/S168

An individual is connected with a company as a director at a time in period A (see VCM10540) only if he receives a payment from the company other than a 'permitted payment' (see below), or becomes entitled to receive such a payment in respect of any part of that period. Similarly, where an associate (see VCM11100) of the individual is a director of the company, that individual is connected with the company only if that associate receives, or becomes entitled to receive, a payment other than a permitted payment.

This rule is extended to cover payments made to the individual indirectly or made to his order or for his benefit.

The rule is also extended to cover payments made by any 'related person' - that is:

- any company of which the individual or his associate is a director and which is either a subsidiary or a partner of the first company or of any subsidiary of it,

and

- any person connected (under ITA07/S993) with any such company or with the company which the director has invested in.

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## Example

Andrew, Brian, Catherine and David each subscribe for 25% of the share capital of a new company called Organic Parsnips Ltd, of which they all become unpaid directors. They are also the owners of a company called Just Carrots Ltd, a company of which they have been paid directors for many years.

Any three of those individuals can control each company, so the two companies are connected by virtue of ITA07/S993. Because the four individuals each receive payments

from a company connected with Organic Parsnips Ltd, they do not qualify for relief on their subscriptions.

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## Permitted payments to directors

In determining whether a director is a 'paid director', certain payments are ignored. They are as follows:

- any payment or reimbursement of expenses which are wholly, exclusively and necessarily incurred by the director in the performance of his duties,
- any interest which represents no more than a reasonable commercial return on the amount lent,
- any dividend or other distribution which does not exceed a normal return on the amount invested,
- any payment for the supply of goods which does not exceed their market value,
- any payment of rent which does not exceed a reasonable commercial rent,
- any reasonable and necessary remuneration which:
    - 
    - is paid for services rendered in the course of a trade or profession, other than secretarial or managerial services or services of a kind provided by the person to whom they are rendered, **and**
    - is taken into account in calculating for tax purposes the profits of that trade or profession.

# VCM11070 - EIS: income tax relief: the investor: connection: directors qualifying for relief despite connection

## ITA07/S169

It is not intended to discourage investors who would like to become directors of the company they invest in (or of a subsidiary) and make their business expertise available to it. Such investors are often known as 'business angels'. Business angels are allowed to qualify for Income Tax relief despite the fact that they receive payment for their services. However, the rule letting in business angels is tightly drawn. It applies only where:

- the only way in which the individual is connected with the company following the investment is that he or she (or an associate) is a director who receives, or is entitled to receive, remuneration, and

**either**

- 
  - at the time when the shares are issued, the director has never before been connected with the company in any way, or been involved in carrying on any part of the trade now carried on by the company (or its subsidiary), whether as an owner of that trade or as a director or employee of the owner, **or**
  - the issue of shares is made before the termination date (see VCM10540) of a previous issue of eligible shares in respect of which the director satisfied the condition just mentioned or
  - the issue is made before the termination date of a previous issue of shares in respect of which the director was eligible for SEIS relief. (see VCM32010).

For this purpose, 'remuneration' includes such items as benefits, and the remuneration must be reasonable in amount. Any case in which it is thought that the amount of remuneration is not reasonable should be submitted to CTIAA (Structure, Incentives & Reliefs team) after ascertaining the facts but before making a challenge.

An individual who was a director of a company previously carrying on the trade is not regarded as having been necessarily 'involved in carrying on' a trade carried on by that company. It is a question of fact whether a director is so involved.

Thomason & Ors v HMRC Commissioners (UKFTT 579) established that the test of previous connection and involvement of director should be applied at the time of issue of the shares. In that case, at the time of the share issue the company had no trade so the directors could not have been involved in carrying on the trade of the company previously. The fact the company then went on to acquire a trade that the directors had previously been involved in did not change the eligibility of the shares already issued as the test applies at the time of the share issue.

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# Example 1

In September 2010 Mr Allison, a retired management consultant, subscribes for shares in British Jeans Ltd, a company with which he had no previous connection, becoming a director working part-time for the company and being paid remuneration. In April 2011 and in December 2013 he makes further investments in the company.

The receipt of remuneration does not prevent his receiving relief in respect of the shares issued in September 2010 or those issued in April 2011. But December 2013 is more than three years after September 2010, so he gets no relief in respect of those shares.

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# Example 2

On 1 May 2010 Jim Brown and his three brothers each acquire 25% of Duntradin Ltd, a long-established company which is now dormant, and become directors of it. On 1 June 2010 they each subscribe £50,000 for shares in the company, and these are issued on 2 June. On 8 June,

when the company begins spending the money raised on assets to be used in a new trade, each of the brothers enters into a service contract with the company.

Thus on 8 June each of the brothers has become connected with the company as a paid director. However, because they have not become entitled to any payment in relation to the period before 2 June each nevertheless qualifies for relief as a 'business angel'.

# VCM11080 - EIS: income tax relief: the investor: connection: persons interested in capital etc of company

## ITA07/S170

An individual is connected with a company if he or she, whether alone or together with any associate (see VCM11100), directly or indirectly possesses, or is entitled to acquire:

- more than 30% of the ordinary share capital (as defined at ITA07/S989) of the company or any subsidiary, or
- for shares issued before 6 April 2012, more than 30% of the composite total of the loan capital and issued share capital of the company or any subsidiary, or
- more than 30% of the voting power in the company or any subsidiary, or
- such rights as would, either in the event of a winding up or in any other circumstances, entitle the individual to receive more than 30% of the assets of the company which would then be available for distribution to equity holders of the company.

The case of Cook v Billings & Others [2001] STC 16 confirmed that attributing the rights of an associate to the individual is correct when considering the individuals' connection to the company.

Voting power and other entitlements are ascertained in the first place by reference to the company's Memorandum or Articles of Association, but note that these can be overridden by any agreement made between the shareholders. Share capital is represented by the nominal value of the shares, excluding any premium paid.

HMRC Commissioners v. 1) Taylor and 2) Haimendorf [2010] UKUT 417 (TCC) established that the individual's loan capital and issued share capital should be considered in combination when determining if more than 30% of the total of the loan capital and issued share capital is held. It is not necessary for each element separately, loan capital and issued share capital, to exceed 30% of the total of the loan capital and the issued share capital in order for the individual to be connected with the company. This is relevant only in respect of shares issued before 6 April 2012.

There is one exception to these 30% tests of connection - see below.

References to a subsidiary on this page are to any company which is at any time in period A (see VCM10540) a subsidiary of the company issuing the shares.

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# 'Entitled to acquire' - S170(9)

Individuals are regarded as entitled to acquire something if they are able to acquire it by virtue of a contractual right or through some other arrangement. They might, for example, hold an option which entitles them to require a shareholder to transfer shares to them. References to being 'entitled to acquire' something apply both where individuals are presently entitled to acquire it at a future date, and where they will at a future date be entitled to acquire it.

Note that an individual who is entitled to require a company to issue to him share capital that is as yet unissued is not 'entitled to acquire issued share capital'.

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# Possession of share capital - S170(1)

The phrase 'directly or indirectly possesses' entitles us to 'look through' intermediaries to the ultimate owner.

### Example 1

Mrs Carstairs acquires 25% of the share capital of Clear Windows Ltd and company X acquires a further 20%. Mrs Carstairs owns half the issued share capital of company X.

Mrs Carstairs possesses 25% of the shares directly and a further 10% indirectly, so she is connected with Clear Windows Ltd and does not qualify for relief.

### Example 2

Mr Crow and Miss Gosling (who are not associates of each other) jointly subscribe £10,000 for 10,000 shares in Cool Shoes Ltd, being 56% of the issued share capital of the company. These shares are registered in their joint names.

In law they hold the shares on a bare trust. For the purposes of ITA07/Part 5 each of them is treated as having subscribed £5,000 for all 10,000 shares (see VCM16040). Neither of them can be said to 'directly possess' anything, but each of them 'indirectly possesses' rights which entitle them to receive part of the assets of the company available for distribution. Those rights amount to 28% of the total amount each, so, as that is less than 30%, they each qualify for relief.

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# Exception to 30% tests

The 30% shareholding tests and the control test are subject to one exception. They do not apply in the period between the incorporation of the company and:

- the date when it first began preparing to carry on a trade,

or

- the date when it first issued shares other than the subscriber shares,

whichever is earlier. (Subscriber shares are those subscribed for by those who signed the Memorandum of Association; they are treated as issued on the incorporation of the company.)

### Example

Rama buys a company 'off the shelf' from a firm of company formation agents. There is a single subscriber share, which is re-registered in his name. A month later the company issues shares to a number of investors including Rama, who then holds only 20% of the shares. With the money raised by the issue the company acquires a trade.

Thus during the initial period of one month, which fell within period A related to the share issue, Rama owned the company. But because there were no other changes to the share capital and the company had not yet started preparing to trade, this is disregarded.

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# Loan capital - S170(8)

The loan capital of a company or any subsidiary is treated for the purpose of ITA07/S170(8) as including any debt incurred by the company for:

- any money borrowed or capital asset acquired by it,
- any right to receive income created in favour of it - for example, where a person contracts to make annual payments to the company in return for a capital sum due at some later date, that capital sum is loan capital,
- consideration the value of which to the company was (at the time the debt was incurred) substantially less than the amount of the debt (including any premium on the debt).

But loan capital is treated as excluding debts arising on a bank overdraft if the overdraft arose in the ordinary course of the bank's business. Where a claim is made that a bank overdraft did not arise in the ordinary course of a bank's business a report should be made to CTIAA (Structure, Incentives & Reliefs team) before any relief is allowed.

Loan capital does not include normal hire purchase debts.

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## Equity holders

Where the 30% test is operated by reference to the rights of an individual in circumstances such as a winding-up, the legislation uses the special concept of equity holders and a special method of computing the percentage entitlement. These are taken from CTA10/PT5, which is concerned with group relief; accordingly ITA07/S170 have to adapt CTA10/PT5 by substituting references to equity holders for references to the parent company where appropriate. Guidance on CTA10/PT5 can be found at CTM81000.

The main consequence of applying CTA10/PT5 for the purpose of measuring an individual's entitlement to receive assets is that all rights in respect of 'normal commercial loans' are excluded from consideration. (Note that most interest-free loans will count as normal commercial loans.) The reason for excluding such loans is that otherwise, under this test, a shareholder who had also lent money to the company could become connected with it simply because it had not prospered and its assets had shrunk to the point where it had enough only to cover the rights of loan creditors, with little or nothing left for the shareholders.

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## Control of the company - S170(6) & (7)

An individual is connected with a company if he or she, whether alone or together with an associate, has 'control' of the company, or of any subsidiary of the company, within the meaning given in ITA07/S995. Note that this definition is not merely in terms of direct shareholdings and voting rights in the company concerned; shareholdings and voting rights in any company, and powers conferred by the documents regulating any company, can be taken into account.

The reference above to a subsidiary is to any company which is at any time in period A, a subsidiary of the company issuing the shares.

There is one exception to this rule, see above.

# VCM11090 - EIS: income tax relief: the investor: connection: persons subscribing for shares under certain arrangements

## ITA07/S171

An individual is connected with a company if he or she, whether alone or together with any associate (see VCM11100), subscribes for the company's shares as part of any arrangement which provides for another person to subscribe for shares in another company with which that

individual, or any other individual who is a party to the arrangement, is connected within the meaning of VCM11050 to VCM11070.

This provision would apply, for example, where A, B and C own the companies A Ltd, B Ltd and C Ltd respectively, and A subscribes for shares in B Ltd, B in C Ltd and C in A Ltd. If there is reason to believe that such an arrangement exists, under ITA07/S243 any person concerned can be required to give information about it.

# VCM11100 - EIS: income tax relief: the investor: meaning of 'associate'

## Meaning of 'associate' - ITA07/S253

For the purpose of the EIS relief an associate of an individual is:

1.
    1. a relative, that is to say, their:

i) spouse or civil partner,

ii) parent or remoter forbear,

iii) child or remoter issue,

but not their brother or sister.

As regards (a) (i) above, separated spouses or civil partners are regarded as associated with each other but divorced persons are not.

Other relatives in (a) (ii) and (iii) should be regarded as associated only if there is a blood relationship, for example, an illegitimate child is an associate but a step-child is not.

1.
    2. a partner - that is, anyone with whom the individual carries on a business as described in the Partnership Act, 1890 (see BIM82001),
    3. the trustee or trustees of any settlement in relation to which the individual claiming relief (or any relative of his - living or dead - within (a) above) is or was a settlor (but see below),
    4. where the individual is interested in (see below) any shares or obligations of the company which are subject to any trust or are part of the estate of a deceased person, the trustees of that trust or the personal representatives of the deceased.

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# Trustees

The trustee or trustees of any settlement to which c) above applies are associates of the individual claiming relief, and therefore any rights or powers which they possess as trustees of that settlement are, in effect, deemed to belong to the individual. This does not, however, apply to any rights or powers they may have in other capacities, for example, in relation to shares owned by them personally or as trustees of other settlements of which neither the individual nor any of his relatives (living or dead) within a) above is or was the settlor.

Where d) above applies, an individual interested by virtue of the trust in shares or obligations of the company which are subject to the trust has as his associate only the trustee or trustees of that trust. Any rights and powers they possess as trustees are deemed to belong to him but not any rights and powers they possess in any other capacity.

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# 'Interested in'

For the purpose of d., the words 'interested in' have a wide meaning. For example, where shares are held by trustees, the trustees, the beneficiaries and the remainderman (if any) of the trust are all interested in the shares. Where shares are held by trustees under a will for persons in succession, the life tenant and the remainderman, as well as the trustees, are interested in the shares. (See, in this connection, CIR v Park Investments Ltd, 43TC200, particularly the judgment of Danckwerts L J at page 225, CIR v Tring Investments Ltd,22TC679, and Alexander Drew and Sons Ltd v CIR, 17TC140).

The executors or administrators are interested in the assets of a deceased person's estate during the period of administration, (Willingale v Islington Green Investment Co, 48TC547). The beneficiaries should be regarded as interested in any assets of the estate from which they may benefit.

# VCM12000 - EIS: income tax relief: general requirements: contents



# VCM12010 - EIS: income tax relief: general requirements: overview

## ITA07/S172

As well as the investor requirements (see VCM11000+) and issuing company requirements (see VCM13000+) there are general requirements relating to the investment and how it is used. Chapter 3 of ITA07/Part 5 sets out the requirements to be met as to:

- 
  - the shares (see VCM12020),
  - the maximum amount raised annually (see VCM12030),
  - the spending of any previously raised SEIS money (see VCM12040)
  - the purpose of the issue of shares (see VCM12050),
  - the use of the money raised (see VCM12060) (see VCM12110 for the meaning of 'qualifying business activity'),
  - the minimum period (see VCM12070),
  - no pre-arranged exits (see VCM12080),
  - no tax avoidance (see VCM12090), and
  - no disqualifying arrangements (see VCM12100).

# VCM12020 - EIS: income tax relief: general requirements: shares requirement

## ITA07/S173

EIS relief is available only where the investor subscribes for shares which meet certain requirements.

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## Shares issued on or after 6 April 2012

The shares must be ordinary shares which, throughout the three year period (VCM10540) carry:

- no present or future preferential right to dividends where either :
  - 
  - The rights attaching to the share include scope for the amount of the dividend to be varied based on a decision taken by the company, the shareholder or any other person. **Note**: this exclusion covers only those shares which carry preferential rights and does not therefore prevent the voting of dividends in respect of non-preferential shares, nor does it prevent shareholders from choosing to waive a dividend payment should they wish to do so; or
  - The right to receive dividends is 'cumulative' - that is, where a dividend which has become payable is not in fact paid, the company is obliged to pay it a later time, normally once funds become available.
- no present or future preferential rights to the company's assets on its winding up, and
- no present or future right to be redeemed.

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## Shares issued before 6 April 2012

The shares must be ordinary shares which, throughout the three year period (VCM10540) carry:

- no present or future preferential right to dividends,
- no present or future preferential right to the company's assets on its winding up, and
- no present or future right to be redeemed.

The rights carried by shares are usually as set out in the company's Articles of Association or as determined by a resolution of the company.

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# Ordinary shares

'Ordinary shares' means shares forming part of a company's 'ordinary share capital', which is itself defined in ITA/S989 as all issued share capital, by whatever name called, other than capital the holders of which have a right to a dividend at a fixed rate but no other right to share in profits.

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# Preferential right

A right carried by a share is a preferential right if that right takes priority over a right carried by some other share. Thus where a company has only one class of issued share capital no share carries any preferential right.

The rights carried by ordinary shares may in some cases be preferential as compared with the rights of deferred shares, but this is not necessarily so. In particular, where deferred shares carry a purely theoretical right to a residue of assets in a winding up (for example where, in the case of a very small company, after the first £20million has been distributed to ordinary shareholders the deferred shareholders are entitled to 1p per share) we do not regard the ordinary shares as carrying a preferential right.

Where a company has two classes of issued share capital, and dividends are declared on one class but not on the other, the right of the former class is not a preferential right.

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# Subscription in cash

The subscription price must be paid wholly in cash (which includes payment by cheque and payment in foreign currency), and the cash must be paid in full by the time the shares are issued.

In the case of Blackburn & Anor v Revenue and Customs Commissioners [2009] STC188 shares were found to be wholly subscribed for in cash and fully paid up at the time of issue although the payment for shares was received after the investor was recorded as a member in the Register of Members. In this case the agreement to issue shares was conditional on payment being received. The payment for the shares was judged to be the final step in the process of issuing shares. Consequently, when the payment was made the condition of the issue was satisfied and the shares were issued as fully paid up. This case is distinguished on its facts; usually payment would not be considered part of the process in issuing shares under the Companies Act. In Blackburn there were also payments before shares were issued - see VCM16050.

There is a separate condition that the shares must be issued to raise money (see VCM12050). We regard cash and money as meaning the same thing in this context.

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## Date of issue of shares

The date when shares are issued is to be ascertained in accordance with company law (see National Westminster Bank plc v CIR, 67TC1). Shares are issued to a person when that person's title to them has become complete. When that happens will depend on the circumstances of the particular case, but normally it will be when the shareholding is entered in the company's Register of Members.

The issue of shares should not be confused with the issue of a share certificate, which merely provides evidence of ownership of shares.

# VCM12030 - EIS: income tax relief: general requirements: maximum amount raised annually through risk capital schemes requirement

## ITA07/S173A

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## Annual investment limit and 'relevant investments'

Companies issuing shares on or after 19 July 2007 are subject to an investment limit which operates on a rolling basis. This limit does not apply in respect of shares issued to the managers of an Approved EIS Investment Fund which closed before 19 July 2007.

In respect of any issue of shares to which the limit applies, the legislation looks at 'relevant investments' made in the company during the 12-month period ending with the date those shares are issued. Should the limit be exceeded in the 12-month period, no relief will be available on the whole of the investment which breaches the limit.

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## Share issues on or after 19 July 2007 and before 6 April 2012

For shares issued during that period, the annual investment limit is £2m. For that period, 'relevant investments' include:

- an investment of any kind made by a VCT,
- an issue of shares in respect of which the company provides an EIS compliance statement (EIS1),
- an issue of shares in respect of which the company provides a CVS compliance statement (CVS1).

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## Share issues on or after 6 April 2012

From that date, the annual investment limit is £5m. 'Relevant investments' now include:

- an investment of any kind made by a VCT,
- an issue of shares in respect of which the company provides an EIS compliance statement (EIS1),
- an issue of shares in respect of which the company provides an SEIS compliance statement (SEIS1),
- any other investment which is a State aid approved by the European Commission in accordance with the Community Guidelines on Risk Capital Investments in Small and Medium-sized Enterprises (as replaced or amended).

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## Risk capital State aids other than EIS, SEIS or VCT investments

The UK Government does not maintain a list of other Risk Capital State aids. The most commonly encountered UK Risk Capital State aids are likely to include Enterprise Capital Funds and certain regional funds including JEREMIE and JESSICA funds. However, there are a number of others both in the UK and in the European Community. A company which has received any risk capital funding either directly from a Government source or otherwise involving some degree of Government support or intervention, should check with the administrator of the fund or the support whether it is considered to be State aid covered by the Community Guidelines mentioned above.

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## Implications for completing form EIS1

To the extent that a share issue includes shares on which relief is to be claimed under EIS, it is only those shares that are included on EIS compliance statements (form EIS1) that contribute towards the limit.

So while all shares included on forms EIS1 count as relevant investments, not all shares within an issue (or subscription) should necessarily be included on those forms - only those shares in respect of which the investor has requested that the company issue a compliance certificate (form EIS3).

In order not to unnecessarily restrict their ability to raise funds, companies should ensure that only those investors who have indicated that they want an EIS3 so that they can claim relief are entered on the compliance statement. There is no statutory provision to amend an EIS1 once submitted but where an EIS1 contains factual errors then corrections can be made within the time limit for the original submission.

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# Example 1

| | |
|---|---|
| 1 September 2011 | Company issues shares for £600,000 |
| 1 October 2011 | Company submits an EIS compliance statement (form EIS1) covering all of those shares to the Small Companies Enterprise Centre (SCEC). The SCEC accepts it and provides the company with certificates (forms EIS3) for the investors to claim relief |
| 1 February 2012 | Company issues a further £1.5 million of shares |
| 1 March 2012 | Company submits an EIS1 covering all of those further shares |

Because the EIS1 relating to the second share issue covers shares that breach the £2 million limit applying at the time, the SCEC will not issue forms EIS3 and the investors in that issue will be unable to claim tax relief. Note that no relief is available in respect of any of the shares in that issue, even though the £2 million limit was only breached to the extent of £100,000.

It is also important to note that it is the amounts entered on the compliance statement that count, irrespective of whether relief is actually claimed on all those amounts. It may be that, for various reasons, investors find they were unable to claim relief on more than £100,000 of the £600,000 invested in the first issue on 1 September 2011. That makes no difference; it is still the figure of £600,000 that counts towards the £2 million limit.

This limit operates by reference to the dates on which relevant investments in the company have been made, **not** by reference to the dates on which compliance statements are submitted. If compliance statements are not made in the same sequence as the share issues to which they relate the submission of compliance statement for an earlier issue may impact on the availability of relief on shares which have already been included on a compliance statement which relates to a later issue. The following example illustrates this.

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# Example 2

The facts are the same as in Example 1 above, except that, for some reason, the company does not submit the compliance statements in the order in which the shares were issued.

| | |
|---|---|
| 1 September 2011 | Company issues shares for £600,000 |
| 1 February 2012 | Company issues another £1.5 million of shares |
| 1 March 2012 | Company submits an EIS1 covering all the shares issued on 1.February. The SCEC issues forms EIS3 in respect of those shares, allowing investors to claim relief. |
| 1 October 2012 | Company submits an EIS1 covering all the shares issued for £600,000 on 1 September the previous year. |

The latter compliance statement relates to the share issue that pre-dates (by 5 months) the issue reported on the statement received in March. The £600,000 of shares covered by this later statement must now be taken into account in determining whether relief was due on the £1.5 million of shares issued on 1 February 2012. Doing so means that no relief is due to any investors in the second issue, and any relief that has been given on those shares will be withdrawn. Relief may however be due on the £600,000 of shares since at the time those shares were issued the £2 million limit was not breached.

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# Example 3

Where the 12-month period straddles 6 April 2012 the £5m limit applies, notwithstanding that the company may previously have reached the £2m limit.

| | |
|---|---|
| 1 June 2011 | Company issues shares for £500,000 |
| 1 September 2011 | Company receives VCT investment of £1.5m |
| 1 December 2011 | Company submits EIS1 for the share issue on 1 June. SCEC accepts it and provides forms EIS3. |
| 1 May 2012 | Company issues shares for £3m |

The £5m limit applies to the share issue on 1 May 2012, so relief will be available for the whole of the share issue in May, once the company submits its EIS1.

The limit in a 12-month period is calculated taking into account any investment in respect of which an EIS1 or SEIS1 has been provided, whether or not relief has been allowed in respect of that share issue. So if the company in Example 1 above wanted to issue further shares in January 2013 it would be limited to raising £3.5m if the investors were to be eligible for

relief, notwithstanding that no relief had been granted on the £1.5m shares issued in February 2012.

# VCM12040 - EIS: general requirements: spending of SEIS money

## ITA07/S173B

If the company has previously raised under money via a share issue which has qualified for relief under the Seed Enterprise Investment Scheme (SEIS), the company must have spent at least 70% of that money, as required by ITA07/S257CC (see VCM33040) before it can issue any shares in respect of which it is intended that EIS relief will be claimed.

If the company needs to raise more money than the maximum £150,000 permitted under SEIS and the intention is that investors will claim under EIS in respect of any excess over that amount, the company is not prevented from raising all the funds from investors at the same time. However it will need to be able to demonstrate that it met the 70% requirement out of its SEIS investment and not out of other monies before the EIS shares were issued.

# VCM12050 - EIS: income tax relief: general requirements: purpose of the issue requirement

## ITA07/S174

### Raising money

Shares must be issued to raise money for the purpose of a qualifying business activity (see VCM12110).

The issue of shares in consideration for the liquidation of a loan, or by the 'conversion' of loan stock, does not raise money for the company. The 'conversion' of loan notes was considered in Optos plc v Revenue & Customs Commissioners (SpC 560)and Domain Dynamics (Holdings) Ltd v Revenue & Customs Commissioners (SpC 701).

If the issue of shares does in fact raise money it can normally be accepted that that was the purpose of their issue. But that is not always the purpose. In particular it may not be the purpose where the shares are issued because the investor exercises a right to acquire more shares, otherwise than in the course of a wider fund-raising share issue by the company in which the investor has the right to opt to participate.

Forthright (Wales) Ltd v Davies (76TC134) determined that the payment of dividends is not a purpose of a qualifying business activity. It found that EIS relief was not due on shares issued to raise money for dividend payments.

See also VCM12090 as regards shares which are issued for non-commercial purposes and for purposes of tax avoidance.

# VCM12060 - EIS: income tax relief: general requirements: use of the money raised requirement

## ITA07/S175

An individual is only eligible for relief if the money raised by the issue of the shares, is employed, within a certain time, wholly for the purpose of a 'qualifying business activity' (see VCM12110) for which it was raised. But if an insignificant part of the money is employed for some other purpose, this is to be disregarded.

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## Meaning of 'employed'

The legislation requires that the money raised by a share issue is 'employed' within a certain time. This ensures that companies do not raise more money than they actually need in order to allow investors to obtain tax relief. In most cases companies will have a business plan which makes it clear why the monies are needed, and how the company intends to use them for the business within the necessary timescale.

What constitutes 'employment' of money was considered in the case of C Richards and Skye Inns Ltd v HMRC [2011] UKUT B25 (TCC). The Tribunal recognised that money is most obviously 'employed' when it is spent, but that the concept of 'employed' extends more widely.

The company's other sources of income may be a relevant factor in determining whether the monies raised by the relevant share issue have been spent. This will particularly be the case where trading income is available to meet the company's day to day running costs. In general it is not appropriate to assume that expenditure has been met first and foremost out of the monies raised by the share issue.

The Tribunal also held that monies may be 'employed' for the purposes of a qualifying business activity if the company has earmarked them in the relevant period for some specific purpose and is keeping them in reserve for that purpose (which does not have to be a purpose calling for expenditure in that period). Whether moneys have been set aside with sufficient precision for a specific purpose so that they can be said to have been 'employed' for the

purpose of a qualifying activity at the time they are set aside, will be a matter to be determined on the particular facts of an individual case.

The company will not fail the 'employment of money' test if an insignificant amount is employed for another purpose.

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# Costs of share issue

Money used to meet the expenses of issuing the shares, which may be very substantial in the case of shares offered by way of a public prospectus, should be regarded as employed in the same way as the remainder of the money raised; for example, money used by a holding company with a trading subsidiary to meet its own costs in issuing shares can normally be accepted as employed for the purpose of the subsidiary's trade. Where the company obtains a listing, for example on the Alternative Investment Market, at the same time as it issues the shares, the use of money to meet the expenses of flotation should normally be regarded as acceptable.

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# Acquisition of shares in another company

For shares issued on or after 6 April 2012, employing money on the acquisition of shares or stock in a company does not of itself amount to employing the money for the purposes of a qualifying business activity.

This does not prevent the money being used to acquire shares in a subsidiary company, providing that after the share issue the subsidiary is a qualifying 90% subsidiary (see ITA07/S190) and that subsidiary then goes on to use the money for a qualifying business activity carried on by it (which will exclude the acquisition of shares or stock in another company).

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# Time limit

The time limit within which the money raised by the issue of the shares, and of all other shares of the same class issued on the same day, must be employed within

- 
  - 2 years from the issue of the shares;
  - if the activity consists of preparing to carry on a trade, 2 years from the issue of the shares or, if later, 2 years from when the company begins to carry on the trade.

For shares issued before 22 April 2009, at least 80% of the money raised must be employed within 12 months after the date of issue, except where the activity consists of preparing to carry on a trade, in which case the time limit is 12 months after the date when the trade begins; any money remaining must be employed within the following 12 months.

Where a company submits form EIS1 before either of the time limits for employment of the money has expired, and not enough money has as yet been employed to satisfy the statutory conditions, it is required to make a declaration on the form that the conditions will be complied with.

# VCM12070 - EIS: income tax relief: general requirements: minimum period requirement

## ITA07/S176

Where money is raised by an issue of shares and that money is to be used for the purpose of qualifying business activity (see VCM12110) the trade concerned (or research and development) must have been carried on for a period of at least 4 months ending at or after the time of the issue of shares.

This means that there must have been four months of actual activity; a company that entered into a few purchase and sale agreements shortly after issuing its shares and then did nothing for four months would not have traded for four months.

There are exceptions for the winding up, dissolution, administration or receivership of a group company in certain circumstances.

# VCM12080 - EIS: income tax relief: general requirements: no pre-arranged exits requirement

## ITA07/S177

### Pre-arranged exits

No relief is available in respect of shares if the arrangements under which they were issued, or any arrangements which otherwise relate to or are connected with the issue, include:

- arrangements which might in any way lead to the disposal of the shares, or of other shares in the company,

- arrangements which might lead to the cessation of the company's trade, or of any trade carried on by a person connected with the company,
- arrangements for the disposal of some or all of the assets of the company or of any person connected with the company.

This rule is intended to ensure that the company is capable of carrying on its trade indefinitely under its existing ownership. There is a let-out for arrangements, of the kind which might be found in a company's Articles of Association, which merely ensure that if its trade fails the company can be wound up in an orderly manner.

The rule does not stop the directors of a company from indicating in advance to potential investors how they envisage that shares in the company might be disposed of at some later date.

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## Underpinning value

No relief is available in respect of shares if the arrangements under which they were issued, or any arrangements which otherwise relate to or are connected with the issue, include arrangements which are intended to protect the value of the investment in any way. This includes, for example, schemes which insure investors against making a loss, and schemes to maintain the value of the shares artificially. There is an exception for ordinary commercial matters such as insurance by the company against normal trading risks.

# VCM12090 - EIS: income tax relief: general requirements: no tax avoidance requirement

## ITA07/S178

### Commerciality and tax avoidance

The shares must not be issued other than for bona fide commercial purposes, and must not be issued as part of a scheme or arrangement whose main purpose, or one of whose main purposes, is the avoidance of tax. The scope of the latter rule cannot be described precisely. However, the reduction of an investor's tax liability which flows from the schemes in the circumstances intended by Parliament is obviously not a tax advantage at which this rule is aimed.

Before any case is challenged solely on these grounds a report should be made to CTIAA (CT Structure, Incentives & Reliefs team).

A report should also be made before any notice requiring information regarding any suspected scheme or arrangement is issued under ITA07/S243.

# VCM12100 - EIS: income tax relief: general requirements: no disqualifying arrangements requirement

## ITA07/S178A

The 'no disqualifying arrangements' requirements was introduced in respect of shares issued on or after 6 April 2012.

This test is intended to prevent the schemes being used primarily for the purpose of delivering a tax mitigation product to investors with little or no other commercial purpose; or of delivering the benefits of tax-advantaged finance to another entity or project which would not itself qualify for support under the schemes or whose owners do not want to relinquish equity. The intention is to disqualify companies which would be unlikely to exist in the first place, or would be unlikely to carry on the particular activities in question (or to carry them on in the manner proposed), were it not for the desire to achieve one or both of those particular aims.

The legislation consists of several subsections.

**Subsection (1)** operates by preventing an issue of shares by an EIS or SEIS company, or shares or securities by a VCT investee company, from qualifying under the schemes if those shares or securities are issued, or any money raised by the issue, is employed ('spent' in the case of SEIS) in consequence of or in anticipation of, disqualifying arrangements.

To determine whether arrangements are 'disqualifying' or not, **subsection (2)** examines the purpose of the 'arrangements' in question. If the main purpose, or one of the main purposes, is both to secure that:

- A qualifying business activity is or will be carried on by the company or by a qualifying 90% subsidiary (that activity being the one for which the relevant shares are issued to raise money) and
- that relevant tax relief is available or the company will form part of a VCT's qualifying holdings,

then we are required to consider whether one or both of Condition A and Condition B are met; if either is met then the arrangements are 'disqualifying'.

What subsection (2) requires us to consider is whether the purpose of the arrangements is to create an activity or the appearance of an activity which will qualify under the schemes so that the tax advantages will be available.

Examples might include (without necessarily being limited to):

- cases where a business appears to be fragmented in a way which is commercially unusual with the result that there is a company which (apart from this test) meets the qualifying conditions for the schemes;
- cases where a transaction which would normally be expected to be between two parties, involves three (or more) parties, where the additional party is a company which (apart from this test) meets the qualifying conditions for the schemes
- cases where the economic substance of a company's activity appears to be at odds with its form (for instance, where contractual arrangements appear designed to generate an outcome similar to a lending or credit facility whilst the contracts are not immediately obviously loan or credit contracts in legal form).

The remainder of the legislation needs to be considered only where arrangements have such a purpose. Where that's the case, if either Condition A or Condition B is met, the arrangements are 'disqualifying'.

Condition A at **subsection (3)** is that as a result of the money raised by the relevant issue being employed for the purpose of the relevant business activity, the whole or the majority of the amount raised is, in the course of the arrangements, paid to or for the benefit of a party or parties to the arrangements or a person or persons connected with such a party.

Condition B at **subsection (4)** is that, in the absence of the arrangements, it would have been reasonable to expect that the whole or greater part of the component activities of the relevant business activity would have been carried on as part of another business by a person or by persons who are party to the arrangements or a person or persons connected with such a party.

'Arrangements' for the purposes of this legislation is defined as including 'any scheme, agreement, understanding, transaction or series of transactions (whether or not legally enforceable)'. It is immaterial whether the company itself is party to all parts of the arrangements in question, and it is immaterial whether a person who is a party to part of the arrangements is aware of the purpose of the arrangements as a whole.

'Relevant tax relief' means SEIS or EIS income tax relief; share loss relief as provided for by Chapter 6 of Part 4 of ITA 2007; capital gains disposal relief as provided by sections 150A or 150E of TCGA 1992; EIS capital gains deferral relief; or SEIS capital gains reinvestment relief.

See VCM14030+ for information about this legislation in the context of the HMRC's advance assurance facility.

# VCM12110 - EIS: income tax relief: general requirements: meaning of 'qualifying business activity'

## ITA07/S179

The shares must be issued in order to raise money for the purpose of a 'qualifying business activity', and the money must be employed for the purpose of that activity.

The term 'qualifying business activity' covers the following:

- carrying on a qualifying trade,
- preparing to carry on a qualifying trade which the company begins to carry on within two years after the issue of the shares,
- carrying on research and development, which must either be carried on when the shares are issued or be commenced immediately afterwards, and which the company intends should benefit or lead to a qualifying trade,

The activity may be carried on either by the company issuing the shares or by a company which is, at the date of issue of the shares, a qualifying 90% subsidiary of that company. See ITA07/S190 (VCM13080) for the meaning of 'qualifying 90% subsidiary'.

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# Preparing to carry on a trade

'Preparing' to carry on a trade covers both the setting up of a new trade and the acquisition of an existing trade from its present owner. Where a company acquires a trade by means of first acquiring the company which carries it on, the acquisition of the shares counts as preparation. However see VCM12060 for periods on or after 6 April 2012.

Preparing to trade does not cover preliminary activities such as market research aimed at discovering whether a trade would be likely to succeed, or raising capital, neither does it cover research and development.

As regards the date when a company begins to carry on a trade, see BIM70501 onwards.

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# Research and development

In relation to shares issued on or after 6 April 2000, 'research and development' is defined in accordance with ITA07/S1006.

In relation to shares issued before 6 April 2000, 'research and development' is defined, in accordance with ICTA88/S312(1), as any activity that is intended to result in a patentable invention or in a computer program.

# VCM13000 - EIS: income tax relief: the issuing company: contents



# VCM13010 - EIS: income tax relief: the issuing company: issuing company requirements: overview

## ITA07/S180

This part of the manual deals with the rules applying to the investee company - that is, the company issuing the shares. Guidance on investor requirements is at VCM11000+ and general requirements is at VCM12000+.

The issuing company must be a 'qualifying company'. To be a qualifying company it must satisfy certain conditions, and most of those conditions apply throughout a period that starts with the issue of the shares and ends immediately before the termination date (VCM10540).

It follows that it cannot be known for certain whether a company qualifies in relation to a given share issue until the termination date related to that issue. This applies in respect of both income tax relief and deferral relief (VCM23000+).

The issuing company must meet requirements pertaining to:

- 
  - UK permanent establishment (see VCM13020),
  - Financial health (see VCM13040),
  - Trading (see VCM13050),
  - Carrying on a qualifying business activity (see VCM13060 and for excluded activities see VCM3000+),
  - Unquoted status (see VCM13090),
  - Control and independence (see VCM13100),
  - Gross assets (see VCM13110),
  - Number of employees (see VCM13120),
  - Qualifying subsidiaries (see VCM13130),
  - Property managing subsidiaries (see VCM13140).

# VCM13020 - EIS: income tax relief: the issuing company: UK permanent establishment requirement

## ITA07/S180A

This legislation applies in respect of shares issued on or after 6 April 2011 and replaces the previous requirement that the issuing company or a qualifying 90% subsidiary carry on the qualifying trade wholly or mainly in the UK. It was introduced as part of the conditions under which the schemes were granted State aid approval by the European Commission.

For an EIS company issuing shares, the requirement is that the issuing company must have a permanent establishment in the United Kingdom throughout Period B that is, at the date the shares are issued. (See ITA07/S159 and VCM10540 for an explanation of Period B).

The legislation does not stipulate where the monies raised under the schemes, are to be used.

For the definition of 'permanent establishment' see VCM13030.

# VCM13030 - EIS: income tax relief: the issuing company: meaning of 'permanent establishment'

## ITA07/S191A

'Permanent establishment' is defined at section ITA07/S191A. Note that the definition is slightly different from that at FA03/S148 which serves for the purposes of the remainder UK Taxes Acts. This is so that the definition can be tailored as necessary for the purposes of the schemes, without the need to modify the more general domestic definition.

The definition is based on Article 5 of the OECD Model Tax Convention. The OECD provides a detailed commentary on each Article of the Model Convention to assist with interpretation. That commentary cannot be replicated in this guidance (as HMRC does not hold the full copyright), but it should be found without difficulty using common internet search facilities.

For a company to be considered to have a permanent establishment in the United Kingdom, either of the following must apply:

- it has a fixed place of business there through which the company's business is wholly or partly carried on; or
- an agent acting on behalf of the company has and habitually exercises there authority to enter into contracts on behalf of the company.

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# Fixed place of business

The legislation lists a number of examples, including:

- a place of management;
- a branch;
- an office;
- a factory,
- a workshop,
- a mine, oil or gas well,
- a quarry or any other place of extraction of natural resources; and
- a building site or construction or installation project.

This list is not intended to be exhaustive; the type of business will determine the type and nature of the premises or facilities required.

But these would qualify as a permanent establishment only if in relation to the business as a whole, the activities carried on there are not of a preparatory or auxiliary character. The legislation lists some examples of activities which might be considered to be preparatory or auxiliary in nature - for instance, storage or display of goods or merchandise belonging to the company; the maintenance of stock owned by the company for storage, display or delivery; the maintenance of stock owned by the company for the purpose of processing by another person; purchasing goods or merchandise or collecting information for the company.

But again, this list is not intended to be exhaustive and whether activities are considered to be preparatory or auxiliary will depend on the nature of the company's business as a whole.

What is critical is the extent to which the activities of the fixed place of business form an essential and substantial part of the whole business.

For the purposes of this part of the EIS legislation, the following points may be worth noting.

- It is the business of the issuing or relevant company which is to be considered, and not the business of the group as a whole if the company is the member of a group. So where the issuing company is the parent company of a group and that company acts mainly as a holding company, there is no requirement that the business of one or more of its trading subsidiaries be carried on from the place of business in question. It will be sufficient that the administrative and management functions of the parent company be carried on there.
- Thus a UK-registered parent company, which carries out the necessary functions of a parent company from a fixed place of business within the UK, is likely to be considered to have a permanent establishment within the UK regardless of where the activities of any trading subsidiaries are carried on.
- The legislation makes it clear that an overseas-registered parent company will not be regarded as having a permanent establishment in the UK merely by virtue of the fact that it has a subsidiary which is resident in the UK, or which carries on its business there. An overseas parent company must itself have a permanent establishment in the UK for it to qualify.
- The issuing or relevant company must meet the requirements of the 'independence' test at ITA07/S185(2) - see VCM13100.

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# Agent acting on behalf of the company

The legislation also allows a company to be treated as having a permanent establishment in the UK where an agent has and exercises authority in the UK to enter into contracts on behalf of the company. This test is offered as an alternative to the 'fixed place of business' test and the company need only meet one of the tests to qualify.

Agents who are independent of the company - that is, who offer their agency services to the company in pursuit of their own business - are excluded. Examples of the types of agency business which would be considered to be independent are brokers and commission agents.

Merely maintaining an employee in the UK will not itself be sufficient to guarantee permanent establishment status. The agent (which may be an individual or a company) must have and must repeatedly use the authority to enter into contracts on behalf of the company or which are otherwise binding on the company. The contracts in question must relate to the substantive business of the company and not merely to matters which would be considered preparatory or auxiliary.

# VCM13040 - EIS: income tax relief: the issuing company: financial health requirement

## ITA07/S180B

This legislation applies in respect of shares issued on or after 6 April 2011. It was introduced as part of the conditions under which the schemes were granted State Aid approval by the European Commission.

The requirement is that the issuing company must meet the financial health requirement at the beginning of Period B - that is, at the date the shares are issued. (See VCM10540 for an explanation of Period B.)

At the relevant time, the company must not be 'in difficulty'. The company is 'in difficulty' if it is reasonable to assume that it would be regarded as 'a firm in difficulty' for the purposes of the European Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty (2004/C244/02).

The EC Guidelines in question are lengthy, but the following paragraphs are most relevant for the purposes of the EIS rules:

'9. There is no Community definition of what constitutes 'a firm in difficulty'. However, for the purposes of these Guidelines, the Commission regards a firm as being in difficulty where it is unable, whether through its own resources or with the funds it is able to obtain from its owner/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, will almost certainly condemn it to going out of business in the short or medium term.

10. In particular, a firm is, in principle and irrespective of its size, regarded as being in difficulty for the purposes of these Guidelines in the following circumstances:

in the case of a limited liability company, where more than half of its registered capital has disappeared and more than one quarter of that capital has been lost over the preceding 12 months;

in the case of a company where at least some members have unlimited liability for the debt of the company, where more than half of its capital as shown in the company accounts has disappeared and more than one quarter of that capital has been lost over the preceding 12 months;

whatever the type of company concerned, where it fulfils the criteria under its domestic law for being the subject of collective insolvency proceedings.

11. Even when none of the circumstances set out in point 10 are present, a firm may still be considered to be in difficulties, in particular where the usual signs of a firm being in difficulty are present, such as increasing losses, diminishing turnover, growing stock inventories, excess capacity, declining cash flow, mounting debt, rising interest charges and falling or nil net asset value. In acute cases the firm may already have become insolvent or may be the subject of collective insolvency proceedings brought under domestic law. In the latter case, these Guidelines apply to any aid granted in the context of such proceedings which leads to the firm's continuing in business. In any event, a firm in difficulty is eligible only where, demonstrably, it cannot recover through its own resources or with the funds it obtains from its owners/ shareholders or from market sources.

12. For the purposes of these Guidelines, a newly created firm is not eligible for rescue or restructuring aid even if its initial financial position is insecure. This is the case, for instance, where a new firm emerges from the liquidation of a previous firm or merely takes over such firm's assets. A firm will in principle be considered as newly created for the first three years following the start of operations in the relevant field of activity.'

Whether it is 'reasonable' to assume a company is 'in difficulty' in this context might be open to interpretation. HMRC intend to follow the example of the Guidelines and will not regard a company as falling within the scope of the restriction if at the date of issue of the relevant shares:

- it is within the first three years of operations in the relevant field of activity and/or
- it has been able to raise funds from its existing shareholders or from the market sufficient to meet its anticipated funding requirements at that time.

# VCM13050 - EIS: income tax relief: the issuing company: trading requirement

## ITA07/S181

The investee company - that is, the company issuing the shares - must fall into one of two categories. It must either exist for the purpose of carrying on a qualifying trade or it must be the parent company of a group whose business is essentially that of carrying on qualifying activities. See VCM13060 for the meaning of 'qualifying trade'.

See VCM16030 regarding the special rules applying where the company participates in a share exchange that results in the insertion of a new holding company over it.

See VCM13070 regarding the rules applying if the company goes into liquidation, receivership or administration.

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## Trading companies

If the company does not meet the trading requirement as a parent company it must exist wholly for the purpose of carrying on a qualifying trade or trades. See VCM13060 for the meaning of 'qualifying trade'.

The purposes for which a company exists fall to be ascertained primarily by reference to what, through its directors and employees, it actually does, and not, for example, by reference to the intentions of those who originally formed it. A new company whose directors are actively engaged in setting up a trade should not be regarded as failing to satisfy the rule merely because it is not yet trading and a large part of its funds is temporarily being held on deposit. However, the making of investments which are less easily realisable is likely to lead to the conclusion that the company exists for investment purposes, even if there is an intention to trade at a later date.

The cessation of trading, other than an involuntary and temporary cessation caused by some eventuality such as a fire, will normally mean that the company ceases to exist for the purpose of carrying on a trade. But there is no reason why the company should not cease one trade and begin another, provided the interval between the two activities is brief. As regards a cessation of trading caused by the company's becoming insolvent, see VCM13070.

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# Parent companies

For a company to be a parent company it must have one or more qualifying subsidiaries (see VCM13130). This includes companies that become qualifying subsidiaries during the relevant period.

Non-qualifying activities carried on must not amount to a substantial (see VCM3010) part of the business.

The way this rule is applied is as below.

The following types of activity are ignored altogether:

- holding shares in a subsidiary, making loans to a subsidiary, and making loans to the parent company,
- holding and managing property used by any group company for the purpose of a trade or of research and development,
- insignificant activities, where the particular company which carries them on exists for the purpose of carrying on a trade.

Everything else done by any company in the group constitutes 'the activities of the group taken as a whole'.

Any activities in the following categories have to be identified:

- trades, or activities which are parts of trades, which are on the list of excluded activities in VCM3010.

- activities which are not carried on in the course of a trade, other than research and development (for example, investment in property or shares).

Such activities must not form a substantial part of the activities of the group as a whole.

The wording of the provision allows us to disregard any trivial or incidental activity.

# VCM13060 - EIS: income tax relief: the issuing company: meaning of 'qualifying trade'

## ITA07/S189

Either the company or at least one of its qualifying subsidiaries must exist for the purpose of carrying on a qualifying trade. For a trade to be a qualifying trade, it must be conducted on a commercial basis and with a view to the realisation of profits - see the guidance at BIM75705 and BIM75710).

In addition, the trade must not consist wholly or as to a substantial part in the carrying on of 'excluded activities' - see VCM3000+.

What the company does must come within the ordinary meaning of 'trade'; that is, it must not count as a trade merely because of the extension of the meaning of that word in ITA07/S989 to include 'any venture in the nature of trade'.

In deciding whether a business is a trade what matters is whether it is actually, or is treated for all purposes of the Taxes Acts as, a trade, not whether the profits from it are assessable under CTA09/PT3 (Trading income).

Thus:

- concerns, such as quarries and gravel pits, whose profits arise out of land and which are brought in by CTA09/S39 are not necessarily trades; each case must be considered on its merits,
- the commercial letting of furnished holiday accommodation, which is treated under CTA10/S65 as a trade for certain purposes only, is not a trade.

For shares issued on or after 6 April 2011 there is no longer a requirement that the trade be carried on wholly or mainly in the United Kingdom. Instead, the requirement is that the issuing company must have a permanent establishment in the UK (see VCM13020).

Activities of research and development from which it is intended that a 'connected' qualifying trade will be derived or will benefit is itself treated as a qualifying trade. (A 'connected' qualifying trade is one carried on by the company that undertakes the research and development or any other member of the same group). Preparing to carry on research and

development does not count as preparing to carry on a qualifying trade (see ITA07/S179 (VCM12100).

Subject to the above matters, all trades are qualifying trades except as set out in VCM3000+.

# VCM13070 - EIS: income tax relief: the issuing company: ceasing to meet trading requirement because of administration or receivership

## ITA07/S182

### Effect of administration or receivership

When a company goes into administration or receivership its directors lose most of their powers. The person who is able to exercise those powers (usually an 'administrative receiver') may act in a way which would cause the company to cease to satisfy one or more of the conditions - for example, they may have to sell the company's assets, with the result that the company is unable to carry on a trade.

With effect from 21 March 2000, any failure to satisfy a requirement which is due entirely to the company's having been put into administration or receivership is to be ignored, provided everything done as a consequence of that is done for commercial reasons and is not part of a scheme or arrangement aimed at avoiding tax.

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## Effect of liquidation

If a resolution is passed, or an order is made, for the winding up of the company (or any other act is done for the same purpose), or if the company is dissolved without winding up, the company will fail to satisfy at least one of the conditions which apply to it.

However, this failure will be disregarded where the winding up or dissolution is for genuine commercial reasons, and not part of a scheme or arrangement for avoiding tax.

The usual 'genuine commercial reason' for winding up a company will be that it is insolvent or is likely to become insolvent. The sooner a company goes into liquidation after ceasing to trade because of insolvency, the sooner it can be established that relief will not be withdrawn from its investors.

# VCM13080 - EIS: income tax relief: the issuing company: issuing company to carry on the qualifying business activity requirement

## ITA07/S183, ITA07/S190

At no time during Period B (see VCM10540) must relevant preparation work, the qualifying trade or relevant research and development be carried on by someone other the qualifying company or one of its qualifying 90% subsidiaries. But the rules do not act to deny relief where an existing trade is carried on by another company and the issue of shares is preparatory to the carrying of a qualifying trade by the qualifying company or one of its qualifying 90% subsidiaries. Neither do the rules act to deny relief in cases in which the qualifying company (or any other company) goes into liquidation, administration or receivership provided that these actions are entered into and carried out for bona fide reasons and that the relevant qualifying trade is not sold on a going concern basis to a person who was connected with the qualifying company during Period B.

This rule does operate to deny relief in cases where the relevant trade is being carried on by the company or a subsidiary in partnership. HMRC issued Revenue and Customs Brief 77/2009 (reproduced at VCM13150) to explain how this is to be regarded as taking effect for shares issued on or after 9 December 2009.

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## Meaning of 'qualifying 90% subsidiary'

For a subsidiary to be a qualifying 90% subsidiary, the relevant company must:

- own at least 90% of the subsidiary's issued share and voting rights.
- be beneficially entitled to at least 90% of the assets available for distribution to equity holders of the subsidiary
- be beneficially entitled to at least 90% of any profits of the subsidiary which would be available for distribution to equity holders (defined at CTA10/S158, see VCM11080).

In addition, no person other than the relevant company must have control of the subsidiary, and there must be no arrangements by virtue of which any of the above conditions could cease to be met.

From 6 April 2007 a company is still to be treated as a qualifying 90% subsidiary if it is held indirectly via a company which is a qualifying 100% subsidiary of the relevant company, (based on similar considerations to those above).

Arrangements for the disposal of the subsidiary do not prevent this test from being regarded as met, providing that the disposal is for genuine commercial reasons and not for the purposes of tax avoidance.

The winding up of a subsidiary, or the subsidiary entering into or being in administration or receivership, do not prevent this test from being regarded as met providing that those events take place for genuine commercial reasons and not for the purposes of tax avoidance.

# VCM13090 - EIS: income tax relief: the issuing company: unquoted status requirement

## ITA07/S184

At the time when the shares are issued, neither they nor any of the company's other shares or debentures or other securities may be quoted - that is, listed on an exchange which is at that time a recognised stock exchange (see CTM60310) or has been designated by HMRC, or be dealt in outside the UK by any means designated by HMRC.

In addition, at the time when the shares are issued there must not be any arrangements for such a listing, or for the company to become a subsidiary of another company, which would not satisfy this requirement. It may become quoted later without the investors losing tax relief, but not if there were arrangements for it to become quoted in existence when the shares were issued.

The Alternative Investment Market (AIM) and the PLUS Markets (with the exception of PLUS-listed) are not considered to be recognised exchanges, so a company listed on those markets can raise money under the EIS if it satisfies all the other conditions. The PLUS-listed market is regarded as a recognised stock exchange and shares listed on that market at the time of issue will not qualify for EIS.

Enquiries as to whether an exchange or a means of dealing has been designated should be addressed to CTIAA (CT Structure, Incentives & Reliefs team).

# VCM13100 - EIS: income tax relief: the issuing company: control and independence requirement

## ITA07/S185

### The control test

The company must not, at any time in Period B (see VCM10540) control, whether on its own or together with any person connected with it, any company which is not a qualifying subsidiary of the issuing company. There must be no arrangements at any time during Period B by virtue of which this test could be breached, whether during Period B or at any other time.

For the meaning of 'qualifying subsidiary' see VCM13130.

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# The independence test

The company is not a qualifying company if at any time during Period B it is under the control of another company or of another company and any person or persons connected with that company.

It is also specifically provided that the company must not be a 51% subsidiary of another company - that is, owned as to more than 50% of its ordinary share capital. That is, the relevant company must directly or indirectly hold more than 50% of the ordinary share capital.

There must not be any arrangements at any time during Period B by virtue of which these rules could be breached, either during Period B or at any other time. But this rule does not apply where the arrangements relate to transactions to which VCM16030 applies.

See below for the meaning of 'arrangements' in this context. Note that the definition includes informal understandings or agreements which are not legally binding.

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# Meaning of 'control'

For the purpose of determining whether a company is under the control of another company on or after 21 March 2000, 'control' has the meaning given to it by ITA07/S995. That is, the power of any person by means of the holding or shares or voting power in any company, or as a result of any powers conferred by a document regulating the company or any other company, that the affairs of the company are conducted in accordance with the person's wishes.

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# Meaning of 'connected'

'Connected' has the meaning given in ITA07/S993, (see CG14580 onwards, which deals with similarly worded legislation).

Note that, as well as the more obvious connections, ITA/S993(7) provide that persons are to be regarded as connected in relation to a company if they act together to secure or exercise control of that company. The provision extends to persons acting on the direction of any of those persons. Guidance can be found at CG14622.

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## Meaning of 'arrangements'

'Arrangements' for this purpose is as defined in ITA07/S257. It includes any scheme, agreement or understanding, transaction or series of transactions, whether or not legally enforceable. Note: prior to 6 April 2012 the definition excluded reference to 'transaction or series of transactions'.

# VCM13110 - EIS: income tax relief: the issuing company: gross assets requirement

## ITA07/S186

Upper limits on the size of the company invested in are imposed by reference to the size of its gross assets. Those limits are:

- £15m immediately before the issue of the shares, and
- £16m immediately after the issue.

(For shares issued before 6 April 2012 those limits were £7m and £8m respectively and for shares issued before 6 April 2006 those limits were £15m and £16m respectively.)

All forms of property that appear on a company's balance sheet are assets for the purpose of this rule. HMRC has issued SP2/06 indicating that ordinarily we will determine the value of a company's assets by reference to the values shown on its balance sheets. The detail of that Statement is included below.

In the case of a company with subsidiaries, the rule applies to the total of the gross assets of the company and its subsidiaries (excluding shares in, and loans to, those subsidiaries). For this purpose it is important to look at the assets of each separate company and not at those shown on the consolidated balance sheet for the group.

For this purpose, no account is taken of:

- 
  - any assets which consist in rights against another company in the group, or
  - any shares in, or securities of, another such company.

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# Valuation of assets

M Revenue and Custom's general approach is that the value of a company's gross assets at any time is the aggregate of the values of the company's gross assets as shown in its balance sheet if the company were to draw one up at that time. 'Gross assets' means all the assets which would be shown on that balance sheet, without any deduction in respect of liabilities. This approach is subject to the proviso that the balance sheet would be drawn up on a basis consistent with that used in the accounts for preceding periods (if any), and in accordance with generally accepted accounting practice.

So if the shares in question were issued immediately after the date to which the company's accounts were drawn up, the value of the company's gross assets immediately before the issue would be the value shown in the balance sheet. And if the shares were issued immediately before the date to which the company's accounts were drawn up, the value of the company's gross assets immediately after the issue would be the value shown in the balance sheet.

Where shares are issued at other times, the values will, in the first instance, be based on the values given in the company's latest available balance sheet. However, these values should be updated as precisely as is practicable, taking into account all the relevant information available to the company (and, where applicable, to its subsidiaries). For example, where a company is able to ascertain the amount of trade debts owed to it at any given time, it would be reasonable to take the aggregate amount of such debts outstanding at the time of the issue or grant.

When accounts covering —

- 
  - the accounting period in which the issue was made,
  - and if they were not available at the time of the issue, those for the immediately preceding accounting period,

become available, the values arrived at in the way described above may need to be reviewed in the light of the information contained in those accounts.

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# Payments in respect of shares

HM Revenue and Customs will not regard the assets of a company immediately before the issue of the shares in question as including any advance payment received by the company in respect of that issue.

Where shares or securities are issued partly paid, the right to the unpaid portion will be regarded as an asset of the company. That asset will be taken into account for the purpose of deciding whether the relevant gross assets rule is satisfied, whether it is shown in the company's balance sheet or not.

# VCM13120 - EIS: income tax relief: the issuing company: number of employees requirement

## ITA07/S186A

There is an upper limit on the number of employees the investee company may have at the time the shares are issued. That number must be fewer than 250 full-time employees, or their part-time equivalents. If the company is a member of a group, that figure is applied to the group as a whole.

Prior to 6 April 2012 this limit was 50 full-time employees. This limit applied to shares issued under the EIS on or after 19 July 2007, but excluding shares issued to the managers of an Approved EIS Investment Fund which closed before 19 July 2007.

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## Who are employees?

Directors are counted as employees for the purpose of this test. But apprentices, students on vocational training, and employees on maternity or paternity leave at the time the shares are issued are not to be counted.

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## Full-time and part-time employees

The headcount limit is expressed in terms of 'full-time equivalent' employees.

HMRC regard a full-time employee as someone whose standard working week (excluding lunch breaks and overtime) is at least 35 hours. Any employee who worked longer than those hours would still only count as one full-time employee.

Where there are part-time employees their full-time equivalence can be calculated on any 'just and reasonable' basis. For example, someone working 21 hours a week would be expected to count as 60% of a full-time employee. Someone working 'one week on, one week off' would count as 50%, while the proportion of an employee working in term times only would depend on the length of those terms in relation to the year as a whole.

So companies (or groups) could have appreciably more than 250 employees at the time the shares were issued, but, if many of them are part-time, could still come under the limit.

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## Seasonal employees

The number of employees of some companies (or groups) may vary over the course of a year. In these situations there is no need to calculate some kind of average figure; the test is whether the limit of 250 full-time employees or their equivalents is met on the day the shares are issued.

# VCM13130 - EIS: income tax relief: the issuing company: qualifying subsidiaries requirement

## ITA07/S187

Any subsidiary that the issuing company has at any time in Period B (VCM10540) must be a qualifying subsidiary of the company.

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## Meaning of 'qualifying subsidiary' - ITA07/S191

A company is a qualifying subsidiary if it is a 51% subsidiary of the investee company. The meaning of 51% subsidiary is the same as that given in CTA10/S1154. That is, the investee company must directly or indirectly hold more than 50% of the ordinary share capital.

In addition in order to be a qualifying subsidiary, no other person other than the company issuing the shares, or one of its subsidiaries, must control the subsidiary, and there must be no arrangements by virtue of which that requirement could cease to be met.

'Control' for this purpose has the meaning given at ITA07/S995 - see VCM13100.

These conditions are not to be regarded as ceasing to be satisfied by reason only of a winding-up or dissolution of the subsidiary or its parent, or of the subsidiary or its parent going into receivership, or of a disposal of the shares in the subsidiary, provided in all cases that this occurs for genuine commercial reasons and not as part of a scheme or arrangement for the avoidance of tax.

# VCM13140 - EIS: income tax relief: the issuing company: property managing subsidiaries requirement

## ITA07/S188

FA04 introduced a requirement that if the company has a subsidiary whose business consists wholly or mainly of holding or managing land or property deriving its value from land, that subsidiary (termed a 'property managing subsidiary') must be a qualifying 90% subsidiary of the company.

References in the legislation to property deriving its value from land include:

- any shareholding in a company deriving its value directly or indirectly from land
- any interest in settled property deriving its value directly or indirectly from land
- any option, consent or embargo affecting the disposition of land

For the definition of 'qualifying 90% subsidiary' see VCM13080.

# VCM13150 - EIS: income tax relief: the issuing company: Revenue & Customs Brief 77/09

**Revenue & Customs Brief 77/09 is reproduced below.**

## "HMRC Interpretation of Section 183 of ITA

### Introduction

This Revenue & Customs Brief explains HM Revenue & Customs' (HMRC) interpretation of how section 183 of the Income Tax Act 2007 (ITA) applies to companies where the relevant trade is carried on in partnership or by a limited liability partnership, and the implications for new investment through the Enterprise Investment Scheme (EIS). This Brief was first published as a Technical Note on 9 December 2009 and this revised version corrects a typographical error in the original.

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## Background

The EIS makes available various tax reliefs to investors who subscribe for shares in a company which meets certain qualifying conditions.

One of the conditions is that the relevant:

- qualifying trade
- preparation work ,or
- research and development

is at no time during the three year period following issue of the shares, carried on by a person other than the issuing company or a qualifying 90 per cent subsidiary of that company.

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# Interpretation

During recent consideration of the EIS legislation HMRC has revised its view of how the legislation has effect in relation to partnerships. HMRC considers that the relevant legislation at section 183 of ITA has the effect of disqualifying a company where the relevant trade, preparation work or research and development, is carried on by the company in partnership or by a limited liability partnership of which the company is a member. This is because where any of these activities are carried on in partnership or by a limited liability partnership; there are persons other than the issuing company or a qualifying 90 per cent subsidiary of that company carrying on the activity.

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# How HMRC intends to implement this interpretation

HMRC is obliged to apply the legislation correctly and its discretion to waive tax which ought to be collected, or to give relief from tax other than as permitted by statute, is very limited.

HMRC will apply this new interpretation as follows:

- where, on or before 9 December 2009, shares have been issued and the certificate of compliance authorised under the procedure in sections 204-206 of ITA following receipt of an EIS1 has been issued, we will not apply this interpretation, and an investors' ability to claim relief will not be affected by it
- where, by 9 December 2009, shares have not been issued then, irrespective of whether the company has had an advance assurance, we will apply our understanding of the law as set out in this Note. So, if shares are then issued we will not authorise the issue of the certificate of compliance for the shares where the relevant trade, preparation work or research and development, is carried on by the company in partnership or by a limited liability partnership of which the company is a member, and
- where shares have already been issued on or before 9 December 2009 but the issue of the certificate of compliance has not yet been authorised under the procedure in sections 204-206 of ITA, we will authorise its issue only where we have given an advance assurance in accordance with section VCM21010 of HMRC's Venture Capital Manual. This only applies in relation to the particular share issue for which the assurance was sought, and where the request had stated that the relevant trade, preparation work or research and development would be carried on by the company in partnership or by a limited liability partnership of which the company is a member. In those circumstances only, provided a favourable response was issued to the company under section VCM21040 of HMRC's Venture Capital Manual, HMRC will not refuse to authorise the issue of the certificate of compliance solely on the basis that we do not (now) believe that they meet the requirements of section 183 of ITA. The shares and the issuing company must meet all the other requirements of the EIS regime for the relevant period.

HMRC recognises that this change of view may have adverse implications for those who had intended carrying out a trade in partnership. As announced in the Note on venture capital schemes published today on the HMRC website, we intend to consult more generally on how to ensure that the EIS scheme is targeted appropriately at small businesses. As part of that consultation HMRC welcomes comments on the law as it applies to partnerships.

For further information about the effect of this Note, companies can contact Kathryn Robertson on 020 7147 2589 or Des Ryan on 020 7147 0818, or if they have already been corresponding with the Cardiff or Maidstone Small Companies Centre, their contact in that office.

Issued 16 December 2009"

Note: The advance assurance guidance is now at VCM14030+.

# VCM14000 - EIS: income tax relief: company and investor procedures: contents

# VCM14010 - EIS: income tax relief: company and investor procedures: overview

An investor cannot claim EIS income tax relief until the company that issued the shares sends a form EIS3 to the investor. There are various procedures that the company and the investor must follow. VCM14080+ sets out what the company has to do and VCM14150+ sets out what the investor has to do.

SEIS is administered in HMRC by the Small Companies Enterprise Centre (see VCM2070).

The SCEC decides if a company and a share issue qualify, and is responsible for monitoring companies to ensure that they continue to meet the requirements of the scheme for the duration of the qualifying period for any share issue.

In advance of inviting applications for shares, companies hoping to attract subscriptions under the EIS can seek assurance that they are likely to satisfy the conditions of the scheme insofar as the company requirements are concerned. There is no requirement for them to seek this assurance, and neither is there a requirement for them to register with HMRC in advance of an issue of shares. Guidance on advance assurances is at VCM14030+.

# VCM14020 - EIS: income tax relief: company and investor procedures: attribution of EIS relief to shares

## ITA07/S201

Normally the amount of Income Tax relief attributable to a holding of shares will be self-evident. Where, however, the maximum amount on which relief is available for a year (see VCM10530) is exceeded, the position is not clear. In this situation the total relief obtained for the year is apportioned between all the holdings of shares for which relief was claimed, or the individual can choose to claim relief on some shares and not on others.

**Example**

Mr Green subscribes £250,000 for shares in each of four qualifying companies in 2011/12, giving a total investment of £1,000,000. But he can only claim relief on a maximum of £500,000. So, for instance, he can opt for relief to be given on the subscriptions for all the shares in two of the companies, or have the relief given on the subscriptions for half of the shares in each of the four companies.

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## Bonus issue

Where some of the shares in a holding were acquired by means of a bonus issue in respect of shares already held, they are treated as having been acquired as part of the original holding.

**Example**

Mr Marley subscribed £48,000 for 2,400 shares issued on 1 June 2012, and obtained relief on that amount. On 1 December 2013 there was a 'ten for one' bonus issue, so he is regarded as having acquired 26,400 shares on 1 June 2012.

If Mr Marley sells 19,800 shares on 1 September 2014 for £54,000 the relief to be withdrawn is tax on 19,800 / 26,400 x £48,000 = £36,000.

If the date when Mr Marley sells is 1 September 2015 (more than three years after 1 June 2012 but less than three years after 1 December 2013) no relief is withdrawn, because all the shares are regarded as issued on the earlier date.

# VCM14030 - EIS: income tax relief: company and investor procedures: advance assurance requests: overview

Companies that are hoping to attract subscriptions under the EIS are encouraged to seek an assurance from HMRC, in advance of inviting applications for shares. The assurance facility allows the company to provide information about its structure and activities as the company intends them to be; and about the proposed investment including how the company intends to use the monies raised. Based on the information provided, HMRC will provide an opinion as to whether we would be able to authorise the company to issue compliance certificates (forms EIS3 - see VCM14110) were the company to carry out its intentions as described and then to submit a compliance statement (form EIS1 - see VCM14090) following an issue of shares. This requires HMRC to form a view at the time of an advance assurance application, as to whether the conditions of the scheme would be satisfied to the extent they need to be satisfied at the point a company provides its compliance statement.

Requests can be dealt with only if they come from the company's secretary or directors or from some person authorised by them to negotiate with HMRC on their behalf. The rules of confidentiality apply, and potential investors making enquiries about a company should address those enquiries to the company itself.

An advance assurance is given in respect of a particular issue of shares and companies should be aware that an assurance given in respect of one share issue should not be regarded as providing assurance in respect of a different share issue.

It is not necessary for the request to identify the intending subscribers, and no assurance as to the availability of relief to a particular subscriber can be given either to the company or to the subscriber in question.

Form SEIS/EIS(AA) is available on the HMRC website at http://www.hmrc.gov.uk/forms/eis-aa-bw.pdf for companies who wish to make an application for an advance assurance. It is not compulsory to use it but companies are recommended to do so as a useful way of giving all the information needed.

That form mentions the company's need to be able to complete the declaration on form EIS1 when shares are issued. Form EIS1 is also on the website - see VCM14080.

# VCM14040 - EIS: income tax relief: company and investor procedures: advance assurance requests: information needed

In order to give an assurance the HMRC officer will need to be satisfied that:

- the company can be expected to be a qualifying company (see VCM13010),
- the shares to be issued will be eligible shares (see VCM12020),
- the shares are to be issued to raise money for a qualifying business activity (see VCM12110),
- the money raised is to be employed only by companies that satisfy the rules of the scheme (see VCM12050).

When making its request for an assurance the company may supply primary facts or broad statements (such as, 'the shares to be issued will be eligible shares'). However, no assurance is given unless the information supplied includes all the following:

- a copy of the latest available accounts of the company, and of any subsidiary company. If the company has not yet drawn up a set of accounts, HMRC does not expect it to do so for this purpose,
- details of all trading or other activities to be carried on by the company and any subsidiary, and a note of which company or companies will use the money raised,
- details of the approximate sum the company hopes to raise, and how it will be used,
- confirmation that the company expects to be able to complete the declaration on form EIS1 in due course,
- a copy of the latest draft of any prospectus, information memorandum, business plan or similar document to be issued to potential investors. Where the company intends to seek investment from an EIS or SEIS Fund, an EIS or SEIS discretionary portfolio arrangement or a VCT, the name of the Fund / Arrangement and of the firm responsible for it, or of the VCT in question. In such cases HMRC may also ask to see any prospectus, information memorandum or brochure relating to the relevant fund raising or offer,
- an up-to-date copy of the Memorandum and Articles of Association of the company and of any subsidiary, and details of any changes to be made,

- details of any subscription agreement or other side agreement to be entered into by the shareholders.

HMRC would advise companies to ensure that they are aware of all of the qualifying conditions of the scheme and to provide any further information they think may be necessary to allow the inspector to consider whether all the requirements are likely to be met. For instance, details of minority holdings in other companies, or details of other companies' minority holdings in the issuing company, may be relevant in determining whether the 'control and independence' requirements will be met - see VCM13100.

# VCM14050 - EIS: income tax relief: company and investor procedures: advance assurance requests: where HMRC will not be bound by an assurance given

There are some circumstances in which HMRC's primary duty to apply tax legislation according to statute and case law may mean that HMRC can no longer be bound by an assurance it has given. For example this may occur where:

- the nature or terms of a transaction or agreement change in a way that has a material impact on the transaction or agreement as a whole,
- the information on which the advance assurance was based has been superseded since the advance assurance was given,
- incorrect, incomplete or misleading information is provided when the assurance application is made,
- an examination of the detail of transactions subsequently entered into by the company (and taking account of any associated transactions involving other parties which could reasonably be regarded as part of a planned set of arrangements) would lead to the conclusion that the substance of the company's activities was other than as described in the application,
- a Court or Upper Tribunal judgment before the investment is made, or before the company makes its statutory declaration on form EIS1, changes the prevailing interpretation of the law on which the assurance was based. An assurance will be based on the prevailing understanding of the law at the time it is given. Where the courts change the prevailing interpretation of the law and subject to the principle of legitimate expectation, HMRC is required to apply the tax legislation as required by the new interpretation of the law,
- the statutory law relevant to the qualifying conditions in respect of the issue of shares for which the assurance was given, changes. If this change is retrospective HMRC will not be bound by any assurance previously given. If the new statute is enacted prior to the issue of shares and is prospective, any previously given clearance relating to the transaction will not be considered to be binding. HMRC has a duty to apply the tax legislation as required by statute at the time the transaction takes place. It remains the company's responsibility to take account of changes in the law.

# VCM14060 - EIS: income tax relief: company and investor procedures: advance assurance requests: declining

HMRC will not give an advance assurance where the relevant shares have already been issued. In that situation the company should submit its compliance statement (form EIS1) in accordance with the statutory procedure (see VCM14090).

HMRC will not give advance assurance if it is not satisfied that the company is likely to meet all the qualifying conditions (although we will not normally refuse to give assurance solely on the grounds that the company may not employ the monies raised within the timescale required by ITA07/S175).

In some cases HMRC may not be able to provide an assurance. This may particularly be the case where it appears the shares may have been issued or subscribed for, for the purposes of tax avoidance. See VCM11040 and VCM12090 as to what is considered to be 'tax avoidance' in the context of the venture capital schemes. It may also be the case where HMRC think there may be 'disqualifying arrangements'. Please refer to VCM12100 for a description of what this means. This is because it is not always possible to determine what the purposes of any transactions or arrangements are until effect is given to those purposes.

Refusal to grant advance assurance does not indicate that HMRC has already reached a view about how the legislation will apply. However in such cases rather than attempting to form a view in advance of the company carrying out its intentions, HMRC will want to examine at the time the company provides its compliance statement (EIS1) the circumstances in which funds have been raised, the company established or activities commenced, shares issued and directors appointed; along with the detail of transactions entered into by the company and any associated transactions entered into by third parties which might reasonably be considered to be part of a planned set of arrangements.

Each case will be considered on its own merits, but factors pointing to a decision not to grant advance assurance on the grounds that there may be 'disqualifying arrangements' are likely to include (without necessarily being restricted to) cases where the following apply:

- 
  - immediately after the proposed investment, the majority of shares, voting rights, rights to assets in a winding up or rights to sale proceeds will be held by any combination of VCTs and/or EIS or SEIS shareholders but voting rights in the EIS or SEIS shares have been delegated to a person or persons who would have an interest in the company entering into 'disqualifying arrangements' and/or decisions about the company's activities will be made by such persons.

- the majority of the activities required to fulfil obligations to customers will be carried out by persons other than employees of the relevant trading company, or will be carried on by employees of the company but other than in their capacity as such, where it seems likely that these arrangements exist as part of 'disqualifying arrangements'.
- the transactions to be entered into by the company will involve the company paying all or most of the monies raised by the share issue to a party to whom it has subcontracted work or from whom it has commissioned work in advance of that work being done, whilst the company will not be paid by its customer until work has been completed, where it seems likely that these arrangements exist as part of 'disqualifying arrangements'.
- the transactions to be entered into by the company will involve the company providing its customer with services or goods, where that provision will involve the company incurring costs which will not be recouped from its customer within a period of 90 days of the goods or services being provided where it seems likely that these arrangements exist as part of 'disqualifying arrangements'.
- the company's activities involve the purchase and re-sale of intangible assets, where vendor or purchaser are parties who would be likely to benefit from, or have an interest in, the company being involved in 'disqualifying arrangements'.
- the prospectus, information memorandum, brochure or similar offer document describes the investment opportunity in a way which suggests that the investment is not high risk. This may include, for instance, statements to the effect that the investment is low-risk or lower risk than other EIS or SEIS investments or that there is a high likelihood of the investor's capital being preserved. In the context of the 'disqualifying arrangements' legislation, HMRC will want to consider the reasons why the investment might be less exposed to risk than other EIS investments.

If there are no grounds for believing that there may be 'disqualifying arrangements', the presence of one or more of these indicators will not mean that no assurance will be given. For instance, the fact that the company subcontracts work as part of its normal trading activities will not prevent HMRC giving an assurance if the subcontracting agreement is not part of 'disqualifying arrangements'.

# VCM14070 - EIS: income tax relief: company and investor procedures: advance assurance requests: responding to

The response to a request for an assurance will take the form of a statement as to whether, on the basis of the information provided, HMRC would be able to authorise the company to issue certificates under ITA07/S204 in respect of the shares to be issued, following receipt of a form EIS1 satisfactorily completed. The granting of an assurance is therefore an indication that HMRC considers that the requirements laid out in Chapters 3 and 4 of Part 5 are likely to

be met insofar as it is possible for them to be met for the time being on the date the company provides its compliance statement.

The assurance does not indicate an acceptance by HMRC that the company will continue to meet all of the requirements which must be met throughout the qualifying period for the shares. The company is advised to make investors aware that the holding of an advance assurance does not guarantee that relief will not be reduced or withdrawn at a later date. Where an assurance is given and shares are issued in reliance on it the company will need to take care that the conditions relating to the company and its trade are complied with throughout the three year period (see VCM10540) related to the shares.

In some cases there will be a clear indication in the company's application for advance assurance that the company may at some future time within the three year period cease to satisfy one of the conditions (for example, excluded activities which the company intends to carry on might come to be a substantial part of its trade, see VCM3000+). As explained above, the assurance given relates only to the likelihood of the requirements being met at the point at which HMRC is being asked to authorise the issue of compliance certificates (EIS3s) to its investors. The assurance may include a reminder about the need for the company to meet the conditions for a continuing period, and may incorporate an explanation as to how it is proposed to apply the test in question (for example, how it is proposed to decide whether the excluded activities make up a substantial part of the trade).

Where a company supplies valuations or forecasts responsibility for their accuracy lies entirely with the company.

Where the officer is unable to give a favourable response to a request for an assurance, a brief explanation of the reason will be given. But it is entirely the company's responsibility to decide what amendment, if any, it should make to its proposals.

# VCM14080 - EIS: income tax relief: company and investor procedures: company procedures: overview

In outline, the statutory procedure for obtaining relief in respect of a subscription for shares is as follows:

1. The company that has issued the shares supplies a statement to HMRC on form EIS1, listing the subscribers who have requested certificates and giving information about such matters as the company's trade and capital structure. Form EIS1 is available from HMRC's website at http://www.hmrc.gov.uk/forms/eis1.pdf
2. If on examining the statement HMRC is satisfied that it should do so, it will send the company the appropriate number of blank forms EIS3, using form EIS2 to authorise it to issue certificates.
3. The company completes the certificates and sends them to the subscribers.
4. Each subscriber - or, where the subscriber is a nominee, the beneficial owner of the shares - can then claim relief (see VCM14160 regarding claims to income tax relief and VCM22180

regarding claims to CGT deferral relief for shares issued before 6 April 1998 and VCM23200 for shares issued on or after 6 April 1998).

It is essential that the company submits the correct information on the EIS1 as the EIS3 certificate issued to the investor is based on this information. In case of Ashley v Revenue & Customs Commissioners (SpC 633)the investor was unable to claim relief as the EIS1 and the subsequent EIS3 referred to the incorrect date for the share issue. The onus is on the investor to check the EIS3 certificate and, if necessary, request that the company correct the position. If the company refuses to correct the position the investor should inform HMRC.

In cases where the subscription is made through an approved investment fund (see VCM16050) the company will send a form EIS3 to the manager of the fund, who will use it as his authority to send each participant in the fund form EIS5. Those participants can then claim relief.

# VCM14090 - EIS: income tax relief: company and investor procedures: company procedures: company's statement on EIS1

### ITA07/S204 (2), S205

A company whose new shareholders ask it for certificates enabling them to claim relief (whether income tax relief or CGT deferral relief) cannot issue them without first obtaining authority from HMRC. To do this the company must provide HMRC with a statement to the effect that the conditions for the relief (apart from any which relate to the investor) have been satisfied so far, and that it intends to ensure that they continue to be satisfied. It is therefore not possible for a company to obtain authority to issue certificates once it has ceased to satisfy any condition. So for instance, coming under the control of another company would make the issue of certificates impossible even where, had relief already been obtained, it would have been preserved by the operation of ITA07/S247 or TCGA92/SCH5B/PARA8 (see VCM16030).

Where there is more than one issue of shares, the company must submit a separate statement in respect of each issue. (All shares of the same class issued on the same day count as one issue). Statements must be made on the appropriate print of form EIS1 (see VCM14080).

A company cannot submit a statement until the trade (or research and development) for which the money was raised has been carried on for four months (see VCM12060). (See VCM13060 for the meaning of 'qualifying trade'.)

However, there is no need for a company to delay submitting its statement until the money raised by the share issue has been employed (see VCM12050).

A company cannot submit a statement after the later of the following dates:

- two years after the end of the year of assessment in which the shares were issued,
- two years after the end of the period of four months referred to above.

# VCM14100 - EIS: income tax relief: company and investor procedures: company procedures: examining EIS1

A company cannot be authorised to issue certificates to its investors unless it has submitted a statement on form EIS1 which complies with the rules mentioned at VCM14090 and the HMRC officer is satisfied that:

- all the information given on form EIS1 is correct, and
- there is no reason not to accept the declaration given on the form.

If so satisfied, the officer must give the authorisation even if it appears that none of the subscribers listed will be able to obtain relief (see Wild v Cannavan, 70TC554). It is therefore not necessary for the officer to consider the identity of the subscribers at this stage.

In examining the statement the officer will consider whether any of the information supplied at any 'advance assurance' stage has proved inaccurate, and will explore any matters about which unsupported statements were originally accepted. Where only draft documents were previously seen (for example, a draft prospectus) the final document will be obtained and examined. If the company did not seek an assurance in advance, all the items listed in VCM14040 above will now need to be supplied.

As with the giving of advance assurances, HMRC is normally bound by a decision to authorise relief, so the company's statement will be considered very carefully and any necessary clarification obtained before a decision is made.

Under ITA07/S207 the furnishing of a false statement attracts a penalty. The maximum penalty is £3,000.

## Value received

If form EIS1 shows that any of the listed subscribers, or any associate of such a person, has received value the implications of this for the availability of relief need to be considered. (See VCM11100 for meaning of associate.)

In any case where the amount of income tax relief that might be claimed by any subscriber will be affected the HMRC officer and the company should agree the amount to be recorded on the form EIS3 to be issued to that subscriber.

# VCM14110 - EIS: income tax relief: company and investor procedures:

# company procedures: authorising the issue of certificates

If satisfied that everything on the form is correct the officer will authorise the company to issue certificates to those subscribers who have requested them. This is done by completing and issuing form EIS2. The appropriate number of forms EIS3 will be sent to the company with the form EIS2 - normally the number of names of subscribers recorded on the front of form EIS1, but if a subscriber is known to be acting as nominee for more than one investor more may be issued (except where the nominee is acting for participants in an approved investment fund - see VCM16050).

Forms EIS3 are not made available to anyone other than a company that has been authorised to issue them. Spare copies may, however, be issued at the officer's discretion where requested (for example, where the company wishes to issue a duplicate to an investor who has lost the original certificate).

Receipt of a form EIS3 or EIS5 by an investor indicates only that HMRC is satisfied that, from the date of issue of the relevant shares to the date the company submitted its compliance statement, the issuing company has met all the requirements insofar as they could for the time being be met. It does not indicate that the investor will be eligible for tax relief.

### Notes for HMRC officers

On each occasion that form EIS2 is issued the officer should send a photocopy of the related form EIS1 to KAI Analysis under cover of a form EIS10, noting the back of form EIS1 accordingly. In any case where the form is accompanied by a lengthy schedule the original can be sent with a request that it be returned after the details needed have been extracted.

The trade classification number to be entered on form EIS10 is the (four-digit) number applicable to the qualifying business activity for which the money was raised. Where that activity is carried on by a subsidiary, this number may be different from that applicable to the company whose shares are the subject of the relief. Where money is raised for research and development the number to be used is the number for the trade that the company intends to derive or benefit from the research and development.

When an authority to issue certificates of relief is sent, the file for the company issuing the shares and also the file for any subsidiary using money raised by the share issue should be clearly marked 'EIS' and a prominent note should be made in each file of the termination date related to the share issue.

# VCM14120 - EIS: income tax relief: company and investor procedures:

# company procedures: action on receipt of EIS3

Where the company has issued a certificate on form EIS3 and the shareholder has obtained either income tax relief or CGT deferral relief, the office dealing with the shareholder sends a copy of the EIS3 claim form or an EIS3 (Internal) to the officer who authorised the issue of the certificate. In each case the officer should check that the name of the subscriber and the amount of the investment tallies with the information given on form EIS1. The issue by a company of a false or unauthorised certificate attracts a penalty under ITA07/S207 the maximum penalty is £3,000 for each such certificate.

The officer will consider whether the individual was entitled to claim the relief obtained. This involves consideration of all the circumstances surrounding the issue of the shares in question. For example, there might be some indication that the subscription may not have been for bona fide commercial reasons - perhaps the fact that a very large premium was paid, or the fact that the company appears to be hopelessly insolvent - in which case the subscriptions may not have been made for bona fide commercial purposes (see VCM12080). Exceptionally there might be evidence that the subscriber had received a loan (see VCM11030) or had an option to sell the shares (see VCM15020). Where the form shows that the relief obtained is or includes income tax relief the officer will consider whether the subscriber in question is a qualifying individual (see VCM11020).

# VCM14130 - EIS: income tax relief: company and investor procedures: company procedures: refusal to authorise issue of EIS3

### ITA07/S206

If, after obtaining all necessary information, the officer decides that not everything on the form EIS1 is correct, a formal refusal to authorise the issue of certificates to the subscribers will be sent. The refusal will normally be in the following form.

‘The company's statement on form EIS1 relating to the share issue made on [date] and dated [date form signed] has been duly considered and I hereby give notice of my decision as follows: authority under Section 204(3) of the Income Tax Act 2007 (ITA) to issue certificates under Section 203(1) ITA is refused. The grounds of this decision are that the statement is not correct in the following respect[s]: [specify].

If the company does not wish to accept this decision it may appeal against it. Written notice of any appeal should be given to me within thirty days of receipt of this notice.

If you appeal I will consider any further information you send me and try to reach agreement with you. If we cannot agree, you can

- 
  - ask for my decision to be reviewed by an HMRC officer not previously involved in the matter, or
  - notify your appeal to an independent tribunal

If you opt for a review you can still notify your appeal to the tribunal after the review has finished.'

# VCM14130 - EIS: income tax relief: company and investor procedures: company procedures: refusal to authorise issue of EIS3

## ITA07/S206

If, after obtaining all necessary information, the officer decides that not everything on the form EIS1 is correct, a formal refusal to authorise the issue of certificates to the subscribers will be sent. The refusal will normally be in the following form.

'The company's statement on form EIS1 relating to the share issue made on [date] and dated [date form signed] has been duly considered and I hereby give notice of my decision as follows: authority under Section 204(3) of the Income Tax Act 2007 (ITA) to issue certificates under Section 203(1) ITA is refused. The grounds of this decision are that the statement is not correct in the following respect[s]: [specify].

If the company does not wish to accept this decision it may appeal against it. Written notice of any appeal should be given to me within thirty days of receipt of this notice.

If you appeal I will consider any further information you send me and try to reach agreement with you. If we cannot agree, you can

- 
  - ask for my decision to be reviewed by an HMRC officer not previously involved in the matter, or
  - notify your appeal to an independent tribunal

If you opt for a review you can still notify your appeal to the tribunal after the review has finished.'

# VCM14150 - EIS: income tax relief: company and investor procedures: investor claims: conditions

## ITA07/S203

An investor who wishes to claim relief in respect of a subscription may do so where the following conditions are satisfied:

- the investor must have received from the company form EIS3, which certifies that the company has not, so far, breached any of the conditions for being a qualifying company,
- the investor must not, by the date of the claim, have breached any of the conditions for being a qualifying individual eligible for relief in respect of the shares,
- the company must have carried on the trade (or research and development) for which the money was raised for 4 months, except where it was unable to do so by reason of having gone into receivership or liquidation. (In practice, the investor will not receive form EIS3 until this condition is satisfied.)

If the subscription was made through an Approved Investment Fund (VCM16050), the investor will not receive forms EIS3, but a form EIS5 from the fund manager showing all the investment made through the fund.

A claim cannot be made more than 5 years after the 31 January following the tax year in which the shares were issued. Note: this is longer than the time limit allowed for most other claims. This is to allow for the fact that before the investor can claim, the company must first have been in a position to submit its compliance statement and to have had it accepted by HMRC. See VCM14090 for the time limits for a company submitting a compliance statement.

# VCM14150 - EIS: income tax relief: company and investor procedures: investor claims: conditions

## ITA07/S203

An investor who wishes to claim relief in respect of a subscription may do so where the following conditions are satisfied:

- the investor must have received from the company form EIS3, which certifies that the company has not, so far, breached any of the conditions for being a qualifying company,
- the investor must not, by the date of the claim, have breached any of the conditions for being a qualifying individual eligible for relief in respect of the shares,

- the company must have carried on the trade (or research and development) for which the money was raised for 4 months, except where it was unable to do so by reason of having gone into receivership or liquidation. (In practice, the investor will not receive form EIS3 until this condition is satisfied.)

If the subscription was made through an Approved Investment Fund (VCM16050), the investor will not receive forms EIS3, but a form EIS5 from the fund manager showing all the investment made through the fund.

A claim cannot be made more than 5 years after the 31 January following the tax year in which the shares were issued. Note: this is longer than the time limit allowed for most other claims. This is to allow for the fact that before the investor can claim, the company must first have been in a position to submit its compliance statement and to have had it accepted by HMRC. See VCM14090 for the time limits for a company submitting a compliance statement.

# VCM14170 - EIS: income tax relief: company and investor procedures: investor claims: shares treated as acquired in preceding year

Where the investor wishes to treat some of the shares as issued in the year before the year in which they were issued (see VCM10530), it will be necessary to make two separate claims.

### Example

Mr Illingworth subscribes £50,000 for 50,000 shares which are issued to him on 30 September 2006. He receives form EIS3 on 31 October 2006. He wants 20,000 shares to be treated as issued in the previous year.

His claim to relief on £30,000 for 2006-07 will be made after the end of the year on his tax return. In the meantime he completes the claim section of form EIS3 to show a claim to relief on £20,000 for 2005-06, thus amending his tax return for that year. At the same time he uses the same means to obtain a coding adjustment for 2006-07.

# VCM14180 - EIS: income tax relief: company and investor procedures: investor claims: examining claims

Where a claim, or a request for a current year adjustment, falls to be examined, the following matters should be considered:

- Was the claimant employed by the company, or a paid director of the company, at any time within the two years before the shares were issued? If so, report the facts to the Inspector who authorised the issue of the form EIS3, who will decide whether the claimant is a qualifying individual.
- Will the relief fall within the maximum amount allowed for the year in question? (See VCM10530).
- If the claim relates to shares which the claimant requires to be treated as issued in the previous year, will the total amount dealt with in this year be within the maximum allowed? (See VCM10530).
- Does the amount on which relief is claimed tally with the amount shown at part 1 of form EIS3 or form EIS5, and is the claim for the correct year?
- If part 1 of form EIS3 shows that any value has been received, has the amount on which relief is claimed been restricted accordingly?

If for any reason the claim falls to be refused, see VCM14200.

# VCM14190 - EIS: income tax relief: company and investor procedures: investor claims: action after receipt

Where a claim is accepted (either without enquiry or after enquiry) this should be notified to the Small Company Enterprise Centre (SCEC) office dealing with the company. If there is an EIS3 claim form send a copy of it to the SCEC office, using form MS117 (EIS) available on LFC. If there is no EIS3 claim form, complete an EIS3 (Internal) and send this. That form is also available on LFC. Sending these forms enables the SCEC to check that the investor qualifies for the relief and that the amount and year are correct, and assists the Inspector in arranging for any reduction of relief which may be needed at a later stage.

When the claim is supported by a form EIS5 (because the investment has been made through an Approved Investment Fund) there is no need to send a copy or show this information on the form, to the SCEC.

Claims to income tax relief totalling less than £5000 need not be referred to SCEC.

# VCM14200 - EIS: income tax relief: company and investor procedures: investor claims: refusal of claims

If a claim cannot be accepted and agreement cannot be reached, a formal notice of refusal should be sent to the claimant with a covering letter, a copy of it being sent to the agent where appropriate. Where the refusal relates to more than one claim, the notice should identify clearly all the separate claims to which it relates.

Forthright (Wales) Ltd v Davies (76TC134) verified that a claim can be refused under ICTA/S306(10) or ITA/S206. There is no requirement for the refusal of a claim to be included within a closure notice.

The notice of refusal should be on the following lines:

'The claim(s) to Income Tax relief under the Enterprise Investment Scheme listed above have been duly considered and I hereby give notice of my decision as follows; the claims are refused. The grounds for this decision are that….

If you do not accept this decision, written notice of appeal should be made to me within 30 days of receipt of this notice.

If you appeal I will consider any further information you send me and try to reach agreement with you. If we cannot agree, you can

- 
  - ask for my decision to be reviewed by an HMRC officer not previously involved in the matter, or
  - notify your appeal to an independent tribunal

If you opt for a review you can still notify your appeal to the tribunal after the review has finished.'

# VCM14210 - EIS: company and investor procedures: obligation to notify HMRC of disqualifying events

## ITA07/S240, S241

### Investor obligations to notify HMRC

If an investor becomes aware of an event which should result in the withdrawal or reduction of relief, he or she is obliged to notify HMRC of that event within 60 days of it occurring. Events which the investor is obliged to notify are any which would result in relief falling to be withdrawn or reduced for any of the following reasons:

- the investor ceases to be a qualifying investor (see VCM11010)
- there is a loan linked to the investment (see VCM11030)
- the shares are disposed of within Period B
- there is a put option or a call option over the shares (see VCM15020)
- the investor or an associate has received value (see VCM15030)

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### Company obligations to notify HMRC

The company is obliged to notify HMRC within 60 days of any event as a result of which any of the following happens or will happen:

- the monies raised by a share issue will not be employed as required by ITA07/S175 (see VCM12060).
- the company ceases to be a qualifying company (see VCM13010).
- the company or a person connected with the company provides value to the investor or an associate (see VCM15030).
- there are repayments of share capital to non-EIS investors (see VCM15090).
- the company acquires a trade or assets from parties controlling the company (see VCM15110).
- the company acquires share capital from parties controlling the company (see VCM15110).

If an investor or the company fails to provide the required information within the 60 day period, or fraudulently or negligently provides incorrect information, either may be liable to penalties under TMA70/S98.

See VCM15170 for HMRC's powers to require the production of information in certain circumstances.

Similar provisions exist at TCGA92/SCH5B Paragraph 16 in relation to EIS capital gains deferral relief - see VCM23480.

# VCM15000 - EIS: income tax relief: withdrawal or reduction of EIS relief: contents

# VCM15010 - EIS: income tax relief: withdrawal or reduction of EIS relief: overview

The legislation provides for the complete withdrawal of any relief attributable to shares if, by reason of some event, any of the conditions for the relief ceases to be satisfied. This is additional to the general power to withdraw relief under TMA70/S29(1)(c) where an HMRC officer discovers that the relief is excessive, which would apply if, for example, it was found that the statement given by the company on form EIS1 was incorrect.

Relief is not due, and must therefore be wholly withdrawn, where it transpires that:

- the shares are not eligible shares (see VCM12020),
- the individual is not a qualifying individual (see VCM11020),
- the company is not a qualifying company (see VCM13010), or
- the company has failed to comply with the time limits for employing the money raised by the issue (see VCM12060).

However, relief cannot be withdrawn by reason of any event occurring after the death of the individual. Similarly, any relief left following the disposal of the shares by the individual cannot be withdrawn by reason of any subsequent event unless, exceptionally, it occurs at a time when the individual is connected with the company within the meaning of VCM11050+, for example, as an employee.

As regards the obligation to report events which result in relief ceasing to be due, see VCM14210.

The legislation also provides for the amount of relief obtained, or otherwise available, to be reduced where during the relevant qualification period:

- the subscriber disposes of his or her shares,
- the subscriber receives value from the company or a connected person,
- the company purchases any of its own shares from a member who has not had relief,
- the subscriber disposes of any share capital or securities of the company to a person connected with the company.

Guidance on the procedure to be followed when the officer dealing with the company finds that relief falls to be reduced is given at VCM15130+.

Withdrawal of relief is usually by Special Assessment, but if the individual makes an amendment (in time) to his self assessment that can be accepted, and any assessment already made can be vacated.

# VCM15015 - EIS: income tax relief: withdrawal or reduction of EIS relief: disposal of shares

## ITA07/S209

Where relief has to be reduced following a disposal, the amount of the reduction is:

- the amount of relief attributable to the shares,

or

- a sum equal to tax at the original EIS rate (20% or 30% depending on the year the shares were acquired) on the amount or value of the consideration received,

whichever is the smaller.

But if the relief attributable to the shares is less than tax at the EIS rate on the amount originally subscribed, for example because that amount exceeded the maximum amount relievable, the reduction in the relief is to be restricted proportionately.

Guidance on the attribution of EIS relief to shares is at VCM14020 and on the identification of shares on a disposal is at VCM16020.

**Example 1**

Miss King subscribed £200,000 for shares in Lovely Fashions Ltd issued to her in 2009-10, and obtained relief of £40,000 (£200,000 at 20%). Two years later she sells the shares under a bargain at arm's length for £110,000.

The withdrawal is calculated at the EIS rate applicable to the year in which relief was given, rather than the EIS rate applicable at the time relief is withdrawn - so in this case, 20%.

20% of £110,000 is £22,000 and this, being less than £40,000, is the amount of relief to be withdrawn. (She may be able to claim Share Loss Relief on the net loss of £72,000, i.e. £90,000 less the remaining tax relief of £18,000, - see VCM70000 onwards.)

**Example 2**

Suppose Miss King's subscription had been £250,000. Because the maximum amount on which she could get relief was £200,000, her relief would have amounted to £40,000 only. That is four fifths of a sum equal to tax at the relevant EIS rate on £250,000, so when she

sells her shares for £110,000 the amount of relief to be withdrawn is not £22,000 but only £17,600.

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## Part disposals

If the disposal is of part only of the holding of shares we need to decide how much of the relief attributable to the holding relates to the shares disposed of. If the shares are disposed of for the same amount or more than the individual paid for them, the relief withdrawn will be a proportionate amount of the relief originally given. If they are disposed of for less than the individual paid for them, (providing the disposal was by way of a bargain at arms length), only relief equal to tax at the EIS rate on the amount of consideration received is withdrawn. The following examples (which assume that disposals are at arms length) illustrate how the amount of relief to be withdrawn is calculated.

**Example 3**

In 2010-11 Mr Larkin subscribed £100,000 for 100,000 shares in Sussex Crafts Ltd and obtained relief of £20,000. Two years later he disposes of 25,000 shares for a consideration of £30,000. The relief is apportioned across the 100,000 shares so that £5,000 is attributable to the 25,000 shares sold, leaving £15,000 attributable to the 75,000 shares retained. Since the relief of £5,000 is less than 20% of the consideration of £30,000, it is withdrawn in full.

**Example 4**

Suppose that Mr Larkin receives only £10,000 for the 25,000 shares that he sells. The apportioned relief of £5,000 exceeds 20% of the consideration of £10,000, so only £2,000 of the relief attributable to those shares is withdrawn. As before, the relief apportioned to the remaining 75,000 shares is £15,000; if those shares are later disposed of at a profit no part of the remaining £3,000 of relief relating to the shares already disposed of can be withdrawn on account of the later disposal.

**Example 5**

Suppose that Mr Larkin had subscribed £600,000 for his 100,000 shares, obtaining the then maximum relief of £100,000, being an amount equal to tax at 20% on £500,000. Two years later he disposes of 25,000 shares for a consideration of £100,000.

The relief of £100,000 is apportioned between the shares, so that £25,000 is apportioned to the 25,000 shares and £75,000 to the 75,000 shares. So the comparison is between the apportioned amount of the relief, that is, £25,000, and 20% of £100,000, being £20,000, and the amount to be withdrawn is the lesser of the two, £20,000. The remaining £75,000 of relief related to the shares disposed of cannot be withdrawn as a result of any later disposal of the other shares at a profit.

# VCM15020 - EIS: income tax relief: withdrawal or reduction of EIS relief: call and put options

### ITA07/S211, S212

Income tax relief is not available in relation to any shares if at any time before the termination date there is a put option or a call option over the shares.

A **put option** is defined by the legislation as an option granted to the investor by any person which, if exercised, would bind the grantor to purchase any of the relevant shares.

A **call option** is defined as an option granted by the investor which, if exercised, would bind the investor to sell any of the relevant shares.

Similarly, deferral relief is not available in relation to any shares where there is either a put option or a call option over the shares (see VCM23280).

# VCM15020 - EIS: income tax relief: withdrawal or reduction of EIS relief: call and put options

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Similarly, deferral relief is not available in relation to any shares where there is either a put option or a call option over the shares (see VCM23280).

# VCM15040 - EIS: withdrawal or reduction of relief: value received by the investor: calculation of reduction of relief

## Amount of reduction of relief, ITA07/S213, S218, S220

Where relief falls to be reduced because the investor has received value from the company, the amount of the reduction is a sum equal to tax at the original EIS rate on the amount of the value received or the amount of relief attributable to the shares, whichever is the smaller.

Note: the EIS rate was 20% for share issues up to and including 5 April 2011. Thereafter it was 30%. The rate to be used in the calculation of the reduction is the rate which applied at the time the relevant shares were issued.

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## Example 1

In March 2008 Mr Dooley was issued with shares for which he had subscribed £10000 and received £2000 relief. On 1 June 2009 he receives value of £7,500. The original EIS rate is 20%. Tax on £7500 at 20% is £1500 and that is the amount of relief withdrawn.

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## Example 2

If Mr Dooley had only had tax liability for that year of £1,000, he would have received only that amount of relief. In this situation the figure of value received of £7,500 must be apportioned by applying the formula at ITA07/S220. The formula is the amount of the relief obtained (£1,000) divided by the amount claimed (£2,000), giving an apportioned value received figure of £3,750. That figure is then multiplied by the EIS rate of 20% to give the sum of £750. The reduction in relief is the smaller of that sum, and the amount of relief attributable to the shares (£1,000). So in this case the relief is reduced by £750.

The effect of this is that his relief is the same proportion as if he had been able to claim all the available relief on his subscription.

It may be that the value received falls within Period C related to more than one issue of shares. In that case the receipt is related to the earliest such issue as far as possible.

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## Example 3

In March 2011 Mr Shah was issued with shares for which he had subscribed £3000, and he obtained full relief for this. In May 2012 he subscribed £10000 for further shares in the same company. Because his Income Tax liability for 2011-12 was small he obtained relief of £400 only for this subscription.

In August 2012 he receives value from the company of £4000. On the first issue the apportioned amount of value received is £4000 x £3000 / £13000 = £923, so the relief

withdrawn is the lesser of £923 x 20% = £184 or £3000 x 20% = £600, meaning relief of £184 is withdrawn.

On the second issue the apportioned amount of value received is £4000 x £10000 / £13000 = £3077, so the relief withdrawn is the lesser of £3077 x 30% = £923 multiplied by £400 / £2000 = £184, or £400, meaning relief of £184 is withdrawn.

Note: the rate at which relief is withdrawn is the rate at which relief was originally given, which in this example is 20% in respect of the first issue of shares, and 30% in respect of the second issue.

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### Example 4 - receipt of value from connected persons

Graham and Mark own Gramark Consultants Ltd. They each subscribe for a 30% holding in a new company, Ecofriendly Umbrellas Ltd, and obtain relief. Shortly afterwards Mark receives value from Gramark Consultants Ltd.

Because Graham and Mark are a group that controls each company the two companies are connected under ITA07/S993(5)(d). So, by virtue of ITA07/S221(c), Mark has received value from a company connected with Ecofriendly Umbrellas Ltd and his relief must be reduced.

# VCM15050 - EIS: income tax relief: withdrawal or reduction of EIS relief: value received by the investor: receipts of insignificant value

### ITA07/S214, ITA07/S215

Where the amount of the value received is 'insignificant' it is ignored. An amount is insignificant for this purpose if:

- it does not exceed £1000, or
- if it exceeds £1000 it is insignificant in relation to the amount subscribed by the individual for the shares in question.

Our view is that for the purpose of the second category above 'insignificant' must be given its normal dictionary meaning of trifling or completely unimportant.

Where there is more than one receipt which is, on its own, insignificant as defined, the rule must be applied to the total amount received within Period C (see VCM10540). For example, suppose an individual received value of £600 on 1 February 2012 and the same sum every three months thereafter. Assuming £1200 was not regarded as insignificant, the individual

would be regarded as receiving value of £1200 on 1 May 2012, a further £1200 on 1 November 2012, and so on.

To ensure that this relaxation is not used for avoidance purposes, it is provided that the amount of any value shall not be regarded as insignificant if it is received under arrangements which exist at any time in the 12 months ending on the date of the share issue.

# VCM15060 - EIS: income tax relief: withdrawal or reduction of EIS relief: value received by the investor: when value is received

## ITA07/S216, ITA07/S217

The circumstances in which individuals receive value, and how that value is quantified for the purpose of computing the amount of a reduction of relief, are shown below. In this context references to payments or transfers to individuals include ones made to them indirectly or made to anyone else to their order or for their benefit.

| Circumstances | Amount |
|---|---|
| 1. The company repays, redeems or repurchases any of its share capital or securities belonging to the individual. | The amount receivable or, if greater, the market value of the shares or securities. |
| 2. The company makes a payment to the individual for giving up his right to any of its the shares or securities on their cancellation or extinguishment. | The amount receivable or, if greater, the market value of shares or securities market. |
| 3. The company repays any debt owed to the individual. A debt incurred after the issue of the relevant shares is not taken into account for this, unless that debt replaced an earlier debt incurred before the share issue. | The amount receivable or, if greater, the value of the debt. |
| 4. The company makes a payment to the individual for giving up his right to any debt on its extinguishment. ('ordinary trade debts' - see below - and debts in respect of payments listed at VCM11060 are excepted from this rule). | The amount receivable or, if greater, the market value of the debt. |
| 5. The company releases or waives any liability of the individual to the company. In addition to an actual release or waiver, a company is treated as having released or waived liability if the individual fails to discharge a liability owed to the company | The amount of the liability. |

| | |
|---|---|
| within 12 months of the time when it ought have been discharged. | |
| 6. The company discharges, or undertakes to discharge, an individual's liability to a third person. | The amount of the liability. |
| 7. The company makes a loan or advance to the individual other than one repaid in full before the issue of the shares. | The amount of the loan or advance. |
| 8. The company provides a benefit or facility for the individual. | The cost to the company of providing the benefit facility less a consideration given for it by the individual. |
| 9. The company transfers an asset to the individual for no consideration or consideration less than its market value. | The difference between the market value of the asset and any consideration given for it. |
| 10. The individual transfers an asset to the company for a consideration in excess of its market value. | The difference between the market value of the asset and the consideration received for it. |
| 11. The company makes any other payment to the individual, except payment within VCM11060 or one made in discharge of an 'ordinary trade debt' (see below). | The amount of the payment. |
| 12. The individual receives any payment or asset in connection with the winding up or dissolution of the company. | The amount of the payment or market value of the asset. |
| 13. The individual disposes of any share capital or securities, or rights over such shares etc., to a person connected with the company. SeeVCM15070 | The amount receivable or, if greater, the market value of the shares. |

In the case of Optos plc v Revenue and Customs Commissioners (SpC 560) the Special Commissioner took the view that loan notes are a form of debt and the issue of conversion shares to repay loan notes is a receipt of value under ITA07/S216(2)(b).

In the case of Blackburn & Another v Revenue and Customs Commissioners (SpC 606) the Special Commissioner considered value received in relation to payments made to the company in advance of a share issue. In contrast to Optos the payment in advance in this case was not considered to create a debt and no value was received by the issue of the shares as

there was a clear intention that the payment was intended to be used to subscribe for shares to be issued at a later time.

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### Ordinary trade debt

This is defined at ITA07/S216(10) as any debt for goods and services supplied in the ordinary course of a trade or business where any credit given does not exceed six months and is not longer than that normally given to the customers of the person carrying on the business.

# VCM15070 - EIS: income tax relief: withdrawal or reduction of EIS relief: value received by the investor: amount of value received

### ITA/S216 (6); ITA/S217

An individual is also regarded as receiving value if a person connected with the company (see VCM11050 onwards):

- purchases any of the share capital or securities of the company which belong to that individual or an associate of his,

or

- makes any payment to him or his associate for giving up any right in relation to such share capital or securities.

The value received is the amount received or, if greater, the market value of the shares or securities.

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### Example

A subscribes £2000 for eligible shares in a company and £1100 for loan stock of the same company. A obtains income tax relief on £2000. B, a paid director of the company, then buys the loan stock, which has a market value of £1100, for £1000, thus in effect obtaining a share of A's tax relief.

The rule in ITA07/S216(6) and ITA07/S217 reduce the amount on which relief is available to A by £1100.

It should be noted that the rule applies whether the sale of shares precedes or follows the subscription for the shares on which relief is claimed, and applies to any types of share capital or securities, for example, preference shares or debentures.

# VCM15080 - EIS: income tax relief: withdrawal or reduction of EIS relief: value received by the investor: receipt of replacement value

## ITA07/S222

The individual can avoid the consequences of receiving value by returning the whole of the value to the person that gave it. The value may be returned in any of the following ways:

- by a cash payment, other than a payment listed below, or a payment for shares or securities of the company (unless the receipt of value in question arose from the receipt of those shares or securities),
- where the receipt of value arose from the waiver or discharge of a liability or debt, by reversing that transaction,
- where the receipt of value arose from either the transfer of an asset to the individual at an under-value or the transfer any asset to the company at an over-value, by the transfer of any asset in the reverse direction at a corresponding under-value or over-value.

Where the value comes from a person connected with the company it should be returned to that person, and where it is received by a person associated with the individual it should be returned by that person. Note that the value must be wholly returned; returning part of it has no effect.

The replacement value must be given without unreasonable delay. If the amount of the value received was the subject of appeal proceedings it must be given within 60 days after the final determination of the appeal. A payment made before the value was received may be taken into account as replacement value, provided it was not made earlier than one year before the issue of the shares.

If the value is replaced by way of a subscription for shares, no claim to relief (or, if the replacement value is given by a company connected with the individual, investment relief under the CVS) can be made in respect of that subscription.

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## Replacement in cash

The payments referred to above are payments of the following types:

- a reasonable payment for goods, services or facilities,
- a payment of interest on normal commercial terms,
- a payment of a dividend which does not exceed a normal return on the investment,
- a payment for an asset not exceeding its market value,
- a payment of rent on normal commercial terms,
- a payment to discharge a trade debt.

# VCM15090 - EIS: income tax relief: withdrawal or reduction of EIS relief: repayments of share capital to other persons

## ITA07/S224

The relief obtained by an individual in respect of shares of a company may fall to be reduced where, within Period C (see VCM10540), the company redeems or repurchases shares in it belonging to another person and that person does not suffer any withdrawal of relief under either the EIS or the CVS as a result.

The rule also applies where a subsidiary of the company makes such a repayment. This is so even where the subsidiary did not become a subsidiary until after the transaction had taken place.

The aggregate amount of all reductions made under this rule in respect of a particular repayment is to be equal to the amount of tax at the EIS rate on the amount of the payment. Where more than one person suffers a reduction that amount of tax must be apportioned between them in proportion to the amounts they subscribed.

This rule is not applied where the amount of the payment made by the company is 'insignificant' - see VCM15050.

There are two other exceptions to this rule.

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## Exceptions

The first is that under ITA07/S224(3)(f) and ITA07/S230 no reduction is to be made where share capital has been issued of a nominal value equal to the authorised minimum required by the Companies Act 2006 for a public company to do business, the Registrar of Companies having issued the company with a certificate under that Section, and any of it is redeemed within 12 months of the date of its issue. (But where a holder of shares which are redeemed in these circumstances has obtained relief on other shares, this exception does not prevent the reduction of that relief under (1) of VCM15060).

The second exception is that, under ITA07/S224 (1)(a)(ii) & (4), where the company's issued share capital includes shares in respect of which investment relief under the CVS has been given:

- where any of that investment relief is withdrawn as a result of the payment, Income Tax relief under the EIS is not withdrawn to the extent that the payment causes the withdrawal of investment relief; and
- where no investment relief is withdrawn, because the payment is less than £1000, Income Tax relief under the EIS is not withdrawn provided no arrangements for the purchase of the shares existed during the period from one year before the date when the shares on which investment relief was obtained were issued to the end of the day of issue.

# VCM15100 - EIS: income tax relief: withdrawal or reduction of EIS relief: insignificant repayments ignored

### ITA07/S224 (3)(a)(ii), ITA07/S225

A repayment of share capital falling within VCM15090 is ignored if both it and the market value of the share capital repaid are insignificant compared with the market value of the remaining issued share capital of the company.

Note that, unlike ITA07/S215, (see VCM15050) this provision does not provide for a specified amount to be treated as insignificant. Our view is that 'insignificant' must be given its normal dictionary meaning of trifling or completely unimportant. SCEC officers should refer to CTIAA (Structure, Incentives & Reliefs team) if in any doubt.

To ensure that this relaxation is not used for avoidance purposes, it is provided that the amount of any value shall not be regarded as insignificant if it is received under arrangements which exist at any time in the 12 months ending on the date of the share issue.

# VCM15110 - EIS: income tax relief: withdrawal or reduction of EIS relief: acquisition of a trade or trading assets

### ITA07/S232; ITA07/S233

#### Acquisition of trade or assets from company owners

As the EIS is intended to encourage genuinely new investment in companies by outsiders (and by paid directors who were outsiders when they first invested in the company) the legislation needs to ensure that relief is not available to anyone who directly or indirectly

owned the trade before it came to be owned by the company. This is done by ITA07/S232 and ITA07/S233.

Where the section applies any relief given to the individual is to be withdrawn. (Under ITA07/S257(4) this has the effect that where relief has not yet been given the individual is not eligible for it.)

To decide whether the provision might apply to an investor we have to consider whether, at any time within P

Period A (see VCM10540), either the individual or any group of persons to which he or she belongs either:

- has more than a half share interest in the trade or part of the trade as carried on by the company or its qualifying subsidiary, or
- controls the company.

In the first case, the provision will apply if the individual or group also had such an interest in the trade, or a part of the trade, at some previous time in the same period when it was carried on by some person other than the company. In the second case, ITA07/S232 will apply if the individual or group, at some previous time in the same period, controlled another company which was then carrying on the trade or part of the trade.

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### Acquisition of share capital from company owners

In addition, ITA07/S233 also cover the situation where the individual or group formerly controlled a company which then carried on the trade and that company has come to be owned by the company in which the individual has now invested.

In the case of an investor who is a paid director the references above to the previous control of the trade within the relevant period are to be read as references to previous control at any time whatsoever.

For the purpose of deciding whether anyone has a half share in a trade or can control a company the rights and powers of each person are to be taken as including the rights and powers of any associate, see VCM11100, and 'control' has the meaning given in CTA10/S450 (see CTM06020).

The persons to whom a trade belongs, or the extent of their interests in it, are to be determined in accordance with CTA10/S941 (see CTM06020).

# VCM15120 - EIS: income tax relief: withdrawal or reduction of EIS relief: relief subsequently found not to have been due

### ITA07/S234

In some cases it may be that the officer forms the opinion that relief falls to be withdrawn even though no notification has been given under ITA07/S240 or ITA07/S241 (see VCM14210). Where in such a case the reason for the officer's opinion is that:

- the company is not a qualifying company, or
- the shares were not issued to raise money for the purpose of a qualifying business activity, or
- the company using the money raised does not satisfy the conditions applying to it, or
- the money raised was not employed for the purpose of a qualifying business activity within the time allowed,

the officer must give notice to the company before relief can be withdrawn. The notice should specify the date of the relevant share issue, state the grounds for the decision, and set out the company's right of appeal against it.

The purpose of this procedure is to allow the party to appeal proceedings to be the company itself in cases where most of the relevant evidence lies within its own power, and to simplify the withdrawal process in cases where there is a large number of investors. But neither the failure of a company to appeal nor any decision by the tribunal in favour of HMRC in any appeal prohibits a shareholder from making his own appeal against a withdrawal assessment subsequently.

Once the officer has given a notice under ITA07/S234 it is not necessary to await determination of any appeal by the company before making an assessment to withdraw relief from individual investors. But if such assessments are made the officer should ensure that all individuals assessed are aware of the fact and that the company's appeal is heard first (or at the same time).

# VCM15130 - EIS: income tax relief: withdrawal or reduction of EIS relief: procedure: overview

Where the officer dealing with the affairs of a company becomes aware that relief falls to be withdrawn he or she will need to notify the tax offices dealing with the individuals concerned. The correct office can be identified from the forms EIS3 or EIS3(Internal) received (see VCM14120).

The notification will need to include the following details:

- the reason for the withdrawal,
- the amount to be withdrawn, if not the whole of the relief,
- the year in which the shares to which the relief relates were issued,
- the reckonable date for interest (see VCM15160).

# VCM15140 - EIS: income tax relief: withdrawal or reduction of EIS relief: procedure: assessments

### ITA07/S235

EIS relief cannot be withdrawn via self-assessment. Instead it should be recovered by the making of a manual Special Assessment using SEES, and the charge entered onto SAFE.

Instructions on how to do this are at SAM22001 to SAM22030.

Where the shares in question were acquired from a spouse or civil partner, the assessment will be on the person they were transferred to (see VCM16010).

# VCM15150 - EIS: income tax relief: withdrawal or reduction of EIS relief: procedure: time limits for assessments

### ITA07/S237

Where an assessment to withdraw relief is required because of an event occurring after the date of the claim to relief, it may be made within six years after the end of the year of assessment in which that event occurred.

A discovery by an Inspector under TMA70/S29(1) that any relief obtained was excessive (for example, because not all the conditions were satisfied at the time when it was allowed) should not be regarded as an 'event' giving rise to the time limit mentioned in the paragraph above. In these circumstances, the time limit in TMA70/S34(1) (that is, not more than four years after the end of the year of assessment to which it relates) applies, except in a case involving a loss of tax brought about carelessly or deliberately where the extended time limits in TMA70/S36 apply.

# VCM15160 - EIS: income tax relief: withdrawal or reduction of EIS relief: procedure: date from which interest is chargeable

### ITA07/S239

Where EIS relief falls to be withdrawn by reason of an event occurring after the date of the claim, there are special rules for determining the relevant date from which interest starts to run. This date will always precede the date when the SA return is amended or the assessment withdrawing relief is made.

Normally the relevant date from which interest starts to run will be 31 January next following the tax year in respect of which the assessment is made.

For assessments made prior to the enactment of Finance Act 2009, the relevant date was the date of the event in question (e.g. the date when the company or the investor breached a requirement, or the date when shares were disposed of, or the date when value was received).

Where the relief is withdrawn following a discovery by the officer under TMA70/S29 (1) that it was excessive, the normal rules in TMA70/S86 for determining the relevant date apply.

# VCM15170 - EIS: income tax relief: withdrawal or reduction of EIS relief: procedure: HMRC power to require information

See also VCM14210 for a description of the obligations imposed on investors and the company to notify HMRC of circumstances which should result in relief being reduced or withdrawn.

### ITA07/S242

If an HMRC officer has reason to believe that a person has failed to give notice of an event (see VCM14210) which removes the entitlement to relief, that person may be required, by notice in writing, to provide such information relating to any event as may reasonably be required. The time limit allowed for furnishing the information must not be less than 60 days.

ITA07/S242 may not be used to issue speculative notices. Any information required under a notice must be confined to matters that may cause the withdrawal of relief.

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### ITA07/S243

In addition to the above, ITA07/S243 allows HMRC to require certain persons to provide information in relation to any scheme or arrangement which the officer has reason to believe may result in EIS relief not being due. The types of arrangement covered by this rule are as follows:

- where the shares are subscribed for tax avoidance purposes (see VCM11040),
- where the company or a subsidiary is put into administration, wound up or liquidated for tax avoidance purposes,
- where shares are subscribed for under the type of arrangements described at VCM11090,
- where there are pre-arranged exit or investment protection arrangements of the type described at VCM12080,
- where there are disqualifying arrangements as described at VCM12100,
- any arrangements which would result in the company failing the control or independence requirements (see VCM13100), or
- any arrangements which would result in either a qualifying 90% subsidiary (see VCM13080) or a qualifying subsidiary (see VCM13130) ceasing to meet the relevant requirements for qualification,

HMRC may seek information from investors, the company, persons connected with or controlling the company, or persons believed to be party to disqualifying arrangements as appropriate to the circumstances and as outlined at ITA07/S243.

Failure to comply with a notice given under ITA07/S242 or S243 may attract penalties under TMA70/S98.

Similar provisions exist at TCGA92/SCH5B/PARA16 in relation to EIS capital gains deferral relief - see VCM23490.

The officer is not precluded by the obligation to secrecy from disclosing to a company, in the course of exercising the power to require information, that relief has been claimed or given in respect of any of its shares.

# VCM16000 - EIS: income tax relief: supplementary and general: contents

# VCM16010 - EIS: income tax relief: supplementary and general: transfers between spouses or civil partners

## ITA07/S245

No relief is withdrawn where one spouse or civil partner disposes of shares to which relief is attributable to the other at a time when they are living together. Following such a disposal, for the purposes of any subsequent disposal or other event, the shares are treated as if they had always been owned by the spouse or civil partner to whom they have been transferred.

Where shares issued to an individual have been transferred to the spouse or civil partner and relief subsequently falls to be withdrawn for any reason, the assessment withdrawing relief should therefore be made on the transferee and not the transferor, even though they are not the person who originally claimed the relief.

# VCM16020 - EIS: income tax relief: supplementary and general: identification of shares on a disposal

## ITA07/S246

An individual who owns shares to which relief is attributable (see VCM14020) may also possess other shares in the same company of the same class. Also, shares to which relief is attributable may have been acquired at various times and at various prices. Consequently, if the individual disposes of a part only of the holding we need rules to identify the particular shares disposed of. The rules are as below.

- Where the shares were acquired on different days, those acquired first are treated as disposed of first.
- As between shares acquired on the same day, the order of disposal is:
    - 
    - shares to which no EIS relief of any kind is attributable, and to which no SEIS relief is attributable,
    - shares to which only SEIS relief is attributable,
    - shares to which EIS deferral relief only is attributable,
    - shares to which EIS Income Tax relief only is attributable,
    - shares to which both EIS types of relief are attributable.
- Where shares have been treated as issued in the year preceding the actual year of issue, for the purpose of claiming Income Tax relief (see VCM14170) those shares are treated as disposed of before the others issued on the same day.

For the purpose of the above:

- shares to which either type of EIS relief is attributable and which have been acquired from a spouse or civil partner are treated as issued when the spouse or civil partner acquired them,
- shares acquired as a result of a company reconstruction are treated as acquired when the original shares in the predecessor company were acquired.

A special rule applies to shares issued as bonus shares - see VCM14020.

A share disposal may result in the withdrawal or reduction of EIS income tax relief - see VCM15015.

# VCM16030 - EIS: income tax relief: supplementary and general: acquisition of issuing company or insertion of new holding company

## ITA07/S247 to S249

Normally an exchange of shares for other shares counts as a disposal. However, the EIS has a provision whereby in certain circumstances the new shares are effectively treated as being a continuation of the old holding. Thus the new shares are treated as having been issued when the old shares were issued and the original qualification periods continue to run.

The circumstances in which this treatment is available are where the effect of the exchange is to insert a new holding company over the original investee company. This may be done as part of a rationalisation of the structure of the business or in preparation for obtaining a listing on a stock exchange. The provisions do not apply where two companies become subsidiaries of the same new holding company or in the case of a take-over by an established company.

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## Conditions

- At the time of the exchange, some relief is attributable to the old shares.
- The new shares are shares in a company in which the only issued shares, immediately before the exchange, are the original subscriber shares.
- HMRC confirmed in advance of the exchange that they were satisfied that it would be effected for bona fide commercial reasons and would not form part of a scheme or arrangement to which TCGA92/S137 (1) would apply - in other words, HMRC gave a clearance under TCGA92/S138 (1) - see CG52632.
- The consideration received in exchange for the old shares consists wholly of the new shares.

These rules are implemented separately for income tax relief and deferral relief, and the income tax relief provision is applied for the purposes of the CGT disposal relief.

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### Other types of share exchanges

For guidance as regards the consequences of other types of share exchanges, see the following -

- EIS disposal relief VCM20000
- EIS deferral relief (shares issued before 6.4.98) VCM22000
- EIS deferral relief (shares issued after 5.4.98) VCM23000

# VCM16040 - EIS: income tax relief: supplementary and general: nominees and bare trustees

## ITA07/S250

Reliefs under the EIS may be available where an individual subscribes for shares, and holds them, through a nominee. This facilitates the use of investment funds, which enable money pooled by a number of investors to be subscribed for shares in a range of companies, the investments being held in the name of a nominee.

For income tax relief the general rule, in ITA07/S157(1), is that to be eligible for the relief an individual must subscribe for shares on his or her own behalf. But it is provided in ITA07/S250(1) that shares subscribed for, issued to, held by or disposed of for an individual by a nominee are to be treated as subscribed for, issued to, etc, that individual.

The company, which may or may not know who the beneficial owner is to be, should enter the name of the actual subscriber on the form EIS3.

### Joint subscriptions - ITA07/S250(2)

Where shares are subscribed for jointly, each of the owners is to be treated as having subscribed an equal amount in respect of those shares. So if spouses or civil partners each subscribe £5000 for 5000 shares and the shares are registered in their joint names they are each treated as having subscribed £2500 for 5000 shares and each is entitled to relief on £2500. This is the case even if all of the funds were provided by one of them.Note that the exception in ITA07/S250 does not go far enough to enable investors to obtain income tax relief if they invest in a partnership which in turn invests in shares (including a limited partnership and a limited liability partnership). This is because rather than having individual

ownership of the shares, the individual will instead own a proportion of all the assets, including shares, owned by the partnership (as will all the other partners in the partnership).

See also VCM10520.

# VCM16050 - EIS: income tax relief: supplementary and general: approved investment fund as nominee

## ITA07/S251

The managers of an investment fund may, if they wish, apply for the fund to be approved by HMRC. Approval carries certain limited advantages, which apply in relation to income tax relief only. They are that:

- the £500 minimum subscription applicable before 6 April 2012 (see VCM10520) does not apply,
- provided 90% of the fund is invested within 12 months after the date when the invitation to participate in the fund closes, (6 months for funds which closed before 6 October 2006) the shares are regarded as issued on the closing date. This will always be earlier than the actual investments, and may in some cases by in a previous tax year.

The Guidelines for the Approval of EIS Investment Funds explain the criteria that determine whether a fund can be approved.

Anyone wishing to enquire about the circumstances in which approval may be given should contact CTIAA (CT Structure, Incentives & Reliefs team), either in writing to

Room 3/63

100 Parliament Street

London

SW1A 2BQ

or by telephone on 020 7147 2589 or 020 7147 0818 or 020 7147 0083.

Where the managers of an approved fund subscribe for shares on behalf of the participants in the fund, the individual participants remain responsible for making their own claims to relief. A single form EIS3 will be issued by each qualifying company to the managers of the fund, who will then supply the participants with certificates on form EIS5.

The managers use form EIS5, which is supplied to them by CTIAA (CT Structure, Incentives & Reliefs team), to certify to each participant that they hold certificates of relief on forms EIS3 relating to subscriptions for shares in the companies listed on that form and to notify the number of shares held on behalf of that participant. Participants can then use the forms EIS5 to claim relief.

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## Investments made through an approved investment fund

### For shares issued in the tax year 2009/10 or later

Subject to the same 90% rule as above, if the shares subscribed for are issued in the same tax year as that in which the fund closes, the investor may elect to have some or all of the relief in the preceding tax year (see VCM10530)

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## Example 1

Mrs Han invests £100,000 via an approved investment fund which closes on 10 March 2010. All of her money is invested in shares which are issued on 15 April 2010. Mrs Han can have relief in the year in which the fund closed, 2009/10.

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## Example 2

Mr McDonald invests £20,000 via an approved investment fund which closes on 10 March 2010. All of his money is invested in shares which are issued on 5 April 2010. Mr McDonald can elect to have his relief in 2008/09, the tax year preceding that in which the fund closed.

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## For shares issued up to and including tax year 2008/09

The option to treat part of the investment as having been issued in the previous year (see VCM10530) is available to investors through approved investment funds where the closing date of the fund is before 6 October in any year.

# VCM20000 - EIS: disposal relief: contents

# VCM20010 - EIS: disposal relief: introduction

Gains arising on disposals of shares in an EIS company may not be chargeable to CGT. This relief is called exemption or disposal relief in this guidance. It applies only to shares attracting EIS Income Tax relief.

The EIS disposal relief legislation is at TCGA92/S150A and TCGA92/S150B. The principal features of the scheme are:

- Gains on the disposal of EIS shares acquired within the annual investment limit that applies for Income Tax relief are exempt unless the Income Tax relief is reduced or withdrawn.
- Losses on the disposal of EIS shares are allowable. The amount of the capital loss is reduced by the amount of the Income Tax relief still attributable to the shares disposed of.
- Capital losses arising from certain disposals of EIS shares can be set against income.
- The ordinary share pooling and identification rules do not apply. Instead the EIS share identification rules are used.

# VCM20020 - EIS: disposal relief: CGT exemption

### TCGA92/S150A (2)

The earliest the CGT exemption can apply is 1 January 1999. A gain on a disposal of shares on which Income Tax relief has been claimed may be exempt if the disposal is made on or after the termination date, see VCM23070, relating to those shares or, where the shares were issued before 6 April 2000, more than five years after the shares were issued. If the shares are disposed of before the termination date relating to those shares or, where the shares were issued before 6 April 2000, within five years after issue, the Income Tax relief or part of it will be withdrawn, see VCM15000+. There is no CGT exemption for any gain arising on such a disposal.

The investor may not be able to obtain Income Tax relief because their total income is too low or their income tax liability is reduced to nil by other reliefs. If the investor does not obtain any Income Tax relief on a subscription for shares in an EIS company there is no CGT exemption for those shares. CGT exemption is available if some Income Tax relief is given even though the effect of the claim is to reduce the investor's Income Tax liability to nil, see VCM20060.

If Income Tax relief is obtained in full (that is, the amount of relief is equal to tax at the lower rate on the full amount of the subscription), and it is not withdrawn or reduced, there is no restriction on the CGT exemption. For example, an investor subscribes £50,000 for 200,000 25p ordinary shares in an EIS company. The investor receives £10,000 Income Tax relief, none of which is subsequently withdrawn. All 200,000 shares would qualify for CGT exemption on disposals made on or after the termination date, see VCM23070, relating to those shares or, where the shares were issued before 6 April 2000, more than five years after the shares were issued.

The holding of a compliance certificate (form EIS3 or EIS5) by an investor does not mean that any disposal of the relevant shares will be exempt from capital gains tax. The EIS3 or EIS5 merely indicates that from the time of investment to the date the company provides its compliance statement, the company is considered to have met the relevant qualifying conditions. It does not indicate either that the company has continued to meet those conditions for the whole of the qualifying period for the shares, or that the investor has met the necessary conditions for relief to be available. In particular, if an investor holds a form EIS3 or EIS5 but does not make a claim to income tax relief, no disposal relief will be available.

# VCM20030 - EIS: disposal relief: CGT exemption restricted

The exemption may be restricted if:

- Income Tax relief is not given on the full amount of the subscription for EIS shares, see VCM20040, or
- the amount of the Income Tax relief is reduced, or is withdrawn in full, see VCM20040.

# VCM20040 - EIS: disposal relief: Income Tax relief restricted

## TCGA92/S150A (3)

The CGT exemption will be restricted if:

- the investor does not receive full Income Tax relief on their subscription, see VCM10500,

**unless**

- the only reason full Income Tax relief cannot be given is because the claim reduces the investor's Income Tax liability to nil, see VCM20060.

The restriction will usually apply when an investor subscribes more than the amount on which Income Tax relief is available. From 6 April 2008 the amount was £500,000. From 6 April 2012 it increased to £1 million. The amounts for other years are given in VCM10530. For example, on 1 July 2011 an individual may have subscribed £600,000 for 100,000 shares in an EIS company. Income Tax relief will only be given on £500,000 of the subscription. The CGT exemption only applies to a proportion of the gain on the disposal or part disposal of the 100,000 shares. You calculate the proportion of the exempt gain using the fraction A / B where:

A = the amount by which the individual's Income Tax liability is actually reduced, and

B = the amount of the subscription x the lower rate of tax for the year of subscription.

**This restriction only applies if the shares are sold at a gain, see VCM20100 for the treatment of losses.**

# VCM20050 - EIS: disposal relief: example

- July 2010 an investor subscribes £750,000 for 100,000 shares in an EIS company.
- Maximum Income Tax relief of £100,000 is given in the tax year 2010-11.
- January 2014 all the shares are sold for £1,350,000.

The chargeable gain is calculated as below.

| | |
|---|---|
| Disposal proceeds | £1,350,000 |
| Less cost | £ 750,000 |
| Chargeable gain | £ 600,000 |

The TCGA92/S150A(3) formula is:

A = Amount of tax relief = £100,000
B Subscription x EIS rate (20% 2010-11) £150,000

The chargeable gain exemption is restricted to:

£600,000 x 2 / 3 = £400,000

The chargeable gain becomes £600,000 - £400,000 = £200,000.

# VCM20060 - EIS: disposal relief: investor's income tax liability reduced to nil

## TCGA92/S150A (3)(c)

The restriction does not apply if the only reason full Income Tax relief cannot be given is because the claim reduces the investor's Income Tax liability to nil. For example, an investor subscribes £100,000 for 100,000 £1 ordinary shares in an EIS company. The investor claims Income Tax relief under ITA07/S158. Only £16,000 worth of relief can be given before their Income Tax liability is reduced to nil, ITA07/S29(2). The restriction in TCGA92/S150A (3) does not apply.

# VCM20070 - EIS: disposal relief: income tax relief reduced

## TCGA92/S150B

The CGT exemption may have to be restricted if:

- the investor's Income Tax relief is reduced because they have received value from the company and or ITA07/S213 applies, see VCM15030.
- ITA07/S224 applies to reduce an investor's Income Tax relief where a company repays, reduces or repurchases any of its share capital or makes payments for giving up rights to share capital, see VCM15090 onwards.

The restriction is calculated as follows:

- compute the chargeable gain in the normal way including the operation of TCGA92/S150A (3), see VCM20040.
- reduce the exemption by an amount calculated by multiplying the gain by the fraction:

Reduction in relief

Total relief attributable to the shares before the reduction

If TCGA92/S150A(3) applies to reduce the exemption the fraction should be applied to the exempt part of the gain and the deduction made from the exempt part of the gain. If the relief has been reduced on more than one occasion the numerator of the fraction is the total amount of all the reductions.

# VCM20080 - EIS: disposal relief: TCGA92/S150B(2): example

In this example TCGA92/S150A(2) applies but TCGA92/S150A(3) does not.

- July 2008 investor subscribes £500,000 for 100,000 shares in an EIS company. Maximum Income Tax relief of £100,000 is given in the tax year 2009-09.
- August 2010 the investor receives value from the company and as a consequence the Income Tax relief is reduced by £20,000 by making an assessment.
- January 2013 all the shares are sold for £650,000.

The chargeable gain is calculated as below.

| | |
|---|---|
| Disposal proceeds | £650,000 |
| Less cost | £500,000 |
| Chargeable gain | £150,000 |

The exemption is reduced by the following amount:

$$\text{Chargeable gain} \times \frac{\text{Reduction in relief}}{\text{Relief attributable to shares before the reduction}}$$

$$£150{,}000 \times \frac{£20{,}000}{£100{,}000} = £30{,}000$$

£120,000 of the gain is exempt and £30,000 is chargeable.

# VCM20090 - EIS: disposal relief: TCGA92/S150B(3): example

In this example TCGA92/S150A(3) applies to restrict the exemption.

- July 2008 investor subscribes £750,000 for 100,000 shares in an EIS company. Maximum Income Tax relief of £100,000 is given in the tax year 2008-9.
- August 2009 the investor receives £100,000 value from the company. The Income Tax relief is reduced by £13,333 (£20,000 x £100,000 / £150,000) by making an assessment.
- January 2013 all the shares are sold for £1,350,000.

The chargeable gain is calculated as below:

Disposal proceeds £1,350,000
Less cost £ 750,000
Chargeable gain £ 600,000

The TCGA92/S150A (3) formula is:

A = Amount of tax relief = £100,000
B Subscription x EIS rate (20% 2008-09) £150,000

The chargeable gain exemption is restricted to £600,000 x 2 / 3 = £400,000 leaving a chargeable gain at this point of £200,000.

The exemption is further reduced by the following amount:

Exempt gain x Reduction in relief
Relief attributable to shares before the reduction

£400,000 x £13,333 = £53,333
£100,000

The exempt gain becomes £346,667 and the chargeable gain £253,333 (£200,000 + £53,333).

# VCM20100 - EIS: disposal relief: losses

### TCGA92/S150A (1)

An investor can claim a loss on the disposal of EIS shares even if the Income Tax relief is not withdrawn. Where such a loss arises it must be reduced by the amount of any Income Tax relief which remains attributable to the shares sold.

# VCM20110 - EIS: disposal relief: losses: example

- June 2008 an investor subscribes £100,000 for 50,000 shares in an EIS company. Income Tax relief of £20,000 is given in 2008-09, as the EIS rate is 20%.
- January 2013 the investor sells all 50,000 shares for £60,000. Income Tax relief of £12,000 on the £60,000 is withdrawn (£60,000 x 20%, the EIS original rate). Income Tax relief of £8,000 is not withdrawn and remains attributable to the shares sold. The allowable loss is calculated as below.

Disposal proceeds £ 60,000

| | | |
|---|---|---|
| Less cost | £100,000 | |
| Reduced by Income Tax relief* | £ 8,000 | £ 92,000 |
| Allowable loss | | £(32,000) |

*This is the EIS Income Tax relief not withdrawn which remains attributable to the shares sold.

# VCM20120 - EIS: disposal relief: part-disposal: example

- July 2010 an investor subscribes £100,000 for 100,000 shares in an EIS company. Income Tax relief of £20,000 is given in 2010-11 as the EIS rate is 20%.
- January 2012 the investor sells 25,000 shares for £10,000. Income Tax relief of £2,000 is withdrawn, (£10,000 x 20%, the EIS original rate). Income Tax relief of £3,000 attributable to the shares sold is not withdrawn. The allowable loss is calculated as below.

| | | |
|---|---|---|
| Disposal proceeds | | £ 10,000 |
| Less cost | £25,000 | |
| Reduced by Income Tax relief* | £ 3,000 | £ 22,000 |
| Allowable loss | | £(12,000) |

*This is the EIS Income Tax relief not withdrawn which remains attributable to the 25,000 shares sold.

# VCM20130 - EIS: disposal relief: income tax relief for capital losses

### ICTA88/S305A and ICTA88/S574

Because losses on the disposal of EIS shares are allowable an investor may be able to set them against their income by making a claim for Share Loss Relief under ITA07/S131. Guidance on Share Loss Relief is at VCM70000 onwards. Shares to which EIS relief is attributable are automatically 'qualifying shares' for Share Loss Relief purposes, regardless of whether the owner subscribed for them or whether the company which issued them was a 'qualifying trading company'. It is nonetheless possible that losses on some EIS shares will not qualify for Share Loss Relief because, for example, the disposal was not such that relief might be available, see VCM74090.

# VCM20140 - EIS: disposal relief: identification of disposals

## TCGA92/S150A (4) to (5)

The ordinary share identification rules do not apply to shares that have attracted EIS relief. There is no pooling of these shares and other matching rules do not apply. Instead the Income Tax rules in ITA07/S246(2)apply. Disposals are identified first against the earliest acquisition. For same day acquisitions the order of disposal is set out at ITA07/S246(3), see VCM16020.

### Example

An investor subscribed £20,000 for 20,000 new shares in an EIS company. These shares were issued to her on 1 June 2010 and were the only shares in an EIS company issued to her in 2010-11. She claimed Income Tax relief on all £20,000.

On 1 July 2012 she bought a further 15,000 shares from a third party for £15,000. These shares did not attract any EIS reliefs.

On 1 January 2014 the taxpayer sold 25,000 shares for £50,000.

For CGT purposes the taxpayer has two separate blocks of shares in the EIS company.

- 20,000 shares acquired 1 June 2010 any gain on the disposal of which after three years is not chargeable.
- 15,000 shares acquired on 1 July 2012 which are not exempt. This is called a TCGA92/S104 holding, see CG50590 onwards.

The shares sold on 1 January 2014 are identified:

- firstly with the 20,000 shares issued on 1 June 2010. As these were have been held for more than 3 years no gain arises on their disposal, and
- secondly with 5000 of the shares from the Section 104 holding.

| | |
|---|---|
| Disposal proceeds (5,000 non-exempt shares) | £10,000 |
| Less cost | £ 5,000 |
| Chargeable gain | £ 5,000 |

An example on same day acquisitions is at VCM23170, example 1.

# VCM20150 - EIS: disposal relief: share reorganisation

### TCGA92/S150A

There are various amendments to the share reorganisation rules of TCGA92/S126 to S130and these amendments can be considered under the two headings below although there is some measure of overlap.

- Bonus issues, see VCM20180.
- Rights issues, see VCM20160.

# VCM20160 - EIS: disposal relief: bonus issues

If a company makes an issue of shares to its shareholders for no payment, this is called a bonus issue. As long as the issue is made in respect of and in proportion to the existing shares TCGA92/S127 will apply to treat all the shares (original and bonus) as though they were the same asset, see CG50290.

If the original shares attracted EIS Income Tax relief the bonus issue shares are treated as if they were acquired at the same time as the original shares and as if they attracted Income Tax relief. Therefore there is no need to distinguish between original and bonus shares when dealing with a disposal or part disposal. If all the shares are sold you should treat all the shares as having had Income Tax relief. If there is a part disposal you should treat the corresponding proportion of the shares as having had Income Tax relief.

# VCM20170 - EIS: disposal relief: mixed holdings

### TCGA92/S150A (6)

A taxpayer may hold shares in a company in respect of which EIS Income Tax relief, or SEIS Income Tax relief, has been given (and not withdrawn) on some of the shares but not on others. If there is a bonus issue in respect of these shares the share reorganisation rules apply to each holding separately. Therefore the new shares are allocated to each separate holding and there is no question of shares that have attracted EIS Income Tax relief, or SEIS Income Tax relief, (which have not been withdrawn) and other shares intermingling.

# VCM20180 - EIS: disposal relief: rights issues

### TCGA92/S150A (7)

The share reorganisation rules on rights issues are disapplied if the original shares attracted EIS Income Tax relief or if the new shares attract the relief and the original shares did not. The taxpayer is treated as having acquired the new shares at the date of the rights issue and for the amount paid for the new shares. Any shares acquired on a rights issue may qualify for EIS Income Tax relief and deferral relief.

# VCM20190 - EIS: disposal relief: share exchanges

When an EIS company is taken over, the acquiring company may issue its own shares in exchange for the original shares; that is the shares which have attracted EIS income tax relief. This is a disposal of the original shares for CGT purposes even though new shares are issued in exchange (i.e. TCGA92/S135 - 137 is disapplied) unless:

In cases where EIS deferral relief is not attributable to the shares:

- all the EIS income tax relief given on the original shares has been withdrawn; this may occur as a consequence of the take-over itself if the EIS company ceases to be a qualifying company as a result of the transactions, see VCM15000+, or

In cases where EIS deferral relief is attributable to the shares OR where deferral relief is attributable and not all the income tax relief is withdrawn:

- the share exchange takes place on or after 6 April 1998 and falls within TCGA92/S150A(8D), see below, or
- the new shares are issued on or after the termination date, see VCM23070, relating to the original shares or, where the original shares were issued before 6 April 2000, more than five years after the original shares were issued and meet the conditions set out in TCGA92/S150A(8A) to (8C), see below.

In cases where EIS deferral relief is attributable to the shares, all the income tax relief is withdrawn and the new shares are issued before 22 April 2009;

- the share exchange takes place on or after 6 April 1998 and falls within TCGA92/Sch5B/Para 8 (see VCM23230); or
- the new shares are issued on or after the termination date, see VCM23070, relating to the original shares or, where the original shares were issued before 6 April 2000, more than five years after the original shares were issued and meet the conditions set out in TCGA92/Sch5B/Para9 (2)(4) and (5) (see VCM23230)

In cases where EIS deferral relief is attributable to the shares, all income tax relief is withdrawn and the new shares are issued on or after 22 April 2009, there will be no disapplication of S135-S137 and there will be no deemed disposal unless S137 applies (see below).

## TCGA92/S150A(8D), ITA07/S247

TCGA92/S150A(8D) effectively applies the provisions of ITA07/S247 for CGT purposes.

Where:

1. on or after 6 April 1998 a company, having issued only subscriber shares, acquires all the shares (and securities) in an EIS company in exchange for the proportionate issue of its own shares (and securities) of a corresponding description, see below, and
2. before the issue of the new shares (and securities) HMRC has notified the new company or the old company that they are satisfied that the share exchange will take place for bona fide commercial reasons and will not form part of any such scheme or arrangements as are mentioned in TCGA92/S137(1), see CG52505,

the share exchange is not treated as a disposal of the original shares and the new shares stand in the place of the old shares in all respects and attract the same relief, see the example at VCM23250. Similar provisions in cases where deferral relief have been given are contained in Para 9.

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## Anti-Avoidance provisions of TCGA92/S137

The Anti-avoidance Group Clearance and Counteraction Team only consider matters that relate to the anti-avoidance provisions of TCGA92/S137. All other matters must be considered by the HMRC officer dealing with the company in the first instance with reference to Capital Gains Technical Group if the problem relates to deferral or disposal relief or CTIS (Structure, Incentives & Reliefs team) if the problem relates to income tax relief.

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## Corresponding description

Corresponding description means that if the new shares (and securities) were shares (and securities) in the old company they would be of the same class and carry the same rights as the original shares (and securities). Shares (and securities) would be of the same class if they would be so treated if dealt with on the Stock Exchange.

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## TCGA92/S150A (8A)-(8C)

Where:

1. one EIS qualifying company, that is a company which has issued one or more EIS3 certificates takes over a second EIS qualifying company, and
2. the acquiring EIS company issues its own ordinary shares carrying no present or future preferential rights etc on or after the termination date, see VCM23070, relating to shares (the original shares) in the second company to which EIS income tax relief is attributable or, where the original shares were issued before 6 April 2000, more than five years after the original shares were issued,

TCGA92/S135 may apply resulting in no disposal of the original shares if its conditions are met and the anti-avoidance provisions of TCGA92/S137 do not operate, see CG52500 onwards.

# VCM20200 - EIS: disposal relief: share exchanges: examples

## Example 1

In June 2008 an investor X, subscribes £10,000 for 10,000 shares in an EIS Company A. He receives EIS Income Tax relief of £2,000 but claims no deferral relief. In August 2010 Company B, an existing trading company, acquires all the shares in Company A in exchange for the issue of one Company B share for each Company A share held. The Company B shares are worth £5 each. This disposal of shares causes all the EIS Income Tax relief attributable to them to be withdrawn. The share exchange provisions of TCGA92/S135 may apply to the disposal. If so, for CGT purposes X will be treated as though he acquired the Company B shares in June 2008 at an acquisition cost of £10,000 and any gain arising on the subsequent disposal of the Company B shares will be chargeable to CGT. This is the case whether or not Company B is an EIS company.

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## Example 2

Suppose the facts are the same as in example 1 above but the take-over by Company B is in August 2011 and Company B is an EIS company issuing its own ordinary shares carrying no present or future preferential rights etc to the shareholders in Company A. The share exchange takes place more than three years after the Company A shares were issued and, providing that income tax relief was not withdrawn, the share exchange provisions of TCGA92/S135 may apply. If so, for CGT purposes, X will be treated as though he acquired the Company B shares in June 2008 at an acquisition cost of £10,000 and any gain arising on the subsequent disposal of the Company B shares will be exempt from CGT.

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### Example 3

Suppose the facts are the same as in example 2 but Company B is not an EIS company and the shares X acquires in exchange for his shares in Company A are worth £5,000. The share exchange is treated as a disposal but the investor is able to claim a loss of £3,000 calculated as below.

| | | |
|---|---|---|
| Disposal proceeds | | £ 5,000 |
| Less cost | £10,000 | |
| Reduced by IT relief not withdrawn | £ 2,000 | £ 8,000 |
| Allowable loss | | (£3,000) |

# VCM22000 - EIS: deferral relief: shares issued before 6 April 1998: contents

# VCM22010 - EIS: deferral relief: shares issued before 6 April 1998: introduction

### TCGA92/SCH5B

Individuals who incur chargeable gains can make a claim to defer that gain if they subscribe for shares. For shares issued before 6 April 1998 deferral relief was only available for shares on which EIS Income Tax relief was obtained. For years up to and including 1997-98 the amount of deferral relief is limited to subscriptions of up to £100,000 for shares issued in any one tax year. To qualify the shares subscribed for must be issued in the period which runs from one year before to three years after the disposal. The deferred gain is brought back into charge on a later disposal of the shares and if certain other events occur. Deferral relief was extended to include shares on which EIS Income Tax relief was not available for shares issued after 5 April 1998, see VCM23000 onwards.

# VCM22020 - EIS: deferral relief: shares issued before 6 April 1998: what gains qualify?

### TCGA92/SCH5B/PARA1 (1)

The relief can be claimed against any chargeable gain arising on the disposal of an asset on or after 29 November 1994. The chargeable gain is the gain after mandatory deductions such as indexation allowance and retirement relief and reliefs which the taxpayer has to claim such as

ill-health retirement relief. The investor may claim deferral relief on less than the whole of his chargeable gain. Deferral can also be claimed when a gain previously deferred under the VCT Scheme or the EIS is brought back into charge. See VCM53000 onwards for guidance on deferral under the VCT Scheme.

# VCM22030 - EIS: deferral relief: shares issued before 6 April 1998: what investments qualify?

### TCGA92/SCH5B/PARA1 (2)

To qualify for deferral relief against shares issued before 6 April 1998 the taxpayer must subscribe for EIS shares on or after 29 November 1994 and receive Income Tax relief on the subscription. The maximum amount of deferral relief which can be claimed in any one tax year is the total amount subscribed up to £100,000 for shares issued in that one tax year. But a gain in excess of £100,000 can be deferred by subscriptions for shares issued in different tax years.

An investor who is unable to obtain the full amount of Income Tax relief available because his or her Income Tax liability is insufficient can still claim deferral relief on the full amount which would qualify for Income Tax relief. For example an investor subscribes £100,000 for 100,000 EIS shares which are issued in the same tax year. Because their Income Tax liability is insufficient the investor's Income Tax relief is restricted to £12,000 but he or she can claim deferral relief up to the full subscription of £100,000 for shares issued in that tax year.

For shares issued before 6 April 1998 deferral relief is not available if the investor's Income Tax liability is nil before taking account of Income Tax relief for an EIS subscription. In these circumstances no Income Tax relief is actually given and as a result deferral relief is not available.

# VCM22040 - EIS: deferral relief: shares issued before 6 April 1998: relevant time limits for making the investment

### TCGA92/SCH5B/PARA1 (3)

The EIS shares subscribed for must be issued in the period which runs from one year before to three years after the disposal. If the shares were subscribed for before the chargeable gain accrued they must still be held at the date the gain accrued.

HMRC has statutory power to extend the EIS deferral relief time limits and this power has not been delegated to HMRC officers in area offices.

If the EIS shares are issued outside the time limits and a request is made for an extension, follow the instructions at VCM58060. This refers to VCT shares but for EIS deferral relief purposes it should be read as referring to EIS shares.

# VCM22050 - EIS: deferral relief: shares issued before 6 April 1998: which individuals qualify?

### TCGA92/SCH5B/PARA1 (4)

To qualify for relief the investor must be resident or ordinarily resident at the date the gain accrued and the date on which they subscribed for the shares. They cannot claim relief if:

- they are also treated as resident in another country by virtue of double taxation relief arrangements, and
- they would not be liable to CGT if the EIS shares were sold at a gain immediately after they were issued.

# VCM22060 - EIS: deferral relief: shares issued before 6 April 1998: how is relief given?

### TCGA92/SCH5B/PARA2

The relief is given by treating the gain as not arising until some future date. There is no requirement that the proceeds of the disposal are actually invested in the subscription for the new shares. The relief has to be claimed.

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### Example

In the tax year 1996-97 an investor makes the following transactions:

- In May disposes of a property incurring an agreed chargeable gain of £84,000.
- In September subscribes for and is issued £60,000 worth shares in an EIS company on which they get Income Tax relief.

The investor can make a claim for up to £60,000 of the £84,000 gain to be deferred

# VCM22070 - EIS: deferral relief: shares issued before 6 April 1998: when is the deferred gain brought back into charge?

## TCGA92/SCH5B/PARA3 (1)

The deferred gain or part of the deferred gain will be brought back into charge when there is a chargeable event. The following are chargeable events whenever they take place.

1. A disposal, including a deemed disposal of the EIS shares by the investor except a disposal to their spouse or civil partner which is covered by the no gain/no loss rule in TCGA92/S58, see CG22200 onwards.
2. A disposal of the EIS shares by a person who acquired them on a no gain/no loss transfer from their spouse or civil partner, the original investor. This does not apply to no gain/no loss disposals back to the same spouse or civil partner.
3. The investor becomes non-resident within 5 years of the issue of the EIS shares, but see exceptions at VCM22080.
4. The person who received the shares on a no gain/no loss transfer from their spouse or civil partner becomes non-resident within 5 years of the issue of the shares, but see exceptions at VCM22080.

**Before 6 April 1998 there were two further chargeable events**

5. When the company ceased to be a qualifying company for EIS purposes within 3 years after the shares were issued or within 3 years from commencing trading if this were later.
6. When the EIS income tax relief was withdrawn or reduced in circumstances to which (a) to (e) above did not apply.

FA98 introduced new TCGA92/SCH5B/PARA3 (1)(e) which replaces these with effect from 6 April 1998. There is a chargeable event when eligible shares cease to be eligible see VCM23060.

# VCM22080 - EIS: deferral relief: shares issued before 6 April 1998: when is the deferred gain brought back into charge: shareholder becomes non-resident

## TCGA92/SCH5B/PARA3 (1)(c) - (d)

The deferred gain will not be brought back into charge by TCGA92/SCH5B/PARA3 (1)(c) and (d) if the taxpayer emigrates by reason of their employment and all the following conditions are satisfied:

- the shareholder becomes non-resident because they are working in an office or employment all the duties of which are performed outside the UK,
- the shareholder becomes resident or ordinarily resident again within three years of the date of becoming non-resident and the shareholder does not sell any of the eligible shares on which they have claimed deferral relief during the intervening period of non-residence.

If the first condition is satisfied you must wait until the end of the three year period to see if the second and third conditions are satisfied before assessing the deferred gain.

# VCM22090 - EIS: deferral relief: shares issued before 6 April 1998: when is the deferred gain brought back into charge: death

### TCGA92/SCH5B/PARA3 (5)

Death is not treated as a disposal. Therefore the death of an investor does not give rise to a release of the deferred gain. Neither will the deferred gain be released if any of the events listed in VCM22070 occur after the date of death. The same rule applies to the death of any person who acquires the shares on a no gain/no loss transfer.

# VCM22100 - EIS: deferral relief: shares issued before 6 April 1998: how much of the deferred gain becomes assessable?

### TCGA92/SCH5B/PARA4

The whole of any deferred gain becomes assessable if the investor disposes of all the shares or if the chargeable event is not a disposal at all (for example if within five years from the time the shares were issued the investor emigrates from the UK).

**Example**

An investor subscribes £50,000 for 50,000 shares and receives full Income Tax relief. They defer a gain of £50,000. After more than five years they sell all the shares making a capital gain which is exempt from CGT. The whole of the subscription was used to defer the gain and as all the shares have been sold the whole of the deferred gain of £50,000 becomes assessable for the tax year in which the shares were sold. The CGT annual exempt amount can be used to cover part of the gain now assessable.

**Part disposal**

If the investor disposes of only some of the shares to which the deferred gain relates only part of the deferred gain will become assessable.

**Example**

The investor subscribes £20,000 for 20,000 shares and receives Income Tax relief in respect of all £20,000. They defer a gain of £20,000. After more than five years they sell 15,000 of the shares making a gain which is exempt from CGT. Part of the deferred gain comes back into charge. The whole of the subscription of £20,000 was used to defer the gain, and as 15,000 of the 20,000 shares have been sold the same proportion of the deferred gain £15,000 becomes assessable for the tax year in which the 15,000 shares were sold. The CGT annual exempt amount can be used to cover part of the gain now assessable.

# VCM22110 - EIS: deferral relief: shares issued before 6 April 1998: taper relief on gain brought back into charge

The deferred gain is treated as accruing at the time of the chargeable event listed in VCM22070. The gain is not recomputed to give further indexation allowance from the date of the original disposal to the date of the chargeable event or April 1998. FA98 froze indexation allowance at April 1998 except for companies, see CG17207.

Taper relief, see CG17895 onwards, should be computed on the amount of the deferred gain accruing as if the accrual occurred on the date of the original disposal. There is no further taper relief due from the date of the original disposal to the date of the chargeable event. Any gain or loss accruing on the disposal of EIS shares themselves in respect of the period for which they were held is treated separately.

# VCM22120 - EIS: deferral relief: shares issued before 6 April 1998: disposals

## TCGA92/SCH5B/PARA4

Disposals are the commonest type of transaction. There are identification rules to determine whether the shares disposed of result in a release of any deferred gains. These rules are necessary because a taxpayer may hold shares in an EIS company and only some of the shares may have attracted deferral relief.

There is no pooling of shares which have attracted relief(s) before 6 April 1998 and the last in first out and other rules introduced by FA98 do not apply.

The share identification rules are set out in TCGA92/SCH5B/PARA4. Disposals are identified on a first in/first out basis where shares are acquired on different days.

If shares are acquired on the same day, disposals before 6 April 1998 are identified first against shares which have not had deferral relief, see VCM23160.

# VCM22130 - EIS: deferral relief: shares issued before 6 April 1998: same day acquisitions: disposals before 6 April 1998

The same day rule will usually apply where an investor has made a single subscription and claimed deferral relief on some but not all of the shares. To apply the same day rule you have to identify the shares which have attracted deferral relief. The basic steps are as follows:

- Identify the amount in respect of which Income Tax relief under ICTA88/S289A was given. This will be £100,000 or the amount of the subscription whichever is lower.
- This amount is attributed equally to each share subscribed for.
- Calculate the number of shares required to give effect to the deferral relief claim.

These steps are illustrated in the examples in VCM22140.

# VCM22140 - EIS: deferral relief: shares issued before 6 April 1998: same day acquisitions: disposals before 6 April 1998: examples

## Example 1

In this example the investor subscribes less than £100,000 and claims Income Tax relief and deferral relief on different amounts. The changes introduced by FA98 would produce the same result in this case because both the subscription and the deferral relief are less than £100,000. This example only highlights the amount of deferred gain which becomes assessable.

An investor subscribes £80,000 for 80,000 shares in an EIS company. They claim Income Tax relief on £80,000 and £60,000 deferral relief. They sell 50,000 shares at a later date.

Following the steps in VCM22130 the amount of the deferred gain becoming assessable is calculated as follows:

- the amount in respect of which Income Tax relief is given is £80,000,
- the £80,000 is attributable equally to all 80,000 shares, £1 is attributable to each share,
- 60,000 shares are required to give effect to the deferral relief claim of £60,000.

The disposal of 50,000 shares is identified:

- first against the 20,000 shares which have not had deferral relief,
- second against 30,000 of the shares which have had deferral relief.

£30,000 of the deferred gain becomes assessable at the later date.

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## Example 2

In this example an investor subscribes more than £100,000 for shares issued before 6 April 1998 and claims deferral relief of less than £100,000. The changes introduced by FA98 would produce a different result if the shares were issued on or after 6 April 1998, see VCM23150 onwards. This example only highlights the deferred gain which becomes assessable.

On 1 June 1995 Y subscribes £200,000 for 200,000 shares in an EIS company. She claims Income Tax relief in respect of £100,000 and deferral relief of £60,000. On 1 June 1996 she sells 25,000 shares. On 1 June 1997 she sells 75,000 shares.

Following the steps in VCM22130 the amount of the deferred gain becoming assessable is calculated as follows:

- the amount in respect of which EIS Income Tax relief is given is £100,000,
- the £100,000 is attributable equally to each of the 200,000 shares, 50p is attributable to each share,
- 120,000 shares are required to give effect to the deferral relief claim of £60,000. This leaves 80,000 shares against which no deferral relief is claimed.

The disposals are identified as below.

| | No Deferral Relief | Deferral Relief |
|---|---|---|
| 1 June 1995 | 80,000 | 120,000 |
| 1 June 1996 disposal | 25,000 | |
| | 55,000 | 120,000 |
| 1 June 1997 disposal | 55,000 | 20,000 |
| | Nil | 100,000 |

20,000 x 50p = £10,000 of the deferred gain becomes assessable in 1997-98.

# VCM22150 - EIS: deferral relief: shares issued before 6 April 1998: share reorganisation

## TCGA92/SCH5B

There are two common types of share reorganisation, bonus issues and rights issues.

The taxpayer may hold different categories of shares issued before 6 April 1998, shares which have attracted no EIS reliefs, shares which have attracted EIS Income Tax relief and shares which have attracted both EIS Income Tax relief and deferral relief. Shares issued on or after 6 April 1998 may attract deferral relief only. When there is a bonus issue each category of share is treated separately and where the shares have attracted deferral relief this continues and is apportioned between the original shares and the bonus issue shares.

Where there is a rights issue the reorganisation provisions of TCGA92/S127 - S130 will only apply to shares to which no EIS Income Tax relief or deferral relief is attributable immediately after the rights issue. The taxpayer holding shares which attract EIS relief is treated as having acquired the new shares at the date of the rights issue and for the amount they paid for the new shares. Any shares acquired on a rights issue may qualify for EIS Income Tax relief and deferral relief, but a separate claim will need to be made.

# VCM22160 - EIS: deferral relief: shares issued before 6 April 1998: share exchanges

When an EIS company is taken over, the acquiring company may issue its own shares in exchange for the original shares; that is the shares which have attracted EIS Income Tax relief and some or all of which have also attracted deferral relief. Even though new shares are issued in exchange this is a disposal of the original shares and the deferred gain comes back into charge unless:

- all the EIS Income Tax relief and deferral relief given on the original shares has been withdrawn, possibly as a result of the take-over, or
- the share exchange takes place on or after 6 April 1998 and falls within TCGA92/S150A/PARA8D, see VCM20190, or
- the share exchange takes place more than five years after the original shares were issued and meets the conditions set out at Section 150A (8A) to (8C), see VCM23230.

**TCGA92/S150A/PARA8D, ICTA88/S304A, TCGA92/SCH5B/PARA8**

Section 150A (8D) effectively applies the provisions of ICTA88/S304A for CGT purposes. These are explained at VCM23230. If they apply the new shares stand in the place of the old shares in all respects. This means that they will attract the same disposal relief on a subsequent disposal as the original shares would have done. Where the conditions of

ICTA88/S304A are met, the shares also meet the requirements of TCGA92/SCH5B/PARA8, see VCM23230, so that the new shares stand in the place of the old shares for deferral relief purposes as well.

**TCGA92/S150A/PARA8A - 8C**

Where the conditions imposed by these provisions are met TCGA92/S135 may apply resulting in no disposal if the technical conditions are met and the anti-avoidance provisions of TCGA92/S137 do not operate, see CG52500 onwards. This would mean that the deferred gain would not be brought back into charge on the share exchange.

In all other share exchanges the taxpayer disposes of his eligible shares and the deferred gain comes back into charge.

# VCM22170 - EIS: deferral relief: shares issued before 6 April 1998: who is assessable?

## TCGA92/SCH5B/PARA5

Rules are necessary to determine on whom the deferred gain should be assessed if there is a chargeable event. These rules are needed because the original investor may have passed the shares on to their spouse or civil partner on a transfer to which TCGA92/S58 applied. Whenever there is a chargeable event within VCM22070 (a) to (d) the gain is assessable on:

- the person making the disposal, or
- the person who becomes non-resident.

For chargeable events before 6 April 1998 where the gain becomes assessable as a result of the chargeable events described at VCM35200 (e) and (f), the gain is assessable on:

- the person who held the shares when the company ceased to qualify, or
- the person who held the shares when Income Tax relief is withdrawn or reduced.

FA98 introduced TCGA92/SCH5B/PARA5 (1)(c) which replaces VCM35200 (a) and (e) for chargeable events taking place on or after 6 April 1998 so that the gain is assessable on the person who holds the shares when they cease to be eligible.

# VCM22180 - EIS: deferral relief: shares issued before 6 April 1998: procedure for claims

The relief must be claimed but there is no statutory form. A claim in the return, computation, correspondence or, for 1996-97 onwards, under SA, will be sufficient.

# VCM22190 - EIS: deferral relief: shares issued before 6 April 1998: procedure for claims: time limits

The time limit for claiming deferral relief is six years from the end of the relevant tax year for 1995-96 and earlier years. For 1996-97 onwards, the time limit is five years from 31 January following the end of the relevant tax year. The relevant tax year is the one in which the later of the following events took place:

- the gain to be deferred arose,
- the EIS shares were issued.

# VCM22200 - EIS: deferral relief: shares issued before 6 April 1998: procedure for claims: postponement application

If the CG arises in a tax year preceding the tax year in which the shares are issued, you cannot give deferral relief immediately. For years before SA, you can accept the appropriate postponement application but you must point out the normal interest provisions will apply if it turns out no relief is due.

Under SA, there is no provision for a postponement application in any circumstances. A claim can only be submitted after the shares have been issued.

# VCM22210 - EIS: deferral relief: shares issued before 6 April 1998: procedure for claims: report to KAI Analysis

Whenever a claim to deferral relief is agreed the office dealing with the claimant's affairs should make a statistical report.

A copy of the report form can also be used as a permanent record of the relief given.

# VCM23000 - EIS: deferral relief: shares issued on or after 6 April 1998: contents

# VCM23010 - EIS: deferral relief: shares issued on or after 6 April 1998: introduction and qualifying gains

## TCGA92/SCH5B/PARA1 (1)

FA98/S74 and FA98/SCH13 introduced significant changes to the existing rules for CGT deferral relief within the EIS. The new rules apply where the shares are issued on or after 6 April 1998.

**Qualifying gains**

The relief can be claimed against any chargeable gain arising on the disposal of any asset by a taxpayer if a qualifying investment, see VCM23020, is acquired by them at a qualifying time, see VCM23030, on or after 6 April 1998. The chargeable gain is the gain after any mandatory deductions and reliefs which have to be claimed. However, the gain to be invested is that before the deduction of taper relief. Any taper relief is deducted when the gain comes back into charge following a chargeable event, see VCM23110. Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008.

Deferral relief can be claimed when a gain previously deferred under the EIS (or under the VCT scheme in respect of shares issued on or before 5 April 2004, see VCM50000 onwards), is brought back into charge. Also, under the new rules, a gain accruing as a result of a claw back of reinvestment relief, see CG62200 onwards, could be the subject of a deferral relief claim. The investor may claim deferral relief on part of his or her gain.

# VCM23020 - EIS: deferral relief: shares issued on or after 6 April 1998: qualifying investments

## TCGA92/SCH5B/PARA1 (2)

**For shares issued before 17 March 2004.**

The investor makes a qualifying investment if:

1. eligible shares for which he or she subscribed wholly in cash, see VCM23060, are issued to him or her on or after 6 April 1998 at a qualifying time, see VCM23030. If the date of the share issue is before the date of disposal, only those shares which are still held by the investor at the date of disposal can form the qualifying investment;
2. the shares are issued by a qualifying company, see VCM23050;
3. on issue, the shares are fully paid up. Any undertaking to pay cash to any person at a future date in respect of the acquisition of the shares prevents the shares from being treated as fully paid up on issue for the purposes of this requirement;
4. the shares are issued for bona fide commercial purposes and not as part of arrangements, the main purpose or one of the main purposes of which is the avoidance of tax, see VCM12080 onwards as the same rule applies for EIS Income Tax relief, ICTA88/S289 (6);
5. the company satisfies the requirements of ICTA88/S289(1A), see VCM13080;
6. all the shares comprised in the share issue - that is, all shares of the same class issued on the same day - are issued in order to raise money for the purpose of a qualifying business activity, see VCM12100;
7. **for shares issued on or after 7 March 2001**, at least 80% of the money raised by the share issue is employed wholly for the purpose of the qualifying business activity referred to above by the company within the time limit in ICTA88/S289(3), see VCM12050, **and** 100% of it has been so employed no later than 12 months afterwards. But if an insignificant amount of the money is employed for some other purpose, it is to be disregarded.
8. **for shares issued before 7 March 2001,** all of the money raised by the share issue is employed wholly for the purpose of the qualifying business activity referred to in (f) above by the company within the time limit in ICTA88/S289 (3), **except** where the deadline occurs on or after 7 March 2001 in which case the 80% and 100% rules in (g) above apply instead. Again, if an insignificant amount of the money is employed for some other purpose, it is to be disregarded.

For acquisitions on or after 6 April 1998 there is no upper limit on the amount of qualifying investments made by an investor in a year. However the amount that can be invested in a single company is limited

- by TCGA92/Sch5B Para 1(2)(da) to £2m (increased to £5m by FA12 in respect of shares issued on or after 6 April 2012) in the year ending with the date the shares are issued, see VCM12030; and
- by the gross assets rule in ITA07/s186, see VCM13110.

Also, the shares do not have to attract Income Tax relief in order to qualify for deferral relief.

**For shares issued on or after 17 March 2004 the following changes apply:**

1. The issue may include 'bonus shares' without causing any of the above requirements to fail to be met. For this purpose, 'bonus shares' are shares which are not issued for payment, whether in cash or otherwise.
2. Only the shares that are issued to investors who claim EIS Income Tax relief or deferral relief have to be issued to raise money for the purposes of a qualifying business activity. Other shares in the same share issue need not be issued to raise money. The requirement at g. above (that the money raised by the issue must be employed by the appropriate time limits) must, however, be met in relation to any money that is raised by the share issue, whether it is paid by EIS investors or other investors.

For shares issued after 5 April 2007 ITA07 applies in place of the ICTA88 references above.

# VCM23030 - EIS: deferral relief: shares issued on or after 6 April 1998: qualifying time

## TCGA92/SCH5B/PARA1 (3)

The deferral relief shares must be issued in the period beginning 12 months before, and ending three years after, the accrual of the gain on which relief is claimed.

HMRC has statutory powers to extend these time limits which have not been delegated to HMRC officers in area offices.

HMRC will extend the time limits where the claimant can show that he or she:

- had a firm intention to comply with the time limits, but
- was prevented by some fact or circumstance beyond his or her control from complying, and
- acted as soon as he or she reasonably could after ceasing to be so prevented.

It is a question of fact and degree and each case is considered on its own merits. Examples of circumstances outside the claimant's control might include death or serious illness of a vital party at a crucial time, unsettled disputes or litigation or unexpected delay in receipt of disposal consideration.

A mere change of intention at a late stage or a shortage of funds arising out of the application of the disposal consideration to some purpose other than the subscription for EIS shares will

not normally be regarded as circumstances beyond the claimant's control. In particular, where a claimant chooses to defer applying for shares until late in the statutory reinvestment period any subsequent issue of shares outside that period will not normally be regarded as a circumstance beyond the claimant's control justifying an extension to the time limit.

No decision on a possible extension of the time limits can be made until the disposal has taken place, the EIS shares have been issued and all other conditions of relief are satisfied.

If the EIS shares have been issued outside the statutory time limits and a request is made for an extension the HMRC officer should explain the criteria set out above to the claimant so that they can demonstrate their case. The officer should then make a report to Specialist PT (Capital Gains) with their recommendation and the claimant's file.

# VCM23040 - EIS: deferral relief: shares issued on or after 6 April 1998: qualifying investors

### TCGA92/SCH5B/PARA1 (1)(a), (1)(d) & (4)

To qualify for relief, the investor must be an individual (or the trustees of a qualifying settlement, see VCM23510) who is resident or ordinarily resident in the UK both at the time the gain accrued and at the time the shares are issued. No claim to relief is allowed if the investor:

- is also treated as resident in another country by virtue of double taxation relief arrangements, and
- would not be liable to CGT if the EIS shares were sold at a gain immediately after they were issued.

# VCM23050 - EIS: deferral relief: shares issued on or after 6 April 1998: qualifying company

### TCGA92/SCH5B/PARA19; ICTA88/S293; Chapter 4 of Part 5 ITA

Guidance on which companies qualify is contained at VCM13000 onwards. Reinvestments in the same company are not qualifying investments, see VCM23180.

# VCM23060 - EIS: deferral relief: shares issued on or after 6 April 1998: eligible shares

## TCGA92/SCH5B/PARA19

Only ordinary shares are eligible shares. TCGA92/SCH5B/PARA19 applies ICTA88/S289(7) or ITA07/S173(2) to define eligible shares as new ordinary shares (issued on or after 6 April 1998 and before 6 April 2000) which, throughout the period of five years beginning with the date on which they are issued, carry:

- no present or future preferential right to dividends or to a company's assets on its winding up, and
- no present or future right to be redeemed.

**For shares issued on or after 6 April 2000**, the five year period is reduced to the period:

- beginning with the issue of the shares, and
- ending immediately before the termination date, see VCM23070, relating to those shares.

**For shares issued on or after 6 April 2012**, the shares must be ordinary shares which throughout that period carry:

- no present or future preferential right to dividends where either :
    - 
    - The rights attaching to the share include scope for the amount of the dividend to be varied based on a decision taken by the company, the shareholder or any other person. **Note**: this exclusion covers only those shares which carry preferential rights and does not therefore prevent the voting of dividends in respect of non-preferential shares, nor does it prevent shareholders from choosing to waive a dividend payment should they wish to do so; or
    - The right to receive dividends is 'cumulative' - that is, where a dividend which has become payable is not in fact paid, the company is obliged to pay it a later time, normally once funds become available.
- no present or future preferential rights to the company's assets on its winding up, and
- no present or future right to be redeemed.

Ordinary shares are defined as shares forming part of the ordinary share capital of the company, within the meaning given by ICTA88/S832 (1) & ITA07/S989.

The fact that shares are eligible on issue is not the end of the matter. Shares cease to be eligible when:

- the requirements of ICTA88/S289 (7) or ITA07/S173(2) cease to be met within the period mentioned above
- For shares issued after 5 April 2007, the provisions of ITA07/S173(2) replace those of ICTA88/S289(7).

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### TCGA92/SCH5B/PARA1A

- an event occurs after the date of issue which causes the company not to be a qualifying company, see VCM23050,
- an event occurs after the date of issue which results in the requirements of ICTA88/S289 (1A) or ITA07/S183 not being satisfied, see VCM13080 (group companies only).

If the use of the money rule in VCM23020 (g) or (h) is not satisfied, the shares are treated as:

- never having been eligible shares if the deferral relief claim is made after the time limit in question has expired, or
- ceasing to be eligible at the expiry of the time limit in question if the claim is made before then.

The company and any person connected with it who has knowledge of the matter must notify the Inspector in any of the circumstances set out above, see VCM23480. Alternatively the Inspector may discover that the shares cease to be eligible because the company does not satisfy all of the conditions. In this case the Inspector notifies the company that the shares cease to be eligible on a certain date. The Inspector's notice shall be taken to be a decision refusing a claim made by the company for the purposes of the TMA70.

Shares are treated as never having been eligible if the facts show that any of the money raised by the issue was raised for a purpose other than a qualifying business activity, see VCM12100.

The above list of events is not exhaustive when considering if shares are eligible. Anti-avoidance rules may also result in shares ceasing to be eligible, see, for example, VCM12100,VCM23260, VCM23270, VCM23280, VCM23300, VCM23440 and VCM23470.

# VCM23070 - EIS: deferral relief: shares issued on or after 6 April 1998: meaning of termination date

### ITA07/S256

The termination date in relation to any eligible shares issued by a company is:

- the third anniversary of the date on which the shares were issued or,

- if the money raised by the issue was for the purpose of a trade (one that is a qualifying business activity within ITA07/S179(2)) and the company has not begun to carry on that trade on the date of issue of the shares, it is the third anniversary of the date on which the company begins to carry on the trade in question.

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### Example 1

Company A issued eligible shares on 1 June 2000. It used the money raised by the share issue for the purposes of a trade which commenced on 1 April 2000. The termination date in relation to the eligible shares is 1 June 2003.

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### Example 2

Company B issued eligible shares on 1 November 2000. It used the money raised by the share issue for the purposes of a trade which commenced on 1 December 2000. The termination date in relation to the eligible shares is 1 December 2003.

# VCM23080 - EIS: deferral relief: shares issued on or after 6 April 1998: how deferral relief is allowed

### TCGA92/SCH5B/PARA2

The relief must be claimed (see VCM23200 for guidance on the claims procedure) and it is given by treating the gain as not arising until some future event. There is no requirement that the proceeds of the disposal giving rise to the gain are directly applied to subscribe for the new shares. The investor can specify an amount of relief in his claim as long as this does not exceed the amount of:

- his unused qualifying expenditure on eligible shares, and
- that part of the original gain which is unmatched.

An investor's qualifying expenditure on eligible shares is the amount subscribed for the shares and that expenditure is unused if it has not been included in an EIS deferral relief claim or in a SEIS re-investment relief claim.

The original gain is unmatched to the extent that it has not been included in a claim to EIS deferral relief within TCGA92/SCH5B, 5C (in respect of qualifying investments in VCT shares issued on or before 5 April 2004, see VCM58010 onwards), or SEIS re-investment relief, TCGA92/SCH5BB.

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### Example

In 2010-11 a taxpayer carries out the following transactions:

- he disposes of a property under an unconditional contract dated 1 May 2010 giving rise to an agreed chargeable gain of £90,000,
- he subscribes for and is issued with £60,000 worth of shares in an EIS company on 1 September 2010,
- he subscribes for and is issued with a further £40,000 worth of shares in another EIS company on 1 December 2010.

The taxpayer can claim a total amount of £90,000 deferral relief in respect of this gain and the two share issues. He does not have to claim relief on his acquisition in September prior to that in December.

# VCM23090 - EIS: deferral relief: shares issued on or after 6 April 1998: time limit for claim

The time limit for claiming deferral relief in respect of shares issued on or after 6 April 1998 is five years from 31 January following the end of the tax year in which the shares were issued. Note that a claim to deferral relief reduces the amount of chargeable gain in the year of disposal. Any repayment or discharge of tax relates to that year, not the year in which the claim is made.

# VCM23100 - EIS: deferral relief: shares issued on or after 6 April 1998: postponement application

Under Self Assessment, there is no provision for postponement of CGT pending the subscription and issue of eligible shares. A claim can only be submitted after the shares have been issued, see VCM23020. For guidance on the claims procedure see VCM23200. For claims and elections under SA see EM6700 onwards.

# VCM23110 - EIS: deferral relief: shares issued on or after 6 April 1998: when is the deferred gain brought back into charge?

### TCGA92/SCH5B/PARA3

The deferred gain, or part of the deferred gain, will be brought back into charge when there is a chargeable event. The events are:

1. a disposal, including a deemed disposal, of the EIS eligible shares by the investor except a disposal to a spouse or civil partner which is covered by the no gain/no loss rule in TCGA92/S58, see CG22200 onwards;
2. a disposal of the EIS eligible shares by a person who acquired them on a no gain/no loss transfer from their spouse or civil partner, the original investor. This does not apply to a no gain/no loss disposal back to the same spouse or civil partner;
3. the investor becoming non-resident within the period beginning with the issue of the shares and ending immediately before the termination date, see VCM23070, relating to those shares, but see exceptions at VCM23120;
4. the person who received the shares on a no gain/no loss transfer from their spouse or civil partner becoming non-resident within the period beginning with the issue of the shares and ending immediately before the termination date, see VCM23070, relating to those shares, but see exceptions at VCM23120;
5. the shares ceasing, or being treated as ceasing, to be eligible shares, see VCM23060 onwards.

**For shares issued before 6 April 2000 but only in the circumstances where no claim to deferral relief or income tax relief has been made on those shares before 7 March 2001**, the period referred to in (c) and (d) above is replaced by a period of five years from the date of issue of the shares.

If a claim to either income tax or deferral relief has been made before 7 March 2001 then the period described in (c) and (d) above applies.

# VCM23120 - EIS: deferral relief: shares issued on or after 6 April 1998: when is the deferred gain brought back into charge: shareholder becomes non-resident

## TCGA92/SCH5B/PARA3 (3)

There will be no chargeable event if the shareholder becomes non-resident by reason of his or her employment and all the following conditions are satisfied:

- the shareholder becomes non-resident because he or she is working in an office or employment all the duties of which are performed outside the UK,
- the shareholder becomes resident or ordinarily resident again within three years of the date of becoming non-resident,

- the shareholder does not sell any of the eligible shares on which they have claimed deferral relief during the intervening period of non-residence.

If the first condition is satisfied you must wait until the end of the three year period to see if the second and third conditions are satisfied before assessing the deferred gain.

# VCM23130 - EIS: deferral relief: shares issued on or after 6 April 1998: when is the deferred gain brought back into charge: death

## TCGA92/SCH5B/PARA3 (5)

As a disposal is not deemed to occur on death, a deferred gain is not brought back into charge on the death of an investor. Neither will the deferred gain be revived if any of the events listed in VCM23110 occur after the date of death. The same rule applies to the death of any person who acquires the shares on a no gain/no loss transfer.

# VCM23140 - EIS: deferral relief: shares issued on or after 6 April 1998: when is deferred gain brought back into charge: tranche size exceeded

## TCGA92/SCH5B/PARA(1)(2)(da)

The tranche size for an investee company may be exceeded in respect of an issue of shares on which EIS deferral relief has been claimed as a result of an event occurring after the claim has been made- see VCM12055. As a result any shares which form part of an issue which exceeds the tranche size will cease to qualify and the deferred gain is brought back into charge.

The deferred gain will be brought back into charge on the date of the relevant event, which will usually be the date of submission of the compliance certificate that caused the tranche size to be exceeded.

# VCM23150 - EIS: deferral relief: shares issued on or after 6 April 1998: how much of the deferred gain becomes assessable?

## TCGA92/SCH5B/PARA4

The whole of any deferred gain becomes assessable if the taxpayer disposes of all the shares or if the chargeable event is not a disposal. (For example, if within five years from the time the shares were issued, or for shares issued on or after 6 April 2000, within the period from the date of issue to the date immediately before the termination date, see VCM23070, relating to those shares, the taxpayer emigrates from the UK).

**Example**

An investor subscribes £50,000 for eligible shares that are issued after 5 April 1998. He claims to defer a chargeable gain of £50,000 from the disposal of a property. He subsequently sells all the shares. The whole of the subscription was used to defer the gain on the property and as all the shares have been sold the whole of that deferred gain of £50,000 becomes assessable for the tax year in which the shares are sold. The CGT annual exempt amount for the year in which the EIS shares are disposed of can be used to cover part of the deferred gain now assessable.

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## Part disposal

If an investor disposes of only some of the shares to which the deferral relief is attributable, a proportionate part of the deferred gain will become assessable.

**Example**

An investor subscribes £30,000 for eligible shares that are issued after 5 April 1998. She claims to defer a gain of £20,000 from the disposal of land against the subscription for the shares. She sells 75% of the shares. When the shares are disposed of, part of the deferred gain on the land becomes assessable. As 75% of the shares have been sold, the same proportion of the deferred gain (£15,000) becomes assessable for the tax year in which the shares were sold. The CGT annual exempt amount for the year in which the shares were sold can be used to cover part of the deferred gain now assessable.

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## Timing, Indexation and Taper relief

The deferred gain is treated as accruing at the time of the relevant chargeable event listed in VCM23110. The gain is not recomputed to give further indexation allowance from the date of the original disposal to the date of the chargeable event or to April 1998. FA98 froze indexation allowance at April 1998 except for companies, see CG17207.

Taper relief, if due, see CG17895 onwards, should be computed on the amount of the deferred gain as if the accrual occurred on the date of the original disposal. There is no further taper relief due from the date of the original disposal to the date of the chargeable event (but see VCM25000 onwards re taper relief for serial EIS investments where a gain accrues or is treated as accruing before 6 April 2008. Any gain or loss accruing on the disposal of the EIS shares themselves in respect of the period for which they were held is treated separately.

# VCM23160 - EIS: deferral relief: shares issued on or after 6 April 1998: identification of disposals

## TCGA92/SCH5B/PARA4 (3) & (4)

A disposal is the most common type of chargeable event. The usual share identification rules, see CG/APP10, do not apply where shares have been issued and deferral relief is obtained in respect of those shares. There was no pooling of shares acquired before 6 April 1998 and the last in first out and other rules introduced by FA98 do not apply. Each acquisition is treated separately.

A shareholder who has made a qualifying investment may possess other shares in the company which are of the same class. Also, qualifying investments may have been made at various times and at different prices. Consequently, where a shareholder makes a disposal, we need rules to identify the particular shares disposed of to determine whether the shares disposed of result in any deferred gains coming back into charge.

**TCGA92/SCH5B/PARA4 (3)**

If the shareholder has acquired shares of the same class on different days and disposes of some but not all of his shares the disposals are identified first against the earliest acquisition.

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## Disposals of shares acquired on same day

**TCGA92/SCH5B/PARA4 (4)**

Please note that the share identification rules have been amended for shares acquired on or after 6 April 1998.

If a shareholder disposes of some but not all of the shares he or she acquired on the same day it is necessary to determine which shares are disposed of. This is done by separating the shares into four categories depending on whether deferral relief alone is attributable to them, EIS Income Tax relief alone is attributable, both or neither. In making this decision, bear in mind that:

- EIS reliefs cannot be attributable to shares if the shareholder did not acquire them by subscription unless the investor acquired them on a disposal within marriage (see below) and the reliefs were already attributable to the shares;
- where an amount of deferral relief or EIS Income Tax relief is attributable to an issue of shares - that is, to all the shares of a particular class of shares which are issued to the investor on the same day - it is attributable to the **whole** of that share issue, and a proportionate amount is attributable to each share.

The shares are treated as disposed of in the order (a) - (d) as below.

| | Shares to which EIS IT relief attributable | Shares to which deferral relief attributable |
|---|---|---|
| (a) Disposed of first | X | X |
| (b) Next | X | Y |
| (c) Next | Y | X |
| (d) Finally | Y | Y |

X indicates that the relief is not attributable.

Y indicates that the relief is attributable.

Under the EIS Income Tax rules some shares may have been treated as issued in the tax year prior to that in which they were actually issued, see VCM10530. Where there is a disposal of shares which includes such shares, and not all of the shares in categories (c) or (d) are treated as disposed of, shares in that category treated for Income Tax relief purposes as issued in the previous tax year are treated as disposed of before those which were not.

For the purposes of these rules, if either relief is attributable to shares disposed of which were acquired by the investor on a disposal within marriage, the investor is treated as having acquired them on the date they were issued.

# VCM23170 - EIS: deferral relief: shares issued on or after 6 April 1998: identification of disposals: examples

# Example 1

An investor subscribes £80,000 for 80,000 shares in an EIS company that are all issued to him on 3 November 1998. He obtains Income Tax relief on £80,000 and £60,000 deferral relief in respect of a gain from a disposal of land. 50,000 of the shares are sold on 4 April 2002.

Following VCM23160 the amount of the deferred gain that accrues at the time the 50,000 shares are disposed of is calculated as follows:

- the £80,000 Income Tax relief is attributable equally to all 80,000 shares,
- the £60,000 deferral relief is attributable equally to all 80,000 shares.

The numbers of shares falling into the categories described in VCM23160 are:

1. None.
2. None.
3. None.
4. 80,000.

The 50,000 shares disposed of are identified as 50,000 of the 80,000 shares to which both deferral relief and Income Tax relief are attributable to them, (d).

£37,500 of the deferred gain (50,000 / 80,000 x £60,000) accrues on 4 April 2002. (Details of the withdrawal of Income Tax relief are not covered by this example).

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# Example 2

On 25 May 2003, Mary disposes of 24,000 of her holding of 34,000 ordinary shares in Z Ltd in an arm's length sale. She had acquired the shares, which are all of the same class, as follows:

- on 1 September 1997, she was issued with 10,000 shares, in respect of which she obtained Income Tax relief,
- on 5 October 1998, she was issued with 5,000 shares, in respect of which she obtained both Income Tax relief and deferral relief,
- on 5 October 1998, she acquired 4,000 shares by private sale from her brother, to whom they had been issued on 1 September 1997,
- on 16 January 1999, her husband transfers 9,000 shares to her. These shares had been issued to him on 5 October 1998, and he had obtained Income Tax relief in respect of the subscription,
- on 25 November 1999, she was issued with a further 6,000 shares, in respect of which she obtained deferral relief.

No Income Tax relief had been withdrawn prior to the disposal.

For the purposes of the identification rules, the 9,000 shares that were transferred to Mary on 16 January 1999 are treated as having been acquired by her on 5 October 1998.

Following VCM23160, the relevant attributions of relief to the shares in her holding are as below, (the dates shown being those which are applicable for identification purposes).

| | 1/9/97 | 5/10/98 | 25/11/99 |
|---|---|---|---|
| a | | 4,000 | |
| b | | | 6,000 |
| c | 10,000 | 9,000 | |
| d | | 5,000 | |

The 24,000 shares that Mary disposes of are identified in the following way. First, TCGA92/SCH5B/PARA4 (3) identifies the 10,000 shares she acquired on 1 September 1997 and 14,000 of the shares she acquired (or is treated as having acquired) on 5 October 1998. TCGA92/SCH5B/PARA4 (4) is now applied to determine which 14,000 of the 5 October 1998 shares are treated as disposed of. This provision identifies the 4,000 shares to which no reliefs are attributable, 9,000 shares to which Income Tax relief (but not deferral relief) is attributable and 1,000 of the 5,000 shares to which both Income Tax relief and deferral relief are attributable.

Mary had subscribed £7,500 for the 5,000 shares that were issued to her on 5 October 1998, and in respect of that subscription she claimed deferral relief for a chargeable gain of £4,000 which accrued to her on 10 November 1998. £800 (£4,000 x 1,000 / 5,000) of the deferred gain becomes assessable on 25 May 2003 when she disposes of 1,000 of these 5,000 shares. (Details of the withdrawal of Income Tax relief are not covered in this example.)

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# Example 3

An investor subscribes £200,000 for 400,000 eligible shares in a company that are issued on 1 February 1999. These are the only shares held by him in that company. He makes a claim to set off £50,000 of the amount subscribed against a chargeable gain which accrues to him on 8 October 1997, £30,000 against a chargeable gain accruing to him on 10 December 1998, and £60,000 against a chargeable gain accruing to him on 28 December 1999. No other gains accrue to him during the period beginning with 1 February 1996 and ending with 1 February 2000, so he cannot set off the whole of the amount he subscribed for the shares against chargeable gains. On 4 April 2001, he disposes of 100,000 of the shares.

As he has disposed of a quarter of the holding, chargeable gains equal in amount to a quarter of each of the original gains accrue on 4 April 2001. So a chargeable gain of £12,500 becomes assessable in respect of the gain deferred from 8 October 1997, a chargeable gain of £7,500 becomes assessable in respect of the gain deferred from 10 December 1998 and a chargeable gain of £15,000 becomes assessable in respect of the gain deferred from 28 December 1999.

# VCM23180 - EIS: deferral relief: shares issued on or after 6 April 1998: losses

## ICTA88/S305A and ICTA88/S574

Where a loss arises on a disposal of shares to which Income Tax relief is attributable see VCM20100 onwards.

Where an allowable loss arises on a disposal of shares to which only EIS deferral relief is attributable, the investor may be able to set the loss against his or her income by making a claim under ICTA88/S574 or ITA07/S131, see VCM20130.

# VCM23190 - EIS: deferral relief: shares issued on or after 6 April 1998: who is assessable?

## TCGA92/SCH5B/PARA5

Rules are necessary to determine on whom the deferred gain should be assessed when there is a chargeable event. These rules are necessary because the original investor may have passed the shares on to their spouse or civil partner on a transfer to which TCGA92/S58 applies. If there is a chargeable event the gain is assessable on:

- the person making the disposal,
- the person who becomes non-resident,
- the person who holds the shares when they cease to be eligible.

# VCM23200 - EIS: deferral relief: shares issued on or after 6 April 1998: claims procedure

## TCGA92/SCH5B/PARA6; ICTA88/S306; ITA07/S203(1)

In order to claim deferral relief the investor will need to submit part 2 of the EIS3 (the compliance certificate) from the company in which the investment is made. This contains a claim form which the investor may use when submitting a claim (with or without a tax

return). The EIS3 form must be submitted with the deferral relief claim whether the claim is made on the tax return or separately.

Guidance on the procedure to be followed by a company to obtain forms EIS3 for issue to investors is contained at VCM14080 onwards.

Relief must not be claimed until the investor has received that form. The EIS3 form contains details of:

- the amount paid on subscription for the shares,
- the company in which the investment has been made,
- the date the shares were issued,
- the office which deals with the company and the company's tax reference,
- the chargeable gains against which deferral relief is claimed.

No deferral relief should be allowed in the absence of an EIS3 form relating to that particular investment.

When a claim is agreed, you should send a copy of the claim form (attached to an EIS3 Cover note, which is available on SEES Forms and Letters) to the office dealing with the company and retain a copy in the permanent notes folder.

On receipt of the EIS3 the office dealing with the company should check that the issue of form EIS3 has been authorised and that the details returned agree.

# VCM23210 - EIS: deferral relief: shares issued on or after 6 April 1998: individual clearance request

You may be asked by individuals or their agents to confirm in advance whether a particular investment will qualify. Note that there is no statutory clearance procedure but Inspectors should offer whatever assistance they can in response to such requests.

It is important not to give a categorical assurance that any proposed investment will qualify. That can only be judged after the investment has been made and all the relevant information is available. Inspectors should therefore give any provisional opinion only “on the basis of the information available” and subject to review if and when a claim for relief is made.

Any enquiry about the qualifying status of a particular company should not be answered. The investor should be advised to ask an officer of the company itself. The company may consult the Small Company Enterprise Centre to find out its qualifying status, see VCM14030onwards. Any advice to a taxpayer about a company may be divulging confidential information.

# VCM23220 - EIS: deferral relief: shares issued on or after 6 April 1998: share reorganisation

## TCGA92/SCH5B/PARA7 and TCGA92/S150A

It is possible for an investor to own shares which attract different types of tax relief or no tax relief at all. For share reorganisations TCGA92/SCH5B/PARA7 (1) divides the shares into three categories but does not deal with shares which attract only EIS Income Tax relief. TCGA92/S150A (6) divides the shares into three categories but does not deal with shares which attract only deferral relief. The combined effect of these provisions is to separate four categories of shares

| | Shares attracting EIS IT relief | Shares attracting deferral relief |
|---|---|---|
| (a) | X | X |
| (b) | X | Y |
| (c) | Y | X |
| (d) | Y | Y |

X indicates that the shares do not attract the relief.

Y indicates that the shares do attract the relief.

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## Bonus issues

### TCGA92/SCH5B/PARA7 (1) and TCGA92/S150A (6)

Where a taxpayer holds shares which fall within more than one of the categories (a)-(d) above and there is a bonus issue, the share reorganisation provisions apply separately to each category. The bonus issue shares are allocated pro-rata among the various categories.

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## Rights issues

### TCGA92/SCH5B/PARA7 (2) and TCGA92/S150A (7)

The normal share reorganisation rules on rights issues are disapplied if the original shares fall within categories (b), (c) or (d) or if the new shares fall within categories (b), (c) or (d) and the original shares did not. The taxpayer is treated as having acquired the new shares at the

date of the rights issue and for the amount paid for the new shares. Any shares acquired on a rights issue may qualify for EIS Income Tax relief and/or deferral relief, but a separate claim will need to be made.

# VCM23230 - EIS: deferral relief: shares issued on or after 6 April 1998: share exchanges

When an EIS company is taken over, the acquiring company may issue its own shares in exchange for the original shares.

The treatment of share exchanges where at the time of the exchange

- deferral relief has been given and not withdrawn AND
- where all income tax relief given has been withdrawn

changed where the new shares in exchange were issued on or after 22 April 2009 (TCGA92/Sch 5B/Para 9).

For share exchanges on or after that date where the above conditions are met, S135 -S137 TCGA 1992 is disapplied, so that the shares are treated as disposed of, only for the purposes of Sch 5B paras 3 and 4.

So the deferred gain comes back into charge (unless TCGA92/Sch5B/para 8 or para 9(2),(4) and (5) apply - see below) BUT the shares themselves are not treated as disposed of for other purposes of TCGA and consequently no chargeable gain or allowable loss will arise on the shares themselves at the time of the exchange.

**TCGA92/SCH5B/PARA9 (1) (before 22 April 2009) and TCGA92/S150A (8)**

Even though new shares are issued in exchange, where the shares are within categories (b) (prior to 22 April 2009) or (d) of VCM23220 there is a disposal and the deferred gain comes back into charge unless:

- the deferral relief and any EIS income tax relief given on the original shares have been withdrawn, or
- particular circumstances prevail, see below.

## Deferral relief

For shares within category (b) of VCM23220, attracting only deferral relief, there are two sets of circumstances where a share exchange is not treated as a disposal and the deferred gain does not come back into charge.

**1. TCGA92/SCH5B/PARA8**

Where:

- on or after 6 April 1998 a company, having issued only subscriber shares, acquires all the shares (and securities) in an EIS qualifying company in exchange for the proportionate issue of its own shares (and securities) of a corresponding description, see VCM23240, and
- the anti-avoidance provisions of TCGA92/S137 do not apply, see CG52505,

the share exchange is treated as not involving a disposal of the original shares, and the new shares stand in the place of the old shares in all respects and attract the same deferral relief, see example at VCM23250.

**2. TCGA92/SCH5B/PARA9 (2),(4) and (5)**

Where:

- one EIS qualifying company, that is a company which has issued one or more EIS3 certificates takes over a second EIS qualifying company, and
- the acquiring EIS qualifying company issues its own ordinary shares carrying no present or future preferential rights etc. in exchange for the original shares more than five years after the original shares were issued, or where the original shares were issued on or after 6 April 2000, on or after the termination date, see VCM23070, relating to the original shares.

TCGA92/S135 applies if its conditions are met and the anti-avoidance provisions of TCGA92/S137 do not operate, see CG52500 onwards. This is not treated as a disposal and the deferred gain will not be brought back into charge on the share exchange and there is no crystallisation of any gain or loss on the shares.

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# Income tax relief and deferral relief

For shares within category (d) of VCM23220, attracting both EIS income tax relief and deferral relief, there are two sets of circumstances where a share exchange is not treated as a disposal and the deferred gain does not come back into charge.

**1. TCGA92/S150A (8D)**

TCGA92/S150A (8D) effectively provides that where the conditions of ICTA88/S304A & ITA/S145, see below, are met, the new shares (and securities) stand in the place of the old shares (and securities) in all respects and the exchange of shares (and securities) is not treated as a disposal of the original shares (and securities). This means that the new shares which are exchanged for the old shares to which EIS income tax relief was attributable will attract the same disposal relief on a subsequent disposal as the original shares would have done. Where the conditions of ICTA88/S304A & ITA/S145 are met, category (d) shares also meet the conditions of TCGA92/SCH5B/PARA8 so that the new shares stand in the place of the old shares for EIS deferral relief purposes as well.

The conditions of ICTA88/S304A and ITA/S145 are that:

- on or after 6 April 1998 a company, having issued only subscriber shares, acquires all the shares (and securities) in an EIS qualifying company in exchange for the proportionate issue of its own shares (and securities) of a corresponding description, see VCM23240,and
- before the issue of the new shares (and securities) HMRC has notified either the old or the new company that they are satisfied that the share exchange will take place for bona fide commercial reasons and will not form part of any such scheme or arrangements as are mentioned in TCGA92/S137 (1), see CG52505.

See example at VCM23250.

**2. TCGA92/S150A (8A) - (8C)**

Where:

- one EIS qualifying company, that is a company which has issued one or more EIS3 certificates takes over a second EIS qualifying company, and
- the acquiring EIS qualifying company issues its own ordinary shares carrying no present or future preferential rights etc. in exchange for the original shares more than five years after the original shares were issued, or where the original shares were issued on or after 6 April 2000, on or after the termination date, see VCM23070, relating to the original shares.

TCGA92/S135 applies if its conditions are met and the anti-avoidance provisions of TCGA92/S137 do not operate, see CG52500 onwards. This is not treated as a disposal and the deferred gain will not be brought back into charge on the share exchange and there is no crystallisation of any gain or loss on the shares.

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# Anti-avoidance provisions of TCGA92/S137

Please note that the only matters considered by the Anti-avoidance Group (Intelligence) Clearance and Counteraction Team relate to the anti-avoidance provisions of TCGA92/S137. All other matters must be considered by the Inspector dealing with the company in the first instance with reference to Capital Gains Technical Group if the problem relates to deferral or disposal relief or CT&VAT (Technical) if the problem relates to income tax relief.

TCGA92/S150A (8) is similar to the provision in TCGA92/SCH5B/PARA9 (1).

TCGA92/S150A (8A) - (8C) are similar to the provisions in TCGA92/SCH5B/PARA9 (2), (4) and (5).

TCGA92/S150A (8D) is similar to the provision in TCGA92/SCH5B/PARA8.

# VCM23240 - EIS: deferral relief: shares issued on or after 6 April 1998: meaning of corresponding description

Corresponding description means that if the new shares (and securities) were shares (and securities) in the old company they would be of the same class and carry the same rights as the original shares (and securities). Shares (and securities) are of the same class if they would be so treated if dealt with on the Stock Exchange.

# VCM23250 - EIS: deferral relief: shares issued on or after 6 April 1998: share exchanges: example

## TCGA92/SCH5B/PARA9, ITA07/S254(2)

### Example 1- share exchange on or after 22 April 2009

An investor holds 100,000 £1 ordinary shares in X Ltd, an EIS company, that is, a company which has issued one or more EIS3 certificates. The shares cost £100,000 and he or she has, in respect of those shares, received £20,000 income tax relief and £100,000 deferral relief relating to a gain from the disposal of another asset.

On 1 May 2009 Y Ltd, a non EIS company that has been trading for some years and with 200 shares in issue, issues new £1 ordinary shares with a market value of £150,000 in exchange for all the shares in X Ltd. HMRC has given advance notification that they are satisfied that the exchange will take place for bona fide commercial reasons and will not form part of a scheme or arrangements to which TCGA92/S137 (1) would apply.

The investor is treated as disposing of the shares for the purposes of IT relief (ITA07/S254(2)) and as the disposal value multiplied by the EIS rate exceeds the relief attributable to the shares (ITA07/S209) the IT relief is withdrawn in full.

As the shares now have deferral relief but not income tax relief attributable to them, TCGA92/Sch5B/Para9(1) applies. For the purpose of TCGA92/Sch5B/para 3 and para 4 only, TCGA92/S135-S137 are disapplied and the shares are treated as disposed of. The disposal gives rise to a chargeable event for deferral relief purposes and the deferred gain of £100,000 is recovered in full.

For all other purposes of TCGA92, S135-S137 continues to apply. The investor is not treated as disposing of the shares in X Ltd. The issue of shares in Y Ltd to the investor is deemed to have taken place on the same date and for the same price as the shares in X Ltd for which they were exchanged were issued. (If the investor acquired the shares in X Ltd on a disposal

within marriage, his or her acquisition of the shares in Y Ltd is deemed to be on the same date and for the same price as the shares in X Ltd were issued.)

No chargeable gain or allowable loss on a disposal of EIS shares themselves will therefore arise at the time of the share exchange.

### Example 2- share exchange before 22 April 2009

The scenario is as example 1 but the share exchange takes place on 1 May 2008.

The IT relief is withdrawn in full as in the previous example.

As the shares now have deferral relief but not income tax relief attributable to them, TCGA92/Sch5B/Para9(1) (as it stood before FA2009) applies. TCGA92/S135-S137 are fully disapplied and the shares are treated as disposed of. The disposal gives rise to a chargeable event for deferral relief purposes and the deferred gain of £100,000 is recovered in full.

The shares are also treated as disposed of for normal CGT purposes, so a chargeable gain before reliefs of £50,000 (£150,000 - £100,000) will arise on the disposal of the shares themselves.

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## TCGA92/SCH5B/PARA8, TCGA92/S150A (8D), ICTA88/S304A & ITA/S145

### Example 3- share exchange by company with subscriber shares only

An investor holds 100,000 £1 ordinary shares in X Ltd, an EIS company, that is, a company which has issued one or more EIS3 certificates. The shares cost £100,000 and he or she has, in respect of those shares, received £20,000 income tax relief and £100,000 deferral relief relating to a gain from the disposal of another asset.

On 1 May 2009 Y Ltd, previously having only 2 subscriber shares, issues new £1 ordinary shares in exchange for all the shares in X Ltd. HMRC has given advance notification that they are satisfied that the exchange will take place for bona fide commercial reasons and will not form part of a scheme or arrangements to which TCGA92/S137 (1) would apply.

The investor is not treated as disposing of the shares in X Ltd. The issue of shares in Y Ltd to the investor is deemed to have taken place on the same date and for the same price as the shares in X Ltd for which they were exchanged were issued. (If the investor acquired the shares in X Ltd on a disposal within marriage, his or her acquisition of the shares in Y Ltd is deemed to be on the same date and for the same price as the shares in X Ltd were issued.)

The income tax and deferral reliefs are attributed to the shares in Y Ltd and are deemed to have been claimed on those shares. Any disposal relief that would have been available on the

disposal of the shares in X Ltd will become available on the subsequent disposal of the shares in Y Ltd. In addition, the information requirements on X Ltd pass to Y Ltd, see VCM23480.

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## Company reconstruction and amalgamation

Although this guidance refers specifically to share exchanges, the same principles apply to company reconstruction and amalgamation within TCGA92/S136 where appropriate. For general guidance on share exchanges and company reconstruction and amalgamation see CG52500 onwards.

# VCM23260 - EIS: deferral relief: shares issued on or after 6 April 1998: reinvestment in the same company

## TCGA92/SCH5B/PARA10

There are three restrictions that are designed, broadly, to prevent deferral relief being available in circumstances where there is a disposal and acquisition of shares in the same company, or within the same group of companies.

Firstly, expenditure on eligible shares in a qualifying company cannot be set under Schedule 5B against a gain arising on the disposal of any shares or securities of:

- that company; or
- any company which is a member of the same group of companies as that company either when the disposal occurs or when the eligible shares are issued.

The second restriction applies if the investor disposes of any shares to which deferral relief is attributable (the 'relief shares'). If the relief shares are shares in, say, company A, an investment by the investor in shares (the 'later shares') which are issued after some or all of the relief shares have been disposed of cannot be a qualifying investment for the purposes of Schedule 5B if the later shares are:

- shares in company A; or
- shares in any company which, at any time since the relief shares were issued, was a member of the same group of companies as company A.

The third restriction applies if deferral relief is attributable to any shares (the 'relief shares') the investor holds in, say, company A, and the gain in question which had been deferred arose on the disposal of shares (the 'original shares') in, say, company B. An investment by the investor in shares (the 'later shares') which are issued after the relief shares were issued cannot be a qualifying investment for the purposes of Schedule 5B if the later shares are:

- shares in company B; or
- shares in any company which was a member of the same group of companies as company B either when the original shares were disposed of or when the relief shares were issued.

# VCM23270 - EIS: deferral relief: shares issued on or after 6 April 1998: pre-arranged exits

## TCGA92/SCH5B/PARA11

Deferral relief is not available where there are arrangements, (see below for meaning of 'arrangements'), at the time of the issue of the shares, or before that time but in connection with the issue:

1. for the subsequent repurchase, exchange or other disposal of the shares or of other shares in or securities of the same company, or
2. for the cessation of any trade which is being or is to be or may be carried on by the company or a person connected with the company, or
3. for the disposal of, or of a substantial amount of, the assets of the company or of a person connected with the company, or
4. the main purpose of which, or one of the main purposes of which, is (by means of any insurance, indemnity or guarantee or otherwise) to provide partial or complete protection for persons investing in shares in that company against what would otherwise be the risks attached to making the investment.

In such cases the shares are treated as not being eligible shares so relief is not available.

The arrangements in (a) do not include any arrangement with a view to such an exchange of shares, or shares and securities, as is mentioned in TCGA92/SCH5B/PARA8, see VCM23230.

The arrangements in (b) and (c) do not include any arrangements applicable only on the winding up of a company unless:

- the arrangements, at or before the time of the issue of shares, include arrangements for the company to be wound up, or
- the company is wound up otherwise than for bona fide commercial reasons.

The arrangements in (d) do not include any arrangements if they are only to provide such protection against business risks as might reasonably be expected in normal commercial circumstances for the company itself, and/or one or more of its subsidiaries, if relevant.

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## Meaning of 'arrangements'

**TCGA92/SCH5B/PARA19**

Arrangements include any scheme, agreement or understanding, transaction or series of transactions, whether or not legally enforceable. Prior to 6 April 2012, the definition omitted reference to "transaction or series of transactions".

# VCM23280 - VCM: EIS: deferral relief: shares issued on or after 6 April 1998: put and call options

## TCGA92/SCH5B/PARA12

Where an investor subscribes for eligible shares and during the relevant period, see VCM23290, either:

1. the investor is granted a put option (being an option binding the grantor to acquire the investor's shares on particular terms), or
2. the investor grants a call option (being an option binding the investor to dispose of his shares to the grantee on particular terms),

over any of those shares, the shares to which the option relates shall be treated as:

- never having been eligible shares if the option is granted on or before the date of issue of the shares, or
- ceasing to be eligible shares on the date the option is granted if that date is after the date of issue.

The shares to which the option relates are those shares which will be treated as being disposed of when exercising the option assuming:

1. the option were exercised immediately after being granted, and
2. any shares acquired by the investor in the company after the grant were disposed of immediately after being acquired.

# VCM23290 - EIS: deferral relief: shares issued on or after 6 April 1998: meaning of relevant period

## TCGA92/SCH5B/PARA19; ICTA88/S312 (1A)(a) & ITA07/S159(2)

**For shares issued on or after 6 April 1998 and before 6 April 2000**, the relevant period is the period beginning with the incorporation of the company, or two years before the issue of the eligible shares if that is later, and ending five years after the issue of the shares.

**For shares issued on or after 6 April 2000**, the relevant period ('Period A' in ITA) is the period beginning with the incorporation of the company, or two years before the issue of the eligible shares if that is later, and ending immediately before the termination date, see VCM23070, relating to those shares.

# VCM23300 - EIS: deferral relief: shares issued on or after 6 April 1998: value received by investor

## TCGA92/SCH5B/PARA13

If an investor subscribes for shares that are eligible for deferral relief but receives value from the company within a certain period, see VCM23310, the shares are treated as:

- never having been eligible shares if the value was received on or before the date of issue of the shares, or
- ceasing to be eligible shares if the value was received after that date.

Note that the amount of the gain assessable is the whole amount. There is no apportionment of the gain brought back into charge even if only part of the value of the investment is returned. Where the investor is a trustee see also VCM23540.

There are two situations when value received on or after 7 March 2001 may be disregarded:

- when the value received is insignificant, see VCM23380,
- when the original supplier of value receives replacement value, see VCM23400.

# VCM23310 - EIS: deferral relief: shares issued on or after 6 April 1998: length of period

## TCGA92/SCH5B/PARA19; ICTA88/S291 (6) & ITA/S159(4)

**For shares issued on or after 6 April 1998 and before 6 April 2000** the period mentioned is the **seven-year period** which is that:

- beginning two years before the issue of the shares, and
- ending five years after the issue of the shares,

except that, where value is received on or after 7 March 2001, the period is reduced to the period of restriction, see below.

**For shares issued on or after 6 April 2000 and before 7 March 2001,** the seven-year period is reduced to **'the designated period'** which is that:

- beginning two years before the issue of the shares, and
- ending immediately before the termination date, see VCM23070, relating to those shares,

except that, where value is received on or after 7 March 2001, the period is reduced to the period of restriction, see below.

**For shares issued on or after 7 March 2001**, the period is **'the period of restriction' ('Period C' in ITA07)** which is that:

- beginning one year before the issue of the shares, and
- ending immediately before the termination date, see VCM23070, relating to those shares.

# VCM23320 - EIS: deferral relief: shares issued on or after 6 April 1998: meaning of receiving value and amount of value received

## TCGA92/SCH5B/PARA13 (2), (4) and (5)

An investor receives value from the company if the company:

- Repays, redeems or repurchases any of the investor's shares or securities in the company, or if it makes any payment to him for giving up his right to any shares or securities.
- Repays, carrying out any arrangements for or in connection with the acquisition of the shares, any debt owed to the investor other than a debt which was incurred by the company:
    - 
    - on or after the date the shares were issued, and

- which was not a replacement of a debt incurred before that date.

(For shares issued prior to 17 March 2004 the debt referred to above is any which was incurred by the company on or after the date the shares were subscribed for. The date of subscription also applies where the debt was incurred before 17 March 2004 and the share subscription took place before that date but the shares were issued on or after 17 March 2004.)

- Makes any payment to the investor for giving up his right to any debt.
- Releases or waives any liability of the investor to the company or discharges, or undertakes to discharge, any liability of his to a third party. A release or waiver is treated as occurring if the liability is not discharged within 12 months of the time when it ought to have been discharged.
- Makes a loan or advance to the investor which has not been repaid in full before the issue of the shares. This includes any debt (other than an ordinary trade debt, see VCM23330) incurred by the investor to the company and the amount of any debt due from the investor to a third party which has been assigned to the company.
- Provides a benefit or facility for the individual.
- Disposes of an asset to the investor at less than market value.
- Acquires an asset from the investor at more than market value.
- Makes any payment to the investor which is not a qualifying payment, see VCM23340.

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# TCGA92/SCH5B/PARA13 (5)

## Other value received

An investor receives value from the company if a person connected (within the meaning of ICTA88/S291A) & Chapter 2 of Part 5 ITA07) with the company, or with a 51% subsidiary of the company, see VCM11050 onwards (ICTA88/S291):

- purchases any of the shares or securities of the company which belong to the investor, or
- makes any payment to him for giving up any right over such shares or securities.

This rule prevents investors from becoming eligible for more relief than would otherwise be available to them. Without the rule, investors could sell any shares in a company on which they have not had relief to shareholders who are connected with the company. Note that the rule applies whether the sale of shares precedes or follows the subscription for the shares on which relief is claimed, and applies to any types of share capital or securities, for example, preference shares or debentures.

**Example**

Company A, an EIS company, has total share capital of 40,000 £1 ordinary shares, X holds 24,000 shares with Y and Z holding 8,000 shares each.

Y and Z sell their shares to X at par and on the following day Y and Z subscribe for a further 20,000 £1 shares at par. The company thus obtains £40,000 but £16,000 of it has effectively come from X.

As there has been a return of value within TCGA92/SCH5B/PARA13 (5) to Y and Z the new shares are not eligible shares and no deferral relief is due.

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## TCGA92/SCH5B/PARA13A (1)

### Amount of value received

The value received by an investor is quantified as shown below.

For value received within:

| | |
|---|---|
| a, b or c of Para 13A(1) | the amount received or, if greater, the market value of the shares, securities or debt in question. |
| d of Para 13A(1) | The amount of the liability. |
| e of Para 13A(1) | The amount of the loan or advance reduced by the amount of any repayment made before the issue of the shares. |
| f of Para 13A(1) | The cost to the company of providing the benefit or facility less any consideration given for it by the individual. |
| g or h of Para 13A(1) | The difference between the market value of the asset and the consideration (if any) given for it. |
| i of Para 13A(1) | The amount of the payment. |
| TCGA92/SCH5B/PARA13 (5) | The amount received or, if greater, the market value of the shares or securities in question. |

# VCM23330 - EIS: deferral relief: shares issued on or after 6 April 1998: meaning of ordinary trade debt

## TCGA92/SCH5B/PARA13 (11)

An ordinary trade debt is defined as any debt for goods or services supplied in the ordinary course of a trade or business where any credit given does not exceed six months and is not longer than that normally given to customers of the person carrying on the trade or business.

# VCM23340 - EIS: deferral relief: shares issued on or after 6 April 1998: meaning of qualifying payment

## TCGA92/SCH5B/PARA13 (7)

Qualifying payments are defined as:

1. Payment of any remuneration, provided that the remuneration is reasonable in relation to the employee's duties.
2. Reimbursement of expenses incurred wholly, exclusively and necessarily as an employee.
3. Payment of any interest which is at a reasonable commercial rate.
4. Payment of normal dividends or other distributions.
5. Payment for supply of goods which is not in excess of their market value.
6. Payment for the acquisition of an asset which does not exceed its market value.
7. Payment of rent which does not exceed a reasonable commercial rate.
8. Payment of remuneration which is reasonable and necessary for services rendered, and which is taken into account in computing Case I or II profits of the business in question.
9. Payment to discharge an ordinary trade debt, see VCM23330.

# VCM23350 - EIS: deferral relief: shares issued on or after 6 April 1998: qualifying benefits

## TCGA92/SCH5B/PARA13 (9)

The provision of a benefit or facility is treated as a receipt of value by the investor unless a cash payment equivalent to the value of the benefit would have been a qualifying payment, see VCM23340. Qualifying payments include reasonable remuneration to employees so if the investor is an employee and receives benefits from the company he will not be treated as receiving value provided that the benefits are part of a reasonable remuneration package. If the benefits are not reasonable by reference to the duties of the employment there will be a receipt of value and the shares will not be eligible for relief. As a result the deferred gain comes back into charge, see VCM23300.

# VCM23360 - EIS: deferral relief: shares issued on or after 6 April 1998: indirect receipt by investor

## TCGA92/SCH5B/PARA13 (10)

An investor receives value if a relevant payment or disposal is made to him indirectly or to his order or for his benefit.

Any reference to an individual in TCGA92/SCH5B/PARA13 includes a reference to any associate of the individual's, see VCM23370.

Any reference to a company within TCGA92/SCH5B/PARA13 includes a reference to a person who at any time in the relevant period is connected (within the meaning of TCGA92/S286, see CG14620) with the company, whether or not the connection exists at the date of the receipt.

# VCM23370 - EIS: deferral relief: shares issued on or after 6 April 1998: meaning of associate

## TCGA92/SCH5B/PARA19 (1)

Associate has the meaning given to it by ICTA88/S417 (3) and (4) & ITA07/S253, see CTM60150, except that brothers and sisters are not included as relatives.

# VCM23380 - EIS: deferral relief: shares issued on or after 6 April 1998: receipts of insignificant value

## TCGA92/SCH5B/PARA13A (2), (3), (4) & (5), TCGA92/SCH5B/PARA13 (1B)

A receipt of value on or after 7 March 2001 will not cause shares to be treated as never having been eligible shares or as ceasing to be eligible shares where the amount received is an amount of insignificant value.

An amount of insignificant value means an amount of value which:

- does not exceed £1,000, or
- if it exceeds £1,000, is insignificant in relation to the aggregate amount of gains deferred in respect of the total expenditure on the shares. (For the purpose of this test, 'insignificant' should be given its dictionary meaning of 'trifling or completely unimportant').

But, an amount of value cannot be treated as insignificant if any arrangements exist in the period starting one year before the shares were issued and ending at the end of the issue date, which provide for:

- the investor, or
- a person who, at any time in the period of restriction, see VCM23310, relating to the shares, is an associate of the investor (whether or not he is an associate at the time of the receipt of value),

to receive, or to be entitled to receive, any value at any time in the period of restriction relating to the shares from:

- the company that issued the shares, or
- a person who, at any time in the period of restriction relating to the shares is connected with the company (whether or not the connection exists at the time of the receipt of value).

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## TCGA 92/SCH5B/PARA13 (1B)

Special rules apply where an investor receives value from the company (the relevant receipt) and, during the period of restriction relating to the shares, has previously received one or more receipts of insignificant value (the earlier receipt(s)). In such cases the amounts of the relevant receipt and the earlier receipt(s) are added together. If the aggregate amount is not an amount of insignificant value, the investor is treated for deferral relief purposes as though the amount of the relevant receipt were equal to the aggregate amount. Once a receipt of insignificant value has been used in this way to increase the amount of a relevant receipt it is ignored in relation to any further receipts of value. References to the investor include anyone who is an associate of the investor, see VCM23370, and the reference to the company includes any person who is connected with the company (whether or not the connection exists at the time of the receipt of value).

# VCM23390 - EIS: deferral relief: shares issued on or after 6 April 1998: receipts of insignificant value: examples

## Example 1

An investor makes a subscription of £30,000 for shares in X Ltd which were issued to him on 1 June 2001. X Ltd commenced trading on 1 January 2001.

He claims and is granted deferral relief in respect of a gain of £30,000 accruing to him on 1 December 2000.

The period of restriction relating to the shares in X Ltd is the period from 1 June 2000 up to and including 31 May 2004.

The investor receives value from X Ltd as follows:

1 October 2001 £200
1 February 2002 £250
1 May 2003 £650

The value received on 1 October 2001 is an amount of insignificant value as it does not exceed £1,000.

The aggregate of the relevant receipt on 1 February 2002 and the earlier receipt on 1 October 2001 (which fell within the period of restriction in relation to the shares) is £450. As this amount does not exceed £1,000 the value received on 1 February 2002 is an amount of insignificant value.

The aggregate of the relevant receipt on 1 May 2003 and the earlier receipts on 1 October 2001 and 1 February 2002 (both of which fell within the period of restriction relating to the shares) is £1,100. As this amount exceeds £1,000 and is not insignificant in relation to the deferred gain, the aggregate is not an amount of insignificant value and the investor is treated as receiving value of £1,100 on 1 May 2003. Therefore the shares issued on 1 June 2001 will be treated as ceasing to be eligible shares on 1 May 2003 unless replacement value is received, see VCM23400.

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# Example 2

An investor makes a subscription of £20,000 for shares in Y Ltd which were issued to her on 1 September 2001. Y Ltd commenced trading on 1 October 1999.

She claims and is granted deferral relief of £20,000 in respect of a gain of £40,000 accruing to her on 1 January 2001.

The period of restriction relating to the shares issued on 1 September 2001 is the period from 1 September 2000 up to and including 31 August 2004.

She makes a further subscription of £15,000 for shares in Y Ltd which were issued to her on 1 February 2002.

She claims and is granted deferral relief in respect of a gain of £15,000 accruing to her on 1 November 2001.

The period of restriction relating to the shares issued on 1 February 2002 is the period from 1 February 2001 up to and including 31 January 2005.

The investor receives value from Y Ltd as follows:

1 December 2001 £100
1 June 2002 £500
1 February 2003 £450

**Shares issued on 1 September 2001**

The value received on 1 December 2001 is an amount of insignificant value as it does not exceed £1,000.

The aggregate of the relevant receipt on 1 June 2002 and the earlier receipt on 1 December 2001 (which fell within the period of restriction relating to the shares issued on 1 September 2001) is £600. As this amount does not exceed £1,000 the value received on 1 June 2002 is an amount of insignificant value.

The aggregate of the relevant receipt on 1 February 2003 and the earlier receipts on 1 December 2001 and 1 June 2002 (which fell within the period of restriction relating to the shares issued on 1 September 2001) is £1,050. As this amount exceeds £1,000 and is not insignificant in relation to the deferred gain, the aggregate is not an amount of insignificant value, and the investor is treated as receiving value of £1,050 on 1 February 2003. Therefore, the shares issued on 1 September 2001 will be treated as ceasing to be eligible shares on 1 February 2003 unless replacement value is received, see VCM23400.

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# Shares issued on 1 February 2002

The value received on 1 December 2001 is an amount of insignificant value as it does not exceed £1,000.

The aggregate of the relevant receipt on 1 June 2002 and the earlier receipt on 1 December 2001 (which fell within the period of restriction relating to the shares issued on 1 February 2002) is £600. As this amount does not exceed £1,000 the value received on 1 June 2002 is an amount of insignificant value.

The aggregate of the relevant receipt on 1 February 2003 and the earlier receipts on 1 December 2001 and 1 June 2002 (which fell within the period of restriction relating to the shares issued on 1 February 2002) is £1,050. As this amount exceeds £1,000 and is not insignificant in relation to the deferred gain, the aggregate is not an amount of insignificant value and the investor is treated as receiving value of £1,050 on 1 February 2003. Therefore,

the shares issued on 1 February 2002 will be treated as ceasing to be eligible shares on 1 February 2003 unless replacement value is received, see VCM23400.

**Note that**, where a receipt of value falls within periods of restriction relating to more than one share issue, the rules do not provide for an apportionment of the amount received. The amount of the receipt must be considered in relation to each separate issue. If the amount received exceeds £1,000 and is not insignificant in relation to the deferred gains the investor has received an amount of value which is not insignificant in relation to each share issue.

# VCM23400 - EIS: deferral relief: shares issued on or after 6 April 1998: replacement value: receipt of

## TCGA92/SCH5B/PARA13 (1A), TCGA92/SCH5B/PARA13B (1)-(3) and TCGA92/SCH5B/PARA13C (1) - (4)

A receipt of value (the original value) during the period of restriction relating to an issue of shares, see VCM23310, is disregarded and, consequently, will not cause the shares to be treated as never having been eligible shares or as ceasing to be eligible shares where all the following conditions are satisfied:

- the shares were issued on or after 7 March 2001 or, where the shares were issued before that date, the original value was received on or after 7 March 2001, and
- the original value was received in any of the circumstances described in VCM23320, except for value received in connection with the repayment of a debt within (b) of TCGA92/Sch5B/Para 13(2), as described in the second bullet of VCM23320, and
- the person from whom the original value was received (the original supplier) receives replacement value in the form of a qualifying receipt, see VCM23410, from the person who received the original value (the original recipient), and
- the amount of the replacement value is not less than the amount of the original value, and
- the receipt of replacement value is not disregarded (see below).

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## TCGA92/SCH5B/PARA13C (1)-(3)

The replacement value does not have to be received after the receipt of the original value. But, the receipt of replacement value is disregarded to the extent to which it has been used on a previous occasion to disregard an amount of value received by the investor in relation to any shares subscribed for by him.

In addition, the receipt of replacement value is disregarded in the following circumstances:

- where the receipt of replacement value occurs before the start of the period of restriction relating to the shares, or
- where the receipt of replacement value occurs after the receipt of the original value but does not take place as soon after that time as is reasonably practicable in the circumstances of the case, or
- where an appeal has been made against an assessment made to revive a gain by reason of a receipt of value and the receipt of replacement value occurs more than 60 days after that appeal has been finally determined.

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## TCGA92/SCH5B/PARA13C (3) & (4)

Where the event which gives rise to the receipt of replacement value is or includes a subscription for shares by:

- the investor, or
- a person who, at any time in the period of restriction is an associate of the investor, see VCM23370, whether or not he is an associate at the time of the receipt of that replacement value,

the person who subscribes for the shares shall not be:

- eligible for EIS income tax relief, or
- treated as making a qualifying investment for the purposes of EIS deferral relief,

in relation to those shares or any other shares in the same issue.

# VCM23410 - EIS: deferral relief: shares issued on or after 6 April 1998: replacement value: meaning of qualifying receipt

## TCGA92/SCH5B/PARA13B (4) & (5)

A receipt of replacement value is a qualifying receipt if it arises:

1. by reason of the original recipient:

1.
    1. making a payment to the original supplier, see VCM23400, (but see the exceptions below); and/or
    2. acquiring any asset from the original supplier for a consideration which exceeds the market value of the asset; and/or
    3. disposing of any asset to the original supplier for no consideration or for a consideration which is less than the market value of the asset;

2. where the original value was within (d) of VCM23320, by reason of an event which reverses the event which constituted the receipt of the original value;
3. where the original value was within TCGA92/SCH5B/PARA13 (5) (see VCM23320) by reason of the original recipient (see VCM23400)

    - 
    - repurchasing the share capital or securities in question, or
    - reacquiring the right in question
    - for a consideration which is not less than the amount of the original value.

**Exceptions to (a)(i) above**

The following payments do not fall within (a)(i) above:

- payments within (c) above;
- payments for any goods, services or facilities provided (whether in the course of a trade or otherwise) by:

1.
    1. the original supplier, or
    2. any other person, who at any time in the period of restriction relating to the shares for which the investor subscribed, see VCM23400, is an associate of or is connected with that supplier (whether or not that person is an associate or is connected at the time of the payment),

- which is reasonable in relation to the market value of those goods, services or facilities;
- any payment of any interest which represents no more than a reasonable commercial return on money lent to:

1.
    1. the original recipient, or
    2. any person who, at any time in the period of restriction relating to the shares for which the investor subscribed, is an associate of the original recipient (whether or not he is such an associate at the time of the payment);

- any payment for the acquisition of an asset which does not exceed its market value;
- any payment, as rent for any property occupied by:

1.
    1. the original recipient, or
    2. any person who, at any time in the period of restriction relating to the shares for which the investor subscribed, is an associate of the original recipient (whether or not he is such an associate at the time of the payment),

- of an amount not exceeding a reasonable and commercial rent for the property;
- any payment in discharge of an ordinary trade debt (see VCM23330);
- any payment for shares in or securities of any company in circumstances that do not fall within (a)(2) above.

# VCM23420 - EIS: deferral relief: shares issued on or after 6 April 1998: replacement value: amount of

## TCGA92/SCH5B/PARA13B (6)

The amount of the replacement value is:

a. In a case within VCM23410 (a), the aggregate of:

- the amount of any payment within VCM40550 (a)(i), and
- the difference between the market value of any asset within VCM40550 (a)(ii) or (iii) and the amount or value of the consideration (if any) received for it.

b. In a case within VCM23410 (b), the same as the amount of the original value, see VCM23320, and

c. In a case within VCM23410 (c) the amount or value of the consideration received by the original supplier.

# VCM23430 - EIS: deferral relief: shares issued on or after 6 April 1998: replacement value: indirect receipt of

## TCGA92/SCH5B/PARA13B (7)

The original recipient receives replacement value if a payment is made to that person indirectly or to his order or for his benefit.

# VCM23440 - EIS: deferral relief: shares issued on or after 6 April 1998: value received by another person

## TCGA92/SCH5B/PARA14

If value is received by another person, the shares are treated as never having been eligible shares or, if the value is received after the shares are issued, as ceasing to be eligible at the later date.

Value is received by another person if, within a certain period, see VCM23400, the company or any subsidiary:

1. repays, redeems or repurchases any of its share capital which belongs to any member other than:

    - 
    - the investor, or
    - another investor who, because of the repayment, redemption, repurchase, or payment within (b) below, has a qualifying chargeable event or has any EIS Income Tax relief withdrawn by virtue of ICTA88/S299 or ITA07/S209, see VCM15015, or ICTA88/S300(2)(a) or ITA07/S216(2)(a), see VCM15050 (i), (or who would have had a qualifying chargeable event or have had any EIS Income Tax relief withdrawn on account of the repayment, redemption, repurchase or payment in question but did not because it constituted a receipt of insignificant value for deferral relief purposes, see VCM23380, or Income Tax relief purposes, see VCM15040), or
    - (for shares issued on or after 1 April 2000), a company which, because of a disposal of shares or repayment, redemption, repurchase or payment within (b) below, has any investment relief withdrawn by virtue of FA00/SCH15/PARA46 or PARA49 (1)(a) (or which would have had any investment relief withdrawn on account of the repayment, redemption, repurchase or payment in question but did not because it constituted a receipt of insignificant value for the purposes of FA00/SCH15/PARA47).

2. makes any payment (directly or indirectly) to any such member, or to his or her order or for his or her benefit, for the giving up of his right to any of the share capital in the company or subsidiary on its cancellation or extinguishment.

In certain circumstances, see VCM23460, an amount of value received by another person is disregarded if the amount received is insignificant.

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# Exception - TCGA92/SCH5B/PARA14 (5)

The rules in paragraph 14 do not apply where a company issues share capital of £50,000 (the minimum amount permitted under the Companies Act) and any of it is redeemed within 12 months of the date of its issue. (Where a holder of shares which are redeemed in these circumstances has obtained relief on other shares, this exception does not prevent the loss of that relief by virtue of TCGA92/SCH5B/PARA13 (1)(b) and (2)(a)).

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## Meaning of qualifying chargeable event - TCGA92/SCH5B/PARA14 (4)

A repayment, redemption or repurchase of share capital to another investor gives rise to a qualifying chargeable event in respect of him if it causes a gain that has been deferred under the EIS to accrue to him.

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## Meaning of subsidiary - TCGA92/SCH5B/PARA14 (7)

References in paragraph 14 to a subsidiary of a company are references to a company which at any time in the relevant period is a 51% subsidiary of the first mentioned company, whether or not it is such a subsidiary at the time of the repayment, redemption, repurchase or payment in question.

# VCM23450 - EIS: deferral relief: shares issued on or after 6 April 1998: return of value to be disregarded

## TCGA92/SCH5B/PARA14A

Where an investing company has its investment relief withdrawn or reduced by reason of a repayment being received by another member of the company, (FA00/SCH15/PARA56 (2)), the circumstances may result in gains deferred under the EIS being revived. In certain circumstances these repayments are disregarded for the purposes of the EIS.

The conditions are that the 'the relevant amount' must not exceed £1,000 and there must have been no 'repayment arrangements' in existence at any time in the period beginning one year before the issue of the shares (on which investment relief is withdrawn or reduced) and ending at the end of the issue date.

'The relevant amount' is calculated using the formula:

X - 5Y where:

X = the amount of the repayment,

Y = the aggregate amount of the investment relief withdrawn by reason of the repayment.

'Repayment arrangements' means arrangements that provide for a repayment by the issuing company (or any subsidiary of that company), or for anyone to be entitled to such a repayment, at any time. This applies whether or not the subsidiary referred to was such a subsidiary at the time of the repayment or when the arrangements were made.

'Subsidiary' has the meaning in TCGA92/SCH5B/PARA14 (7), see VCM23440

# VCM23460 - EIS: deferral relief: shares issued on or after 6 April 1998: value received by another person: insignificant amounts

## TCGA92/SCH5B/PARA14AA

A repayment, redemption, repurchase or payment received by another person, see VCM23440, will not cause the shares to be treated as never having been eligible shares or as ceasing to be eligible shares if:

- the shares were issued on or after 7 March 2001 or, where the shares were issued before 7 March 2001, the repayment, redemption, repurchase or payment was made on or after 7 March 2001, and
- the repayment, redemption, repurchase or payment is insignificant.

A repayment, redemption, repurchase or payment is insignificant if the greater of:

- the market value of the shares to which it relates (the target shares) immediately before the event, and
- the amount received by the other person,

is insignificant in relation to the market value of the remaining issued share capital of the company (or, as the case may be, the subsidiary in question of that company) immediately after the repayment, redemption, repurchase or payment occurs.

'Insignificant' should be given its dictionary meaning of 'trifling, or completely unimportant'.

For the purposes of this test the target shares are treated as having been cancelled at the time the repayment, redemption, repurchase or payment occurs.

But, a repayment, redemption, repurchase or payment cannot be treated as insignificant if any arrangements exist in the period starting 1 year before the shares for which the investor subscribed were issued and ending at the end of the issue date, which provide for:

- a repayment, redemption, repurchase or payment, or
- for anyone to be entitled to such a repayment, redemption, repurchase or payment,

by

- the company, or
- any subsidiary of the company (whether or not it is a subsidiary at the time the arrangements are made),

at any time in the period of restriction, see VCM23310, in relation to the eligible shares.

'Subsidiary' has the meaning in TCGA92/SCH5B/PARA14 (7), see VCM23440.

# VCM23470 - EIS: deferral relief: shares issued on or after 6 April 1998: investment-linked loans

## TCGA92/SCH5B/PARA15

If an investor subscribes for shares which are eligible for deferral relief and he or she (or any associate) receives an investment-linked loan within the relevant period, see VCM23290, the shares are treated as:

- never having been eligible shares if the loan is made on or before the date of issue of the shares, or
- ceasing to be eligible shares if the loan is made after that date.

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## Meaning of Investment-linked loan

A loan is investment-linked if it would not have been made, or would not have been made on the same terms, were it not for the EIS investment.

For these purposes the giving of any credit to the investor and the assignment of any debt from the individual to the lender are both treated as the making of a loan.

When considering investment-linked loans, any reference to an investor includes a reference to an associate, see VCM23370, of his.

Where the investor is a trustee, see VCM23540.

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## Statement of Practice

Our interpretation of this provision is given in SP6/98 - which replaces SP3/94, the text of which is reproduced at VCM11030.

# VCM23480 - EIS: deferral relief: shares issued on or after 6 April 1998: information requirements

## TCGA92/SCH5B/PARA16

The legislation provides for the Inspector to be notified in writing where any event occurs which brings a deferred gain back into charge, see VCM23110.

The investor has to notify HMRC within 60 days if:

- the eligible shares are disposed of, other than a disposal within marriage, within five years of the issue of those shares (where the shares are issued on or after 6 April 1998 and before 6 April 2000),
- the investor, or a person who has acquired the shares from the investor on a no gain/no loss transfer from their spouse or civil partner, becomes non-resident within that period,
- the shares cease to be eligible as:

1.
    1. an option has been granted over them, see VCM23280,
    2. the investor (or any associate) has received value from the company, (or any person connected with it), see VCM23300. A notification must be given even if the effect of a receipt of value is disregarded by virtue of a receipt of replacement value, see VCM23400 onwards. But, where replacement value has been, or is expected to be, received by the original supplier of value, the notification should include particulars of that receipt or expected receipt.
    3. the investor (or any associate) receives an investment-linked loan, see VCM23470.

**For shares issued on or after 6 April 2000**, the five year period is reduced to the period beginning with the issue of the shares and ending immediately before the termination date, see VCM23070, relating to them.

Similar requirements are placed on the company, and any person connected with the company who has knowledge of the matter.

Notification has to be sent to HMRC within 60 days if:

1. the shares cease to be eligible shares because:

    - 
    - an event occurs which causes the company not to be a qualifying company;
    - the requirements of ICTA88/S289 (1A) or ITA/S183(1) cease to be satisfied, see VCM13080;

- investors, or their associates, receive value from the company or any person connected with it; a notification must be given even if the effect of the receipt of value is disregarded by virtue of a receipt of replacement value, see VCM23400 onwards; but where replacement value has been, or is expected to be, received by the original supplier of value, the notification should include particulars of that receipt or expected receipt;
- any payment, repayment, redemption, or repurchase falling within TCGA92/SCH5B/PARA14 (1) is made, see VCM23440; or

2. the money raised by the share issue, or, as the case may be, 80% of it, is not used within the time limit in question, see VCM23020 (g) and (h), and the company has issued an EIS3 certificate to anyone who subscribed for shares in the issue.

In the case of a connected person, the 60 day period runs from the date of that person coming to know of the event.

# VCM23490 - EIS: deferral relief: shares issued on or after 6 April 1998: Inspector's power to require information

## TCGA92/SCH5B/PARA16 (5)

If an officer of HMRC has reason to believe that a person:

- has failed to give notice of an event which removes the entitlement to relief, or
- has given or received value which, but for the fact that the amount received was insignificant, see VCM23380, would have triggered a requirement to give a notice under TCGA92/SCH5B/PARA16 (1) or (2), see VCM23480, or
- has made or received any payment, repayment, redemption or repurchase falling within TCGA92/SCH5B/PARA14 (1), see VCM23440, which, but for the fact that the amount received was insignificant, see VCM23460, would have triggered a requirement to give a notice under TCGA92/SCH5B/PARA16 (2), see VCM23480,

they may, by notice in writing, require that person to furnish them with such information relating to any event as they may reasonably require. The time limit allowed for furnishing the information must not be less than 60 days. Formal notices should be issued only where informal requests for information have produced no, or an inadequate, response. Speculative notices should not be issued and any information required under a notice must be confined to matters that may cause the withdrawal of relief.

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## Avoidance - TCGA92/SCH5B/PARA16 (6)

If an Inspector has reason to believe that any investor is claiming relief in circumstances where:

- the shares are subscribed for and issued for tax avoidance purposes, see VCM23020 (d),
- the shares are subscribed for in circumstances where there are arrangements to achieve a pre-arranged exit, see VCM23270,
- the shares are shares in a company which is controlled by another company or which controls another company which is not a qualifying subsidiary, see VCM13130,
- arrangements exist for a subsidiary of the company which issued the shares to cease to meet the conditions for it to be a qualifying subsidiary of that company, see VCM13130.
- Or (in the case of shares issued on or after 17 March 2004) that after the shares are issued:
- there is a scheme or arrangement that could cause the company to cease to be a qualifying subsidiary of a qualifying company,
- the company or its subsidiary takes any of the following actions as part of a scheme or arrangement the main purpose of which or one of the main purposes of which is the avoidance of tax,
- it enters into administration or receivership or carries out actions as a result of being in administration or receivership,
- it is wound up or dissolved without being wound up,

and that as a result:

- the company would not be a qualifying company, (see VCM23060), or
- the requirements of ICTA88/S289(1A) or ITA07/S183(1) would fail to be met (see VCM13080), or
- the requirement that the trade or research and development which is funded by the issue of the shares is carried on for a minimum period of four months would not be met (see VCM12060), or
- a subsidiary which is required to be a qualifying 90% subsidiary of the company would cease to be such a subsidiary (see VCM13080),

There is provision for an officer to request, by notice in writing, information on the precise circumstances of the share issue or the scheme or arrangement. The time limit allowed for furnishing the information must not be less than 60 days.

Notices requesting information can be issued to:

- The claimant (in cases (a), (b), (f) above).
- The company (in cases (a) to (f) above).
- Any person controlling the company (in all cases apart from (b) above).
- Any other company in question, or any person controlling such a company (in cases falling within (f) above).

A report should be made to Capital Gains Tax Technical Group before such a notice is issued.

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## Shareholdings - TCGA92/SCH5B/PARA16 (9)

Where any relief has been claimed an Inspector may require any person who holds or has held eligible shares in the qualifying company, and any person on whose behalf any such shares are or were held, to state whether these are or were held on behalf of someone else and, if so, to give the name and address of that person.

This provision enables an Inspector to obtain the name and address of the beneficial owner of the eligible shares, not only where they are held in the name of a nominee but also where they are held through a series of nominees. Any notice requiring such information should normally be served by the Inspector dealing with the company's affairs.

An Inspector is not precluded by the obligation to secrecy from disclosing to a qualifying company, in the course of exercising the power to require information, that relief has been claimed or given in respect of any of its shares. Care should be taken not to disclose whose subscriptions have been the subject of relief.

# VCM23500 - EIS: deferral relief: shares issued on or after 6 April 1998: procedure where relief is no longer due

Where the officer of HMRC dealing with the affairs of a company becomes aware of circumstances which indicate that deferral relief is no longer due in respect of shares which it has issued, he or she will need to notify the offices dealing with the individuals concerned. The offices can be identified from forms EIS4, see VCM23200.

The notification will need to include details of:

- the reason why the relief is no longer due and the date of the event,
- the amount of deferral relief no longer due,
- the year in which the shares to which the relief relates were issued.

# VCM23510 - EIS: deferral relief: shares issued on or after 6 April 1998: trustees

## TCGA92/SCH5B/PARA17

For the purposes of deferral relief any reference to an individual investor includes a reference to the trustees of a settlement and the reference to any asset within TCGA92/SCH5B/PARA1

(1), see VCM23010, includes a reference to any asset comprised in any settled property to which TCGA92/SCH5B/PARA17 applies.

EIS Income Tax relief and CGT disposal relief, see VCM20000 onwards, are not available to trustees.

The interests of the beneficiaries do not have to be interests in possession. However, relief may not be available if the beneficiaries' interests alter between the time of the relevant disposal and the time of the relevant share acquisition. Also, the amount of the chargeable gain eligible for deferral relief will be restricted unless the beneficiaries are all individuals. When considering beneficiaries, references to individuals include any charity, see CG67501.

# VCM23520 - EIS: deferral relief: shares issued on or after 6 April 1998: trustees: basis of restriction

The flow chart below summarises how to calculate the proportion of the chargeable gain arising to trustees which is eligible for deferral relief.

The flow chart describes the consequences of the legislation. The process followed by the legislation is complex. Where at least one individual has an interest in possession, all the other interests in the settlement are treated as another interest in possession. If any of the beneficiaries without an interest in possession, whether entitled to capital or income, is not an individual, then that deemed interest in possession is treated as held by a non-individual, otherwise it is treated as held by an individual.

Where there is an actual interest in possession at both the disposal date and the acquisition date, you look at the percentage of the income to which individual holders of interests in possession are entitled, including the deemed interest in possession. Provided the percentage is higher at the acquisition date, relief is due on the percentage share at the disposal date.

If there is an actual interest in possession at the acquisition date and none at the disposal date, or vice-versa, no relief is due.

Examples are at VCM23530.

Flow chart

## Trust as beneficiary

If an interest in a trust is held by a second trust you should look through to the beneficiaries of the second trust in order to determine the portion of the chargeable gains eligible for deferral relief.

# VCM23530 - EIS: deferral relief: shares issued on or after 6 April 1998: trustees: examples

The following examples illustrate how the proportion of the gain eligible for deferral relief is calculated for disposals by trustees. In all the examples A, B, C and D are individuals; X and Y are companies.

## Example 1

Settled properties are held on an accumulation and maintenance trust for the benefit of A, B and C. Each of them will become absolutely entitled to one third of the settled property on reaching age 18. If any of the beneficiaries dies before age 18, D becomes absolutely entitled to their share of the settled property.

As all the beneficiaries are individuals all chargeable gains arising on disposals by the trustees will be eligible for deferral relief.

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## Example 2

This is an accumulation and maintenance trust of a different kind. A, B and C are each entitled to one third of the property, if alive, on their 25th birthday. If none reaches the age of 25, D gets the property. They are entitled to their share of the income, and therefore have an interest in possession, from their 18th birthday. An asset is sold just before the oldest, A reaches his 18th birthday. Therefore at that date there was no interest in possession. If the trustees acquire qualifying shares after A's 18th birthday relief is still due, because although there is now an interest in possession it is for a fixed period, up to A's 25th birthday.

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## Example 3

A is entitled to 35% of the income of the settlement. The remainder is held on discretionary trusts for B, C and D. The trustees have power to appoint capital to A, B, C and D. The default trust is in favour of X, the local football club, which is not an individual or charity. The process is that we have a real interest in possession held by A and a deemed interest in possession held by a company. Therefore 35% of the gains are eligible for relief.

# VCM23540 - EIS: deferral relief: shares issued on or after 6 April 1998: trustees: anti-avoidance

## TCGA92/SCH5B/PARA18

TCGA92/SCH5B/PARA13 and PARA15, see VCM23300 onwards and VCM23470, apply where the investor is a trustee as if references to the investor included:

- the trustees themselves,
- any beneficiary (individual or charity) who has an interest in the property at a relevant time which qualifies for deferral relief, see VCM23510,
- any associate, see VCM23370, of such an individual, or any person connected with such a charity.

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## Meaning of relevant time

For the purposes of TCGA92/SCH5B/PARA18 the relevant times are the date the shares are issued, and

- the time when the value is received, even if its effect is disregarded because it is an amount of insignificant value, see VCM23300 onwards, or
- in a case where the effect of a receipt of value is disregarded because of a receipt of replacement value, see VCM23400 onwards, the time when the original value is received, or
- the time when the loan is made, see VCM23470.

# VCM25000 - EIS: taper relief for serial investments: contents

**Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008**

# VCM25010 - EIS: taper relief for serial investments: introduction: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

## TCGA92/S150D and TCGA92/SCH5BA

FA99/S72 and FA99/SCH7 introduced new rules which, in specific circumstances, allow an extension of the qualifying holding period for taper relief purposes. This extension benefits serial EIS investors by allowing a greater amount of taper relief against a deferred gain which is revived (otherwise known as a gain brought back into charge) on the final disposal. The extension can apply only where the shares in the first EIS company were issued after 5 April 1998 and disposed of after 5 April 1999.

Further detail on the meaning of qualifying holding period is at CG17900 onwards.

# VCM25020 - EIS: taper relief for serial investments: qualifying gains: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

### TCGA92/SCH5BA/PARA1

Taper relief can apply on a cumulative basis if the whole or part of a chargeable gain is deferred under the EIS and the gain has accrued on the disposal of shares to which EIS deferral relief or Income Tax relief (or both) was attributable at the date of disposal. It is only the chargeable gain which accrues on account of the increase in value of the shares over the period they were held which can qualify for cumulative taper relief. The chargeable gain must then be deferred under TCGA92/SCH5B because qualifying expenditure on shares in a second EIS company is set against it, see example at VCM25080.

# VCM25030 - EIS: taper relief for serial investments: extended qualifying holding period: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

### TCGA92/SCH5BA/PARA3

If the whole or part of the deferred gain is revived because of a disposal of shares in the second company, the qualifying holding period which applies in relation to the gain for taper relief purposes is treated as beginning when the shares in the first company were acquired and ending when the shares in the second company were disposed of.

# VCM25040 - EIS: taper relief for serial investments: period when no shares held: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

### TCGA92/SCH5BA/PARA4

If there was a gap between the disposal of the shares in the first company and the acquisition of the shares in the second company, the qualifying holding period does not include the gap.

# VCM25050 - EIS: taper relief for serial investments: further deferrals: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

A deferred gain which is revived on a disposal may be deferred again under the EIS any number of times provided successive qualifying investments are made. In these circumstances, when the deferred gain is revived on account of the disposal of the shares in the last company in the series, the qualifying holding period applicable to the gain for taper relief purposes begins when the shares in the first company were issued and ends when the

shares in the last company were disposed of. (Any time at which no shares were held does not count for taper relief purposes.)

# VCM25060 - EIS: taper relief for serial investments: VCT investments: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

If the deferred gain is revived on the disposal of shares in the second EIS company and is then deferred under TCGA92/SCH5C in respect of a VCT investment the qualifying holding period ends when the shares in the second EIS company are disposed of.

VCT deferral relief is abolished in respect of shares issued after 5 April 2004.

# VCM25070 - EIS: taper relief for serial investments: chargeable event other than a disposal: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

If the deferred gain is revived because of a chargeable event under of TCGA92/SCH5B/PARA3 (1) other than a disposal of shares, see VCM23110, the extension of the qualifying holding period does not continue. In such circumstances, the qualifying holding period comes to an end when the shares in the first company were disposed of, or, if there was a series of qualifying investments in EIS companies, when the gain was most recently revived on a disposal of shares.

# VCM25080 - EIS: taper relief for serial investments: chargeable event other than a disposal: example: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

On 5 September 2004, Alfred disposes of an oil painting at a gain of £250,000 which he had acquired on 12 August 1998. He invests £400,000 in shares in ABC Ltd on 14 December

2004, and obtains deferral relief by setting £250,000 of the expenditure on these shares against the gain on the painting. He disposes of all the shares in ABC Ltd on 3 January 2008 at a gain of £110,000, and they qualify as a business asset for taper relief purposes throughout the period for which he held them.

The deferred gain of £250,000 which is brought back into charge on 3 January 2008 when the shares in ABC Ltd are disposed of qualifies for 6 years' taper relief as a non-business asset.

The gain of £110,000 on the ABC Ltd shares qualifies for 3 years' business asset taper relief.

If Alfred defers these gains under the EIS by setting qualifying expenditure on shares in another company against them, the gain of £110,000 can benefit from cumulative taper relief but the gain of £250,000 cannot.

# VCM25090 - EIS: taper relief for serial investments: business or non-business asset: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

### TCGA92/SCH5BA/PARA5

There are special rules to determine how much of the revived gain qualifies for the business asset taper and how much qualifies for the non-business asset taper.

First, trace the path of successive holdings of shares which begins with the investment in the first company and ends with the investment whose disposal finally revives the gain.

Second, treat the revived gain as though it were a gain on the disposal of an asset which in turn assumes the character of each shareholding in the path for the period in which the shares in question were held.

If there is a period in which two successive shareholdings are held simultaneously, the character of the one acquired earlier is assumed until it is disposed of, at which point the character of the later acquisition is assumed instead, see example at VCM25100.

# VCM25100 - EIS: taper relief for serial investments: business or non-business asset: example 1: Taper relief does not apply to

# gains accruing or treated as accruing after 5 April 2008

Victoria disposes of some shares in ABC Ltd to which deferral relief is attributable at a gain of £100,000. She held the shares from 2 May 1998 until 2 May 2005, and they qualify as a business asset for taper relief purposes throughout that period.

She invests £100,000 in shares in XYZ Ltd, and obtains deferral relief by setting the expenditure on these shares against the £100,000 gain on the ABC shares. The XYZ Ltd shares are issued to her on 1 September 2004 and she disposes of them at a gain of £50,000 on 2 May 2008. The shares do not qualify as a business asset for any part of that period.

The £100,000 gain is brought back into charge on 2 May 2008. The qualifying holding period for taper relief purposes begins with 2 May 1998 and ends on 2 May 2008. For taper relief purposes, Victoria is treated as having disposed of an asset which was a business asset shareholding for the seven years from 2 May 1998 until 2 May 2005, and a non-business asset shareholding for the 3 years from 2 May 2005 until 2 May 2008. The £100,000 gain is therefore split pro rata into a £70,000 gain on a business asset which has been held for 10 years, and a £30,000 gain on a non-business asset which has been held for 10 years.

The amount of this gain which is chargeable is £35,500, being £17,500 (25% of £70,000) for the business asset plus £18,000 (60% of £30,000) for the non-business asset part.

# VCM25110 - EIS: Taper relief for serial investments: business or non-business asset: example 2: Taper relief does not apply to gains accruing or treated as accruing after 5 April 2008

Albert disposes of some shares in DEF Ltd to which deferral relief is attributable at a gain of £140,000. He held the shares from 1 August 1998 to 31 August 2003. A revived gain of £50,000 accrues to him when the shares are disposed of. The original gain in question, which had accrued on the disposal of an oil painting on 5 January 1998, had been deferred under TCGA92/SCH5B because qualifying expenditure on the DEF Ltd shares was set against it. The DEF Ltd shares do not qualify as a business asset for taper relief purposes at any time in the period Albert held them.

He invests £170,000 in shares in GHI Ltd and obtains deferral relief by setting £50,000 of the expenditure against the revived gain and £120,000 of the expenditure against the gain of £140,000. He pays tax for the year of assessment 2003-04 on £20,000, being the `unused' part of the chargeable gain of £140,000. The qualifying holding period applicable for the £20,000 gain comprises 5 whole years so 85% of the gain is chargeable to CGT. The GHI Ltd shares

are issued to him on 2 January 2006 and he disposes of them at a gain of £100,000 on 1 October 2012. The shares qualify as a business asset for taper relief purposes throughout the period Albert held them. He pays tax for 2012-13 on the £100,000 gain and on the earlier gains of £50,000 and £120,000 which are revived when he disposes of the GHI Ltd shares.

**£100,000 Gain**

This gain accrues on the disposal of a business asset. There are six whole years in the qualifying holding period, so 55% of the gain is chargeable to CGT.

**£50,000 Gain**

This gain is treated for taper relief purposes as accruing at the time of the disposal of the oil painting in the 1997-98 tax year. It does not, therefore, qualify for any taper relief.

**£120,000 Gain**

The qualifying holding period for taper relief purposes begins on 1 August 1998 and ends on 1 October 2012. The period between 31 August 2003 and 2 January 2006 does not count, see VCM25040. The length of the qualifying holding period is 14 years 61 days less 2 years 124 days so there are 11 whole years. The relevant period of ownership (the period of 10 years ending with 1 October 2012 leaving out the period which does not count) is 3,653 days long. It comprises 2,464 days for which the asset is treated as a business asset and 1,189 days for which it is treated as a non-business asset.

The revived gain of £120,000 is split into two gains for taper purposes. A gain of £80,942 (£120,000 x 2464 / 3653) arises on the disposal of a business asset and a gain of £39,058 (£120,000 x 1189 / 3653) arises on the disposal of a non-business asset.

Therefore, 25% of the gain of £80,942 and 60% of the gain of £39,058 are chargeable.