

FINANCE ACT 2012

EXPLANATORY NOTES

INTRODUCTION

Section 39 Schedule 7: Enterprise Investment Scheme

Summary

1. [Section 39](#) and Schedule 7 make a range of changes to the Enterprise Investment Scheme (EIS), in respect of shares issued on or after 6 April 2012. This increases the annual amount an investor may invest under the EIS, and provides for three simplifications to the EIS rules. A trade which consists substantially in the receipt of feed-in tariffs (with certain exceptions) will become a non-qualifying activity. Monies used to acquire shares or stock in a company will no longer be regarded as employed for the purposes of a qualifying business activity. A “no disqualifying arrangements” test is introduced. The Schedule also raises the thresholds for eligible companies under the scheme, subject to a Treasury appointed day order. The increases in these thresholds are subject to State aid approval.

Details of Schedule

Part 1

2. Paragraph 1 introduces the changes to be made to Part 5 of the Income Tax Act 2007, dealing with EIS income tax relief.
3. Paragraph 2 removes the requirement for an investor to have subscribed a minimum of £500 in a company in order to qualify for relief.
4. Paragraph 3 of the Schedule increases from £500,000 to £1million the annual amount that an investor may invest under the EIS.
5. Paragraph 4 amends the EIS “connected person” rules so that any loan capital that the investor has in the company is not taken into account when computing whether they are excluded from EIS income tax relief through having a 30 per cent interest in the company.
6. Paragraph 6 widens the definition, for EIS, of the sorts of shares for which investors can subscribe under the scheme to include shares carrying certain preferential rights to dividends. Shares are still excluded if: a) they carry preferential right to assets on winding up; or b) if the amount and timing of the dividends depend on a decision of the company or any other person; or c) if the rights to dividends are cumulative (that is, the right to receive a dividend rolls forward to future periods if the company has insufficient profits to pay the dividend).
7. Paragraph 7(2) increases, for EIS, the annual amount of investment that a company may raise under the VC schemes from £2million to £5million. The increase is subject to State aid approval and will come into effect in respect of shares issued on or after 6 April 2012, subject to a Treasury appointed day order bringing the legislation into effect.

*These notes refer to the Finance Act 2012 (c.14)
which received Royal Assent on 17 July 2012*

8. Paragraph 7(3) provides that where a company has received any other risk capital investment which constitutes a State aid, that investment is also taken into account in calculating whether the £5million limit has been reached.
9. Paragraph 8 amends the rules on how the monies raised by the share issued are to be employed, so that monies used to buy shares or stock in a company will no longer be regarded as having been employed for the purposes of a qualifying business activity.
10. Paragraph 9 introduces a “no disqualifying arrangements” requirement. Arrangements are “disqualifying” if they are entered into with the purpose of ensuring that any of the venture capital schemes tax reliefs are available in respect of the relevant company’s business, and either: all or most of the monies raised under the scheme are paid to or for the benefit of a party to the arrangements; or in the absence of the arrangements, it would be reasonable to expect that the business would be carried on as part of another business by a person who is a party to the arrangements or a person connected with such a party.
11. Paragraph 11 increases the gross assets limit for EIS from £7million before the EIS investment and £8million afterwards to £15million and £16million respectively. The increases are subject to State aid approval and will come into effect in respect of shares issued on or after 6 April 2012, subject to a Treasury appointed day order bringing the legislation into effect..
12. Paragraph 12 increases the limit on the number of employees that a qualifying company may have from fewer than 50 to fewer than 250. The increase is subject to State aid approval and will come into effect in respect of shares issued on or after 6 April 2012, subject to a Treasury appointed day order bringing the legislation into effect..
13. Paragraphs 13 and 14 exclude as qualifying trades, any which consist substantially in the generation or export of electricity in respect of which the company receives a feed-in tariff under a UK government scheme or a similar overseas scheme. This applies generally where the relevant shares are acquired on or after 6 April 2012. For shares issued on or after 23 March 2011 and before 6 April 2012, a holding will still qualify providing the subsidised generation or export begins before 6 April 2012. Trades where the electricity is generated by anaerobic digestion or hydroelectric power are not excluded by the legislation. Irrespective of the means by which electricity is produced, trades carried on by community interest companies, co-operative societies, community benefit societies or Northern Irish industrial and provident societies are not affected by the legislation.
14. Paragraph 17 brings the legislation in line with that on the new Seed Enterprise Investment Scheme, by making clear that the death of an investor within the qualifying period for the shares will not trigger the reduction or withdrawal of relief.
15. Paragraph 19 amends the information powers at section 243 of the Income Tax Act 2007, to allow HM Revenue & Customs (HMRC) to seek information in relation to the “disqualifying arrangements” requirement from relevant parties.
16. Paragraph 21 amends the existing definition of “arrangements” to make it clear that “arrangements” includes a single transaction or a series of transactions.

Part 2: Enterprise Investment Scheme: Chargeable gains

17. Paragraph 26 introduces the changes to be made to the Taxation of Chargeable Gains Act 1992 (TCGA), dealing with EIS disposal relief and EIS deferral relief.
18. Paragraph 27 makes an amendment to section 150A of TCGA to ensure that the calculation of any capital gain on the disposal of shares to which EIS relief has been attributable takes account of EIS relief at the appropriate rate.

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19. Paragraph 29 increases, for reinvestment relief under Schedule 5B to TCGA, the annual amount of investment that a company may raise under the VC schemes from £2million to £5million. The increase is subject to State aid approval and will come into effect in respect of shares issued on or after 6 April 2012, subject to a Treasury appointed day order bringing the legislation into effect..
20. Paragraph 30 introduces a “no disqualifying arrangements” requirement. Arrangements are “disqualifying” if they are entered into with the purpose of ensuring that any of the venture capital schemes tax reliefs are available in respect of the relevant company’s business, and either: all or most of the monies raised under the scheme are paid to or for the benefit of a party to the arrangements; or in the absence of the arrangements, it would be reasonable to expect that the business would be carried on as part of another business.
21. Paragraph 31 amends the information powers at Paragraph 11 of Schedule 5B, to allow HMRC to seek information in relation to the “disqualifying arrangements” requirement from relevant parties.
22. Paragraph 32 amends the existing definition of “arrangements” to make it clear that “arrangements” includes a single transaction or a series of transactions.

Background Note

23. The EIS and Venture Capital Trusts (VCT) scheme encourage investment in small, higher risk trading companies by offering tax incentives to investors in qualifying companies.
24. Following consideration of responses to a consultation document "Financing a Private Sector Recovery", published on 26 July 2010 and to a further consultation, “The path to strong, sustainable and balanced growth" (the “Growth Review”), published on 29 November 2010, the Chancellor announced in his Budget on 23 March 2011 that subject to State aid approval, limits on the size of companies which can benefit under the schemes would be increased.
25. A further consultation document, "Tax-advantaged venture capital schemes: a consultation" was published on the Treasury website on 6 July 2011 seeking views on ways in which the EIS and VCT might be improved.