These notes refer to the Income Tax Act 2007 (c.3)
which received Royal Assent on 20 March 2007

INCOME TAX ACT 2007

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 5: Enterprise investment scheme

Overview

Chapter 2: The investor

Overview

543. This Chapter sets out the conditions which the investor must meet in order to be a “qualifying investor” in relation to the issue of shares in question.

Section 162: Overview of Chapter

544. This section states the three conditions that must be met by an investor in order to be a qualifying investor and indicates where further detail can be found about them. It is new.

Section 163: The no connection with the issuing company requirement

545. This section provides that the investor must not be connected with the issuing company during the period indicated. It is based on section 291(1) of ICTA.

546. There is a reference to connection before the issuing company is incorporated. This covers for example a former employee of a company which becomes a subsidiary or partner of the issuing company within the prescribed period, see section 167(1)(a).

Section 164: The no linked loans requirement

547. This section denies relief in the cases set out (loans connected with the subscription for the relevant shares). It is based on section 299A of ICTA.

548. The effect of the cross-reference in section 299A(2) of ICTA to section 307(6)(ca) of ICTA is achieved by making reference in section 239(1) of this Act (date from which interest is chargeable) to the meaning of “the making of the loan” in this section.

549. Section 1008(1) notes that “assignation” is the term used in Scotland for “assignment”. Both terms are used in section 299A(2)(b) of ICTA.

Section 165: The no tax avoidance requirement

550. This section stops the investor being a qualifying investor if the subscription was not for commercial reasons or if a main purpose was tax avoidance. It is based on section 289(6) of ICTA. There is a complementary requirement in respect of the issue of the shares in Chapter 3 of this Part.

551. Section 289(6) of ICTA has introductory wording about the investor “not being eligible for relief”. There is no need for similar introductory words in this section, because

section 162 already provides that the investor is not a qualifying investor if the no tax avoidance requirement is not met, and is therefore not eligible for EIS relief (section 157(1)(b)).

552. To be consistent with related legislation, for example paragraph 14 of Schedule 15 to FA 2000 (corporate venturing scheme), this section refers to "commercial reasons" rather than "commercial purposes".

Section 166: Connection with issuing company

553. This section defines, for the purposes of this Chapter, the meaning of an individual being connected with the issuing company and provides signposts to the sections that provide further detail of the way in which such connection can occur. It is based on section 291(2) of ICTA.

554. This section clarifies the application of the definition of connected in section 291(2) of ICTA. See *Change 38* in Annex 1.

Section 167: Employees, directors and partners

555. This section defines how an individual can be connected with the issuing company as a result of a person being "an employee, director or partner". It is based on section 291(2), (3) and (4) of ICTA.

556. *Subsection (3)* is based on section 291(4) of ICTA. It provides that an individual who is both a director and an employee of the issuing company is covered by *subsection (1)(c)* rather than *subsection (1)(a)* and so can benefit from the let-outs in sections 168 and 169. In such a case, references in sections 167 to 169 to an individual in his or her capacity as a director also includes the individual in his or her capacity as an employee. So, for example, in these cases any remuneration received as an employee is taken into account in section 169(2).

Section 168: Directors excluded from connection

557. This section provides that an individual will, in specific circumstances, not be connected with the issuing company. It is based on sections 291(5) and 291A(1), (2), (3) and (6) of ICTA.

558. This section allows, in limited cases, the investor to be eligible for EIS relief in relation to a share issue even if the investor (or an associate) is a director of the issuing company. Such limited cases *broadly* include those where:

- the sole reason for connection would have been the relationship as director; but
- in relation to the period over which connection is tested;
    - — there are no payments to the individual (or to certain other persons), and no entitlement to such payments, from the issuing company (or from certain other persons), or
    - — any such payments fall to be disregarded by virtue of *subsection (2)*.

559. *Subsection (4)(a)(i)* narrows the definition of "related person". See *Change 39* in Annex 1.

560. The meaning of "connected" in *subsection (4)(a)(ii)* is found in section 993. This differs from the other references to "connected" in this Chapter, which take their meaning from section 166.

561. The words "at any time in period A" in *subsection (5)* are needed to convey the full meaning of the expression "51% subsidiary" in section 291A(6) of ICTA. For the source legislation, this expression has a specific definition in section 312(1) of ICTA, but this

is not reproduced in the rewritten EIS sections. Instead a "51% subsidiary" in this Part takes its meaning from section 838 of ICTA - see section 989.

Section 169: Directors qualifying for relief despite connection

562. This section provides an exception to the rule that a person is not a qualifying investor if that person is connected with the issuing company. It is based on section 291(5) and section 291A(4) and (5) of ICTA.

563. This exception might apply to certain, otherwise unconnected, business angel investors whose only connection with the issuing company will be as directors. (A business angel is the term used for investors who also make their business expertise available to a company by becoming a director.)

564. In *subsection (3)(a)* the reference to "connected" takes its meaning from section 166, see *Change 38* in Annex 1.

565. In section 291A(5) of ICTA there is a reference to the word "trade" including "any business, profession or vocation". As an incorporated company cannot carry on a vocation there is now in *subsection (3)(b)* a reference to "the trade, business or profession" carried on by the company or its subsidiary.

Section 170: Persons interested in capital etc of company

566. This section sets out cases in which an individual is treated as connected with the issuing company because of certain interests in that company or a subsidiary of that company. It is based on section 291(5) and section 291B of ICTA other than section 291B(5).

567. In *subsection (1)(a)*, based on section 291B(1)(a) of ICTA, there is a reference to ordinary share capital without the word "issued". This is because the definition of ordinary share capital in section 989 defines ordinary share capital in terms of issued share capital.

568. In *subsections (1)(a), (2)(a)* and *(10),* it has been made clear that the subsidiary referred to is the subsidiary of the issuing company.

569. *Subsection (6)* refers to "the issuing company". This replaces a reference to "a company" in section 291B(4) of ICTA, on which subsection (6) is based. The clarification is consistent with the context of section 291B of ICTA generally and with the reference in section 291B(5) of ICTA to "another company … assuming it to be an issuing company" in particular.

Section 171: Persons subscribing for shares under certain arrangements

570. This section provides a further instance where an individual is treated as connected with the issuing company. It is based on section 291B(5) of ICTA.

571. The references to "connected" take their meaning from section 166, see *Change 38* in Annex 1.