

Tax factsheet

Tax reliefs for investment in UK businesses

The UK tax system offers various reliefs intended to encourage investment in UK businesses. The way that tax relief is given and the conditions which need to be satisfied vary considerably. In the majority of cases, relief is only available for investment in a trading company and shares will generally need to be held for a set period of time to benefit from the relief. Another common condition is that where the investment takes the form of shares, they are in an unquoted company (for these purposes, an AIM listing qualifies as unquoted).

This factsheet outlines some of the key tax reliefs available, but does not attempt an exhaustive analysis of the various conditions. Non-domiciled individuals using the remittance basis may be eligible for Business Investment Relief (BIR) – see our separate factsheet for more detail.

Income tax and capital gains tax relief

Enterprise Investment Scheme

The Enterprise Investment Scheme (EIS) offers 30% income tax relief on up to an annual £1 million investment in qualifying companies (£2 million where any amount over the basic

£1 million limit is invested in qualifying 'knowledge-intensive' companies). Where income tax relief has been claimed, shares will be free of capital gains tax (CGT). It is also possible to roll over gains on other assets into an EIS investment, with the deferred gain only crystallising on the ultimate disposal of the shares.

Conditions apply to both the investor and the investee company. The conditions for income tax and CGT relief are not identical. The conditions include:

- Shares must be issued fully paid in cash (an important point, which can easily be overlooked).
- Relief is withdrawn where the shares are not held for three years.
- The investor cannot be connected with the company. This includes being an employee or director of the company (although exceptions exist for business angels and unpaid directors).
- The company must carry out (or be preparing to carry out) a qualifying trade. Certain trades, including property development, leasing, banking, and operating nursing homes or hotels, are specifically excluded.
- The company must meet certain size requirements. Gross assets must be no greater than £15 million before the issue of EIS shares (and no greater than £16 million afterwards), and the company must have fewer than 250 full time equivalent employees. This latter limit is increased to 500 where the company is classed as a 'knowledge intensive company'.
- A company generally has seven years from its first commercial sale to obtain EIS funding.



- There are limits – both annual and absolute – on the level of venture capital funding that a company can obtain.
- The monies raised through EIS must be used to grow or develop the business.

Seed Enterprise Investment Scheme

The Seed Enterprise Investment Scheme (SEIS) is similar in structure to EIS, but focused on smaller companies – the company limits here are gross assets of up to £200,000 and fewer than 25 employees. Reflecting the higher-risk nature of investments in these businesses, income tax relief is given at 50% on up to £100,000 of investment annually.

In addition, the SEIS shares are exempt from capital gains tax on sale if certain conditions are met, and up to 50% of the amount invested (capped at £50,000) can be set against other capital gains arising in the year of investment (effectively reducing the gain subject to tax).

Many of the conditions for SEIS relief are similar to those which apply for EIS. There are differences, however, including:

- The trade must be less than two years old to qualify for SEIS; and
- The company must not have previously issued EIS shares.

Venture capital trusts relief

A Venture Capital Trust (VCT) is a quoted investment fund which invests in small and medium-sized companies – very broadly, the sort of companies which qualify for EIS status. Income tax relief is available for investments in the fund at 30% on up to £200,000 investment a year. This relief is withdrawn where the VCT shares are not held for a minimum of five years. Dividends paid out by the VCT on investments within the £200,000 annual limit are received free of income tax, and the subsequent sale of VCT shares is free of CGT.

Conditions for the relief to apply include:

- That the VCT itself must be listed on an EU regulated market;
- That the VCT's investments are diversified – no more than 15% of its investments can be in a single company;
- That at least 70% (80% for accounting periods beginning on or after 6 April 2019) of its investments must be in 'qualifying holdings' – broadly, in UK resident companies (or companies with a UK

permanent establishment) carrying on a qualifying trade. As with EIS and SEIS, certain trades are excluded.

Social Investment Tax Relief

Social Investment Tax Relief (SITR) gives 30% income tax relief on up to £1 million of qualifying investment annually. Unlike the other reliefs outlined above, SITR can be given in respect of qualifying debt as well as equity investment. Any gains on the disposal of the investment will be free of CGT. But this will only apply to capital gains (eg on a sale of shares); interest or redemption premiums on debt would be taxed as income and therefore not be tax free. Other gains in the year of investment can be rolled into the SITR investment, with the deferred gain crystallising on the disposal of the investment.

For SITR to be available, investments must be in a 'qualifying social enterprise' (broadly, a registered charity or community interest company). The social enterprise itself is subject to a number of conditions, including having fewer than 250 full-time equivalent employees, and meeting the same gross assets test as applies for EIS (maximum of £15 million immediately before, and £16 million immediately after, the investment). There is a cap on the amount of investment that each social enterprise can raise under the SITR.

Capital gains tax reliefs

Investors' Relief

Investors' Relief was introduced in Budget 2016, and offers a reduced 10% rate of CGT (rather than the standard 20%) on gains on the disposal of qualifying shares. New shares must have been issued on or after 17 March 2016 fully paid in cash, and need to be held for a minimum of three years.

Relief is only available where the investee company is a trading company (or the holding company of a trading group). The general definition of 'trading company' applies here (where the trading company does not carry on substantial, broadly 20%, non-trading or investment type activities) and the additional exclusions which apply for EIS, SEIS and VCT reliefs are not in point.

For Investors' Relief to be available, the investor must not be a director or an employee of the company. Limited exclusions apply where a business angel becomes an unpaid director following their investment, or where an individual becomes an employee more than 180 days after they make their investment (provided there was no reasonable prospect that this would happen at the point that the investment was made).

There are no annual limits on investments qualifying for Investors' Relief, but a lifetime cap of £10 million of qualifying gains does apply.

Business Asset Disposal Relief (BADR) - previously called Entrepreneurs' Relief

BADR is, in outline, broadly similar to Investors' Relief: a reduced 10% rate of CGT applies to qualifying gains, subject to a lifetime cap of £1 million (this is in addition to the £10 million cap for Investors' Relief mentioned above). The key difference is in focus: unlike Investors' Relief (and, indeed, the income tax reliefs outlined above), BADR is aimed at those with an active involvement in the business.

BADR is available on qualifying disposals of unincorporated businesses, as well as on shares. In the case of shares, relief is only available where, throughout the 24 months before the disposal, the shareholder:

- Is an officer or employee of the company; and
- Holds more than 5% of the ordinary share capital and voting rights of the company; and either
- Is beneficially entitled to at least 5% of the company's distributable profits and 5% of the company's assets for distribution to equity holders in a winding up; or
- Is beneficially entitled to at least 5% of the proceeds on a sale of the entire ordinary share capital of the company (in determining whether this test is met at any time in the requisite 24 month period, the whole of the ordinary share capital is deemed to be sold at its market value on the last day of that 24 month period).

Where a company issues new shares to raise funds, diluting an individual's holding below the 5% level, the individual will be able to make a deemed disposal of the shares immediately before the dilution, locking in their entitlement to BADR on the accrued gain up to that point.

The company itself must be a trading company, or the holding company of a trading group. Note that the EIS, SEIS and VCT restrictions don't apply here, and 'trading' takes its usual broader meaning (where the trading company does not carry on substantial, broadly 20%, non-trading or investment type activities).

BADR is potentially worth up to £100,000 for an individual or £200,000 for a married couple or civil partnership. There are a number of quirks in the legislation which can mean that relief is inadvertently lost: ensuring that full relief is available is, therefore, a key part of corporate structuring for entrepreneurs.

Conclusions

Various forms of tax relief are potentially available on an investment in UK business, and the impact of the relief can be considerable, particularly in the context of higher risk investments, where the tax relief can mitigate a potential financial loss. Potentially available tax reliefs should, therefore, be assessed when considering a new investment. Equally important, though, is ensuring that all the conditions for relief are met both at the time of investment and throughout any qualifying period: an inadvertent breach can cause a costly withdrawal of relief.

For advice regarding any of the issues raised here, please contact your usual Saffery Champness partner, or contact Martyn Dobinson on T: +44 (0)161 200 8383, or E: martyn.dobinson@saffery.com.

This factsheet is based on law and HMRC practice at 1 November 2021.

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