AIM is the London Stock Exchange’s international market for young and growing companies. AIM provides an ideal environment for these ambitious businesses to access the capital and liquidity of the London markets – the largest and deepest pool of international capital in the world.

AIM’s unique regulatory framework is based around balancing the flexibility a growing company needs.

Businesses from all over the world continue to be attracted to AIM. In August 2012, over 1,100 companies from numerous countries and sectors were on the market and a total of £79 billion had been raised since AIM’s launch.

Baker Tilly is a leading independent firm of accountants and business advisers that specialises in providing an integrated range of services. It provides its growing and established business clients with audit, accountancy, personal and corporate taxation, VAT, management consultancy, corporate finance, IT advisory, restructuring and recovery and forensic services. The firm has national coverage through its network of offices and is represented internationally through its independent membership of Baker Tilly International.

Baker Tilly’s clients include high net-worth individuals and growing entrepreneurial companies. Baker Tilly is acknowledged as a market leader acting for AIM companies as auditors and/or reporting accountants. It has recognised specialists in the legislation relating to the tax benefits that can be applicable to AIM companies and investors.

Baker Tilly, who is represented on the AIM Advisory Group of the London Stock Exchange, has been voted AIM Accountant of the Year in the Growth Company Awards five times and is the present joint incumbent of this award.

Important note
While every effort has been made to ensure accuracy, information contained in this booklet is not intended to be comprehensive and recipients should not act upon it without seeking professional advice. The summaries of the tax benefits contained in this booklet are based on legislation enacted up to and including the Finance Act 2012.

Only a summary of the tax reliefs, the principal qualifying criteria and the persons to whom they might apply are set out in this booklet. It is not the intention of this booklet to provide the full terms of the relevant legislation which are often complex, and the relevance of and ability to claim particular reliefs will generally depend on an individual’s personal circumstances.

Investments in unquoted companies usually carry higher risks but potentially higher returns and may not be suitable for all investors.

Accordingly, professional advice should be obtained before making an investment.

The information contained in this booklet does not constitute investment advice and should not be used as the basis for investment decisions. Provision of the information is in no way intended, directly or indirectly, as an attempt to market or sell in any country any financial instrument.
A guide to AIM tax benefits
- Finance Act 2012 update

Several key changes to the Enterprise Investment Scheme and Venture Capital Trust scheme have been enacted by Finance Act 2012. These changes are effective from April 2012.

The following changes to the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) have been introduced in Finance Act 2012:

- An increase in the limits on the size of qualifying companies to up to 250 employees and gross assets of £15 million, from the previous limits of up to 50 employees and gross assets of £7 million
- An increase in the maximum annual amount that can be invested through EU State Aided funding including EIS and VCTs in an individual qualifying company to £5 million
- The removal of the £1 million maximum investment limit that any one VCT can invest in a company (subject to a joint venture rule)
- An increase in the maximum annual amount that an individual can invest through EIS to £1 million

In addition, the Government has also introduced a new scheme for earlier stage businesses. The Seed Enterprise Investment Scheme (SEIS) offers tax reliefs to individuals investing in start-up and early stage companies. Although SEIS is not directly relevant for AIM companies, it forms part of the measures in place to help encourage an effective funding environment for smaller, growing businesses.

October 2012
A guide to AIM UK tax benefits

This guide outlines the various tax reliefs available to investors in AIM companies and also the principal criteria which both companies and investors need to meet to take advantage of them.

The tax advantages are those which relate to investments in qualifying unquoted companies. Companies traded on AIM and a number of other markets (see Part 4) are regarded by HM Revenue and Customs (HMRC) as unquoted for this purpose.

The tax reliefs available include:

- Capital gains tax (CGT)
  - gift relief
- The Enterprise Investment Scheme (EIS)
- Inheritance tax (IHT)
  - business property relief
- Relief for losses
- Venture Capital Trusts (VCTs).

The guide is divided into four parts. The first part highlights the reliefs available to individual investors. The second part explains how funds may be raised with the benefit of such reliefs and the criteria AIM companies need to meet in order to ensure the availability of the tax reliefs for investors. The third part deals with foreign companies. The fourth part deals with special situations such as companies which move to and from the Official List, and obtaining advance assurance from HMRC in respect of proposed investments under the EIS and from VCTs. It also includes some information about the SEIS, newly introduced for start-ups and early stage companies.

It is stressed that available tax reliefs should not be the principal reason for investment and should never outweigh the commercial criteria of investment proposals. However they can enhance financial returns as well as assist with an investor’s tax planning.

Note for trustees: it is beyond the scope of this guide to consider in detail the tax reliefs in respect of trustees and professional advice should be obtained.

Note for non-UK companies: although this guide covers overseas considerations in Part 3, a separate guide entitled A guide to AIM UK tax benefits – non-UK companies is available (from the London Stock Exchange).
Capital Gains Tax (CGT)

There is no general CGT relief for gifts (although transfers between husband and wife are on a no gain no loss basis). However, if shares or securities in an AIM trading company are transferred, other than at arm’s length, the deemed capital gain arising can be ‘held over’, ie the CGT liability is postponed until a subsequent arm’s length disposal by the transferee, who effectively inherits the transferor’s base cost. The relief must be claimed by both the transferor and transferee within five years and ten months of the end of the relevant tax year.

Who can benefit from CGT gift relief?
- The relief is particularly useful for the transfer or gift of shares within families.
- The transferee must be resident or ordinarily resident in the UK and remain so for six years.
- There are no specific requirements for the transferor.
- There is no minimum or maximum holding required.
- It does not apply to a gift of shares to a company.

Enterprise Investment Scheme (EIS)

The Enterprise Investment Scheme (EIS) can benefit individual investors who subscribe for new ordinary shares in AIM companies which qualify as trading companies. Qualifying investments up to £1 million in aggregate in a tax year (husband and wife may each invest £1 million) entitle an investor to the following tax reliefs:

30 per cent initial income tax relief on investment (‘initial relief’)
- 30 per cent (subject to state aid approval) initial income tax relief on investment (‘initial relief’).
- For investments in qualifying shares made in a particular tax year, any part of the investment may be treated as made in the previous tax year.
- Relief is restricted to the actual income tax liability for the year, if lower than 30 per cent of the cost of the investment.

Example – investment of £100,000

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross investment in shares</td>
<td>100,000</td>
</tr>
<tr>
<td>Income tax relief at 30%</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Effective cost of investment</td>
<td>70,000</td>
</tr>
</tbody>
</table>
Exemption from capital gains tax on disposal

- The investment must be held for three years.
- Initial relief must not be withdrawn.
- The exemption is restricted if initial relief was not given on the full amount or if that amount has been reduced.

Loss relief if the investment fails or is disposed of at a loss

- This is calculated at an investor’s top rate of tax (currently 50 per cent for a higher rate payer) effectively on the net loss, after taking into account the initial tax relief.
- Losses can be relieved either against capital gains in the year of loss or a subsequent year or against income in the year of the loss or the previous year.
- The maximum net loss can thus be restricted to 35 per cent of cost (see example).

<table>
<thead>
<tr>
<th>Example – investment of £100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>£</strong></td>
</tr>
<tr>
<td>Realised value of shares after three years</td>
</tr>
<tr>
<td>Original gross investment in shares</td>
</tr>
<tr>
<td>Tax-free gain</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>50% taxpayer</th>
<th>40% taxpayer</th>
<th>20% taxpayer</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Realised value of shares</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Original gross investment</td>
<td>(100,000)</td>
<td>(100,000)</td>
</tr>
<tr>
<td>EIS income tax relief</td>
<td>30,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Loss</td>
<td>(70,000)</td>
<td>(70,000)</td>
</tr>
<tr>
<td>EIS loss relief – tax at 50%/40%/20%</td>
<td>35,000</td>
<td>28,000</td>
</tr>
</tbody>
</table>

1 Cap on unlimited income tax reliefs

HMT/HMRC issued a Technical Consultation on 13 July 2012, proposing a cap on unlimited income tax reliefs which will have effect from 6 April 2013. The proposal is to cap relief at £50,000 or 25% of an individual’s income, whichever is greater. Whilst the cap will not apply to the up-front income tax relief given on investment under the EIS, it is proposed that it will apply to restrict any income tax loss relief available on a future disposal of the shares at a loss. Therefore loss relief may be restricted to the greater of £50,000 or 25% of an individual’s income with effect from 6 April 2013.
Capital gains tax

Tax deferral

In addition, or as an alternative to claiming the initial relief, investors may defer assessment of capital gains tax on other gains by reinvesting those gains in subscriptions for new ordinary shares in qualifying companies.

- Reinvestment of other capital gains must be made up to one year before and three years after the disposal which gave rise to the gain.
- The period of deferral is until the investment is disposed of or the investee company ceases to qualify.
- There is no limit (up to the amount of the capital gain) that can be deferred in this way.
- The gain to be reinvested is after any claim for Entrepreneur’s relief*.

An investor may therefore benefit not only from the 30 per cent initial tax relief and the other reliefs as above (for investments up to £1 million*), but also by deferral of assessment to capital gains tax on the gain which is reinvested.

Accordingly, it is possible for investors to claim initial tax relief of 58 per cent (for a higher rate taxpayer) on the first £1 million* (re)invested. However 28 per cent is a deferral only and is repayable when the investment is disposed of or the investee company ceases to qualify.

Example – investment of £100,000

This example assumes that the investor is a higher rate UK taxpayer with a capital gain of £100,000 (ie a CGT liability of £28,000).

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross investment in shares</td>
</tr>
<tr>
<td>less CGT deferral at 28%</td>
</tr>
<tr>
<td>less EIS initial income tax relief at 30%</td>
</tr>
<tr>
<td>Net cost of investment</td>
</tr>
<tr>
<td>CGT payable on disposal of shares</td>
</tr>
</tbody>
</table>

*Entrepreneur’s relief was introduced by the Finance Act 2008 in relation to disposals taking place on or after 6 April 2008, and was amended in Finance (No 2) Act 2010.

When claimed on a disposal occurring after 23 June 2010 the rate of capital gains tax on the chargeable gain becomes 10%.

The definition of “material disposal of business assets” is complex and outside the scope of this guide, although it should be noted that, in particular, a disposal of shares will not qualify unless it is in an investor’s personal company (i.e. the investor holds at least 5% of the ordinary share capital and voting rights). It is recommended that individuals requiring information on Entrepreneur’s relief seek appropriate professional advice.
#### Who can benefit from EIS investment?

Most individual investors, subject to their personal circumstances, should be eligible. Their qualifying status must continue for three years following subscription in new ordinary shares. However for initial relief and CGT exemption, an individual:

- need not be UK resident (but must be a UK taxpayer)
- must not be connected with the company as:
  - an employee
  - an existing paid director (but may be a paid director once the issue has been made)
  - a shareholder (with associates) with more than 30 per cent of the share capital, voting power or rights to more than 30 per cent of the assets on a winding up
  - otherwise able to control the company
- may be a new director (but specialist advice should be sought)
- his or her spouse can each invest up to £1 million per annum.

For deferral relief, an investor:

- must reinvest a chargeable gain in the period one year before and up to three years after it arises
- must be UK resident or ordinarily resident in the UK at the time of the original gain, its reinvestment and for three years thereafter
- can be connected, ie control the company or be an employee or director
- can reinvest an unlimited amount (up to the amount of the gain(s) deferred).
## Part 1 - The tax benefits for individual investors

### Example
An asset which cost £200,000 in August 2010 is disposed of after two years in September 2012, realising a gain of £1,180,000 which is reinvested immediately to defer the gain under the EIS. The EIS deferral shares are sold in October 2016 for £2,000,000. Separate calculations illustrate the gains respectively if initial relief of £1 million is claimed in respect of the reinvestment and if such relief is not claimed.

#### Disposal September 2012

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds of sale</td>
<td>1,380,000</td>
</tr>
<tr>
<td>Cost (Aug 2010)</td>
<td>(200,000)</td>
</tr>
<tr>
<td>Chargeable gain (tax deferred by reinvestment)</td>
<td>1,180,000</td>
</tr>
</tbody>
</table>

#### Sale of EIS deferral shares October 2016

<table>
<thead>
<tr>
<th></th>
<th>Deferral relief only</th>
<th>Initial &amp; deferral reliefs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds of sale</td>
<td>2,000,000</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Cost of EIS shares</td>
<td>(1,180,000)</td>
<td>(1,180,000)</td>
</tr>
<tr>
<td>CGT exemption £1,000,000/£1,180,000 x £820,000</td>
<td>820,000</td>
<td>820,000</td>
</tr>
<tr>
<td>Gain on EIS deferral shares</td>
<td>820,000</td>
<td>125,085</td>
</tr>
</tbody>
</table>

#### Deferred gain on disposal of original business asset

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain on original chargeable asset</td>
<td>1,180,000</td>
<td>1,180,000</td>
</tr>
<tr>
<td>Total chargeable gains</td>
<td>2,000,000</td>
<td>1,305,085</td>
</tr>
<tr>
<td>Tax at 28%</td>
<td>560,000</td>
<td>365,424</td>
</tr>
<tr>
<td>Less: initial income tax relief at 30% (restricted to relief based on limit of £1 million)</td>
<td>–</td>
<td>(300,000)</td>
</tr>
<tr>
<td>Total tax</td>
<td>560,000</td>
<td>65,424</td>
</tr>
<tr>
<td>Effective tax rate on total gains of £2,000,000 (1,180,000 + 820,000)</td>
<td>28%</td>
<td>3.3%</td>
</tr>
</tbody>
</table>

#### Notes
The first column assumes that an investor will only be able to claim deferral relief without any initial income tax relief on the reinvestment. The second column assumes that an investor is also able to claim initial income tax relief and is entitled to CGT exemption on the EIS investment. However these reliefs are restricted as the amount of the gain reinvested is over £1 million which is the maximum that can be invested under the EIS to qualify for CGT exemption and initial income tax relief. If the gain in 2012 is less than £1 million there would be no overall tax payable in respect of the subsequent gain on the EIS shares. The example ignores the impact of any claim for Entrepreneur’s relief that may be made in respect of the original disposal.
Inheritance tax (IHT)

Business Property Relief (BPR)

BPR can be an extremely valuable relief for individuals who invest in qualifying AIM listed companies.

The main benefit of BPR, where it is available, is that it provides up to 100% exemption from IHT in respect of “transfers of value”. The most common transfer of value involving shares arises following the death of a shareholder either where the shares form part of the death estate or were transferred by way of a lifetime gift within the previous seven years.

The full 100% exemption for a shareholding is only applicable to certain unquoted companies (see page 15). For these purposes, shares admitted to AIM are regarded as unquoted.

The investment must be held for at least two years before a chargeable transfer for IHT purposes.

Who can benefit from IHT Relief?

Estates and beneficiaries of UK domiciled individuals who are likely to be assessed for IHT on a chargeable transfer, which include the following:

• death of the shareholder
• death of the donor, if the shares were gifted within seven years of death
• chargeable lifetime transfer (eg into a relevant property trust).
Relief for losses

Should an investment in shares be disposed of at less than cost, it may be possible to relieve the loss arising against capital gains of that or a subsequent year.

Where the investment is in new shares subscribed for (i.e. not purchased from an existing shareholder) in a trading company which satisfies the EIS conditions, the loss arising may instead be relieved against income of that year or the previous year.

If there is any loss remaining after claiming relief against income, such loss is available for relief against capital gains either of the current or subsequent years.

An example where the loss is in respect of an EIS investment is covered on page 5. For companies which become fully quoted see page 20.

Who can benefit from relief for losses?

- Individuals or trustees who are resident or ordinarily resident in the UK.
- Separate rules apply for companies.
- The loss must arise as a result of a sale at arm’s length, a liquidation or where the investor is able to claim that the investment has become of negligible value.

---

\(^1\)Cap on unlimited income tax reliefs

HMT/HMRC issued a Technical Consultation on 13 July 2012, proposing a cap on unlimited income tax reliefs which will have effect from 6 April 2013. The proposal is to cap relief at £50,000 or 25% of an individual’s income, whichever is greater. Whilst the cap will not apply to the up-front income tax relief given on investment under the EIS, it is proposed that it will apply to restrict any income tax loss relief available on a future disposal of the shares at a loss. Therefore loss relief may be restricted to the greater of £50,000 or 25% of an individual’s income with effect from 6 April 2013.
Venture Capital Trusts (VCTs)

A Venture Capital Trust (VCT) is a fully listed company, similar to a quoted investment trust, which is approved by HM Revenue & Customs and whose investments must, after three years, be at least 70 per cent in qualifying unquoted trading companies. In this way, investors in VCTs can gain access indirectly to a professionally managed portfolio of unquoted (see also Part 4) investments – which, for this purpose, can include shares in qualifying AIM companies.

Investments in VCTs (whether purchased in the market or subscribed for) of up to £200,000 in a tax year entitle individual investors to the following tax reliefs:

- exemption from tax on dividends.
- exemption from capital gains tax on disposal of shares in the VCT.
- 30 per cent initial income tax relief on the amount invested, up to £200,000 in new ordinary shares issued by VCTs, provided the shares are held for five years.

Who can benefit from a VCT investment?

Most individual investors, subject to their personal circumstances, should be eligible – there is a maximum limit of £200,000 per annum which can be invested by each of a husband and wife.

Initial relief

An investor:

- need not be UK resident but must be a UK taxpayer
- must hold the investment for five years.
Part 2 - The benefits and criteria for qualifying companies

Capital gains tax

CGT gift relief

Where there is a transaction in the shares of an unquoted qualifying trading company (which for this purpose can include those on AIM) which is conducted other than at arm’s length, eg as a part of a family estate planning exercise, a gain which is otherwise chargeable may be held over until the holding is disposed of by the acquirer as set out in Part 1.

Which companies qualify?

- Unquoted trading companies (including those on AIM) and holding companies of trading groups.
- Trading companies where the person making the gift holds at least 5 per cent of the voting rights.

Enterprise Investment Scheme (EIS)

Under the EIS, a qualifying unquoted trading company (see page 13) subject to its size and other qualifying criteria, can raise up to £5 million annually of new ordinary share capital from individual investors who may be able to take advantage of the tax benefits summarised in Part 1. This £5 million limit is the maximum that can be raised under all risk capital schemes, taken together within the 12 months ending on the date of the relevant investment.

The risk capital schemes are the SEIS, EIS and VCTs and other equity-based state aid, as defined.

If this £5 million limit is exceeded then the whole of the amount raised that takes you over the £5 million is disqualified, not just the amount in excess of £5 million.
Part 2 - The benefits and criteria for qualifying companies

Which companies qualify for investment under the EIS?

The legislation is complex. However, the following is a summary of the key criteria that a company must meet:

The shares must be in an unquoted trading company. For this purpose, shares admitted to AIM are regarded as unquoted.

- The shares issued must be new shares and must be subscribed for wholly in cash and must be fully paid up at the time of issue.
- Prior to 6 April 2012 eligible shares were effectively only ordinary shares. The rules have been brought into line with the VCT legislation and from 6 April 2012, an eligible share can have a preferential right to dividends provided that such a right is not cumulative, the dividend cannot be varied and the preferential shares are non-redeemable.
- The shares issued must carry no preferential rights to a company’s assets on winding up.
- From 6 April 2011, the funds raised by the issue of EIS shares must be employed wholly for the purposes of a qualifying business activity carried on anywhere in the world provided that the issuing company has a UK permanent establishment (see page 18). Prior to 6 April 2011, the funds raised needed to be employed in a qualifying business activity carried on wholly or mainly in the UK.
- The funds raised must be employed in the trade no later than 2 years from the date subscription or, if later, commencement of trade (which must commence no later than two years after the issue of shares).
- The aggregate gross assets must not exceed £15 million before investment and £16 million immediately after.
- The company must have less than 250 full-time equivalent employees when the shares are issued.
- The company must also meet the following qualifying criteria throughout the three year period from the issue of shares or the start of trading if later:
  - the company must be unquoted – AIM companies are regarded as unquoted (see also Part 4) for this purpose. A company must be unquoted (which can include a company on AIM) only at the time of the issue of EIS shares provided that no arrangements exist at that time for the company to become quoted
  - the company must exist wholly (other than to an insignificant extent) for the purpose of carrying out a qualifying business activity
  - for which purpose the activities of all companies in a group are considered as one. If the company is a parent company, the activities of the group as a whole must be substantially qualifying. (This is usually taken to mean up to 20 per cent of activities may be non-qualifying.)
  - the company must either carry on a qualifying trade (ie not investment activities) or be the parent company of a trading group. Incidental purposes, which are defined as having no significant effect on activities of the company, can be disregarded
  - the company must not be controlled by another company (ie one that is or is entitled to exercise direct or indirect control so as to obtain the right to receive over 50 per cent of the income on a distribution or assets on a winding-up) or be a 51 per cent subsidiary or under the control of another company and any persons connected with that other company
  - the company must not be in difficulty at the beginning of the period. Whether it is “reasonable” to assume a company is “in difficulty” in this context might be open to interpretation, however HMRC’s current intention is to not regard a company as being in difficulty 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 – in this respect companies which are able to raise new funds whilst already listed on AIM or upon IPO should not be regarded as being in difficulty.

– Any subsidiary of the issuing company must be at least 51 per cent owned. If funds raised under the EIS are employed in a subsidiary, or the subsidiary’s business is involved wholly or mainly in the holding or managing of land or property deriving its value from land, that subsidiary must be either:
  – directly owned at least 90% by the parent
  – 100% subsidiaries of direct 90% subsidiaries of the parent
  – 90% subsidiaries of direct 100% subsidiaries of the parent
  – collectively, these are known as “qualifying subsidiaries”.

• There are a number of anti-avoidance measures which include such matters as the purchase of other companies and repayment or redemption of shares and professional advice should be sought. In particular, it is essential that the relevant shares must be issued for 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.

Note: it is possible for the company to apply for advance assurance to HM Revenue & Customs prior to issuing shares in order to establish whether the HM Revenue & Customs considers that the shares to be issued will be eligible and the activities of the company are qualifying. Further details in respect of this are on page 22.

Qualifying business activities

Most trades (not investment activities) qualify but some activities do not, including the following:

• property development
• letting of property
• dealing in land, commodities, futures, shares or securities
• dealing in goods other than by normal wholesale or retail
• banking, insurance, money lending, debt factoring, hire purchase or other financial activities
• legal or accountancy services
• farming, market gardening, forestry woodlands or timber
• operating or managing property-backed establishments such as hotels, guest houses, nursing homes, residential care homes or managing property used for any of these activities
• receipt of licence fees or royalties, except where the company or qualifying subsidiary has created the greater part by value of the intellectual property exploited
• ship building
• coal production
• steel production
• feed-in tariff subsidised generation of electricity where shares are issued after 23 March 2011 but electricity production does not commence until after 6 April 2012.
Part 2 - The benefits and criteria for qualifying companies

Inheritance tax (IHT)

Investments in shares and securities in trading companies may qualify for inheritance tax business property relief at either 50 per cent or 100 per cent. The 50 per cent relief is available for controlling interests in quoted trading companies. However, investments in unquoted trading companies (including those on AIM) attract 100 per cent relief, which can encourage investment through tax planning opportunities. Restrictions apply where the company owns ‘excepted’ assets not used for the purposes of the trade.

Which companies qualify?

IHT is more concerned with the individual’s domicile. Accordingly, a company need not be UK resident. Most trades qualify but a company’s business must not be wholly or mainly that of:
- dealing in securities, stocks and shares
- dealing in land or buildings
- making or holding investments (unless that of a market maker or discount house).

Relief for losses¹

Should an investment in an unquoted trading company (which for this purpose can include an AIM company) fail or be disposed of at a loss, tax relief for the loss may be available as set out in Part 1 which can reduce the financial exposure of investors to a fall in value. The shares of the company may subsequently be listed on a designated stock exchange, provided that arrangements are not in existence at the time the shares are issued.

Which companies qualify?

- must be an unquoted trading company (including those on AIM) at the date of disposal
- must have qualified for a continuous period of six years ending on disposal or entire period of ownership if less
- must carry on a qualifying business activity essentially as under the EIS (see page 14).

Venture Capital Trusts (VCTs)

VCTs are companies listed on the Main Market similar to investment trusts, approved by HM Revenue & Customs and whose investments, after three years, must consist of at least 70 per cent in new issues in unquoted qualifying trading companies (which for this purpose can include such AIM companies). Thirty per cent of qualifying investments must be in new ordinary shares of investee companies.

Provided that the gross assets and qualifying employees tests outlined above are met at the time of the investment, the company may raise up to £5 million under all risk capital schemes (SEIS, EIS and VCT and all other equity state aided investment), taken together in total.

There is generally no restriction to the amount that may be invested by an individual VCT within the £5 million overall limitation, however the maximum qualifying investment that may be made by an individual VCT may be restricted where a group company is either a member of a partnership or party to a joint venture and at least one of the other members/parties is a company. The maximum qualifying investment for an individual VCT will be £1 million divided by the number of companies (including the relevant company) which, at the time when the relevant holding is issued, are members of the partnership or, as the case may be, parties to the joint venture.

Investment can be in:
- new ordinary shares and/or
- preference shares or loans with a minimum term of five years.

No holding must be more than 15 per cent of a VCT’s investments and at least 10 per cent by value of a VCT’s holding in any one company must be in eligible shares. Prior to 6 April 2011, eligible shares were effectively only ordinary shares. Since 6 April 2011 this rule has been relaxed whereby an eligible share can have a preferential right to dividends provided that such a right is not

¹Cap on unlimited income tax reliefs
HM Treasury issued a Technical Consultation on 13 July 2012, proposing a cap on unlimited income tax reliefs which will have effect from 6 April 2013. The proposal is to cap relief at £50,000 or 25% of an individual’s income, whichever is greater. Whilst the cap will not apply to the up-front income tax relief given on investment under the EIS, it is proposed that it will apply to restrict any income tax loss relief available on a future disposal of the shares at a loss. Therefore loss relief may be restricted to the greater of £50,000 or 25% of an individual’s income with effect from 6 April 2013.
cumulative, the dividend cannot be varied and the preferential shares are non-redeemable.

In regard to funds raised by VCTs after 5 April 2011, 70% of their qualifying holdings must be invested in the form of eligible shares in qualifying companies within three years. However, where their funds were raised prior to this date, only 30% of qualifying investments must be in eligible shares.

Which companies qualify?
To be a qualifying holding of a VCT most unquoted trading companies (which includes those on AIM) qualify but some do not. The following matters should be considered:

• see pages 13 and 14 in relation to the EIS for qualifying companies and activities
• if a company is to remain as a qualifying holding, it must do so throughout the period the investment is held by a VCT
• if a company becomes quoted, eg by moving to the London Stock Exchange’s Main Market or a recognised foreign stock exchange, it is still regarded as unquoted for a further five years.

Note: it is possible for investee companies to apply to the HM Revenue & Customs for advance assurance. Further details are shown on page 22.
Overseas considerations

The place of incorporation, or other residence status (broadly where a company is managed or controlled), of the company raising funds may be a relevant factor in the investor’s entitlement to the various reliefs considered in this guide. The specific circumstances of the investor will also need to be considered and detailed professional advice should be sought.

Shares and securities in a non-UK incorporated or resident company are regarded as unquoted as long as they are not quoted on an exchange designated by HM Revenue & Customs.

The impact of the residence or place of incorporation is as follows.

CGT gift relief

The company
Residence is not relevant.

The investor
The investor must be resident or ordinarily resident in the UK in the tax year of transfer.

The transferee must be within the charge to UK CGT whether or not resident or ordinarily resident in the UK in the tax year of transfer and the next six years (or until an earlier date of disposal) and not be a company.

EIS

The company
Residence of a company is itself of no relevance but the funds raised under the EIS must be issued by a company which itself has a permanent establishment in the UK (see page 18). Prior to 6 April 2011, the funds could only be used in a business which was carried on wholly or mainly in the UK. This requirement has been removed and this is beneficial to UK companies looking forward to expand internationally.

From 6 April 2011 a foreign company which has a UK permanent establishment (such as a factory) in the UK can raise funds and use them in an overseas subsidiary’s trade provided the subsidiary carries on a qualifying trade and that the group as a whole meets the criteria for a trading group as set out on page 13.

It must be the company raising the funds which has the UK permanent establishment. It is not sufficient for the issuing company to have a UK subsidiary.

The relevant period is the period beginning with the date of issue of the shares and ending either three years after that date or, where the company (or subsidiary) was not carrying on the ‘qualifying trade’ on that date, three years after the date on which it begins to carry on the trade.

The investor
An investor need not be UK resident other than for purposes of deferral relief as set out in Part 1 and, in order to claim income tax relief, an investor must be a UK taxpayer.
Inheritance tax

The company

The place of incorporation and location of the share register may be of importance to certain investors (see below).

The investor

Individual investors who are not regarded as domiciled in the UK may enjoy certain benefits in respect of investments which are not regarded as situated in the UK for tax purposes. Finance Acts from 2008 onwards have contained a raft of measures affecting the UK taxation of non-domiciled individuals. The rules are complex and advice should therefore be sought with regard to the individual’s tax status.

Relief for losses on investments¹

The company

The issuing company must, as with the EIS, have a permanent establishment in the UK. The relevant period is the period beginning with the incorporation of the company, or, if later, one year before the date on which the shares were issued, and ending with the date of disposal of the shares.

The investor

Generally the residence of an individual is not a significant factor. To offset the loss against income (rather than capital gains – see Part 1), the investor must have other income assessed to UK income tax in either the tax year of the loss or the previous year.

Venture Capital Trusts

The company (raising funds from a VCT)

As for the EIS, except that there is no relevant period.

The investor (in a VCT)

As for the EIS.

¹Cap on unlimited income tax reliefs

HM Treasury/HM Revenue and Customs issued a Technical Consultation on 13 July 2012, proposing a cap on unlimited income tax reliefs which will have effect from 6 April 2013. The proposal is to cap relief at £50,000 or 25% of an individual’s income, whichever is greater. Whilst the cap will not apply to the up-front income tax relief given on investment under the EIS, it is proposed that it will apply to restrict any income tax loss relief available on a future disposal of the shares at a loss. Therefore loss relief may be restricted to the greater of £50,000 or 25% of an individual’s income with effect from 6 April 2013.

What is a Permanent Establishment?

For periods after 6 April 2011, the test of whether the issuing company has a UK permanent establishment is statutorily defined:

- A permanent establishment is, broadly, a fixed place of business such as an office, branch or construction project. Additionally, a dependent agent in the UK who is capable of binding the company to contracts can constitute a permanent establishment.
- A permanent establishment is not a place of business where only “preparatory or auxiliary” activities are carried out.
- Nor would a company qualify as having a permanent establishment in the UK solely by virtue of being incorporated there.
- A company does not have a permanent establishment in the UK by virtue of holding a UK resident subsidiary.
Part 4 – Other aspects

Moving from AIM to the Main Market

The reliefs dealt within this guide are, in the main, only available for investments in unquoted companies. For this purpose, the legislation provides that a company is an ‘unquoted company’ (whether or not UK resident) where none of its shares, stocks, debentures or other securities is:

- listed on a recognised stock exchange, which includes a ‘designated’ exchange outside the UK; or
- dealt in outside the UK by any ‘designated’ means.

‘Designated’ means designated by an order made for the purposes of defining an unquoted company.

For the purposes of the legislation outlined in this booklet, HM Revenue & Customs considers that companies whose shares are traded on AIM are unquoted.

The effect of a company’s status changing depends upon the particular relief. A summary of the consequences is outlined below.

CGT gift relief

Shares or securities of a ‘trading company’, or of the holding company of a trading group qualify where the shares etc are not listed on a recognised stock exchange. Relief is also available on the disposal of shares in the transferor’s personal company. A ‘personal company’, in relation to an individual, is a company where not less than 5 per cent of the voting rights are ‘exercisable’ by the individual. Change in status is only relevant to the extent that, at the time of disposal, the investment does not qualify for gift relief.

Enterprise Investment Scheme

For the EIS, 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. 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.

The shares of the company may subsequently be listed on a recognised stock exchange, provided that arrangements are not in existence at the time the shares are issued under the EIS.
Inheritance tax

The relief is available as follows:

100 per cent
- Any unquoted shares in a company not listed on a recognised stock exchange. (For this purpose, admission to AIM does not constitute a listing on a recognised stock exchange).
- Unquoted securities which either by themselves or with other such securities or unquoted shares gave the transferor control of the company.

50 per cent
- Shares or securities giving control of a ‘quoted’ company.

It is necessary to determine the status of the shares at the time of the transfer. Any change in status during the period of ownership is irrelevant.

Relief for losses¹

To be able to obtain relief for losses against income, a ‘qualifying trading company’ is a company which at all times in the relevant period (ie the period ending with the date of disposal of the shares and beginning with the incorporation of the company, or, if later, 1 year before the date on which the shares were issued) has been an ‘unquoted’ (page 19) company.

The shares of the company may subsequently be listed on a recognised stock exchange, provided that arrangements are not in existence at the time the shares are issued.

Venture Capital Trusts

If the company ceases to be an unquoted company at a time when its shares are comprised in the qualifying holdings of the VCT, this condition is treated as continuing to be met, in relation to shares or securities acquired before that time, for the following five years, provided the VCT is approved as a VCT when this change takes place.

¹Cap on unlimited income tax reliefs

HMT/HMRC issued a Technical Consultation on 13 July 2012, proposing a cap on unlimited income tax reliefs which will have effect from 6 April 2013. The proposal is to cap relief at £50,000 or 25% of an individual’s income, whichever is greater. Whilst the cap will not apply to the up-front income tax relief given on investment under the EIS, it is proposed that it will apply to restrict any income tax loss relief available on a future disposal of the shares at a loss. Therefore loss relief may be restricted to the greater of £50,000 or 25% of an individual’s income with effect from 6 April 2013.
Moving from the Main Market to AIM

If, conversely, a company moves from the Main Market or other recognised stock exchange to AIM, then all the tax benefits relating to an ‘unquoted company’ will become available where the company also qualifies in accordance with the relevant legislation. The effects on the benefits covered in detail elsewhere in this guide on a transfer from the Main Market of the Exchange to AIM, are briefly summarised below.

CGT gift relief

Following a transfer from the Exchange’s Main Market to AIM, investors will be able to take advantage of this relief for transactions not at arm’s length made after the transfer to AIM. Note, however, that a shareholding of at least 5 per cent will be eligible for relief irrespective of the quoted status of the company.

Inheritance tax

The shares held in a quoted company should, upon its transfer to AIM, qualify for 100 per cent business property relief once the shares in the company have been ‘owned’ for two years prior to the chargeable event.

Relief for losses¹

Existing holdings will not qualify for loss relief available for set off against income tax as this relief only applies to new shares issued in unquoted (see page 19) trading companies. Relief against other capital gains will continue to be available. However, following transfer to AIM, loss relief, to be set off against income in the year of the loss or the previous year as set out in Part 1, will apply to new share subscriptions which are qualifying holdings should they be subsequently realised at a loss.

EIS and VCTs

New share subscriptions after the transfer to AIM by a ‘qualifying company’ may qualify for tax reliefs under these schemes, thereby possibly attracting investment from private individuals or VCTs.

¹ Cap on unlimited income tax reliefs

HMT/HMRC issued a Technical Consultation on 13 July 2012, proposing a cap on unlimited income tax reliefs which will have effect from 6 April 2013. The proposal is to cap relief at £50,000 or 25% of an individual’s income, whichever is greater. Whilst the cap will not apply to the up-front income tax relief given on investment under the EIS, it is proposed that it will apply to restrict any income tax loss relief available on a future disposal of the shares at a loss. Therefore loss relief may be restricted to the greater of £50,000 or 25% of an individual’s income with effect from 6 April 2013.
Obtaining clearance

EIS and VCTs

Advance assurance

For investors to gain some assurance that an investment in shares in a company should qualify, it is possible to obtain written advance assurance from HM Revenue & Customs prior to the allotment of shares, that the shares to be issued will be eligible for the EIS, will be a qualifying holding for VCTs and that the trade will be qualifying. Confirmation that provisional approval has been obtained can be included in the prospectus or relevant document provided to potential investors.

Advance assurance, which can only be obtained by the company, is based solely on the information provided to HM Revenue & Customs and applies only to the conditions that need to be satisfied by the company. It is important, in order for the provisional approval to be valid, to make full disclosure and draw attention to all relevant matters. Advance assurance is provided on a nonstatutory basis and there is no specific time period within which HM Revenue & Customs has to respond. It is, therefore, recommended that an application be made well in advance.

The information that is expected to be provided to HM Revenue & Customs' Small Company Enterprise Centre with the application for advance assurance includes:

- a copy of the latest available accounts for the company and each of its subsidiaries
- an up-to-date copy of the memorandum and articles of association of each company and each of its subsidiaries and details of any proposed changes
- a copy of the draft of any document to be issued to potential investors, eg prospectus or AIM admission document
- details of any subscription or similar agreement to be entered into by the shareholders
- details of all trading or other activities carried on, or to be carried on, by the company and its subsidiaries
- the approximate amount to be raised and details of how this will be used.

Form EIS (AA) is available from HM Revenue & Customs to assist with the process of obtaining provisional approval in respect of investment under the EIS. The form (use of which is optional) includes further details of the level of assurance that can be obtained and of the information required by HM Revenue & Customs in order to process the application.

Formal EIS approval and issue of EIS certificates

This process applies to both the company and the individual and cannot be applied for until after the later of the date the eligible shares are issued or four months after the company (or its trading subsidiary) commences trading.

A Form EIS1 has to be completed by the company and submitted to HM Revenue & Customs specialist Small Company Enterprise Centre (SCEC). On this form details in respect of the company/group, the share issue and other relevant information are provided to the SCEC. Formal approval is given by the SCEC, if it is satisfied that relevant requirements of the legislation have been satisfied, by the issue of Form EIS2, together with blank Forms EIS3. The Forms EIS3 need to be completed by the company and sent to the qualifying investors, to enable them to make the relevant claims to their local Tax Inspector.

VCT formal approval

There is no formal approval procedure for investments made by VCTs. VCTs do, however, have to provide HM Revenue & Customs with annual returns detailing qualifying investments and are subject to ongoing reviews and declarations. VCTs issue individual investors with certificates which confirm that eligible shares have been issued to the investor, for genuine commercial reasons and are not loan linked. Qualifying investors can then make the relevant claims to relief.

Ongoing HM Revenue & Customs review

EIS/VCT qualifying companies and VCTs are subject to ongoing review by HM Revenue & Customs (EIS – in respect of the relevant period).
The Seed Enterprise Investment Scheme (SEIS)

Given the very early stage nature of eligible companies the SEIS is unlikely to apply directly to AIM companies but an overview of the scheme is included for completeness as it is one of the measures in place to ensure an effective funding environment for smaller growing companies.

SEIS is intended to encourage investment in start-up and early stage companies by offering generous tax reliefs to individuals investing in such companies after 5 April 2012. The scheme is similar to the existing EIS although there are some significant differences between the SEIS and EIS schemes.

In order to qualify under the scheme, there are many matters to be considered by both the investor and the company to be invested in; a summary of the main issues is provided below:

What tax reliefs are available for investors?

**Income tax relief** - equal to 50% of the amount subscribed for new shares in investee companies, capped at £100,000 total investments by an individual in a year. The tax reduction cannot reduce an individual's income tax liability below £nil but from 2013/14 the investor can elect to carry back the relief to the preceding tax year to access tax paid then.

**Capital gains disposal relief** – Where the shares have been held for three years and income tax relief has been given (and not withdrawn), a gain on disposal is exempt from capital gains tax.

**Loss relief** – A loss arising on the disposal of shares invested under the SEIS may be offset either against an individual’s general income or against their capital gains. The loss is the amount of the subscription net of Income Tax relief obtained. For a 50% taxpayer this can be as much as 25% of the investment in the event of a total loss.

**Capital gains tax exemption relief** – If a capital gain accrues to an individual in 2012/13 and in that year the individual also subscribes for shares under the SEIS, so much of the gain as is equal to the amount subscribed (or the amount of the gain if less) will be exempt from tax.

Who is eligible for relief?

Only individuals (not companies or partnerships) subscribing funds wholly in cash, for fully paid up new shares in the investee company, without any preferential rights to assets on a winding up or a right of redemption qualify for relief.

The scheme is not available to people connected with the company, such as employees or individuals holding more than 30% of the share capital or voting rights. Associates of these people, such as spouses, parents or children, are also excluded, but siblings are not associated for EIS purposes.

Directors are not treated as connected to the company, whether or not remunerated. Should an employee wish to benefit from SEIS income tax relief, they will need to be a director at the time of investment and invest more than any salary received from the company prior to their investment.

How is relief lost?

Relief is lost if an individual disposes of their shares within 3 years, or becomes connected to the company in that time, or if the company is taken over within this 3 year period.

Relief is also withdrawn if the investor “receives value” from the investee company in a number of prescribed ways. “Value received” is interpreted broadly and will catch many repayments of loans, etc. or the provision of benefits or other facilities. Value will also be treated as received if the company repurchases any of its shares; even those upon which no SEIS relief was claimed. Dividends, however, are not receipts of value.

Where value received is less than the amount invested, the SEIS relief can be reduced as opposed to wholly withdrawn.

Which companies qualify for investment?

The full criteria for a company to be a qualifying company are extensive. However, key points to be considered are:

The company must not be controlled by another company and this applies from the investee company’s date of incorporation. This means that purchasing an ‘off the shelf’ company from corporate formation agents to use as the start-up company will jeopardise the availability of the
relief at the outset. This is because the off the shelf company will have been under the control of a corporate shareholder at some point after incorporation, even if the shares are transferred to a non-corporate subscriber before the SEIS share issue. SEIS companies need to be new companies set up from scratch and not purchased ‘off the shelf’.

The company must be either an unquoted trading company or the parent of an unquoted trading group which operates through a permanent establishment in the UK. The company cannot have received any prior funding under the EIS or from Venture Capital Trusts (VCTs).

The company must be carrying on a new qualifying trade; i.e. one that commenced within the two years before the investment.

The business of the group and the company employing the funds raised must not consist to a substantial extent (normally taken to mean more than 20%) of excluded activities (such as property development, dealing in land, farming, leasing, accountancy, legal services and various financial activities).

The funds raised under the SEIS must be used for the purposes of the group’s trade within three years.

The group must have fewer than 25 full-time equivalent employees at the time of investment.

The gross assets of the company (aggregated with those of its subsidiaries) must be less than £200,000 immediately before the investment.

**How much can a company raise?**

A single company or group is currently limited to total investments under the SEIS of £150,000 in total.

Any equity-based state aid (as defined) already received must be deducted from this £150,000 limit.

The investment must be made without the benefit of any pre-arranged exit route or any other arrangement designed to give protection against the usual risks of investment.

Warrants granted to the investor for the issue of further shares or options for the company to buy back the individual’s shares are treated by HMRC as such methods of protecting an investor’s risk and, accordingly, are not allowed under the scheme.

After SEIS funds have been raised and 70% of the funds have been used in the business, the company can raise further funds under the EIS scheme or from VCTs. Following lobbying from Baker Tilly on the draft legislation, directors who have made investments under the SEIS will be able to make further investments under the EIS scheme within three years of the original investment.