The new investors’ relief (IR) allows investors to enjoy a lower rate of tax of 10% on lifetime gains of up to £10m on investments into shares in non-listed trading companies, which are issued after 16 March 2016 and held for at least three years before a disposal. This relief is in addition to entrepreneurs’ relief (ER). Although IR has some similarities to ER, the relief is restricted to external investors only and is more akin to enterprise investment scheme (EIS) relief, although with fewer restrictions over the type of company that can qualify and how investments are structured. Given the tax savings of up to £1m per investor and the potentially wide application, we anticipate IR to be a popular tax relief and something which tax advisers will need to understand and advise on now.

**How does it work?**

All legislative references are to TCGA 1992 unless otherwise specified.

FB 2016 Sch 14 introduces two new sets of provisions: the first (ss 169VA to 169VR) governs the operations of the relief; and the second (Sch 7ZB) is a section governing the withdrawal of the relief, where value is received by the investor. To qualify for the relief, a number of conditions need to be met.

Given the potential tax savings and limited restrictions, we anticipate that this relief will become very popular.

**Conditions for the shares**

- There must be a new issue of share(s), on or after 17 March 2016, and the consideration must consist wholly of cash.
- Shares must be fully paid up when issued.
- The shares have to be subscribed for, and issued for, genuine commercial reasons and not as part of a scheme or arrangement, the main purpose, or one of the main purposes of which, was the avoidance of tax.
- The share must be subscribed for, and issued, by way of a bargain at arm’s length.
- Shares have to be ordinary shares, i.e. not fixed rate shares.

**Conditions for the individual**

- During the holding period for the shares, the individual cannot be an officer or employee of the company or group and neither can anyone connected to the individual.
- The individual has a lifetime limit of £10m of capital gains that can qualify for IR. This is in addition to the £10m lifetime ER limit that they may claim on other disposals.
- The shares have to be held continuously by the individual for at least three years from the date of issue to the point of disposal, or until 6 April 2019 if the shares were issued after 16 March but before 6 April 2016. (However, see the comments below regarding spousal transfers.)

Connection, for the purposes of the above test, consists of relatives, i.e. a spouse or civil partner, direct lineal and brother and sister. It also covers partners who are connected via a partnership. This is the wider connection test, found at s 286, rather than the narrower test used for EIS.

**Conditions for the investee company**

- The company’s shares can’t be listed on a recognised stock exchange at the point the shares are issued.
- It must be a trading company or the holding company of a trading group throughout the holding period.

‘Recognised stock exchange’ is the definition given by ITA 2007 s 1005, which means that primary issues of shares by AIM companies can qualify for IR.

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The trading company test mirrors the existing test for trading companies and groups for ER, and business asset holdover relief, which is found at s 165. There is one key distinction, in that a company will be treated as continuing to trade after it has entered administration, receivership or liquidation, provided this is for genuine commercial reasons and not for the avoidance of tax. We understand this is the equivalent of the ‘phoenix company’ rules also introduced in FB 2016 s 35 for employees and officers making capital gains. Recent published discussions (www.bit.ly/1X0nOS1) with HMRC on the application of the new ‘phoenix company’ rules suggest that it accepts these rules are fairly broad, but will be providing some detailed guidance as to when it considers these rules should apply. Hopefully, it will introduce similar guidance for the purposes of IR.

The prohibition on employment and the wide definition of connected persons ... means it is unlikely that owner managers will be able to take advantage of this relief to raise capital from within families

Value received
The new IR rules import a large chunk of the EIS rules preventing any receipt of value in relation to the investment. The receipt of value rules are there to try and ensure that investments are providing businesses with new capital for growth, rather than recycling existing sources of capital. As with the EIS rules on capital gains, any receipt of value other than an insignificant receipt (generally, less than £1,000) can mean that none of the shares qualify for IR. As with the EIS rules, there is a facility to allow the investor to repay value inadvertently received back to the company or the other person who originally provided it, and thus retain the qualifying IR status of their shares.

Value received can take a large number of forms. It can cover the repayment of share capital or loans, other benefits or payments with the company and any transactions with the company not at arm’s length. The relevant period for receiving value is one year before the share issue, up until three years after the issue date.

Key considerations for the tax adviser
Given the above new rules, what are some of the key points to bear in mind when advising clients on the implications of their investments? We think this naturally breaks down into three distinct areas: pre-investment considerations; ongoing considerations during the investment holding period; and disposal considerations.

Pre-investment considerations
At the stage when an individual is considering making an investment in a company, some of the key questions to establish whether an investment should or can be structured to qualify for IR might be:

- Does the company or group undertake trading activities?
- Is the investment structured to allow the individual to qualify for IR, i.e. is there an issue of new ordinary shares rather than an acquisition of existing shares?
- Has the individual received any value from the company in the past year? It may be possible to rectify this before making the investment.
- Can the subscription for shares be paid for wholly in cash and not left outstanding? Care needs to be taken here.
- Is the individual an employee or director, or is anyone connected to the individual an employee or director? This will deny IR but it may be possible to rectify this before making the investment.
- Are more advantageous reliefs available? Not only do EIS and SEIS allow for a potential tax free gain on disposal rather than the 10% rate for IR, they can also provide income tax relief on investment and on losses on disposal.

Ongoing considerations during the investment holding period
- Care needs to be taken that the company or group retains its trading status during the holding period. One common issue for privately owned companies is that the diversification into investment activities or the retention of surplus cash not required for trading purposes could risk the company becoming viewed as not ‘substantially’ trading and losing its trading status for both IR and ER.
- Reorganisations: The new IR rules (ss 169V1 to 169VO) are quite clear as to what happens to the IR status and history of shares post reorganisation (unlike the ER rules). These should be examined carefully when a reorganisation is in point. Similar to ER, the IR rules allow an election to be made to crystallise gains on a reorganisation when otherwise the tax rules would provide for share for share tax neutral treatment. There are 12 months following the 31 January after the tax year of the reorganisation, in which to make the election.

Disposal considerations
- Where individuals have shares acquired at different points in time, there are some detailed rules which determine which shares are disposed of, so these should be reviewed in detail in advance of a disposal.
- Where shares are transferred between spouses or civil partners, the transferee will be treated as having subscribed for the shares at the same time that the transferor did. Therefore, where an individual wants to utilise his/her spouse’s or civil partner’s lifetime limit, the individual would be able to transfer the shares to their partner or spouse, immediately before a third

### Comparison of reliefs

<table>
<thead>
<tr>
<th></th>
<th>SEIS</th>
<th>EIS</th>
<th>ER</th>
<th>IR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Maximum investment in tax year</strong></td>
<td>100,000</td>
<td>1,000,000</td>
<td>No limit</td>
<td>No limit</td>
</tr>
<tr>
<td><strong>Income tax relief</strong></td>
<td>50%</td>
<td>30%</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>CGT reinvestment relief</strong></td>
<td>Up to half invested</td>
<td>No limit</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>CGT rate on disposal</strong></td>
<td>0%</td>
<td>0%</td>
<td>10%&lt;sup&gt;1&lt;/sup&gt;</td>
<td>10%&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>IT/CGT loss relief</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Ownership</strong></td>
<td>&lt;30%</td>
<td>&lt;30%</td>
<td>&lt;5%</td>
<td>No limit</td>
</tr>
<tr>
<td><strong>Directorship permitted</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>X</td>
</tr>
<tr>
<td><strong>Minimum holding period</strong></td>
<td>3 years</td>
<td>3 years</td>
<td>12 months</td>
<td>3 years</td>
</tr>
</tbody>
</table>

1. On first £10m of lifetime gain
2. Cannot be an employee within 3 years of subscription
3. 'Business angel' not previously employed or connected to the company
4. Can be director or employee
party disposal. It will therefore be important to understand the available quantum of lifetime reliefs available and also whether any transfer restrictions apply to the shares.

- There is no specific time limit for a claim given by the legislation, so the time limit reverts to the default four years post the tax year in which the disposal is made.

Comparison with other reliefs

As you will have noted from the above, the investors’ relief draws on both the ER and EIS legislation; however, there are some important differences.

The prohibition on employment and the wide definition of connected persons used for IR means it is unlikely that owner managers will be able to take advantage of the new IR to raise capital from within families, as at least one family member is likely to be either an employee or officer of the business. ER will therefore continue to be the primary form of tax relief for entrepreneurs.

EIS fundraising tends to favour riskier investments, by prohibiting certain types of preferential return to EIS investors. IR does not have these same restrictions, so investment can be structured to appeal to more risk averse investors, therefore increasing the range of investors and the amount of available capital.

There is no minimum shareholding requirement, unlike the 5% test for ER, and as AIM companies are not regarded as listed on a recognised stock exchange, IR is likely to form an important driver for equity capital raising on this market. This is especially so when combined with the possibility of qualifying for business property relief that AIM investments can offer. Unlike EIS, there are no restrictions on the amounts raised and there are no restrictions on the size of the business. (EIS is restricted to companies or groups with gross assets of less than £15m before a fund raising.) There are a number of AIM companies with market capitalisations of more than £1bn, for example, which would be able to make use of this relief. Coupled with the forthcoming Action 4 restrictions on interest deductibility, does this mean the financing pendulum will swing away from debt and back to equity capital for AIM and other non-listed private businesses?

Investors’ relief draws on both the ER and EIS legislation; however, there are some important differences

It is very early days, as the relief won't start to apply to disposals until 6 April 2019. However, we are already seeing substantial interest from our clients in this relief and we welcome this addition to the armory of tax reliefs to encourage longer term investment in UK companies.

For related reading visit www.taxjournal.com

- FB 2016: Entrepreneurs’ relief changes (Martin Mann, 20.4.16)
- Your guide to Finance Bill 2016 (Claire Hooper, 30.3.16)
- FA 2014: The new social investment tax relief (Carolyn Steppler & Neil Morgan, 18.9.14)
- Ask an expert: Mitigating CGT by EIS or SEIS reinvestment (Paul Howard, 25.10.12)
- Comparing the EIS and SEIS (Annette Morley, 9.2.12)
- The new seed enterprise investment scheme (Erika Jupe & Clara Snow, 19.1.12)
- Practical issues on EIS and VCT investment (Erika Jupe, 26.5.11)

Important Announcement

Slevin’s Guide to Entrepreneurs’ Relief

is being extended to include commentary on

Investors’ Relief.

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Buy now and receive a free copy of the August 2016 update. Quote Ref: TJ166.

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