TAXREP 9/12

ICAEW TAX REPRESENTATION

SEIS, EIS AND VCTS

Comments submitted in February 2012 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales (ICAEW) to HMRC in response to the draft Finance Bill 2012 clauses on the new SEIS and changes to EIS and VCT scheme rules published in December 2011

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SEIS, EIS AND VCTS

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the draft Finance Bill 2012 clauses published by HMRC on 6 December 2011 at hmrc.gov.uk/budget-updates/06dec11/fb2012-dc.pdf
   Seed Enterprise Investment Scheme, draft clauses from page 12, explanatory notes from page 59.
   Enterprise Investment Scheme, draft clauses from page 70, explanatory notes from page 79.
   Venture Capital Trust, draft clauses from page 83, explanatory notes from page 91.

2. We have already had meetings with HMRC to discuss these proposals and should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. Information about the Tax Faculty, the Corporate Finance Faculty and ICAEW is given below. We have also set out, in Appendix 3, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

5. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

7. The Corporate Finance Faculty is the voice of corporate finance within ICAEW. The faculty is responsible for submissions to regulators on behalf of ICAEW. Its members include corporate finance advisers, reporting accountants, lawyers, bankers, private equity houses, brokers, business angels, academics and companies. It provides a range of services to its members including a monthly magazine Corporate Financier.

KEY POINTS

8. We believe that further funding support for start-up and early stage businesses is needed since a shortage of easily accessible funding is a hindrance to growth.

9. Tax relief for those investing in new businesses is one way to achieve this. The nature of these businesses makes them a more risky investment prospect and this often leads investors to ask for a greater return from the capital they invest. A tax subsidy increases this rate of return and will be enhanced through using the new Seed Enterprise Investment Scheme (SEIS).

10. When we met with HMRC in January 2012, we were told there is no further information on when EU approval will be given for the proposed increases to the company size and investment limits. The employee limit will increase from 50 to 250; gross assets will increase from £7m before/£8m after to £15m before/£16m after; the annual amount of investment that a company may receive under EIS and VCT rules will increase from £2m to £10m.

11. The rules will apply to investee company shares issued after 5 April 2012 and members have told us they have deals lined up ready to proceed. This delay is harmful to UK businesses.

EIS/VCTs and disqualifying arrangements

12. The proposed draft ss 299A and 178A and para 11A Sch 5B TCGA 1992 are too broad and not workable in their current form. The draft proposals would make it impossible to put any existing business in share form. The majority of venture capital trust (VCT) investments are in conjunction with management buy outs (MBOs) and Management Buy Ins (MBIs) and this proposed section will eliminate those transactions.

13. The response document states that this is a clear change of policy, but this change, certainly for VCTs will reduce the effectiveness of the relief. The proposed legislation should be focused more clearly to address EU concerns regarding state aid so as not to exclude transactions that do not breach the EU state aid guidelines.

14. The three capital types which appear to be in point are venture capital, risk capital and expansion capital. Venture capital specifically excludes buy-outs. However, risk and expansion capital while including venture capital do not specifically exclude buy-outs. In our view, there should be a way where the type of transactions which typically benefit from VCT investment can still be carried out with appropriate tax relief. This could, for example, use some form of quasi-equity arrangement. We would like to know if the UK Treasury has received specific guidance from the EU on the form the VCT relief could take without breaching the guidelines?

Seed Enterprise Investment Scheme

15. In July 2011, HM Treasury published its consultation, Tax-advantaged venture capital schemes: a consultation, in which it set out proposals for a new Business Angel Seed Investment Scheme (BASIS). We recommended that rather than developing BASIS as a new standalone scheme, a better approach would be to incorporate the support for seed investment by special provisions within the existing EIS. We hoped this would mean
    - Less new legislation
    - Easier and cheaper administration
    - Building on existing familiarity

16. While we are pleased that the proposals for the Seed Enterprise Investment Scheme (SEIS) use this approach, we are disappointed that the draft clauses run to 47 pages, much of which are just copied from the EIS legislation and is almost incomprehensible to all but the specialist adviser.

17. There will indeed be many businesses which will be able to raise funds using the SEIS and then go on to raise further funds under the EIS. For these businesses, the SEIS rules being as complex as the EIS rules will not add to the burden of legislation. However, for those small businesses which are not going to raise further funding, often those which might not have been able to attract funding with EIS levels of relief alone, keeping within the very considerable list of rules will be a problem.

18. We understand the need to prevent avoidance, but feel this fails to reflect the needs of the customer user group. These businesses will be at a vulnerable stage in their development and the rules for the SEIS should be simple, certain and easy to claim.

19. Our members' experiences of the current EIS, where start-up companies have tried to implement their own schemes, is that too frequently they inadvertently do something to invalidate the relief –see appendix 2. The new SEIS is aimed at companies which probably have even less experience of the tax system and dealing with complex tax reliefs.

20. We fear that the cost of professional advice needed to implement any SEIS will be disproportionate to the amount of money which can be raised under these schemes. This is attributable to complex legislation rather than excessive charging.

21. It is difficult to see how a new relief which is arguably even more complex than the existing EIS, is going to help these start-up companies. In our view there is unlikely to be a high take up of the new SEIS in its current form.

22. The expression in new s257 HC (4), ITA 2007, 'genuine new venture' is very difficult to define. Considerable guidance will be needed on this.

23. The policy objective of the SEIS is to help *'…smaller, riskier, early stage UK companies, which may face barriers in raising external finance, to attract investment, making it easier for the companies to be established and to grow.'*

24. The relief is not available where an investor wishes to invest in a small unincorporated business which has already begun to prove its business model by making early sales. Setting up a company before starting to trade is unduly onerous and does not make good business sense for young entrepreneurs who usually have little or no business advice, yet that is what these rules require.

25. We accept that EIS relief is available, but do not see why the more generous SEIS should not also be given to these very risky start ups when they incorporate. Perhaps restricting the relief in such cases to unconnected parties might be a way forward?

Advance assurance

26. It is important that businesses and investors know with certainty whether an investment will qualify for tax relief.

27. Where a business is likely to need substantial funds, we envisage SEIS funding will be raised for an initial £150,000, but with a commitment at the same time for follow on EIS investment, after the necessary amount (70%) of first round funding has been spent, together with any other commercial requirements achieved. It would not make commercial sense for a business to only start looking for the next funding round after the 70% of SEIS money has been spent.

28. Accordingly, we envisage one advance assurance application being made to cover both SEIS and EIS investment.

SPECIFIC COMMENTS

29. Of particular concern are the following clauses:
    - Disqualifying arrangements, s 178A and s 257CF, ITA 2007.

- Prohibition of acquisitions as a qualifying business activity, s 179, ITA 2007.
- Forbidding EIS relief for paid directors following SEIS investment, S169, ITA 2007.
- Restricting the possibility for corporate investment under the SEIS through the gross assets test, s 257 DJ, ITA 2007.
- The no subsidiaries rule under the SEIS, s 257 DH, ITA 2007.

The no disqualifying arrangements requirement, s 178A and s 257CF

30. It seems that this drafting will catch arrangements where investors make it a condition of their investment that the company is a qualifying company for the purposes of the relief. For example, consider an existing company which carries on a business of manufacturing smoothies. The directors want to manufacture other fruit products. They approach an investor who will only invest into a new company and that new company must be a qualifying company for EIS purposes. They set up the company and the investment.

31. This would seem to be caught as this could have been carried on as part of their original business. Is this the intention?

32. If an existing company sets up a new company with the intention of hiving off an existing trade this will be caught by the changes to "qualifying business activity" so this section is not required to prevent that.

33. It would be helpful if HMRC could publish some examples of what this is seeking to catch. We set out an illustration of the practical problem this causes for very small new businesses and have set out further scenarios which we believe may be caught in Appendix 1.

Illustration

Jake is a T shirt designer who left college in July 2012.
He buys plain t shirts and makes his own designs which he has printed on for him using a printing business he found on the internet. He trades through J Ltd.

In late November a local school agrees to place an order with Jake for 800 t shirts provided they can be delivered before the last week of term. Otherwise they will buy them from their existing supplier of school uniforms in Hong Kong. Jake knows he can only meet this deadline if he buys his own printer, which will cost £5,000.

Jake's former tutor from art college (Bill) says he will invest in his business and subscribes for £5,000 new shares for which Jake gives him 30% of the company.

Is SEIS relief available?
Are these disqualifying arrangements?
S257 CF(2)

(a) (i)The main purpose of the arrangement is to secure that J Ltd carries on a business which consists of printing T shirts, and
(ii)Bill will get tax relief for the shares which raise money for the activity, and
(b) Condition B is that it would have been reasonable to expect that the T shirts would have been carried on as part of another business (in Hong Kong)

Conclusion: We would say yes they are

34. S 178A (2) (a) the word ‘secure’ is undefined and is far too wide. It would be helpful if either, ‘secure’ could be defined, Condition B is refined so that normal financing ‘arrangements’ are excluded or there is an overall exclusion for normal commercial financing.

Change to “Qualifying Business Activity”, s 179 and s 257CF(6)

Scenario	**Analysis**
1) Newco is set up and attracts EIS investment. The funds used by Newco are used to acquire the entire share capital of a company carrying on a qualifying trade.	Under the proposed changes to section 179 it would now be disallowed as the target company shareholders would receive cash as part of the transaction.
2) Newco is set up and attracts EIS investment. Newco subsequently acquires an existing company on a share for share exchange with no cash. The EIS monies are used to develop the trade further.	Under the proposed changes to section 179 this transaction would not be allowed as the shares were not subscribed for. This is the case even though the monies have not passed to the shareholders of the target company.
3) Newco is set up and attracts EIS investment. The money is used to subscribe for new shares in a target company and that money is used to repay the loans owed to those shareholders.	Is this allowed?

35. In our view, Condition B, is unduly onerous as currently drafted. Unless the intention is to restrict SEIS/EIS relief to just those businesses which are undertaking unique research and development business activity, it is almost certain
‘to expect that the component activities of the relevant qualifying business activity would have been carried on as part of another business’.

36. We suggest restricting condition B to apply only where the business would have been carried on by a person connected in any way to the investor or the investee.

FURTHER DETAILED POINTS ON SPECIFIC CLAUSES

Venture capital trusts

S 287, ITA 2007

37. Removing the £1m per VCT is welcome and simplifies the administration of the scheme.

S 291 (3A), ITA 2007

38. This effectively prohibits share acquisitions of companies using VCT (or EIS funds). It is prejudicial to companies which seek to grow non organically, to buy and build or rationalise fragmented industry sectors.

39. This prevents shell company investments where there is a subsequent acquisition of the shares of the trading company, even where the funds raised are to be used for working capital purposes.

S 292, ITA 2007

40. The increase from £2m to £10m is welcome, but the applicable amount that can be raised will depend on the existing gross assets of the company. The original Budget note referred only to

a gross assets limit of £15 million before venture capital scheme's investment thus indicating a further £10 million could possibly be raised. This, in our opinion, would have more accurately reflected the 'equity funding gap'. Transfer pricing legislation refers to £43m and EMI £30m.

S 297, ITA 2007

41. The increase in gross assets requirement is welcome but see our point re s 292 above.

42. The increase in employees to 250 in section 297A is also welcome, but it is difficult to see how this is commensurate with gross assets limited to £16m. A gross assets limit nearer £25m would be more appropriate.

S 299A, ITA 2007

43. This is extremely difficult to understand, is very wide ranging and subjective. We believe is not workable in its present form and without further definitions of 'party' and 'connected'. It will require a very detailed guidance note.

44. We conclude that while this will sensibly exclude say a large company hiving off a small activity to a VCT backed company and the larger non qualifying company effectively receiving VCT funding when it could simply carry on that activity itself, it will or could (possibly in conjunction with S291 3A) exclude the following:

    - All acquisitions of shares
    - MBIs
    - MBOs whether or not EIS relief is claimed by the management team
    - Secondary buy outs
    - Certain trade and assets purchases

45. Whether or not all the above are excluded is not conclusive and is subjective. We recommend that HMRC sets out the specific examples which they seek to prohibit and seek assistance from industry professionals in order s to draft the appropriate amendments to the legislation.

46. At present it is unclear as to who will be considered to be a party to arranging the issue of the shares in different circumstances eg vendor, purchaser, directors of vendor, directors of purchaser, VCT or EIS investors. As drafted the legislation could actually be interpreted to include all fund raisings where VCT or EIS funds are to be raised.

47. We consider that the legislation would better be drafted to include a prohibition of an ongoing material commercial involvement by the relevant party.

48. We understand that MBOs are forbidden by EU State Aid requirements and this section is intended to capture them as well, but would point out that the very vast majority in our experience do not work to allow EIS relief to the management team on account of ss 232 and 233 ITA 2007.

Enterprise Investment Scheme

S158, ITA 2007

49. The increase in the individual investment limit to £1 million is extremely welcome

S169, ITA 2007

50. There is an omission to the draft legislation:

51. Under the SEIS a director who has invested under that scheme can receive reasonable remuneration from the company before or after investment. The intention would be that the company can obtain further investment after the EIS after the SEIS funds have been spent,

one further source of this EIS investment would be its founder directors who invested the seed capital.

52. Section s169 has not been changed to factor in the effect of the SEIS: If a director who has made an investment under the SEIS wished to make a further investment into the company he would be precluded from EIS relief if he had drawn a salary following his SEIS investment but before any EIS investment.

53. We would hope that s169 is amended at subsection (4) to also include “shares which met the definition of relevant shares under s257CA issued before the termination date of those shares.

S170, ITA 2007

54. The removal of loan capital from the 30% test is most welcome and removes a number of anomalous situations.

S172, ITA 2007

55. Disqualifying Arrangements and acquisitions – see earlier comments re VCTs

Seed Enterprise Investment Scheme (SEIS)

56. Overall this is a welcome addition to the venture capital schemes.

57. To make the numbering of the legislation less cumbersome and more readily identifiable, we recommend that s 257A should become a schedule to ITA 2007 (we would assume schedule 5).

S257 BA (1)

58. Why should a former employee be barred from investing under the scheme? A full time sales director would qualify but a full time sales manager would not. We note that this mirrors s167, ITA 2007 for EIS, but do not see why this restriction should also be applied to the SEIS.

S257 CA (3)(a) ITA 2007

59. No dividend can be paid without a decision (existence of reserves, continued solvency etc.) being made by a company. The only conceivable structure would be setting up a third party escrow of cash to pay dividends automatically, which is impossible under 257 CB.

60. We note that this wording mirrors the EIS. In order for a preference share to be a qualifying share for EIS and VCT purposes it must not have any preferential right that is discretionary or cumulative.

61. The literal reading of this wording is that a dividend cannot be paid on an ordinary share if holders of preference shares are not entitled to the same dividend, as it could be argued that such a dividend would be preferential. We would like HMRC to clarify this.

S 257 CA (5)

62. We understand the term ‘incapacity’, but do not understand the need for the wording ‘incapacitated by…..other cause’?

S 257 CC

63. The wording used in this clause requires all the money to have been spent on the qualifying activity within (broadly) 3 years. It goes on to say that the relief won’t fail just because an insignificant amount may have been spent for another purpose. This is different from the situation where not all the money has been spent and a small sum is still retained.

64. We consider that the provision should also allow a minor amount to be left unspent.

S 257 DA, ITA 2007
We do not see why it is necessary for the issuing company to be under two years old. We appreciate that the relief is for new businesses, but feel it should be extended to companies that haven't traded or received any investment income to date, ie dormant companies that may have been incorporated earlier.

S257 DB (2), ITA 2007
65. We consider the use of the term 'wholly' to be too strong. 'Incidental' should be defined. It is likely that such incidental matters would relate to small non cash assets on the balance sheet, but as the company can only have a maximum of £200,000 of gross asstes prior to any investment, it seems unlikely that many of these will be non-trade items.

S257 DD (1), ITA 2007
66. We understand that HMRC solicitors say this legislation does not preclude subcontracting, but we are unconvinced. If the intention is to allow assistance by third parties for specific tasks, we do not consider (1) (b) and (c) are then necessary.

67. This clause needs to be made clearer.

S257 DH, ITA 2007
68. The draft legislation would appear to prevent any subsidiary being created in the three year period following investment, which may not be commercially sensible.

69. If a company wishes to expand abroad it may be beneficial to set up subsidiaries in these territories as opposed to operating there through a branch.

70. We understand that HMRC has not included the extra clauses needed to allow for subsidiaries in order to restrict the length of the legislation. We consider this to be a false economy. As the legislation already runs to 47 pages, three more won't be a material addition.

S257 DJ, ITA 2007
71. This is likely to preclude any corporate investor from being able to hold more than 25% as its proportion of gross assets will be included within the £200,000 test. This seems to be unnecessarily restrictive.

S257 EC (6), ITA 2007
72. A time limit for HMRC to give its response to the issuing company would make good sense commercially.

S 257 (FH) (11), ITA 2007
73. Remuneration for services as a director in this sub clause could simply be added to the list of 'excluded payments' in sub clause (3)

S 257 HC, ITA 2007
74. The expression 'genuine new venture' is very difficult to define. Considerable guidance will be needed on this.

75. The policy objective of the SEIS is to help *'…smaller, riskier, early stage UK companies, which may face barriers in raising external finance, to attract investment, making it easier for the companies to be established and to grow.'*

76. In addition, the relief is not available where an investor wishes to help a small unincorporated business which has already begun to prove its business model by making early sales.

77. A member has told us of a recent case of a business set up to supply goods over the internet. The girl left school with GCSE's and an interest in fashion and beauty and began buying and selling Ugg boots, sourced from China. She then realised that there was also a market for

quality hair extensions. As it happened she was financed by friends and family, but not all such businesses have that option available. On incorporating last year, had she sought venture capital finance from third parties, she would have been ineligible for the SEIS, having already started trading. Yet without first proving her business model, she would have found raising funds difficult. Setting up a company before starting to trade is unduly onerous and does not make good business sense for young entrepreneurs who usually have little or no business advice, yet that is what these rules require.

78. We accept that EIS relief is available, but do not see why the more generous SEIS should not also be given to these very risky start ups when they incorporate. Perhaps restricting the relief in such cases to unconnected parties might be a way forward?

79. S 257HC(2) says '...if subsection (3) or (6) applies'. We believe this should read '....if subsection (3) applies'.

80. S 257 HC (4), second line, second occasion of use of the word 'on' should, we think, be 'of'.

81. What is the position where an approved EIS fund invests in an SEIS? The Approved Fund legislation does not appear in the draft SEIS legislation, which suggests that there could be several treatments, particularly as the Nominee legislation has been transferred suggesting that an unapproved scheme does work for SEIS.

82. As s 251 is not replicated as s257 HC (which is where we would have expected it to be), this seems to suggest that approved funds do not extend to SEIS shares. However, this exclusion does not seem to have any logic, especially as the nominee provisions in s 250 have been replicated in s 257 HB almost word for word. Please could HMRC explain the omission or replicate the provision?

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APPENDIX 1

FURTHER ACQUISITION CONSEQUENCES OF DRAFT FINANCE BILL CLAUSES

No		Allowed/Disallowed	Reason
We have taken the opportunity to outline what we expect the consequences of s179 2A and s291 3A will be in respect of newly-incorporated companies looking to acquire the business of an existing trading company, whether by shares or trade and asset sale			
1	NEWCO preparing to carry on its trade raises EIS/post April2012 VCT funds and makes acquisition of shares for Cash of qualifying trading company using EIS or VCT funds	Disallowed	At the time of issue, the business activity of the company is “preparing to trade. The trade itself arises out of an acquisition of shares which is not shares by subscription therefore specifically precluded by S179 2A and 291 3A
2	NEWCO preparing to carry on a qualifying trade makes acquisition of shares using non EIS or VCT funds but employs EIS or VCT funds for working capital in the acquired company	Disallowed??	At the time of issue, the business activity of the company is “preparing to trade. The trade itself arises out of an acquisition of shares which is not shares by subscription therefore specifically precluded by S179 2A and 291 3A
3	NEWCO preparing to carry on a qualifying trade makes acquisition of trade and assets of target using EIS/post April 2012 or VCT funds	Allowed	Trade and asset purchase not caught unless a disqualifying arrangement
4	NEWCO preparing to carry on a qualifying trade makes a share for share acquisition of a qualifying trading company and then raises EIS/post April 2012 VCT funds and employs for working capital in the enlarged group	Disallowed??	At the time of issue, the business activity of the company is “preparing to trade. The trade itself arises out of an acquisition of shares which is not shares by subscription therefore specifically precluded by S179 2A and 291 3A

The following situation concerns a company which incorporates on Day 1, purchases the business of the Target on Day 2 (using Non EIS funds or share for share exchange) and the issue of EIS VCT shares occurs on Day 3 (“the issue”). In each situation the group would be considered as carrying on a qualifying trade at the date of issue. The gross assets of the company immediately before the issue would include the enlarged trade and, accordingly, the group meets the size conditions under which the legislation is intended			
5	EXISTING qualifying trading company raises EIS/post April 2012 VCT funds and uses these to fund working capital of the trade	Disallowed??	The business activity consists of a qualifying trade carried on by the Group. However the trade arose in the group by an acquisition of shares, not by subscription in a company which is carrying on the qualifying trade. Accordingly this is precluded by s179 2A and s291

			3A.

The following situation concerns a company which incorporated in 1994 and purchased a trading company that year through a share for share exchange. The group has been trading for the past 17 years in which time there has been no major change in the nature or conduct of trade, meaning the trade carried on now is inherently the trade that was purchased 17 years ago. The gross assets of the company would include the enlarged trade and, accordingly, the group meets the size limits before the issue of shares under which the legislation is intended. (we have an actual example of this)			
6	EXISTING qualifying trading company raises EIS/post April 2012 VCT funds and uses these to fund working capital of the trade	Disallowed??	The business activity consists of a qualifying trade carried on by the Group. However the trade arose in the group by an acquisition of shares, not by subscription in a company which is carrying on the qualifying trade. Accordingly this is precluded by s179 2A and s291 3A. Despite the fact that such an acquisition occurred 17 years ago *The question is what does a trade consist of?*

The following situation concerns a company with gross assets of £12m which commenced its own trade several years ago and is looking to expand. It has identified a target company which is worth £8 million. The trade of the target is the same as that currently carried on by the company in that, post-acquisition, the trades of both entities would be considered as part of the overall trade of the group. In each case EIS-VCT funds would be raised prior to any other investment and up to the gross assets limits expected to be in place post 6 April 2012 The enlarged group would, of course, be greater than the size limits for which the legislation is intended. The following scenarios are prepared on the basis that the group carries on a qualifying trade irrespective of whether it hives up the trade of its target into the parent company post acquisition of the shares. However, if a hive-up would be required in this circumstance please advise accordingly.			
7	EXISTING qualifying trading company raises EIS/post April 2012 VCT funds and uses these to acquire the shares for cash of a qualifying trading company	Allowed	The group is carrying on a qualifying business activity. The acquisition of the target is not itself a separate qualifying business activity and, accordingly, the use of the money raised to buy the Target's shares is used for the purposes of the company's qualifying business activity. Accordingly s179 2A and s291 3A do not apply.
8	EXISTING qualifying trading company raises EIS/post April 2012 VCT funds but acquires a qualifying trading company using non EIS/post April 2012 VCT	Allowed	The relevant qualifying activity is the trade, which itself did not exist as a result of an acquisition and any acquisitions augment the existing trade. Accordingly s179 2A and s291 3A do not apply.

	funds – EIS and VCT for working Capital only		
9	EXISTING qualifying trading company raises EIS/post April 2012 VCT funds to acquire the trade and assets of a qualifying business from a vendor company	Allowed	Not a share acquisition so OK unless a disqualifying arrangement. Unlikely to be a disqualifying arrangement as the company would be a qualifying holding anyway, therefore the arrangement to purchase the trade and assets from the previous vendor cannot be part of any agreement to secure EIS and VCT tax reliefs.
10	EXISTING qualifying trading company raises new EIS/ post April 2012 VCT funds, acquires a qualifying trading company by way of share for share exchange but employs the EIS and VCT funds in the acquired company for working capital	Allowed??	The qualifying business activity, for which the money was raised, does not consist of an acquisition of shares. The group is already carrying on a qualifying trade which has not consisted of an acquisition of shares. Accordingly s179 2A and s291 3A do not apply

The following situation concerns a newly-incorporated company which is looking to purchase a company in difficulty. The target has significant bank loans which the bank will sell to the new company at a significant discount. The company will raise EIS and VCT funds prior to any other funding. It will then purchase the loan notes and then, on the same day, subscribe for so many shares in the target which will give it 90% control of the target. The consideration for these shares will be the loan notes it holds owed by the company.			
11	NEWCO preparing to carry on a qualifying trade makes acquisition of debt using non EIS or VCT funds, which are subsequently exchanged for share capital. EIS and VCT funds used for working capital in the acquired company	Allowed	The qualifying business activity arises as a result of an acquisition of shares in a company by subscription, immediately before which the company is not a 90% subsidiary, and after which the company is a qualifying 90% subsidiary. Accordingly s179 2A and s291 3A would not apply.
12	NEWCO preparing to carry on a qualifying trade makes acquisition of debt using non EIS or VCT funds, which are subsequently exchanged for share capital.	Disallowed, but not as a result of s179 2A or s291 3A	In this circumstance the money raised would be used to purchase debt. The use of the money raised is accordingly money-lending which is excluded under s192 and s303 and not wholly for a qualifying activity/

APPENDIX 2

COMMON PITFALLS OF USING THE EIS

The EIS rules are complex and we are concerned that as the SEIS rules are very similar, the smaller businesses at which the new relief is targeted will be at even greater risk of transgression. Clear HMRC guidance highlighting these pitfalls will be necessary to support the launch of the new scheme.

In our members' experience, the following rules are where some of the most common errors are made by investors using the EIS:

- Shares are not paid for in cash or are not fully paid up.
- Failure to use new shares i.e. second hand shares.
- Issuing EIS 3 certificates without having HMRC approval.
- The individual cannot convert loans to the company into EIS shares because they would fail to subscribe for shares – problem with start-ups.
- 'Accidental' loans to the company.
- The individual is appointed as a director before subscribing for shares and is therefore connected with the company. This is not always practical given that directors have to be appointed on formation of a company.
- The individual must not have signed trading contracts on behalf of the company before he subscribes for his EIS shares. If he does then he would not qualify for EIS relief as he would have been previously involved in carrying on the company's trade.
- The individual is inadvertently connected with the company because the associates rule includes partners of, say, a film partnership scheme.
- During the company's three year relevant period there are arrangements in place where the company will, or even could, come under the control of another company even if these arrangements will not take effect until after the relevant period has passed.
- Shares with preferential rights are created inadvertently, for example by issuing restricted shares to employees. The existing EIS shares would as a result have a preferential right that could be caught.
- The shareholders' agreement states that the EIS shareholders get their money back before another class of shareholders in the event of winding up.
- The shares are not issued properly because the investor's name has not been entered onto the register of members correctly or at all.
- The share certificate has not been issued properly or at all.
- There is a share reorganisation within the company which means that the "EIS shareholders" no longer qualifying for EIS relief because they hold more than 30% of the ordinary share capital, even if this is only for a short period of time.
- The company uses premises which are owned by an EIS shareholder or an associate. If the company pays more than market rent, the EIS shareholder is likely to receive value from the company.

APPENDIX 3

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see http://www.icaew.com/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx).