

TAXREP 2/05

ENTERPRISE INVESTMENT SCHEME (EIS)

TAX LAW REWRITE: BILL 4

*Memorandum submitted in January 2005 by the Tax Faculty of the
Institute of Chartered Accountants in England and Wales in
response to an invitation to comment issued in November
2004 by the Inland Revenue Tax Law Rewrite Team*

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INTRODUCTION

1. We welcome the opportunity to comment on Paper CC(04)18 Bill 4: Enterprise Investment Scheme dated 10 November 2004 and published by the Revenue's Tax Law Rewrite team at <http://www.inlandrevenue.gov.uk/rewrite/exposure/menu.htm>.

WHO WE ARE

2. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
4. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

GENERAL COMMENTS

5. We confirm that we found the provision of origins within the draft paragraphs, rather than separately, to be helpful in reviewing the material. This caused no difficulty in understanding the Explanatory Notes. Annexes A – D were also helpful for the purpose of understanding the draft Schedule.
6. Various references are made in the Explanatory Notes to drafting being similar to that for CVS (the Corporate Venturing Scheme provisions in Schedule 15 FA 2000). We have not yet reviewed the rewritten CVS legislation, and accordingly note these references in passing; but we agree that in principle it is sensible to rewrite similarly-structured tax reliefs on similar lines, in order to avoid any unnecessary confusion and to assist readers' understanding.
7. A basic question arises as to whether the rewritten EIS material should be placed in a Schedule to Bill 4, as it is currently drafted in Paper CC(04)18 (with the short introductory clause to be drafted), or whether it should be incorporated as an integral Part of the Bill. As effectively a self-contained set of rules complete in itself for the purposes of EIS, it can be treated either way. If a principle of keeping the number of

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Schedules to a minimum, or avoiding them, is accepted then the location of this substantial material in a separate Part of the Bill is preferable (the same comments can, of course, also be made in the case of Community Investment Tax Relief). It is, however, clearly sensible to delay any decision on this structural aspect until the Bill 4 material has been developed further and the shape of the Bill can be seen more clearly.

8. The material in Chapter 3 of part 7 ICTA 1988 has been rearranged into a more logical and intelligible order, and the unpacking of certain material and the grouping of related material to improve access is helpful. The material itself is in parts still complex, particularly in Part 6 (withdrawal or reduction of EIS relief), caused primarily and understandably by the anti-avoidance concern, but any further improvement in its intelligibility is rather a matter for simplification than for the rewrite.
9. The order of Parts 1 – 8 is logical. Part 1 is a useful introduction, and it is also helpful to the reader to gather together the requirements regarding the investor in Part 2, the various general requirements in Part 3 and the requirements regarding the issuing company in Part 4. The introductory paragraphs 2 (in Part 1), 6 (in Part 2), 15 (in Part 3) and 23 (in Part 4), signposting key paragraphs, also works well and this is a much clearer approach than that adopted in s 289 ICTA (Eligibility for relief). It would, however, seem appropriate to signpost Part 5 (EIS relief) from paragraph 1 to emphasise the nature of EIS relief as a tax reduction.
10. Reference throughout to ‘the investor’, ‘the issuing company’ and ‘the relevant shares’ are helpful (brief) references as is the use of Periods A, B and C for shorthand reference to relevant periods. The tabular presentation in paragraph 60 (the amount of value received for the purposes of paragraphs 56 and 61), in paragraph 82 (Interest) and in paragraph 86 (Power of Inland Revenue to require information) add clarity.
11. The non-gender drafting approach can, however, be stilted (as in paragraph 59(5), for example) but this is unavoidable from the adoption of this approach.
12. We note that the draft Schedule does not include any material for the consequential changes to other legislation that may be needed, nor any transitional provisions that may be needed in relation to BSS relief, BES relief or to those provisions of EIS that do not affect current issues of shares.

QUESTIONS

13. **Q1.** It is implicit in s 291A(5)(b)(i) and s 291B(5) ICTA that the s 291(2) ICTA definition of ‘connected’ individual should apply. We accordingly have no objection to paragraph 8, through its application to Part 2 (except paragraph 10(4)), also applying the definition of an individual connected with the issuing company to paragraphs 11(3)(a) and 13 (derived from s 291A(5)(b)(i) and s 291B(5) ICTA respectively).
14. **Q2.** Agreed.

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15. **Q3.** Agreed.
16. **Q4.** We have no objection to paragraph 19(1) treating the requirement, that the qualifying business activity is carried on for a minimum period, as a condition of eligibility, rather than a condition for a claim (to which there is an entitlement), for EIS relief.
17. **Q5.** Agreed.
18. **Q6.** We welcome the widening, in paragraph 32(6) (meaning of “non-qualifying activities”), of the class of ship leasing that is ‘permitted leasing’, in line with current practice.
19. **Q7.** We agree that it is appropriate that paragraph 36(4)(b) should refer to “the trader” rather than to “the company” as in s 297(3)(c)(ii) ICTA, to make clear that paragraph 36(4)(b) applies whether or not the person holding the goods is a company (as clearly intended by s 297(2)(g) ICTA).
20. **Q8.** Agreed.
21. **Q9.** We have no objection to the addition of the words ‘and claims’ in paragraph 44(2)(a).
22. **Q10.** We agree that paragraph 44(2)(b) should provide that the £200,000 figure be used to set a limit on the amount by which the individual’s income tax liability may be reduced by EIS relief, rather than the amount of subscriptions in respect of which that relief may be claimed.
23. **Q11.** Agreed.
24. **Q12.** We agree that it is unnecessary in paragraph 47(2) (Entitlement to claim) to include the words ‘and admitted’ in s 306(7) ICTA, in view of the pre-requisite of a compliance certificate to be issued with the authority of the Inland Revenue in order for the individual to make a claim.
25. **Q13.** We agree the change to refer generally to the “Inland Revenue”.
26. **Q14.** It is appropriate to oblige the Inland Revenue to notify the company requesting permission to issue compliance certificates to investors of its decision as to whether or not such permission is given. There should also be provision for a (short, at most 60 days) time limit within which the Inland Revenue are obliged to give such notice.
27. **Q15.** We agree that it is unnecessary to rewrite s 299(3) ICTA.
28. **Q16.** We agree that paragraph 54(3) and (4) should clarify that ‘A’ (the amount of the reduction in the investor’s income tax liability attributable to EIS relief) is based on the ‘gross amount’ of EIS relief obtained by the investor.

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29. **Q17.** In the absence of any explicit order being set out in the source legislation regarding the reduction or withdrawal of EIS relief in consequence of value received by the investor, it appears logical to apply paragraphs 61 – 63 consecutively when calculating the paragraph 56(2)(a) amount and we have no objection to this order being set out on a mandatory basis in paragraph 56(3) (Value received by the investor) as a helpful aid to navigation for users of the legislation.
30. **Q18.** Having regard to Explanatory Notes paragraphs 176 and 177, we agree that the reference to “the issuing company” in paragraphs 59(3) is appropriate. We agree that the reference in source legislation s 301(3) ICTA to ‘a company’ can include non-corporate connected persons, paragraph 64(c) in the rewritten legislation (to which the user will need to refer) making this clear as regards paragraph 59(3).
31. **Q19.** We agree the proposed rewrite change setting out steps in paragraph 62(2) for the purpose of calculating the withdrawal/reduction of EIS relief, where obtained for two consecutive years on two deemed issues resulting from shares actually issued in the later year, where the investor receives value. It is appropriate that the relief withdrawal/reduction consequence should be clearly applicable in these circumstances, and the drafting of paragraph 62(2) achieves this.
32. **Q20.** We agree that paragraph 63(2) and (3) should clarify that ‘A’ (the amount of the reduction) is based on the “gross amount” of EIS relief obtained by the investor.
33. **Q21.** As with paragraph 56(3) (please see our response to Q17), we similarly agree that it is helpful for paragraph 67(3) (value received by other persons) to set out as consecutively the order in which to apply the variations in paragraphs 69 – 72, where more than one variation affects the amount in paragraph 67(2)(a).
34. **Q22.** Having regard to Explanatory Notes paragraph 203, we agree that it is appropriate in paragraph 67(4)(b) and (c) to use the words “that person’s shares in the issuing company” to make explicit what is thought to be implicit in s 303(1B)(b) and (c) ICTA.
35. **Q23.** We agree the inclusion of a reference to the disregard in paragraph 67(6) (Value received by other persons), but would it be clearer to redraft the disregard as being ‘to the extent to which the repayment has already been taken into account in withdrawing or reducing EIS relief’? This would then focus on the amount of the repayment itself, rather than perhaps less clearly on the EIS relief attributable to the shares involved.
36. **Q24.** As with paragraph 62(2) (please see our response to Q19), we similarly agree with the setting out of steps in paragraph 71(2) to deal with repayments in cases where the investor obtains EIS relief for two separate years in respect of shares issued in the later year.
37. **Q25.** We agree that paragraph 72 should clarify that ‘A’ (the amount of the reduction) is based on the “gross amount” of EIS relief obtained by the investor.

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38. **Q26.** We have no objection to the proposed omission from paragraph 73(1)(b) of the restriction in s 303(9)(b) ICTA that eligible shares be issued after the registrar of companies has issued the certificate under s 117 Companies Act 1985.
39. **Q27.** We agree the drafting of paragraph 81(3) to restrict the shares that need consideration in deciding whether an assessment under paragraph 78 can be made because of events occurring after the complete disposal of shares to which EIS relief is attributable, by ignoring any shares for which period A has ended and any shares which EIS relief is not attributable.
40. **Q28.** We agree the omission of ss 306(9), 307(6)(a) and (aa) and (7) of ICTA from the rewritten legislation as inappropriate sub-sections in the context of self-assessment.
41. **Q29.** If a transitional provision is considered necessary in respect of s 294 ICTA will it also be necessary to preserve the effect of s 307(8) ICTA, in order to identify the time of withdrawal of EIS relief for s 294 ICTA purposes, where s 307(5) ICTA (fraudulent or negligent conduct) continues to apply?
42. **Q30.** Paragraph 84 (Information to be provided by the issuing company etc) is easier to understand than s 310(2) with (2A) ICTA, particularly in view of s 310(2)'s uninformative cross-references to various other sections and the improved layout of paragraph 84 which makes it more readily intelligible. We comment on other specific aspects in our responses to Q31 and Q32.
43. **Q31.** We have no objection to paragraph 84(1) providing a link with the requirement to provide a compliance statement and making it explicit that a notice of certain events is required on the hypothesis that EIS relief has been obtained. We agree that this resolves the difficulties inherent in s 310(2) ICTA as to whether the company and connected person are expected to know whether an individual investor has obtained EIS relief; or, that information of the specified events must be provided to the Inland Revenue whether or not the investor has obtained relief and whether or not the company has provided a compliance statement.
44. **Q32.** We agree that it is appropriate that paragraph 84(4) should remedy the defect in s 310 ICTA, by catering for the possibility that an issuing company will have no immediate knowledge of a receipt of value from a connected person, through providing for the issuing company to give notice of the event within 60 days of coming to know of it.
45. **Q33.** We agree that it is unnecessary to rewrite s 310(3) ICTA.
46. **Q34.** We agree that it is appropriate to include paragraph 88(3)(b), (d) and (f) in rewriting s 304(2) ICTA (Husband and wife), as clarifying the 'step in shoes' treatment that applies after shares have been transferred between spouses, by making explicit what can be regarded as implicit in s 304(2) ICTA.
47. **Q35.** We agree that it is appropriate in paragraph 100(6)(b) (Minor definitions etc) to refer to the reduction as well as the withdrawal of relief.

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48. **Q36.** We have no objection to the inclusion of new sub-paragraph 100(7), which treats conditions that must be met over a period of time as met at times before that period has ended (provided that nothing has occurred to prevent their being met).

SPECIFIC COMMENTS ON DRAFT PARAGRAPHS

- para 10 *Directors excluded from connection*
49. (3)(a) What is the authority for including the words ‘carried on wholly or partly in the United Kingdom’?
- para 12 *Persons interested in capital etc of company*
50. (1)(a) ‘issued’ should be inserted before ‘ordinary’ (share capital), in accordance with s 291B(1)(a) ICTA.
- para 14 *The no tax avoidance requirement*
51. Section 289(6) ICTA requires the shares to be both subscribed for ‘and issued’ for bona fide commercial purposes. Paragraph 14 implies such issue, but does not explicitly require it. Is this intended?
- para 21 *The no pre-arranged exits requirement*
52. (1)(c) We note the qualification of ‘substantial amount’ by the bracketed ‘in terms of value’. This phrase does not feature in s 299B(1)(c), but we agree that value appears to be the appropriate measure.
- para 31 *Meaning of “qualifying 90% subsidiary”*
53. (4)(a) What is the purpose of and authority for adding the word ‘including’ (references to an equity holder)? S 289(13)(a) ICTA provides that references in paragraph 3 of Schedule 13 to the first company are to be read as references (only) to an equity holder.
- para 48 *Compliance certificates*
54. With reference to Explanatory Notes paragraph 139, it would be helpful if further explanation of the operation of paragraph 48(4) could be given. Whilst accurately rewriting the s 306(4) ICTA source legislation, the words ‘the authority must be given or renewed after the receipt of the notice’ (under paragraph 84 or paragraph 16(2) or (4) of Schedule 5B to TCGA 1992) implies that the necessary authority will always be forthcoming regardless of the details notified. Is this intended or is the intended meaning that, *if* the authority is given or renewed, it must be given or renewed only after receipt of the notice?
- para 50 *Appeal against refusal to authorise compliance certificate*
55. Why has the word ‘refusing’ (in s 306(10) ICTA) been changed to ‘disallowing’ (a claim to the Inland Revenue to authorise the issue of a compliance certificate)? The word ‘refusing’ appears more appropriate in a context where a claim is refused, although perhaps ‘rejecting’ is more appropriate?
- para 61 *Value received where there is more than one issue of shares*

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56. Para 61 is drafted on the basis of issues of shares *including* shares in respect of which the investor obtains EIS relief, whereas the source legislation in s 300 (IBA) and (IBB) ICTA uses the words ‘comprising’ and ‘comprised’. The latter subsections appear to envisage *all* the shares in each issue being shares in respect of which the investor obtains EIS relief, whereas the rewritten paragraph 61 is capable of targeting (value received from) shares attracting EIS relief within an issue. This is clearly more practical, where an investor may claim EIS relief only on some of the shares; but is this not a change in the law requiring a PRC?

DETAILED COMMENTS ON DRAFTING

57. para 17 *The purpose of the issue and the use of money raised requirement*
The reference to sub-paragraph ‘(2)(b)’ should be to ‘(3)(b)’.
58. para 18 *Meaning of “qualifying business activity”*
(4)(b) Should the word ‘on’ be inserted after ‘carrying’ in the second line?
59. para 20 *The no linked loans requirement*
In Explanatory Notes paragraph 53, should ‘of’ be inserted in the second line following the second ‘making’?
60. para 23 *Introduction*
In (e), the signpost should be to paragraph 29.
61. para 26 *The gross assets requirement*
In Explanatory Notes paragraph 74, insert ‘to’ after ‘likely’.
62. In Explanatory Notes paragraph 75, in the first line, ‘it’ should be ‘is’.
63. para 45 *Attribution of EIS relief to shares*
We note that the reference in paragraph 45(1) is to the ‘reduction or withdrawal’ of EIS relief, whereas Parts 6 and 7 refer to its ‘withdrawal or reduction’.
64. In Explanatory Notes paragraph 127, the reference to ‘paragraph 97’ should be to ‘paragraph 98’.
65. Part 6 *Withdrawal or reduction of EIS relief*
Overview In Explanatory Notes paragraph 147, in the second line, insert ‘to’ after ‘relation’.
66. para 75 *Acquisition of a trade or trading assets*
Should the reference, in the second line, to ‘paragraph 9’ be to ‘paragraph 10’?
67. para 76 *Acquisition of share capital*
Should the reference, in the second line, to ‘paragraph 9’ be to ‘paragraph 10’?
68. para 77 *Relief subsequently found not to have been due*
(2)(a) In the first line, within the brackets, should the word ‘purposes’ be ‘purpose’ as in the paragraph 17 title?

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- para 88 *Husband and wife*
69. In Explanatory Notes paragraph 275, in the second line, delete one of the two words 'that'.
- para 95 *Meaning of "disposal of shares"*
70. In Explanatory Notes paragraph 293, the reference that paragraph 97 'may' treat the reorganisation as a disposal of the 'old shares' is a little confusing in view of the mandatory nature of paragraph 97(2). Perhaps 'may treat' should be replaced by 'treats'?
- para 99 *Meaning of "the termination date"*
71. Explanatory Note paragraph 297 states that paragraph 99 is based in part on s 312(2) ICTA. Is this correct?
- para 100 *Minor definitions etc*
72. In Explanatory Notes paragraph 306, in the second line, the references should be to paragraphs 48(1) and 49(1) and not to paragraphs 46(1) and 47(1).
73. In Change {jc 440}, in the title the bold reference should be to paragraph 100(7) and not to paragraph 99(7); and in the final paragraph the references also need correction to paragraphs 100(7), 48(1) and 49(1).
- para 101 *Index of defined expressions*
74. In Explanatory Notes paragraph 312, should 'term' be inserted after 'A' at the beginning of the second sentence?

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