



TAXREP 28/12

(ICAEW REP 104/12)

ICAEW TAX REPRESENTATION

FINANCE (No 4) BILL 2012 - BRIEFING

ENTERPISE INCENTIVES - CLAUSES 38-39 AND SCHEDULES 6-7

Briefing submitted in June 2012 by ICAEW Tax Faculty in relation to the above provisions in Finance Bill 2012

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INTRODUCTION

1. ICAEW submitted Briefings to the Public Bill Committee on various clauses in Finance (No 4) Bill 2012. The present TAXREP reproduces the content of the Briefing on the provisions in clause 38 and Schedule 6 relating to Seed Enterprise Investment Schemes and clause 39 and Schedule 7 relating to the Enterprise Investment Scheme.

WHO WE ARE

2. 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 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. 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.
4. 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.

BRIEFING

ENTERPRISE INCENTIVES (Clauses 38 – 39)

These clauses have a key role to play in getting businesses to grow and help drive the economic recovery. Overall, we welcome the early consultation on the proposals and the subsequent publication of the draft clauses. We consider that these changes may attract more investment through EIS, but the limits for the SEIS are so small that the costs of doing due diligence on the company will eat significantly into the relief.

Clause 38 and Schedule 6: Seed Enterprise Investment Scheme

This clause is aimed at encouraging seed investment in early stage companies. It does this by giving initial income tax relief to investors (including directors and employees) of 50% of the full amount invested on investments up to £100,000. In addition, for 2012/13 only, capital gains reinvested in SEIS shares will be exempt from CGT. The maximum amount any company can raise using SEIS is £150,000.

With a cumulative limit for a small company of just £150,000 for SEIS and a £5m limit for EIS, it is hard to see why a third party investor would choose to invest in a company that has assets of less than £5m, as at that level the risk of failure is likely to be very much reduced. Extending the relief to more well-established businesses would be a welcome extension, as would allowing employees to benefit from the scheme.

What is effective?

The government made a number of changes to the draft legislation which make SEIS a more workable scheme than originally set out. These changes include:

- Qualify investments if they have subsidiaries. This will allow more flexibility, for example allowing the company to set up a separate subsidiary if it decides to expand abroad and needs a separate structure to facilitate this.
- Determine eligibility by reference to the age of any trade being undertaken rather than to the age of the company. It is common for a trade to begin trading as an unincorporated entity and then to incorporate at the point when it seeks third party investment.
- Remove reference to the holdings of other entities in calculating asset and employee tests.
- Allow directors who have qualified under SEIS to continue to qualify under EIS.

What we are concerned about

- The legislation on the SEIS remains long and complex. Although HMRC has already published useful guidance explaining the rules and process, we consider that this is no substitute for well written legislation in the first place.

We remain concerned that companies which are supposed to benefit from it will not seek the necessary professional advice (accountancy/legal) needed to implement SEIS because they fear that the cost will be disproportionate to the amount of money which can be raised under the scheme. The maximum amount any company can raise using SEIS is £150,000.

- The legislation in its current form is unworkable for employees who want to invest in their company.

Although the draft legislation has been changed to 'allow previous (but not current) employees to qualify', the problem remains that the receipt of value rules have not been changed to accommodate this. Further change is needed to make this legislation work as intended.

We seem to have a strange situation in that, following points raised in the ICAEW response to the consultation on the draft legislation, see TAXREP 9/12, s257BA, the rule that there should be no employee investors has been changed. Now, an investor cannot be an employee of the company during period B (this runs from the date of issue of the shares and on for three years). In the draft legislation, an investor could not have been an employee from incorporation. This is good, but there remains a problem.

This would, on its own, allow people to be employed by the company for six months, then become directors (directors are not counted as employees), then invest and obtain SEIS relief; the individual's future remuneration from employment is now received as a director of the company and so is not a receipt of value under s257FH(11).

But, the receipt of value rules refer to any receipt of value in period A (from incorporation) where only payments to an individual as a director would not be considered a receipt of value. So the remuneration which the employee received prior to their investment (in the previous six months) as an employee would not be an excepted payment for receipt of value purposes. Consequently, that individual's SEIS relief would be reduced or removed in relation to his salary from the last six months. This has been confirmed to be the case by HMRC.

So although the former employee can invest under SEIS, the relief is limited and therefore makes SEIS ineffective.

The solution is to remove s257FH (11) and also change the wording at s257 FH (3) to match para 13 (7a) Sch 5b TCGA 1992.

This would mean that remuneration for an employee, reasonable to that employment would be allowed.

It would also ensure that expenses incurred as an employee would be allowed.

- No disqualifying arrangements

Schedule 6 s257CF *The no disqualifying arrangements requirement*: Under this section as currently drafted, any growth in the company benefitting from the SEIS appears to be barred. This could be fixed by adding 'on a similar scale' in s 257CF (4) after 'carried on'

Recommendations to government

It is important that Government should change the receipt of value rules as outlined above.

Clause 39 and Schedule 7: Enterprise Investment Scheme

This clause increases the limits in applying for EIS from £500,000 to £1m, with 30% income tax relief available. Whereas SEIS focuses on start-ups, EIS is being extended to medium sized businesses. This is welcomed.

What is effective?

We are pleased that HMRC has removed the £500 minimum investment under the EIS. This has unnecessarily restricted relief to otherwise qualifying individuals in the past, who may make further significant equity investments in a growing company after their initial stake.

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ICAEW 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 icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)