



London
Stock Exchange

AIM

A guide to AIM tax benefits



London
Stock Exchange Group



A guide to AIM UK tax benefits

AIM

AIM is London Stock Exchange's market for smaller, growing companies from the UK and across the globe. 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.

In September 2015, the market had 1,063 companies from numerous countries and sectors with an aggregate value of over £73 billion, and a total of £94 billion had been raised since AIM's launch.

RSM

RSM (formerly Baker Tilly) is a leading provider of audit, tax and consulting services to middle-market leaders, globally. We empower clients to move forward with confidence and realise their full potential. With around 3,500 partners and staff in the UK and access to more than 37,500 people in over 110 countries across the RSM network, we can meet our clients' needs wherever in the world they operate.

The firm is acknowledged as a market leader acting for AIM companies as auditors and reporting accountants with market recognised specialists in the legislation relating to the tax benefits applicable to both AIM companies and investors.

RSM is represented on the AIM Advisory Group of the London Stock Exchange and has been voted AIM Accountant of the Year in the Growth Company Investor Adviser awards, a record five times.

6

parts to this helpful guide

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

The guide is divided into six 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 overseas considerations including 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 Seed Enterprise Investment Scheme (SEIS), introduced for start-ups and early stage companies in April 2012.

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.

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Recent tax policy changes impacting AIM companies

Summer Finance Bill 2015 Update

Following the Summer Budget, the Finance Bill 2015 first published in July 2015 proposes a number of significant changes to the Seed Enterprise Investment Scheme ("SEIS"), the Enterprise Investment Scheme ("EIS") and Venture Capital Trust ("VCT") legislation. The changes are largely to ensure that the schemes which relate to "risk finance investments" comply with the European Commission's Guidelines on State Aid to promote risk finance investment.

The Finance Bill is not due for enactment until November 2015, from when most of the proposed amendments are to be effective. However, whilst HMRC will process compliance statements (see page 15) that comply with current legislation they are not providing advance assurances (see page 15), to companies that do not comply with the Finance Bill proposals in respect of all new share issues prior to enactment. Accordingly, the changes outlined below are important and should be read in conjunction with the relevant sections of this booklet.

EIS and VCT

Growth and Development

All qualifying investments must be made with the intention to grow and develop a company or subsidiary company.

Company Age Limit

Companies must raise their first risk finance investment (which includes investment under the EIS or from VCTs) within a certain period from the date of first commercial sale. The limits are: i) 10 years for a "knowledge intensive" company (essentially a company carrying out substantial research and development activities and either is creating or has created intellectual property or employs a requisite number of skilled employees); and ii) 7 years for other qualifying companies. A company may still qualify if its first relevant investment is outside this period and if it raises relevant risk finance (which can include EIS or VCT funds) that amounts to more than 50% of the average annual turnover of its current group over the last 5 years and such new funds are employed for the purpose of entering a new product or geographical market.

Lifetime Risk Finance Limit

A company will be subject to a lifetime cap of risk finance raised of £20 million for a knowledge intensive company and £12 million for other qualifying companies. The rules are complex as such funds invested in past and future subsidiaries or trades can count towards these limits.

No Acquisitions

The prohibition of the use of EIS and VCT funds to acquire the share capital of other companies has been extended to the acquisition of existing businesses, assets, trades and goodwill. "Protected" VCT funds, i.e. those raised by VCTs prior to 6 April 2012, which were otherwise allowed to be used for share acquisitions will no longer be so protected.

Employee Limit for Knowledge Intensive Companies

This has been increased to less than 500 from 250 at the time of EIS or VCT investment.

EIS only

Investor Independence

All investors seeking EIS reliefs must be "independent" from the company at the time of investment i.e. a share subscription seeking EIS reliefs must either be for subscriber shares or follow a previous risk finance investment (such as under the EIS, SEIS or Social Investment Tax Relief). Accordingly, an investor who already holds any non EIS or SEIS qualifying shares will not be eligible for EIS reliefs on any further share subscription.

SEIS, EIS and VCT

With effect from 6 April 2015 it is no longer a requirement for 70% of SEIS funds to have been employed before a subsequent issue of shares under the EIS or to a VCT.

Note: the definitions and detailed legislation in respect of the above changes are complex and beyond the scope of this note and this booklet to detail in full and subject to possible further change prior to enactment. Accordingly, specific professional advice should be taken before considering raising new funds under the SEIS, EIS and from VCTs.

Finance Bill 2014 and stamp duty tax exemption for eligible securities on a recognised growth market

From 28 April 2014, stamp duty and the stamp duty reserve tax will no longer be chargeable on transactions in securities admitted to a recognised growth market provided that they are not also listed on a recognised stock exchange (as defined in Section 1005 (3) – (5) of the Income Tax 2007).

Finance Act 2013 and The Individual Savings Account (Amendment No 3) Regulations 2013 update

From 5 August 2013, individuals are able to invest in AIM companies through their stocks and shares Individual Savings Accounts (ISAs). ISAs are generally seen as tax efficient as an individual pays no tax on the income received from ISA savings and investments (including dividends), nor does the individual pay tax on capital gains arising on ISA investments (losses are not allowable). The annual limit which an individual can pay into a stocks and shares ISA for the period 6 April 2014 to 5 April 2015 is £15,000 (£11,520 for 2013/14).

AIM has been approved as a recognised growth market under the criteria set out in Clause 108 and Schedule 20 of the Finance Bill 2014. On this basis, securities on AIM that are not listed on a recognised stock exchange will not be subject to the tax. AIM issuers must ensure they inform Euroclear UK & Ireland Limited of their stamp duty exemption status by way of a Stamp Duty Exemption self-certification form.

Part 1

Tax benefits for individual investors

Capital gains tax (CGT) gift relief

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', i.e. 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.

Entrepreneurs' Relief

Entrepreneurs' Relief where available can reduce the rate of CGT applicable on disposal from 28 per cent to 10 per cent.

Certain conditions need to be met in order to claim the relief and the disposal must represent a material disposal of business assets. A disposal of shares will not qualify for the relief unless it is an investor's personal company (i.e. the investor holds at least 5 per cent of the ordinary share capital and voting rights). The individual must also be either an officer or employee of the company or a group company. It is recommended that where Entrepreneurs' Relief is potentially available the person seeks appropriate professional advice prior to taking action.

Enterprise Investment Scheme (EIS)

The 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 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	£
Gross investment in shares	100,000
Income tax relief at 30%	(30,000)
Effective cost of investment	70,000

Exemption from CGT 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.

Example – investment of £100,000	£
Realised value of shares after three years	200,000
Original gross investment in shares	(100,000)
Tax-free gain	100,000

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 45 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 38.5 per cent (see example).

38.5%
Income tax loss relief can restrict a loss on investment down to 38.5%

Example – investment of £100,000	45% taxpayer £	40% taxpayer £	20% taxpayer £
Realised value of shares	Nil	Nil	Nil
Original gross investment	(100,000)	(100,000)	(100,000)
EIS income tax relief	30,000	30,000	30,000
Loss	(70,000)	(70,000)	(70,000)
EIS loss relief – tax at 45%/40%/20%	31,500	28,000	14,000
Net loss	(38,500) 38.5%	(42,000) 42%	(56,000) 56%

CGT deferral

In addition, or as an alternative to claiming the initial relief, investors may defer assessment of CGT 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.

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 CGT 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.

100%

capital gains tax deferral available

Example

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

Example – investment of £100,000	£
Gross investment in shares	100,000
— less CGT deferral at 28%	(28,000)
— less EIS initial income tax relief at 30%	(30,000)
Net cost of investment	42,000
CGT payable on disposal of shares	28,000

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, i.e. control the company or be an employee or director
- can reinvest an unlimited amount (up to the amount of the gain(s) deferred).

Example

An asset which cost £200,000 in April 2012 is disposed of after two years in May 2014, 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 2017 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 May 2014		£
Proceeds of sale		1,380,000
Cost (August 2010)		(200,000)
Chargeable gain (tax deferred by reinvestment)		1,180,000
Sale of EIS deferral shares October 2017		Initial and deferral reliefs £
Proceeds of sale	2,000,000	2,000,000
Cost of EIS shares	(1,180,000)	(1,180,000)
–	820,000	820,000
CGT exemption $\frac{£1,000,000}{£1,180,000} \times £820,000$	–	(694,915)
Gain on EIS deferral shares	820,000	125,085
Deferred gain on disposal of original business asset		
Gain on original chargeable asset	1,180,000	1,180,000
Total chargeable gains	2,000,000	1,305,085
Tax at 28%	560,000	365,424
Less: initial income tax relief at 30% (restricted to relief based on limit of £1 million)	–	(300,000)
Total tax	560,000	65,424
Effective tax rate on total gains of £2,000,000 (1,180,000 + 820,000)	28%	3.3%

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 2014 is less than £1 million there would be no overall tax payable in respect of the subsequent gain on the EIS shares.

40^p
potential BPR
saving for every
£1 invested

Inheritance tax (IHT)**Business property relief (BPR)**

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

The main benefit of BPR, where it is available, is that it provides up to 100 per cent 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 per cent exemption for a shareholding is only applicable to certain unquoted companies (see page 07). 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 (e.g. 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.

There is a cap on the amount of loss which can be relieved against income, which is restricted to the higher of £50,000 or 25 per cent of income. This cap does not apply to losses made on disposal of shares on which EIS income tax relief has been claimed.

An example where the loss is in respect of an EIS investment is covered on page 02. For companies which become fully quoted see page 10.

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.

Venture Capital Trusts (VCTs)

A VCT is a fully listed company, similar to a quoted investment trust, which is approved by HM Revenue & Customs (HMRC) 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 CGT on disposal of shares in the VCT
- 30 per cent initial income tax relief on the amount subscribed for, 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.

For initial relief, investors:

- 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

£5^m

Qualifying companies can raise up to £5m pa in aggregate under the Risk Capital Schemes

Enterprise Investment Scheme (EIS)

Under the EIS, a qualifying unquoted trading company 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 Seed Enterprise Investment Scheme (SEIS), EIS, Venture Capital Trusts (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 a company over the £5 million limit is disqualified, not just the amount in excess of £5 million.

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
- 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 09)
- 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)

- Funds raised after 5 April 2012 cannot be used for the acquisition of the share capital in another company (although the acquisition of a business and its assets is allowed)
- 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 at the time of issue of EIS shares – AIM companies are regarded as unquoted (see also Part 4) for this purpose. A company can become quoted provided there are no arrangements to become so at the time of issue
 - the company must exist wholly (other than to an insignificant extent) for the purpose of carrying out a qualifying business activity
 - 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 (i.e. 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 (i.e. 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 HM Revenue & Customs' 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 more than 50 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 per cent by the parent
 - 100 per cent subsidiaries of direct 90 per cent subsidiaries of the parent
 - 90 per cent subsidiaries of direct 100 per cent 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
- There must also be no “disqualifying arrangements” – essentially contrived structures, whereby access is gained to or for the benefit of EIS or VCT invested funds by a person or persons who are a party to the arrangements or a party who would otherwise not qualify for investment and who would normally have carried on the trade of the company, e.g. by fragmenting it.

Note: it is possible for the company to apply for advance assurance to HM Revenue & Customs (HMRC) prior to issuing shares in order to establish whether HMRC 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 12.

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
- Subsidised generation or export of electricity
- Subsidised generation of heat or subsidised production of gas or fuel

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, e.g. 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.

Inheritance tax (IHT)

Investments in shares and securities in trading companies may qualify for IHT 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 losses

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 07).

VCTs

VCTs are companies listed on the Main Market similar to investment trusts, approved by HMRC 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).

Provided that the gross assets and qualifying employees tests outlined on page 06 for the EIS 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 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 per cent 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 per cent 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 06 and 07 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, e.g. by moving to 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 HMRC for advance assurance. Further details are shown on page 11.

Part 3 Overseas considerations

Considerations:

- Company's place of incorporation or other residence status
- Investor's circumstances
- Permanent establishment.

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 (HMRC). The impact of the residence or place of incorporation is as follows:

Capital gains tax (CGT) gift relief

The company – residence is not relevant.

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.

Entrepreneurs' Relief

The company – residence is not relevant. There is no condition that the shares need to be in a UK incorporated company, as such sale of shares in an overseas company can potentially qualify for Entrepreneurs' Relief.

The investor must be subject to UK capital gains tax on the sale of the shares and meet the specific conditions associated with the relief.

Enterprise Investment Scheme (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. 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 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 06. 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 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.

£5^m

Qualifying companies can raise up to £5m pa in aggregate under the Risk Capital Schemes

Relief for losses on investments

The 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 (VCTs)

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.

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

Moving markets

EIS and VCT status can usually be retained

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 guide, HM Revenue & Customs (HMRC) 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.

Entrepreneurs’ Relief

There is no condition that the shares be unquoted for Entrepreneurs’ Relief as such the sale of shares in a Company listed on a main market may qualify for Entrepreneurs’ Relief provided the specific conditions are met.

Capital gains tax (CGT) gift relief

CGT gift relief is not available where the shares or securities are listed on the Main Market. In order to take advantage of the relief a transfer would need to take place prior to movement to the Main Market.

For shares where the relief has previously been claimed and the shares continue to be held by the transferee, the change in company status does not affect the claim and the CGT will only become due on event of a disposal.

Enterprise Investment Scheme (EIS)

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.

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 losses

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 (i.e. the period ending with the date of disposal of the shares and beginning with the incorporation of the company, or, if later, one year before the date on which the shares were issued) has been an ‘unquoted’ 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 (VCTs)

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.

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 losses

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 06) 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.

≥ 5%

shareholding eligible for CGT gift relief

100%

business property relief for two-year 'owned' shares transferred to AIM

Part 5 Obtaining clearance

Assurances and approval

Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs)

Advance assurance

For investors to gain comfort that an investment in shares in a company should qualify, it is possible to obtain written advance assurance for the company from HM Revenue & Customs (HMRC) that the shares to be issued will be eligible for the EIS, will be a qualifying holding for VCTs and the trade will be qualifying. Confirmation that advance assurance has been obtained can be included in the AIM Admission Document or other relevant document provided to potential investors.

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

The information that is expected to be provided to HMRC's 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, e.g. 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 HMRC to assist with the process of investment under the EIS and SEIS. The form (use of which is optional - a comprehensive application letter is often preferable) includes further details of the

level of assurance that can be obtained and information required in order that HMRC may process the application.

The application should be sent to:
Small Company Enterprise Centre (Admin team)
Mid-size Business S0777
PO Box 3900
Glasgow G70 6AA

telephone: 03000 588907
e-mail: enterprise.centre@hmrc.gsi.gov.uk

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 EIS 1 ("Compliance Statement") must be completed by the company and submitted to the Small Company Enterprise Centre that has been dealing with the company or otherwise to:
Small Company Enterprise Centre (Admin Team)
Mid-size Business S0777
Newcastle upon Tyne NE98 1ZZ

A company cannot submit a Compliance Statement until the trade (or research and development) for which the money was raised has been carried on for four months and cannot be submitted after the later of two years after the end of the year of assessment in which the shares were issued or two years after the end of the period of four months from commencement of the company's trade as referred to above.

VCT formal approval

There is no formal approval procedure for investments made by VCTs. VCTs do, however, have to provide HMRC 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 HMRC review

EIS/VCT qualifying companies and VCTs are subject to ongoing review by HMRC (EIS – in respect of the relevant period).

Part 6 Other matters

86%

potential tax reliefs for investment in start-up and early stage companies

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. 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 per cent 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 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 (CGT).

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 45 per cent taxpayer this can be as much as 22.5 per cent of the investment in the event of a total loss.

CGT exemption relief – if a capital gain accrues to an individual in 2014/15 and in that year the individual also subscribes for shares under the SEIS, 50 per cent of the amount subscribed (or amount of gain if less) will be exempt from tax.

An additional rate taxpayer could receive total tax relief of up to 86.5 per cent on a qualifying SEIS investment (50 per cent income tax relief, 22.5 per cent loss relief and 14 per cent CGT exemption). In 2012/13 where the CGT exemption was available on the whole investment it was possible to have total tax relief in excess of the amount invested but under existing rules this is no longer possible.

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 per cent 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 Enterprise Investment Scheme (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 three years, or becomes connected to the company in that time, or if the company is taken over within this three-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 is applied from the investee company's date of incorporation.

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 per cent) 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 HM Revenue & Customs 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 per cent 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 RSM 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.



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