

Overview

The Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) reliefs were originally designed to address the equity gap for businesses where funding requirements were between £250,000 and £2 million. The increases scheduled for April 2012 are designed to extend the scope from £2 million up to £10 million.

However, the government recognises the need to encourage investment for the smallest companies and start ups. Accordingly, it is consulting on developing a new venture capital scheme targeted at seed level investment by business angels – the Business Angel Seed Investment Scheme (BASIS) designed to:

- address the fund-raising issues faced by start up businesses; by
- encouraging investment from business angels.

The proposal is that the scheme will provide tax relief at a higher rate than under EIS (currently 30%) and on a wider basis of investment. However, both the target company and the investor would be more closely defined than under the current EIS or VCT schemes.

The consultation document addresses three key issues:

- what is a seed stage company;
- what constitutes a qualifying investment;
- how do you define a business angel.

Seed company proposed definitions

The proposals outlined indicate that a seed company would be one with certain characteristics, including some of:

- not yet started to trade;
- no sales contracts in place;
- gross assets under a specified limit;
- preparing to trade, e.g. by developing prototypes, creating a business plan, negotiating contracts, etc.
- not yet engaged in large scale commercial manufacturing.

One difference from EIS is that the intention of the proposals is not to require the company to start trading within a specified period. However, the monies raised will be required to be spent during the seed stage activity.

Type of investment

It is envisaged that investment could be made by way of equity and loans on a tax relieved basis. There is likely to be a minimum equity requirement, currently indicated to be at least 70%. In those circumstances it is proposed that equity could include some form of unsecured finance where the return is based on the results of the company.

The overall investment limit, though, is likely to be lower than £500,000.

Business angels

The EC definition of business angels refers to wealthy private individuals who invest directly in young, new and growing unquoted businesses and provide advice to the businesses. Their investment is usually by way of equity, but they may also provide other long-term finance.

The government proposal is for a business angel to be classified as an individual who:

- has previously invested in four or more seed stage companies;
- is a director of the target company, or provides other support or advice.

The consultation expresses a concern that individuals may take up nominal positions on boards without making a real contribution, just to facilitate relief, and does not want to encourage this.

However, the government also wishes for the scheme to be flexible enough to permit investment by both individuals and syndicates.

Summary

There is potential for the new relief to be attractive to certain investors who have an interest in helping to create and develop new companies. The tax relief appears to be relatively generous and could well encourage investment.

The key concern is on the definition of business angels, particularly the requirement for previous investments. Hopefully the legislation will permit earlier EIS investments to count toward this.