



HM Revenue
& Customs

The Enterprise Investment Scheme: draft guidelines for the approval of knowledge-intensive funds

Contents

Foreword.....	2
Draft guidelines.....	3

Foreword

This document contains the draft guidelines for the approval of Enterprise Investment Scheme (EIS) knowledge-intensive funds.

These guidelines are based on those currently available for the approval of EIS funds (<https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm16050>) under the existing legislation. They have been adapted to take account of the changes that will focus approved funds on knowledge-intensive investments and the increased flexibility available to fund managers in the timing of investments.

We are always happy to consider further ideas for improving guidance, please contact us by email at venturecapitalschemes.policy@hmrc.gsi.gov.uk or in writing to:

Venture Capital Schemes Policy Team
3C/21
100 Parliament Street
London
SW1A 2BQ

Guidelines for the approval of EIS Knowledge-Intensive Funds

Background

1. The EIS rules provide for tax reliefs to be available for investment made by individuals through nominees, including where the nominee is an investment fund manager. If a fund manager wishes to, it can seek approval for its investment fund under section 251 ITA 2007, so that the fund is an “approved knowledge-intensive fund” (“approved KI fund”).

It is not necessary to obtain such approval for an investment fund in order for the individual investors to qualify for EIS relief, but approval has certain advantages. In particular, an individual who invests in an approved KI fund may be able to obtain relief earlier than if the fund had not been approved (see paragraph 12 below).

2. In this document:
 - References to “**CTA 2010**” are references to the Corporation Tax Act 2010;
 - “**EIS**” means the Enterprise Investment Scheme;
 - references to “**ITA**” are references to the Income Tax Act 2007;
 - “**fund**” means an approved KI fund under section 251 ITA;
 - references to “**FSMA**” are references to the Financial Services and Markets Act 2000;
 - “**prospectus**” means any prospectus, brochure, memorandum or other document inviting participation in an investment fund and approved by the UK Listing Authority (UKLA);
 - “**manager**” means the person or persons responsible for the management of an approved investment fund;
 - “**shares**” means ordinary shares which meet the requirements of section 173 ITA.
3. These guidelines set out, for the benefit of persons intending to set up a fund, the principal criteria used by HMRC in deciding whether to approve a fund. They should not, however, be regarded as anything more than guidelines; they do not attempt to deal with every consideration which may be relevant. The guidelines also refer to various matters which, although not essential, prospective fund managers may wish to cover in the memorandum.
4. The prospectus should reproduce the following paragraph in a prominent position:

“The approval of a fund by HM Revenue & Customs is relevant only for the purpose of attracting certain tax advantages provided by section 251, Income Tax Act 2007. Such approval covers only certain administrative matters. It in no way bears on the commercial viability of the investments to be made; neither does it guarantee the availability, amount or timing of relief from income tax or capital gains tax.”

The manager of the investment fund

5. The manager of the fund should be a person authorised to carry on investment business by the Financial Services Authority under the FSMA.

Participation in the fund

6. Participation in the fund need not be restricted to individuals seeking tax relief under the EIS, provided that applicants are required to state on the application form whether they will be seeking such relief.

The participant's interest in the shares

7. The shares in which the fund capital is invested should be subscribed for by, issued to and held by the manager, acting as nominee of each individual participant, and the memorandum should contain a clear statement of this relationship. Under section 250 ITA the shares will be treated for the purposes of the legislation relating to income tax relief under the EIS as subscribed for by, issued to and held by the participant personally. No security similar to the units of an authorised unit trust should be interposed between the participant and the shares. The participant must at all times be the beneficial owner of the shares, being entitled to a whole number of shares in each company and not just having a proportionate interest in all the shares in which the fund capital is invested.
8. Provision may be made for participants to be allowed to end their participation in the fund at any time, but if a participant exercises any such right the manager must sell all the shares which are held on behalf of that person.

The closing of the fund

9. In order that the amount invested in each company may be spread pro rata between all the participants (see paragraph 14 below) the manager should not make any investment of the fund capital until the fund has closed.
10. If a prospectus is issued for a fund which is to be managed by a person or persons already managing another fund, HMRC normally requires that the new fund shall not close until the earlier fund has been invested to the extent of 90% of its capital.

The process of investment

11. The fund should be invested in a minimum of four companies, and the amount invested in any one company should not exceed 50% of the fund capital. The manager's stated intention should be to use the fund capital only to make investments which will enable participants to obtain tax relief under the EIS on the full amount subscribed. The manager may reserve the right to return any small surplus which cannot be invested to the participants.

12. Under section 251 ITA, if the fund has:

- invested 50% of its capital within 12 months of the date the fund closed,
- invested 90% of its capital within 24 months of the date the fund closed,
- within that 24 month period at least 80% of the fund's capital has been invested in the shares of companies that were knowledge-intensive at the time the shares were issued, and
- provided certain information to HMRC (see paragraph 22 below)

then the investments are to be treated as made in the year in which the fund closed, even if they were actually made in a later year. Investors may also elect under section 158(4) ITA to treat some or all of their investments as made in the year prior to that in which the fund closed.

13. The prospectus should state whether the manager intends the fund to satisfy this condition. If, in order to do so, it is necessary to return any part of the amount subscribed to participants, that should be done before the 24 months have expired.

Allocation of shares between participants

14. The number of shares in each company allocated to each participant should be calculated by reference to the proportion that his or her subscription to the fund bears to the total subscriptions of all participants, except as set out in paragraph 15 below. Minor variations from such pro rata allocation are permissible, however, in order to avoid the holding of fractions of shares or to avoid a participant's being allocated a very small number of shares in a particular company. The circumstances in which any such variation would be made should be set out in the prospectus.
15. The manager may arrange to exclude practising accountants or other professional persons from any investment which their professional rules prevent them from making. Any amounts not invested for this reason should be returned to the participants concerned and not used to increase their share of other fund investments.

Realisation of investments

16. Participants should not be allowed to instruct that particular shares should be sold on their behalf, although they may be allowed to end their participation in the fund altogether (see paragraph 8 above).
17. The prospectus should set out the manager's proposals for termination of the fund. Termination is achieved either by disposal of all the holdings of shares or by the transfer of all shares held into the names of the participants. The manager may reserve the power to dispose of shares within 3 years of their issue provided that the circumstances in which that may be done are set out in the memorandum. Where only part of a holding is disposed of, the number of each participant's shares disposed of should be determined in a way compatible with the rules for their allocation (see paragraph 14 above).

18. Any option for the manager to subscribe on his or her own behalf for the shares of a company in which an investment has been made through the fund should not be capable of assignment, except to employees of the manager, until 3 years have elapsed since it was made.

Certificates of relief and reports to participants

19. In order to obtain tax relief participants need certificates issued under section 251 ITA to the effect that the manager holds forms EIS 3 issued by the companies invested in. These certificates should be given to the participants by the manager on forms EIS 5, which are obtainable from HMRC only after the provision of the information set out in paragraph 22 below.

20. Forms EIS 5 can be provided to the manager at any time once the conditions described in paragraph 12 above have been met. For example, if an approved fund invests 90% of its capital in KI companies within 6 months of the fund having closed, the fund manager may request the forms EIS 5 for issue from HMRC at that point – there is no need to wait until 24 months have elapsed.

21. If it is not possible to certify that the conditions have been met within 24 months of the date when the fund closed guidance should be sought from HMRC.

22. HMRC will not provide an approved fund manager with forms EIS 5 unless the fund manager has given HMRC the following information:

- the date that the fund closed,
- the names, addresses and Unique Taxpayer Reference numbers of the investors in the fund,
- the total amount of capital the fund has received from each of those investors,
- the shareholdings in which that capital has been invested,
- the date on which each of those investments was made, and
- whether or not each shareholding was in a KIC at the time the investment was made.

23. Fund managers should make reports to participants on their investments from time to time in accordance with FSMA requirements. When dividends are received on their behalf appropriate statements should be sent to them in accordance with section 1105 CTA 2010.

Application form

24. The form on which applications to participate are invited should require applicants to declare that they are applying on their own behalf, and that they will notify the manager:

- if any investment is made in a company with which they are connected as defined in sections 166, 167, 170 and 171 ITA, or
- if within three years of the issue of the relevant shares they become connected with a company invested in or receive value from such a company.

Being connected with a company will result in the loss of income tax relief in respect of that investment unless, exceptionally, the participator is a "business angel" qualifying for relief by virtue of sections 169 and 170 ITA.

The form should also request individual applicants to state their Unique Taxpayer Reference number and National Insurance number.

Enterprise Investment Scheme rules

25. Any direct or indirect references to the rules of the Enterprise Investment Scheme in the prospectus should be accurate and fair in the view of HMRC.
26. The prospectus should explain the procedure by which participants will become able to claim tax relief and set out the time limit for doing so.

Obtaining approval

27. Anyone seeking approval for a proposed investment fund should submit a request to the BAI Innovation & Growth Team by email:
venturecapitalschemes.policy@hmrc.gov.uk

Or by post:
BAI Innovation & Growth Team 3C/21
HMRC
100 Parliament Street
LONDON
SW1A 2BQ

28. Any request for approval should demonstrate how the requirements of these guidelines are met and state that the manager will:
 - send to HMRC, when requested to do so, the information referred to in paragraph 22 above.
 - notify HMRC without delay if a participant reports that he or she has become connected with a company in which an investment has been made, or has received value from such a company.
 - notify HMRC without delay of any event which has caused a company in which an investment has been made not to be a qualifying company, or not to have been a KI company at the time the investment in that company was made.

It should also certify that the manager is satisfied that the prospectus submitted complies in all respects with the regulations issued by the Financial Services Authority or the requirements of the FSMA.

29. A copy of the draft fund prospectus must be included.
30. Requests for approval are dealt with as quickly as possible, however it is advisable not to fix any launch date for a fund until formal approval of the fund has been obtained.